

On competition

*This paper discusses the reliance on the concepts of "competition" in the formulation of policy. It is not a fully referenced document and is intended to inform policy discussions.*¹

Context

Since the 1980s there has been in Australia a "reform" program that has put the reliance on markets and competition as a goal at the heart of policy discussions. A recent example has been in the "framing paper" published as part of the Convergence Review². This paper and the proposed principles it it are imbued with the language of competition.

The paper is correct in noting the role that the "encouragement of competition" has played. Before a review as significant as the Convergence Review continues it is worthwhile reviewing the acceptance.

This paper is one of a set that discusses the concept of "market" and "competition" as used in public policy. This paper contrasts the conception of competition as interpreted by courts and the concept of competition that underpins the policy theory.

Competition as policy

In October 1992, Prime Minister Keating asked a committee chaired by Fred Hilmer to conduct a review of National Competition Policy. The report of that committee is the most cited justification for the policy construct of competition policy.³

However, the report itself never particularly inquired into the merits of competition, as its Terms of Reference made the assumption that competition was good for the country and the economy.

Nevertheless the reports introduction did state some of the grounds for the belief;

If Australia is to prosper as a nation, and maintain and improve living standards and opportunities for its people, it has no choice but to improve the productivity and international competitiveness of its firms and institutions. Australian organisations, irrespective of their size, location or ownership, must become more efficient, more innovative and more flexible.

Over the last decade or so, there has been a growing recognition, not only in Australia but around the world, of the role that competition plays in meeting these challenges. Competition provides the spur for businesses to improve their performance, develop new products and respond to changing circumstances. Competition offers the promise of lower prices and improved choice for consumers and greater efficiency, higher economic growth and increased employment opportunities for the economy as a whole. (P.1)

The report introduces many of the now well worn concepts about competition. The objective of competition policy is then briefly stated.

Competition policy is not about the pursuit of competition for its own sake. Rather, it seeks to facilitate effective competition in the interests of economic efficiency while accommodating situations where competition does not achieve economic efficiency or conflicts with other social objectives. These accommodations are reflected in the content and breadth of application of pro-competitive policies, as well as in the sanctioning of anti-competitive arrangements on public benefit grounds. (P.6)

Competition policy in this construction is entirely focussed on the concept of "economic efficiency", a concept which is poorly understood at best and is arguably highly deceptive.⁴

The statement is quite explicit that the policy seeks to “accommodate situations where competition ... conflicts with other social objectives.”

There are three aspects of competition as envisioned in these statements that are further explored below. These are the varieties of competition, the relationship between competition and markets, and the relationship between competition policy and social objectives.

The varieties of competition

The Hilmer report stated that

Competition may be defined as the "striving or potential striving of two or more persons or against one another for the same or related objects".(P.2 citing F.G.Dennis 'Competition' in the History of Economic Thought)

The report went on to analyse the components of the definition to stress the possibility that the competition was potential rather than actual and that two competitors might be sufficient. They also opined that the persons might not really compete against each other for the same objects, raising the possibility of competition by differentiation.

In doing so the report never reflected on the extent to which any of these things detracted from competition achieving the supposed outcome of “efficiency”. The only case in which efficiency was referred to was in contestability theory, a conclusion that subsequent research found was illusory in any case where there were “sunk costs”. It just so happens that in markets with one provider it is usually the sunk costs that create that outcome, hence making contestability irrelevant.

Interestingly the concept of competition that is the object of policy and legislation is not actually laid out in the Act. As a consequence it is judicial interpretation on which we rely. Two important definitions are

Competition expresses itself as rivalrous market behaviour. In the course of these proceedings, two rather different emphases ... Competition is a process rather than a situation. Nevertheless, whether firms compete is very much a matter of the structure of the markets in which they operate were placed upon the most useful form such rivalry can take. ⁵

Competition is a process and the effect upon competition is not to be equated with the effect upon competitors, although the latter may be relevant to the former. Competition is a means to the end of protecting the interests of consumers rather than competitors in the market⁶

Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away. Competitors almost always try to ‘injure’ each other in this way. This competition has never been a tort...and these injuries are the inevitable consequence of the competition sec. 46 is designed to foster. ⁷

The first definition from the Australian Competition Tribunal actually traversed the territory of whether the rivalry had to be price based or could be non-price based. The second from the Federal Court introduces the idea that the impact on competitors is not the issue. The third definition from the High Court specifically permits the idea that the competition involves firms harming each other.

In this the courts interpret competition as an activity between firms rather than for customers.

An analogy for the distinction is available in sport. In a game of tennis, the two players confront each other, and the action of each depends directly on the action of the other, they are competing between themselves. In a game of golf the competitors all have the common goal of completing the course in the least number of strokes. While they pay attention to the kind of equipment each is using, and may make a decision about a specific shot depending on their assessment of how much risk their opponent will take or what their opponent does, the bulk of the effort is competing for a low score.

The latter kind of competition is the kind that market theorists will demonstrate generates efficiency. The legal definitions however rely far more on the former version.

And once competition reaches the point of each participant considering the action of the other you have the economic circumstances that immediately invalidate the theory of economic efficiency.

Competition and markets

The judicial interpretation extends to the concept of market as expressed in public policy. Indeed the judicial interpretation is that the relevant interpretation is ordinary English meaning, not the meaning of theory.

The concept of a 'market' is a metaphor used to describe a range of competitive activities by reference to function, product and geography. The application of the metaphor may be informed by economic analysis, provided it is rooted in commercial realities. However, whether or not a particular corporation has market power, within the meaning of a provision such as s 46 of the Act, is not a matter to be resolved by debates between expert witnesses; the issue is raised by statutory words of ordinary English meaning which are to be construed and applied by the Court.⁸

Within the construct of trade practices law, the relation between markets and competition is that the market of relevant activity is first defined, and then the question of whether there is competition in that market is addressed.

There is nothing in this construct that facilitates the outcome of markets as tools for communicating preferences.⁹ Where competition exists as an exercise of producers exercising rivalry in their ability to attract consumers you get some way to achieving the benefits of markets.

The generally accepted outcome of competition, as described by Hilmer above, is the threefold benefit of lower prices, choice for consumers and innovation. The extent to which these outcomes will occur depends on the actual market design involved. It is not just a simple binary choice between the presence or absence of "competition".

Competition policy and social objectives

The benefit of competition policy offered by Hilmer was economic efficiency while accommodating the conflicting interests of social policy.

The single most commonly violated social policy by the application of competition policy is the consequence that some citizens will be denied access to relevant goods or services. This is very explicitly an equity goal, and falls outside the calculus of efficiency.

It need not do so however. There is a perfectly good theory that says it is in the economic interests of the well off to ensure adequate provision for the less well off, as it is a cheaper alternative than the enforcement against the crime that would otherwise occur as a consequence. That is, the social policy can be construed as an economic policy. However,

the very nature of the argument is that it is the kind of externality that typical markets do not manage well.

A consequence of this conflict can be seen in telecommunications policy, where a Universal Service policy is buttressed against a competition policy. This is generally contrasted with a pre-existing policy of national centralised monopoly that internalised the cross-subsidy.

But the fact that in a competitive market some consumers won't get served is not a "market failure", it is the market in operation.

Conclusion

The concept of competition used in public policy is founded too much on the concept of rivalry between providers rather than rivalry for customers. The relationship between markets and competition is configured as a market being the arena within which competition occurs, rather than the market being the mechanism for propagating information through the economy.

¹ Paper prepared by David Havyatt June 2011.

² The Convergence Review refers to an independent review "to examine the policy and regulatory frameworks that apply to the converged media and communications landscape in Australia" see http://www.dbcde.gov.au/digital_economy/convergence_review

³ National Competition Policy at <http://ncp.ncc.gov.au/docs/Hilmer-001.pdf>

⁴ See the DigEcon Research paper *On Efficiency*

⁵ Re Queensland Co-operative Milling Association Ltd., Defiance Holdings Ltd. (Proposed Mergers with Barnes Milling Ltd.) at

[http://www.accc.gov.au/content/item.phtml?itemId=784498&nodeId=c920ec0aa3b674f1723ea1dbd00f0281&fn=49.%20Queensland%20Co-operative%20Milling%20\(1976\)%20ATPR%2040-012.pdf](http://www.accc.gov.au/content/item.phtml?itemId=784498&nodeId=c920ec0aa3b674f1723ea1dbd00f0281&fn=49.%20Queensland%20Co-operative%20Milling%20(1976)%20ATPR%2040-012.pdf)

⁶ Universal Music Australia Pty Ltd v Australian Competition & Consumer Commission [2003] FCAFC 193 (22 August 2003) <http://www.austlii.edu.au/au/cases/cth/FCAFC/2003/193.html>

⁷ High Court in Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Company Limited & Anor.

A good general discussion is also at

(http://www.kensingtonswan.com/Publications/Competition%20&%20Consumer/The_meaning_of_competition.pdf)

⁸ Universal Music Australia Pty Ltd v Australian Competition & Consumer Commission [2003] FCAFC 193 (22 August 2003) <http://www.austlii.edu.au/au/cases/cth/FCAFC/2003/193.html>

⁹ See DigEcon Research paper *On markets*

About DigEcon Research

Purpose

DigEcon Research is a stand alone research body. Ultimately, its pursuit is policy research, the focus of which is the meaning and significance of the Digital Economy. This policy research encompasses both economic and social research.

Researching the significance of the Digital Economy

The concept generally referred to as the Digital Economy is frequently discussed but there is little shared meaning in the term. A key definitional issue is whether the Digital Economy is something yet to happen or in which we are now embedded.

DigEcon Research focuses on the analysis of social and economic change rather than an analysis of a notionally static "Digital Economy". Analysis of the change as it occurs should highlight those areas where there is genuine policy choice rather than merely a need to adapt policy to changes that have already occurred.

Before Thomas Kuhn popularised the idea of "paradigms" J.K.Galbraith railed against the "conventional wisdom". There is no denying that what Kuhn called "normal science" or the repeated application of existing theory to new problems results in most practical developments. It is equally true that the application of existing theory to problems they were not designed for results in, at best, vacuous solutions and, at worst, wildly dangerous outcomes.

The Digital Economy challenges the fundamental concepts of neo-classical economics. It also challenges most of the precepts of how societies are organised. In this context policy research needs to focus on what is different, not on what is the same. The Digital Economy is not just a matter of means of production but about the fundamental structures of social organisation.

Work program

This research is designed both to inform policy makers and to assist those who would seek to influence policy makers or to make business decisions. DigEcon Research however does not provide strategy recommendations nor undertake policy advocacy on behalf of any party.

A key element of the research will relate to the direct regulation of the converging industries of telecommunications, media, consumer electronics and information technology. However, the agenda encompasses the wider economic and social policy issues.

The scope of the research agenda will ultimately depend upon the researchers who wish to participate in what is more an idea than an entity.

In the crowded Australian research field there are a number of "bodies" that share some of the objectives of DigEcon Research. DigEcon Research aspires to contribute to the work of these and any other researchers in the field.