REGULATING FOR COMPETITION?

Trade Practices Policy in a Changing Economy

Edited by Michael James

Alan Moran • Philip Williams • Daniel Oliver • W. R. McComas
John Collinge • John Logan • Frank Milne • R.R. Officer
Thomas G. Parry • Kerrin Vautier • James Farmer • Thomas J. DiLorenzo

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held in Sydney on 29 February 1988
and in Auckland on 7 March 1988.

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Editorial Note

This volume is a record of the combined proceedings of a CIS conference held in Sydney on 29 February 1988, and an NZCIS conference held in Auckland on 7 March 1988.

Philip Williams, Daniel Oliver, Thomas G. Parry and Kerrin Vautier gave their papers at both conferences. The paper by W.R. McComas and the joint paper by John Logan, Frank Milne, and R.R. Officer were given at the Sydney conference, where commentaries were given by Warren Pengilley, Peter Swan, Geoffrey de Q. Walker and P.W. Gallagher. John Collinge and James Farmer gave their papers at the Auckland conference, where Allan Bollard and Stephen Jennings were commentators. Additional speakers participated in the panel discussions at both conferences; edited versions of these discussions appear near the end of the volume.

I wish to thank all the participants for their help in compiling this record. I am especially grateful to Alan Moran for writing the Introduction, to Thomas DiLorenzo for his paper 'Antitrust Policy and Competitiveness' (which appears here as an Appendix), and to Rose Philipson for her assistance in preparing the volume and compiling the index.

Michael James

Introduction

Alan J. Moran was appointed Director of the Commonwealth's Business Regulation Review Unit shortly after it was established in 1985. Previously he worked for eleven years in the Departments of Trade and Industry. His publications include 'Business Regulation — Its Scope, Costs and Benefits in Australia', in Michael James (ed.), *Restraining Leviathan: Small Government in Practice*, CIS, Sydney, 1987.

The views expressed in this paper are not necessarily shared by the Commonwealth government.

Introduction

Alan Moran

Beginning with President Carter's appointment of Alfred Kahn as head of the Civil Aeronautics Board, a number of appointees to American regulatory boards have attempted to pull down from the inside much of the regulatory apparatus they have been charged with administering. Other names that spring to mind include Mark Fowler at the Federal Communications Commission and Arthur Hull Hayes at the Food and Drug Administration. Daniel Oliver, who was head of the Federal Trade Commission (FTC) when he addressed these conferences, shares the credentials of these appointees to American regulatory bodies.

The appointments in themselves reflect the revival of free market economics among professional economists in the 1970s. This renewed approach is thematic to the issues of competition policy raised by the contributions in this wide-ranging collection.

Consumer Welfare, Efficiency, and *Per Se* Rules

Daniel Oliver gives a rather hesitant 'yes' to the question frequently posed to himself: 'Do we need a Federal Trade Commission?' He then assigns to government rather than to market actors most of the blame for the failures of competition. His case for the FTC rests on its having taken on board the fusion of law and economics associated with the University of Chicago, Judge Bork, and others. He maintains that an adequate defence of the FTC requires that the consumer interest be the sole basis for adopting any intervention and that *per se* rules be vanquished by the rule of reason.

Yet using consumer welfare as the sole criterion can mean sacrificing gains in efficiency. As Philip Williams points out in his paper (and R. R.Officer reinforces in discussion), 'a dollar is a dollar', and focusing on the imperative of passing all benefits on to the consumer may mean denying the optimal efficiencies that may arise should they be retained, for whatever reasons, by the producer.

Mr Oliver is highly critical of *per se* rules on resale price maintenance (RPM), such as that adopted in Australia under s. 48 of the Trade Practices Act (TPA). RPM is still alive (just) in the US, while in Australia, as the recent Commodore Computers case has shown, it packs an enormous punch and includes the Trade Practices Commission (TPC) as one of its seconds. In fact, RPM can be legally circumvented in Australia by use of a franchise approach or by selling on consignment. Although this creates a different set of legal relationships, the economic result is basically unchanged. Those falling foul of TPC attacks could therefore avoid the fines they might incur by what to an economist are no more than alternative market arrangements. Such re-arrangements are presumably less convenient to the companies concerned, but the fact that legal loopholes are available raises the question of why s. 48 is so tenaciously pursued by the TPC in areas, like computer supply and retail, that clearly exhibit high levels of competition.

The ideology on which Mr Oliver's approach rests contrasts with that of other law-oriented contributors. Philip Williams is uneasy about the equity implications of a free-market approach, but comes down against the courts applying any rule other than that of fostering efficiency. His citation of George Gunton, dating back to 1888, and made in the context of the lead-up to the Sherman Act, shows that the contestability theory of Baumol, Panzer and Willig is merely a rediscovery. According to the quotation (and contestability theory), incipient or potential competition arising from open markets is enough to ensure efficient market provision of goods and services.

However, Dr Williams does not agree that open entry is sufficient. He points to areas where he considers competition to be absent. One counterfactual example he offers is the case of the professions, where he sees price as inflexible and the market strain being taken by the incumbents, who limit supply. There is, however, evidence that inflexibility in the pricing of occupational services stems from government-sanctioned entry barriers, standards specifications, and price-fixing (Benham and Benham, 1975; Federal Trade Commission, 1984; Young, 1987). This assessment is of course central to Mr Oliver's analysis.

Dr Williams also points to the Laidley case and the break-up of AT&T as evidence that the procompetitive elements of trade practices acts have been effective in thwarting abuse (*Laidley [Leon] Pty Ltd* v. *Transport*

Workers' Union of Australia & Ors [1980] ATPR 40-147, 40-149). As Peter Swan points out in his commentary, cases like this could only have arisen because of labour market regulation; similarly, the mammoth submission by the US Justice Department (1987) to Judge Green indicates that, whatever the merits of allowing competition, AT&T's forced divestiture has almost certainly meant some efficiency losses.

Dr Williams, however, opposes regulation on pragmatic grounds. Like Mr Oliver, he is suspicious of *per se* rules but considers them valid in some areas because of judicial ignorance of economics. In this view he is joined by Warren Pengilley, though Pengilley has different views on which *per se* rules might be the appropriate ones. Such prescriptions appear to favour simplicity — a worthy goal — but in doing so they may place undue priority on the court and paper-burden costs rather than the costs of economic distortion. Simple rules may become simplistic.

In his commentary, Geoffrey de Q. Walker is sympathetic to the abandonment of *per se* rules but argues that, in practical terms, price competition in Australia owes much to s. 48. This raises powerful doubts about the theoretical merit of the government disengaging from this area. No market is perfect, of course, but if RPM allows inefficient practices (as opposed to allowing manufacturers to insist on their retailers charging particular margins, thereby ensuring a wider retail network, better after-sales services, and so on), then some rethinking is necessary. If open markets do not generate competitive (or 'contestative') efficiency, even in small economies like Australia's, then the pillars of the Chicago School's approach rest on insecure foundations. Empirical work on what happened in Australia before 1974 could still offer insights into how sticky prices really were.

W.R. McComas, who, like John Collinge, describes the practical implementation of competition law, shares none of the scepticism expressed by other contributors towards *per se* rules. But this stems from the particular definition of competition from which he argues. This includes the claim that for market freedom to work, each participant must offer a bundle of skills and allow the market to determine the price. Doubtless his views are influenced by his assessment — which many would regard as erroneous — that, without regulation, the marketplace has 'more often than not' been characterised by self-regulatory collusion.

Predatory Behaviour and Raising Rivals' Costs

One way such collusion might occur, according to some advocates of the antitrust notion of predatory behaviour, is by a predatory manufacturer requiring his suppliers to deal with his rival on disadvantageous terms.

Attractive though such a strategy would be, the practical ability to pursue it is questioned by Thomas DiLorenzo, who finds little empirical support for it. He notes that the theory assumes, implausibly, that the predator's rivals are completely ignorant of what is happening to them and therefore sit back and allow themselves to be preyed on.

Professor DiLorenzo notes that, despite Daniel Oliver's scepticism about the theory of raising rivals' costs, much of the work on it has taken place at the FTC during Mr Oliver's stewardship. He claims that giving antitrust authorities greater power to prosecute cases of alleged non-price predation would be inviting uncompetitive firms to sue their more efficient and successful rivals, thus inhibiting rather than promoting industrial competitiveness.

Market Power and Market Definition

Dr Williams addresses what he thinks is an obsession with the definition of a market in trade practices litigation and administration. He refers to the High Court judgment in the Queensland Wire case (*Queensland Wire Industries Pty Ltd v. BHP* [1989] ATPR 40-925), in which the High Court overturned the view of the full Federal Court that no market for the product (Y-bars) existed because there had been no transactions. Dr Williams considers the High Court to be correct in defining the market so as best to assist the analysis of market power.

Warren Pengilley, in his commentary, and more fully elsewhere (Pengilley, 1989), criticises the basis of this decision. He maintains that, in rejecting an American-style 'essential facilities' approach, the High Court has energised s. 46 but left little in the way of future guidance for the courts, particularly over the degree to which the decision applies only to a monopolist. Moreover, he suggests that the Court seems to be denying a powerful firm the ability to refuse to supply a competitor and shifting on to the judiciary the role of determining what an appropriate price should be. The TPC in its Rural Guidelines (24 August 1989) takes Dr Williams's position on this matter, and is to issue a paper intended to offer guidance as to how it will be interpreting the implications of the High Court decision.

The Professions and the Labour Unions

A robust application of the Chicago School's approach is provided in the paper by John Logan, Frank Milne, and R.R. Officer. They argue that monopoly cannot exist if there is freedom of entry. This claim requires some caveats: natural monopoly is a fact even if it is not as common as many would argue. Natural monopoly usually has high sunk costs, which prevent the 'hit and run' competition that would otherwise force an exclusive supplier to act as though competitors were seeking to take his business.

The authors tease out the issues arising from the application of their preferred approach to the professions, which shows that regulation of the professions normally restricts supply, adds to price and generates social losses. They argue that a theoretical case for regulation can be demonstrated where inadequate information would otherwise be generated, and note that, in practice, the professions do little to help in this respect: for instance, they follow 'grandfathering' practices, impose advertising bans, and have little in the way of refresher courses. However, they point out that the practical impossibility of levying a fee for producing impartial information may mean it is underproduced and may justify regulation of product standards and the enforcement of certification.

Labour markets have long been treated differently in Australia from both the professions and the general run of regulation. Under s. 51 of the TPA, labour unions are exempted from ss. 45, 46 and 47, dealing respectively with collusion, monopolisation, and exclusive dealing. In the US, as Professor DiLorenzo observes, unions are similarly exempted from antitrust prosecutions, and, under s. 9(a) of the National Labor Relations Act of 1935, have their monopoly position underwritten by exclusive representation rights.

At the time of writing (September 1989), the force of such provisions is evident in the Australian domestic airline pilots' strike/mass resignation. Conventional analysis would see any excessive market power enjoyed by the domestic pilots as stemming from their monopoly powers. These powers are particularly strong (and arguably could only exist) where labour monopolies are accompanied by monopolies in product markets, especially where these are government-mandated. In the US, where the air transport market is deregulated, notwithstanding unions' exemption from antitrust, there appears to be a wide range of pilot remuneration levels, and considerably higher productivity levels. The former feature is likely to generate financial pressures on airlines paying higher wages. In Australia, the termination of the Two-Airline Policy in September 1990 may lead to a reduction of the market power of the domestic airlines' pilots: this was doubtless an important background factor in the dispute. Such a reduction would be even more likely in the absence of the centralised wage-fixing system.

Harmonisation of Trans-Tasman Competition Policy

The final section of this volume is devoted to an area of competition policy that is of particular joint concern to Australia and New Zealand.

Thomas G. Parry, Kerrin Vautier and James Farmer each address aspects of the Closer Economic Relations Agreement as it is likely to affect trade practices law. Professor Parry points out that Australia's Trade Practices Act and New Zealand's Commerce Act may not be very different in their treatment of anticompetitive conduct. But in some particular areas they differ greatly: for example, in New Zealand the great bulk of possible takeovers are subject to authorisation procedures.

In arguing for harmonisation to allow for greater economic efficiency, Ms Vautier warns against the risk of opting for something that is not best international practice. Moreover, she points out that over the long term the internationalisation of capital and labour is dissolving all economic boundaries. Particularly relevant in this connection is the work undertaken by the European Commission pointing to the considerable gains available from action to eradicate various non-tariff barriers and the remaining barriers to extra-EC competition (Cecchini, 1988). Significantly, the European Commission argues that only occasionally is harmonisation the best way of achieving efficiencies. The practical difficulties of replacing ten or so national standards with homologation are such that mutual recognition of each member's standards both offers bureaucratic economies and tends to bring about a winding down of regulatory impositions.

James Farmer's assessment of the differences in Australian and New Zealand competition law is that the 1986 NZ Consumer Act has placed competition at centre stage. Since then, he argues, the two countries have been operating on broadly similar principles, and their courts tend to come to compatible decisions. One outstanding difference is the protection Australian law offers its citizens against antitrust suits overseas: a protection flowing from the Westinghouse case in the US. This, however, could hardly be considered to be a matter of major practical substance.

In the final analysis, however, as Dr Farmer points out, a trans-Tasman Commercial Court is the only way to adjudicate law between the two countries; but this has not received any political support to date.

Conclusion

This volume thus contains a range of different views on the future of competition policy. The paper by John Logan et al. comes closest to a pure *laissez faire* approach. Those by W.R. McComas and John Collinge, describing the basis of the present administration of competition law in Australia and New Zealand, present a pragmatic approach to intervention to redress market failure. Philip Williams adopts a similar approach, but he also delves deeply into the philosophical bases of intervention. Although he does not share the ideological approach of Logan et al. — or of Daniel Oliver — his views on how the system can be improved stand somewhat closer to the *laissez faire* model than do the views of Messrs McComas and Collinge. These positions taken together seem to canvass the bases on which competition policy issues will be addressed for the foreseeable future.

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Why Regulate for Competition?

Philip Williams is Reader in Economics at the Graduate School of Management, University of Melbourne. He was previously a member of the teaching staff in the Departments of Economics at Melbourne University and Monash University. He has served as an Economic Adviser to the UK Price Commission and as a consultant to a number of Australian corporations and government bodies and is currently a part-time member of the Law Reform Commission of Victoria. He is a member of the Board of Editors of *Australian Economic Review*.

Why Regulate for Competition?

Philip L. Williams

I. EFFICIENCY AND STANDARDS

I wish to provide an immediate answer to the question posed by the title of my paper. The remainder of the paper is devoted to explaining and exploring my answer within the context of the systems of regulation in Australia and New Zealand.

We should regulate for competition where that regulation enhances the efficiency with which resources are allocated. We should not regulate for competition if that regulation lessens the efficiency with which resources are allocated.

Economics is concerned principally with how resources are allocated and whether the systems of allocation are efficient. However, efficiency can only be assessed with reference to an objective standard. The standard used in economics is what may be called the dollar votes of consumers. We may imagine that each participant in the economy has a pile of dollar notes. Each dollar note counts for one vote in determining how the resources of the economy ought to be allocated. If a person spends some votes in purchasing brown leather sandals, that expenditure will encourage resources to flow into the production of brown leather sandals. By voting in the marketplace with

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I acknowledge comments and suggestions from Maureen Brunt, Frances Hanks and R.R. Officer. None of these agrees with every proposition in the paper.

dollar notes, the consumer has been able to influence the allocation of resources.

An efficient allocation is one that maximises the dollar votes of consumers: consumers would be prepared to pay more for the resulting allocation than for any alternative allocation. Efficiency is enhanced when resources are reallocated so that consumers are prepared to pay more dollars for the new allocation than they were for the old.

This standard implicitly embodies Hume's law: that a dollar is a dollar. Hume's law means that if two persons are bidding at an auction for a seaside cottage and a poor homeless family is outbid by a wealthy family wishing to own a seaside weekender, the result of the bidding is efficient. The house has been placed in the hands of those who offer the more dollar votes.

The effect of Hume's law is to divorce consideration of the allocation of resources from consideration of the distribution of wealth (or income). The implication is that if one does not like the market allocation of the seaside cottage, one should look to measures that improve the wealth of poorer families. One should not override the market's ability to allocate resources efficiently.

Competition policy affects two principal types of efficiency: **production** efficiency and **allocation** efficiency. Production efficiency assesses the costs incurred during the process of production. If production is undertaken without each enterprise minimising its costs per unit of output, and without taking advantage of all available economies of large-scale production, then resources are wasted. More resources are used in the process of production than are needed. These wasted resources have an alternative use: they could be used to produce other goods that consumers would value. Accordingly, production efficiency is necessary if the economy is to allocate resources efficiently.

The second form of efficiency is allocative efficiency: resources must be allocated to produce those goods or services for which consumers are prepared to pay most. If buyers are willing to pay to cover the cost of the extra resources needed to produce more brown shoes, then these should be produced. Conversely, if buyers are not willing to pay enough to cover the costs of the marginal producer of black shoes, then that producer should not be using the nation's valuable resources to produce black shoes.

The economist's standard of consumer dollar votes is not the only standard invoked in public debates over competition policy. The Bell Resources offer for BHP and the offers for newspapers and television stations in Australia in 1987 caused much outraged comment from journalists. Very little of this outrage was the result of the economist's concern for the efficiency with which resources are allocated. Naturally, this does not mean that many journalists were mistaken — although many were. Rather, it means that the values of the journalists differed from those generally adopted by economists when they assess the efficiency with which resources are allocated.

II. COMPETITION AND EFFICIENCY

Any enterprise may face competitive pressure, either from firms established in the same industry or from the threat that new firms may become established within the industry. Although economists have long distinguished these two types of competitive pressure, they have disagreed for just as long about whether both are needed to ensure efficiency, or whether one alone is sufficient.

During the debate over trusts that preceded the passage of the first antitrust statute of the United States (the Sherman Act of 1890), some people argued that freedom of entry alone was sufficient. The most famous of these advocates was George Gunton.

> If the gates for the admission of new capital are always open, the economic effect is substantially the same as if the new competitor were already there; the fact that he **may come** one day has essentially the same effect as if he **had** come, because to **keep him out** requires the same kind of influence that would be necessary to **drive him out**. And as the latter always involves greater risks than the former, on the principle of self-interest the former is most likely to be adopted. There is really little to fear, in this line, so long as arbitrary barriers are kept out of the way, because in the absence of legal restriction the active influence of the potential competitor is ever present. (Gunton, 1888:403; emphasis in original)

The two principal propositions in this passage have become identified with what may be loosely called the Chicago School of economics in the post World War II period. The first is that low barriers are sufficient for a competitive environment. The second is that, in the absence of barriers created by the state, entry is generally free. Clearly, if one believes these two propositions, one is likely to be sceptical of the economic benefits of any regulation for competition.

Following the landmark decision of the Australian Trade Practices Tribunal in QCMA and Defiance Holdings (1976) ATPR 40-012 at 17 246, Australian courts and administrators have acknowledged that the condition of entry to an industry is of prime importance in any assessment of the extent to which an industry can be classified as competitive. However, the heavy weight given to the condition of entry should not cause other factors to be neglected.

John Stuart Mill argued against giving sole weight to the condition of entry on empirical grounds: because one can observe trades under which collusion on price coexists with freedom of entry, freedom of entry is not sufficient to ensure a competitive industry.

By combining free entry with price collusion, resources are allocated in the worst possible way. The price collusion produces allocative inefficiency because the high price limits demand and so causes too few resources to flow to the industries. The freedom of entry ensures that profits are eliminated — not by lowering costs but by raising unit costs through fragmenting the market among a large number of producers, each of whom is unable to take advantage of economies of scale. The result is production inefficiency.

Mill's examples may still be apposite: 'The fees of physicians, surgeons, and barristers, the charges of attorneys, are nearly invariable. Not certainly for want of abundant competition in those professions, but because the competition operates by diminishing each competitor's chance of fees, not by lowering the fees themselves' (Mill, 1985[1909]:247).

Perhaps a more obvious example is the net book agreement in the United Kingdom. Both book publishing and retailing exhibit relatively free entry. However, collective resale price maintenance has existed for almost a century (for a record of the defence of the net book agreement before the UK Restrictive Practices Court in 1962, see Barker & Davies, 1966).

If one accepts the Gunton line, then one need proceed no further. As it happens, I (along with John Stuart Mill, Alfred Marshall and the mature J.B. Clark) do not. So I shall proceed with the argument.

Competition requires both an absence of collusion among firms within the industry in question, and freedom for potential entrants to enter the industry. Barriers to entry may be defined as disadvantages that potential entrants suffer (as a class) compared with incumbents. Following Salop (1979:335), barriers may be classified as strategic if they are purposely erected to reduce the possibility of entry. Accordingly, firms can pursue anticompetitive strategies either by engaging in collusion or by erecting barriers to entry.

III. EFFICIENCY AND PROFIT

Competition produces an efficient allocation of resources by ensuring that the only way of earning a high rate of return on investment is to initiate a new product or process for which consumers are prepared to vote with their dollars. In the absence of competition there is another avenue to profit: monopoly power, either through collusion or through strategies designed to raise barriers to entry.

Although profit is the motive of most businesses, profit can be achieved either through acting efficiently or by the exercise of monopoly power. This formulation was clearly seen by the High Court of New Zealand in the first full hearing under the Commerce Act 1986. The Auckland Regional Authority (ARA) sought the assistance of the Court as to whether the contracts by which it had granted Avis and Hertz joint exclusive use of Auckland International Airport violated the Commerce Act and so were unenforceable. Under s. 36 of the Commerce Act, the use of a dominant position is contrary to the section only for certain nominated purposes. The agreed Statement of Facts recorded that the stated purpose of ARA in granting the concessions to Hertz and Avis was to maximise income. Nevertheless, Barker J concluded that a less immediate purpose was the excluding of other potential concessionaires.

> Although ARA's motive may have been to maximise rent, by accepting only two rental car operators, its means of achieving this object was the use of its dominant position to exclude competitors of the successful concessionaires. The collateral contracts therefore had the purpose of excluding other potential concessionaires. (*Auckland Regional Authority* v. *Mutual Rental Cars TR (Auckland Airport) Ltd, Tasman Rental Cars Ltd and Dominion Budget Rent-A-Car Ltd (1984)*, High Court of New Zealand, Auckland Registry, Judgment of Barker J dated 31 July 1987, pp. 79-80)

If the industry is competitive, a firm can be highly profitable over a long period of time only by continually developing new ways of better serving its customers. In its defence against antitrust prosecution in the US, IBM chose to characterise its profit performance as such a reward for efficiency. The prosecution, however, characterised IBM's profit as returns to monopoly power (see Fisher, McGowan & Greenwood, 1983). Regulation for competition can be defended as a set of rules by which business strategies are directed to producing an efficient allocation of resources. By proscribing strategies designed to enhance monopoly power, the only source of profit that remains is the creation of more efficient means to allocate resources.

According to this standard, two types of strategies should be subject to regulation: (i) collusion among firms that would otherwise be competitive; and (ii) the strategic creation of barriers to entry. I do not wish to argue that such strategies should always be proscribed. Indeed, the strategies may be justifiable because, although anticompetitive, they produce other efficiencies. But I do argue that, in principle at least, they are suspect.

IV. REGULATION IN A PERFECT WORLD

In a world where regulators are omniscient and regulation is costless, it is easy to see how the procompetition sections of the Australian Trade Practices Act and the New Zealand Commerce Act might promote the goal of an efficient allocation of resources.

Horizontal Agreements

Section 45 of the Australian Act and s. 27 of the New Zealand Act proscribe contracts, arrangements or understandings that substantially lessen competition. This proscription may be interpreted as a prohibition against forms of collusion that are designed to limit competition within an industry.

A clear case in which s. 45 of the Australian Act was useful was the challenge by the Trade Practices Commission (TPC) to agreements made in mid-1983 in the oil industry. Meetings in May and June (including conferences before the Conciliation and Arbitration Commission) were attended by representatives of the Transport Workers Union (TWU), the Australian Petroleum Agents and Distributors Association (APADA), and seven major oil companies. Although the oil companies denied they were parties to any agreement, the TPC alleged that they were parties to an agreement with the following obligations: (i) that oil companies would deliver petroleum products only to retail sites they were supplying as at 13 February 1980; (ii) that petroleum wholesalers would do likewise; and (iii) that a register of petroleum products distributors would be drawn up, with the oil companies providing a list of all persons to whom they supplied petroleum products and whom they wished to be on the register; but before doing so must sign an agreement not to supply a service station supplied direct by the oil companies prior to 13 February 1980 (Trade Practices Commission, *Tenth Annual Report*, 1983-84:267, 1984:97-8).

After the TPC had instituted proceedings against the alleged parties to the agreement, the TWU and the APADA announced that they were withdrawing from the agreement. An agreement such as that alleged would have had a dramatic influence on the allocation of resources had it been enforced. In effect, the expansion of the activities of petroleum wholesalers that had occurred since 1980 would have been reversed, and the patterns of distribution of petroleum would have been set in concrete indefinitely.

One of the costs associated with trade practices legislation is that the legislation may proscribe conduct that promotes economic efficiency. Although I know of no instances in which ss. 45-45E of the Australian Act or ss. 27-30 of the New Zealand Act have had such an effect, the possibility remains. For example, such an effect might occur in circumstances similar to those of the famous US case of *Chicago Board of Trade* v. *United States* (1918) 246 US 231. The case involved what was known as the 'call' rule of the Board. The rule applied to the period between the close of the call and the opening of the session on the next business day. Between those times, members were prohibited from purchasing any wheat, corn, oats or rye 'to arrive' at a price other than the closing bid at the call. Such a rule is innocuous from the point of view of the extent to which a market is competitive. Nevertheless, it may still be caught by the *per se* prohibition against fixing, controlling or maintaining prices.

Abuse of Monopoly Power

Section 46 of the Australian Act and s. 36 of the New Zealand Act also may be interpreted as promoting a more efficient allocation of resources. Under such an interpretation, the sections would proscribe the creation of barriers to entry where such strategies were contingent on the market power of the incumbent firms.

Over the last decade, the literature of industrial organisation has greatly clarified the ways in which strategic barriers can be erected. The strategy always involves an investment: either in the form of plant and equipment or in the form of profit forgone during a period of predatory behaviour. The investment is a sunk cost, in that the asset (whether physical or enhanced reputation) cannot be resold for the price at which it was purchased (see Milgrom & Roberts, 1987).

In November 1985 the Department of the Treasury in New Zealand made a submission to the Minister of Finance arguing, among other things, that clause 36 should be deleted from the Commerce Bill. It may be that the implementation of s. 36 will be so clumsy that Treasury will be proved correct. However, one benefit of the section — if it is sensibly interpreted and administered — is that it can act as a bulwark against heavy-handed strategies of government-created or natural monopolies. Indeed, the first full case under the Commerce Act involved the use of s. 36 for precisely this purpose. The result of the hearing was that Budget Rent-A-Car gained access to the airport terminal in Auckland. Similarly, whatever one may think of the break-up of the Bell-AT&T network in the US, one must acknowledge that pressure in the form of an antitrust litigation caused the protective wall of that regulation to be breached.

We cannot depend on the state to remove the sources of the monopoly power. Generally, such action (to the extent that it can operate) is desirable. But the fact is that the state will act to remove such power only if it is pressed to do so. One source of pressure is the apparatus of pro-competition legislation.

The Special Case of Vertical Restraints

Both the Australian and New Zealand statutes single out certain vertical restraints for special treatment. A vertical restraint is said to exist if a firm (for example, a manufacturer) has an arrangement to sell to a vertically-related firm (for example, a retailer) on conditions that restrict the freedom of the second firm to trade with a third party. Examples of such restraints are resale price maintenance, territorial protection and tying. In both countries the statutes contain *per se* prohibitions against resale price maintenance. The Australian statute also contains a *per se* prohibition against third-line forcing. That is, the supply of goods or services on the condition that the purchaser will acquire other goods or services from another supplier is absolutely prohibited.

It is easy to find cases where vertical restraints are used either to facilitate coordination among members of an industry or to erect barriers to entry. Indeed, much resale price maintenance is caused by retailers' applying pressure to manufacturers for the manufacturers to prevent price competition at the retail level. However, such restrictions on competition do not mean that the practices should be proscribed.

Many vertical restraints can be justified in terms of economic efficiency (Hanks & Williams, 1987). If one accepts that economic efficiency ought to be the test of any restraint, then one must allow that resale price maintenance and third-line forcing are sometimes desirable. In particular, resale price maintenance may promote economic efficiency if it prevents free riding of various types. For example, in *Trade Practices Commission* v. *Stihl Chain Saws (Aust.) Pty Ltd* (1978) 13 ATPR 40-091 at 17 822, one reason the defendant terminated a Melbourne discounter was that the discounter advertised its discounted price regularly in a publication that reached purchasers throughout Victoria, southern New South Wales and Tasmania. Country purchasers were prevailing upon their local dealers for service under warranty — even though the chain saws had been purchased (at a discount) in

Melbourne. It could be argued that the Melbourne discounter was gaining a free ride on the service that country dealers were obliged to provide, and that the cheapest way to prevent this free riding was via resale price maintenance.

Mergers

Both the Australian statute (s. 50) and the New Zealand statute provide for controls over mergers that would produce dominance in a market. Mergers are generally motivated by the possibility of an income stream to the merged entity that is higher than the sum of the income streams to the entities when acting independently (see empirical evidence in Bishop, Dodd & Officer, 1987). The increased income stream may result either from gains in economic efficiency or from increased market power. So mergers ought to be subject to controls for the same reason as contracts, arrangements and understandings.

One worrying feature of these controls and their interpretation is the view within the Australian TPC that s. 50 does not usually prevent mergers providing two well-matched local firms remain within the industry (Trade Practices Commission, 1986:3). This view was the basis of the TPC's refusal to challenge significant mergers in the beer and domestic air travel industries.

It is not clear to me that the Commission's interpretation of s. 50 is right — either as a matter of economics or, if I may say, of law. If barriers to entry are significant, then duopolists may behave in a non-rivalrous way so that they gain dominance without any contracts, arrangements or understandings that could be proved before a court. This argument was used against the transfer of the Pacific Division of Pan American to United Airlines (see Fisher, 1987). Two-firm dominance may be as worrying as dominance by a single firm.

In this section I have expressed certain reservations about the form of the statutes in Australia and New Zealand. The argument has been presented on the assumption that the costs of administration and compliance are zero and that those responsible for administering the statutes are omniscient. These assumptions clearly fail to reflect reality.

V. REDUCING THE COSTS OF ADMINISTRATION AND COMPLIANCE

Casual observation suggests that procompetitive legislation generates costs in two principal areas: (i) litigation; and (ii) compliance in an uncertain legal environment.

The most notorious example of the cost of trade practices litigation in Australia is the Tradestock case, which concluded in February 1985. In his judgment Franki J stated:

> The case was fought with extreme determination. Interlocutory proceedings occupied some 60 days before a single Judge of the Court and some 20 separate judgments were given in respect of these interlocutory applications. Five appeals were brought to the Full Court of this Court from certain of these judgments.
>
> Three applications were made for special leave to appeal to the High Court from the judgments of the Full Court. Of these one was refused, one apparently was not proceeded with and the third was granted although the appeal was unsuccessful. No appeal was brought by the Commission ...
>
> The evidence occupied 173 days and the addresses 32 days. In addition, the parties gave me certain written submissions. The submissions for the Commission extended over about 700 pages, those for the first defendant over about 1400, those for the second defendant over about 800, those for the third defendant over about 500, those for the sixth defendant over about 200, those for the seventh defendant over about 15, and those for the eighth and ninth defendants over about 50. In addition the first defendant sought to tender a further 600 pages in relation to facts which two expert economists had been asked to assume. I declined to accept this further material ...
>
> Every point which could possibly be raised concerning the admissibility of evidence appears to me to have been taken and I provided some 40 rulings on the admissibility of evidence during the hearing. The majority of these were in writing, copies of which were given to the parties. Some of the rulings have now been published (1984 ATPR 40-483 at pp. 45 531 to 45 585). Four senior counsel and seven junior counsel were in Court most of the time and from time to time other counsel appeared. 105 witnesses were called. The interlocutory applications extended over more than 2000 pages of transcript and the hearing over 16 000 pages. In addition, about 1000 exhibits were tendered ... (*TPC* v. *TNT Management Pty Ltd & Ors* [1985] ATPR 40-512, 46 084-5)

It is clear that those who administer our court system have a responsibility to develop procedures to ensure that this experience is not repeated. First I will discuss ways of reducing the uncertainty of litigation. Then I will turn to two ways in which the administration of the statutes has strayed from the path that leads to economic efficiency: market definition and public benefit.

Reducing the Uncertainty of Litigation

The costs of compliance can be reduced by reducing the uncertainty associated with the outcome of litigation. This is the principal defence of *per se* prohibitions. The argument is that the strategy condemned by the rule is so obnoxious, and certainty of the law is so desirable, that it is worth bearing the cost of the occasional proscription of innocuous conduct.

Regarding price-fixing, my feeling is that, if the courts and administrators were to gain more familiarity with the law and economics of trade practices, price agreements would, except in exceptional circumstances, be condemned as substantially lessening competition. However, while there remains some doubt that administrators and courts would make this judgment, for the sake of certainty it may be better to retain the *per se* prohibition of price-fixing.

It is less easy to justify the *per se* prohibition of individual resale price maintenance because there are many instances where such a strategy can be defended as enhancing economic efficiency. The *per se* prohibition of third-line forcing embodied in the Australian statute proscribes so much efficiency-enhancing conduct that it is impossible to defend.

A second way to reduce the uncertainty of trade practices litigation is to increase the expertise in economics available to the courts. The Commerce Act of New Zealand allows for a lay member to sit with the judge in the High Court. The limited experience we have of this procedure is encouraging. Litigants know that only arguments that are reasonably sound in economics will be accepted by the courts. This can only increase the certainty associated with the result of litigation.

An Obsession with Market Definition

A principal cause of the uncertainty involved in trade practices administration or litigation is the extent to which administrators and judges depart from the precepts of economics. If the ultimate function of the statutes is to promote economic efficiency (and competition is interpreted as the means by which this goal is pursued), the definition of the market becomes merely one part of the process by which competition is analysed. Unfortunately, in litigation over trade practices throughout the world the definition of the market is often seen by the litigators or courts as decisive to their arguments.

The recent judgments of the Full Federal Court of Australia in *Queensland Wire Industries* v. *BHP* and the High Court of New Zealand in *Tru Tone Limited* v. *Festival Records RML* are examples in which arguments over definitions of markets have proved decisive.

From the viewpoint of economic efficiency, the real issue in trade practices litigation ought to be the extent to which the accused parties are subject to competitive pressure — either from other firms within the industry or from potential entrants. The market is merely a tool of analysis that should assist in making this investigation.

This conflict between law and economics in antitrust litigation is not new. In a classic article of 1937, Edward Mason expounded this problem as follows:

> The economists' emphasis is on control of the supply or price of a product. And 'product' is defined in terms of consumer choice, for if consumers find that the goods sold by two competing dealers are different, they are different for purposes of market analysis regardless of what the scales or calipers say. Some control of the market exists whenever a seller can, by increasing or diminishing his sales, affect the price at which his product is sold. Since, outside the sphere of agricultural and a few other products, almost every seller is in this position, it is easy to see that if monopoly is identified with control of the market, monopolistic elements are practically omnipresent. This is the logical conclusion, it is submitted, where the emphasis is laid upon control of the market and the monopoly concept is considered as a tool of analysis only, unrelated to public policy. But if monopoly is considered to be a standard of evaluation useful in the administration of public policy, then other considerations must be involved.
>
> It is so used in the law. (Mason, 1957[1937]:335-6)

What Mason had to say about monopoly power can be applied *a fortiori* to defining a market. Economists define a market only as a tool of analysis. In considering issues of public policy, their eye is trained to the goal of economic efficiency. If the defining of a market in identifying a monopoly is used as a standard of evaluation then the goal of an efficient allocation of resources has departed from vision.

Fortunately, the High Court of Australia has recently pronounced on this issue in a most decisive manner. In the unanimous decision of *Queensland Wire Industries* v. *BHP* (1989) ATPR 40-925, the High Court upheld the appeal of QWI against the judgment of the Full Federal Court. The decision of the High Court makes clear that the process of defining a market should be object-oriented: the market should be defined so as best to assist the analysis of market power.

Public Benefit

Both the Australian and the New Zealand statutes provide for the authorisation of certain conduct. In essence, they provide for authorisation to be granted if the benefit to the public outweighs any detriment caused by the conduct in question.

It is clear that, despite the arguments of economists (see Hanks & Williams, 1987; Officer, 1987), the Australian TPC and the New Zealand Commerce Commission do not always adopt the standard of economic efficiency in their evaluation of public benefit. In particular, they frequently depart from Hume's law that a dollar is a dollar. Because they value benefits to consumers above benefits to, say, shareholders, both bodies have hesitated to classify cost reduction from restructuring as a public benefit unless competition in product markets compels the restructured firm to pass on these benefits to purchasers in the form of lower prices.

To my knowledge, this has never been the attitude of the Australian Trade Practices Tribunal. Indeed, in QCMA and Defiance Holdings the Tribunal stated that:

> we see as anything of value to the community generally, any contribution to the aims pursued by the society including as one of its principal elements ... the achievement of the economic goals of efficiency and progress. If this conception is adopted, it is clear that it could be possible to argue in some cases that a benefit to the members or employees of the corporations involved served some acknowledged end of public policy even though no immediate or direct benefit to others was demonstrable ... (QCMA and Defiance Holdings [1976] ATPR, 40-012 at 17 242)

Despite quoting this passage in its recent decision of Henderson's Federal Springs Works Pty Ltd (1987) ATPR (Comm.) 50-054, the Australian Commission proceeded to state that for a benefit to qualify as a public benefit it must accrue to a party other than the owners of the firm.

> There are thus clearly stated intentions to streamline the efficiency of the Australian automotive industry, that makes rationalisation in this industry a matter of special concern. Thus the TPC would accept that the rationalisation benefits that accrue from this acquisition (as already indicated) would qualify as public benefits if there is sufficient to show

> that the benefits once gained will not, as a result of market power, be retained solely by Hendersons itself in the form of higher profits. (at 57 156)

Similarly, the New Zealand Commerce Commission recently argued along the same lines and claimed the support of an economist for its denial of Hume's law.

> The Commissions finds Dr Bollard's analysis persuasive in that, in the absence of an effective competitive discipline, the benefits resulting from the merger would be likely to benefit the company and shareholders, and that there would be no discipline which would ensure that benefits would flow through to the consumer, for example. This fact is something which the Commission can and should take into account in the weighing process. Where the detriments are likely to be to the wider public, the Commission may give weight accordingly. (Fletcher Challenge Ltd/NZ Forest Products Ltd [Decision No. 213], para. 168)

As I argued at the start of this paper, to deny Hume's law is to confuse the efficient allocation of resources with the distribution of income. The authorities that administer trade practices statutes should not have to pursue two goals simultaneously: an efficient allocation of resources, and a redistribution of income from shareholders to purchasers.

A better implementation of policy would result if trade practices authorities were to aim only for an efficient allocation of resources, and to leave concern about the distribution of income to the departments of government responsible for taxation and transfer payments.

VI. CONCLUSION

An efficient allocation of resources is one that maximises the dollar votes of consumers, counting a dollar as a dollar. Subject to a very few qualifications, competition is a mechanism that can deliver such efficiency.

In order for a market to be competitive, firms within the market must behave as rivals. Free entry is not always sufficient to ensure rivalrous behaviour.

In a world of omniscient administrators and costless administration the Australian Trade Practices Act or the New Zealand Commerce Act would play a valuable part in ensuring that markets were competitive. However, to the extent that litigation is costly and its outcome uncertain, that practitioners use market definition to decide issues of public policy, or that administrators pursue goals other than economic efficiency, the net result of regulation is more likely to be a cost than a benefit.

It is impossible to conduct an objective study of the net effects of regulation for competition. One must make a judgment in the light of the evidence. However, by reducing the costs and uncertainty of litigation, by relegating the definition of the market to the status of a tool of analysis, and by ensuring that the sole goal of those administering the statutes is economic efficiency, we could make it much more likely that the systems of regulation would produce a sizeable net benefit.

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Comments on Philip Williams

Comments on Philip Williams

Warren Pengilley

I compliment Philip Williams on his erudite exposition of most of the theoretical reasons as to why we should regulate for competition and on his observations in relation to some of the theoretical reasons for where we have probably gone wrong. I am glad to see from his paper that economists have at last reached the conclusion that Hume's law is correct and that 'a dollar is a dollar'. This must be a change for economists. A dollar is a dollar — not a seasonally adjusted dollar, a 'real' dollar, a 'present value' dollar or an 'indexed' dollar! This conclusion of economists no doubt makes those of us who have lesser pretensions in the area happy to know that economists agree with what we always knew — that is that 'a dollar is a dollar'.

Dr Williams's analysis is a fine one on **where** we have gone wrong. He quite rightly highlights the high cost of litigation and uncertainty of result — to use what are perhaps his prime examples — as major deficiencies in the present competition law. However, his paper is not as strong on **why** we have gone wrong. For example, while he quite rightly talks about the problems of the high costs of litigation and criticises this, the real question is **why** we have

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these high costs and why the other inadequacies of which he speaks are present. I do not feel that these aspects are as fully explored as they could be. Accordingly, it is on these aspects that I wish to make my brief commentary.

Competition Law Is Not All About Economics and Efficiency

First, I do not believe, with all respect to economists, that economic efficiency is or ever was the sole, or even a major, aim of competition law. One can look through the United States cases and the US Congressional Record, for example, and find that a prime purpose of the antitrust law when enacted was the protection of small business — this in many cases regardless of whether small business was economically efficient or not. There is also plenty of material that states that the competition laws are aimed at protecting against the exercise of power — again, regardless of whatever economic efficiencies this power may bring. The collective *per se* ban is explicable, for example, largely in these terms. In the European Economic Community, it is clear again that one of the prime objectives is to forge political unity through market unity — again, regardless of whatever economic efficiencies may or may not result from this.

Australia is not immune from this. Thus when we talk about restricting the *per se* impact of resale price maintenance (RPM), we forget the political history in which the resale price maintenance law was spawned. Our present Prime Minister, Mr Robert Hawke, was in 1972 a director of Burkes Stores in Melbourne. Burkes Stores was a discount operation. Perhaps it does not speak wonders of our Prime Minister's business acumen that it soon went broke. Burkes wished to discount shirts to a 15 per cent mark-up. Dunlop, which made the shirts, insisted on a 22.5 per cent mark-up. Dunlop said to Burkes that it would not supply shirts if Burkes undercut the 22.5 per cent mark-up. Burkes said to Dunlop that if Burkes were not supplied, there would be no labour to make the shirts which Dunlop wished to sell. There was a stand-off and eventually RPM became illegalised. It became illegalised with bipartisan support because the Liberal Party stated that it intended to introduce the legislation in any event. Mr Hawke claims to have 'smashed' RPM In Australia. The Liberal Party claims to have enacted the illegalisation of RPM in Australia. Both parties claim the credit for the legislation and I think both are still wedded to the illegalisation of RPM. One's view of this matter is no doubt about as objective as most of one's views about politics. Nonetheless, it seems to me, given this background, rather fruitless to be talking about imposing a competition test for resale price maintenance. This would be *de facto* legalising the practice.

Likewise, I think it is somewhat academic to be talking about relaxation of the third-line forcing provisions in s. 47(6) of the Trade Practices Act. This section was brought in basically to ban building societies and other financiers from tying home purchasers into expensive insurance. It has achieved this purpose. Any tampering with the section would be opposed by vast sections of the community. Undoubtedly, whatever the economic benefits of the practice, the political thought of the day (and probably also of today) saw building societies tying insurance as being a bad practice. Section 47(6) has eliminated the practice. If there were a competition or efficiency test hung on to s. 47(6), the practice would clearly remain.

I end my brief observations in this regard by pointing out that the grandfather of antitrust law — the Sherman Act of the US — owed very little to economists. In fact, Schwartz, Flynn & First (1983) state that the proponents of the 1890 antitrust legislation in the US saw no need to attempt any type of penetrating analysis of the underlying economic theory which supported their views. The authors state that economists had virtually nothing to do with the passage of the Sherman Act. They played no role in seeking it, drafting it or testifying or working on its behalf. Members of Congress simply proclaimed 'the norm of free competition to be too self evident to be debated, too obvious to be asserted' (Schwartz et al., 1983:83, and works there cited).

Also, despite what may be a criticism of *per se* offences — that these have economic deficiencies on a case by case basis — these offences are matters that: can be most easily understood; can be most easily complied with; and are the easiest for business to adjust to notwithstanding the inconvenience of adjustment.

Certainty in the law is a most important factor — a point which Philip Williams makes in his paper, though he seems to believe that the *per se* nature of the RPM ban should be reassessed. It is important to note that the judge-made *per se* offences in the US cite certainty as the prime reason for their evolution. It saves judicial time and effort and gives clear guides for business conduct. We all want this in the law.

We are used to a type of general proscription in other areas of the law where it is assumed, as an overall matter, that such proscription is applicable. The highway code, for example, says you are not to exceed the speed limit. It does not say that you are not to exceed the speed limit unless you are driving a pregnant mother to hospital, chasing a fleeing criminal, or exceeding the limit in a number of other circumstances where one might feel that such conduct is justifiable. These exculpatory matters are left to the discretion of the court as to penalty and to the prosecution authorities as to whether, in all the circumstances, a prosecution should be mounted. As a matter of civil law, there is no negligence exculpation if you should happen to have an accident while driving negligently for totally meritorious purposes. Even a fire engine or an ambulance receives no favourable negligence considerations if running a red light. (I make these observations pre-Transcover, legislation that has limited the application of the common law principles of negligence in the case of road accidents. The effect of this legislation is not within the scope of this commentary.)

Rather than do battle for the soul of economics, I would like to comment on a few pieces of pragmatism.

Per se Rules Have Benefit, but We Have Some Bad Ones

The *per se* rule has benefit. I think the example used by Dr Williams of the Chicago Board of Trade case is misdirected if it is aimed to show the inappropriateness of *per se* rules. The defendants in that case were exonerated. If, however, he were to have talked about how we had mistranslated the US law of collective boycott into our exclusionary provision law, then I would feel more sympathy. The result of this mistranslation in both Australia and New Zealand is that something that is not anticompetitive and not condemned *per se* in the US is, in Australia, *per se* banned as a matter of statutory construction. While the Swanson Committee of 1976 accurately assessed the US law on collective boycott and recommended its adoption here, the US position was mistranslated by the parliamentary draftsperson in Australia with the result that perfectly innocent practices in Australia, both in social terms and in economic terms, are *per se* banned. Here I think there are good grounds for condemning the Australian Trade Practices Act and its New Zealand equivalent, but I fear that any amendment of such legislation will not occur until some perfectly meritorious soul finds himself subject to a significant damages verdict. This is likely to be a trade association expelling a member on perfectly proper grounds but finding itself subject to s. 4D of the Trade Practices Act for doing so. I may be wrong in this as regards New Zealand, where there is to be a review of the Commerce Act this year and I know that the point I make is a matter specifically to be considered on such review. I predict the New Zealand law will be changed but I have some doubts as to whether Australia will follow.

Trade Practices Adjudication

If one were, to use Sir Garfield Barwick's analogy, looking at the administration of our trade practices law with the eyes of the man from Mars descended onto this planet, we would see some things that are perfectly obvious:

(1) Both the Federal Court of Australia and the Trade Practices Tribunal determine issues related to competition. However, one adjudicative body has a judge as the sole arbitrator. This judge is untrained in economics or business and has to work under highly constricting laws of evidence. The Trade Practices Tribunal, deciding essentially the same issues in a public benefit context, has expert economic and business expertise available to its decision-makers and is not constrained by the rules of evidence. The position is even more peculiar when the Federal Court regularly cites the holdings of the Tribunal in the Tribunal's reasoned competition analyses. It should be obvious to the man from Mars that one or the other method of adjudication is what is required. Can't we make a decision as to which is the best? If not, why not? There are ways around the constitutional impasses of judicial life tenure if a way around this has to be found.

(2) There are some even more obvious things in relation to adjudication by the Federal Court. A judge, no matter how learned, is a lawyer, not an economist. The conclusion that follows this is that a judge is not necessarily an appropriate person to be determining economic issues. I think there should be much wider debate in relation to at least the following matters:

- whether it would be wise to have the Tribunal adjudicate on competition issues;
- whether it would be wise to have a specialised division of the Federal Court of Australia on trade practices issues;
- whether it would be wise to be looking for judicial appointments in fields in other than the traditional seed bed from which such appointments are made;
- whether it would be wise to have the judiciary undertake a course in competition law or economics prior to appointment to the bench, or regularly to undertake update education in these areas. No doubt this would be anathema to our judiciary — whenever I have floated this matter with a judge, I have received a response along these lines. However, it is accepted in the United States. Further, it seems to me that if lawyers have to do Mandatory Continuing Legal Education there is no reason why judges should not do Mandatory Continuing Judicial Education.

If all these things seem a little strange, let me say that nearly all of them are in force in the US and at least some of them are incorporated in the New Zealand legislation.

We must be concerned at a number of trends that probably are explicable only by admitting that our judiciary is not appropriately educated in economics. For example, it is a tragedy that the full Federal Court recently in the appeal to *Queensland Wire* v. *BHP* found it so easy to pour scorn on the 'essential facilities' doctrine, dismissing it in four pages of not very impressive reasoning: reasoning that was not even essential to the disposition of the case before it. Thus the Australian judiciary purported to be ruling authoritatively on a US antitrust doctrine of a least 75 years standing in a judgment that I would say indicated fairly convincingly that the Court understood neither the doctrine itself nor the economic reasoning behind it. The only excuse I can find for this judgment is that it was written on Christmas Eve and therefore may have suffered from some of the frivolity of that occasion. (I hope this comment does not result in the application of the precedent in *Gallagher* v. *Durack* [1983] 152 CLR 238, under which Norm Gallagher spent some time in the penitentiary for contempt of the Federal Court because of his criticism of the way it reached its decisions.)

(3) It is clear that the rules of evidence are one of the main bugbears of trade practices laws. The rules of evidence are made for murder trials, and in this regard I support them fully. However, they are not appropriate for assessing questions of opinion rather than questions of fact. It seems to me absurd that an economist cannot give an expert opinion (at least this seems to be the present state of the Australian law) whereas a medical practitioner or an engineer can do so. It is likewise absurd (at least this seems to be the present state of the Australian law) that properly conducted survey evidence is inadmissible as hearsay whereas it is probably the best manner of determining issues. In his paper, Dr Williams has made reference to the New Zealand decision in the Auckland Regional Airport Authority case. I commend this case as an example of why survey evidence should and must be admissible, and I hope that the Australian courts will follow it.

(4) Dr Williams clearly states the problem of the Tradestock case. This case is nothing short of a national litigation disaster not only in terms of what it held but perhaps more importantly in terms of its procedures. This procedure was possible only because formal rules of evidence apply in court proceedings and the presiding judge thought he had to abide by these rules to the most minute degree. This meant the case became unmanageable, although perhaps other presiding judges may have taken a stronger managerial role (and I am sure a United States judge for example would have done so) when defence counsel engaged in what were obvious obfuscatory techniques. While Dr Williams clearly states the problems and says we have to have answers to them, I do not think that we have a habit of thinking out answers in advance too well. What happens is that we have a series of crisis reactions. This makes it all the more important that the presiding judge or the presiding tribunal have the capacity to make appropriate directions unhampered by obfuscatory techniques hiding under evidentiary rules. It is also

important, in my view, that the presiding authority be one that does not wish to play legal games but has the capacity to get to the substance of what it is all about. I am not quite sure that our present judicial system has this capacity, and I believe we should search for ways of amending or varying the methods by which these matters are evaluated.

My view of crisis reaction is, I believe, vindicated by history. Notwithstanding the well-founded criticisms of the Tradestock case and the plea in Philip Williams's paper that procedures be changed, nothing of substance has been done yet and I should imagine that the first time anything will occur will be when we have another Tradestock. When this arrives, of course, we will still be battling under the prior procedural rules and the prior methods of evaluation, so there is a fairly good chance we will get the prior result.

The Administration of the Statute

Dr Williams speaks in his paper about the administration of the statute. I have already said something in this regard; I would like to make two other observations.

Litigation costs and the view of the Trade Practices Tribunal. In relation to the cost of litigation, one real problem has recently been foreshadowed by the Trade Practices Tribunal in the case of Re Media Council of Australia (No.2) (1987) ATPR 40-774. The problem is that if the Tribunal decides an issue contrary to the manner in which the Commission has previously decided it, this constitutes 'changed circumstances' such that the Commission should then go back and re-evaluate its prior decision. I suggest that this is disaster, which creates uncertainty and must be checked — if necessary by legislation. It must be the ultimate uncertainty that one can work under a decision for perhaps a decade and then find the Tribunal deciding the matter a different way and the prior decision upset because of the subsequent reasoning. This does not happen in ordinary litigation, where the prior decision, if unappealed, stands. I think there is an excellent case for the same process, as a matter of a fundamental fairness and as a matter of business certainty, applying in the case of authorisation determinations. I would hope that the Tribunal might come out strongly on this issue and negate the uncertainty it has caused in the Media case, though I somewhat suspect that it will not and that the uncertainty will continue in the case of all applicants who have already been given authorisation by the Commission. (For further observations on this point see Pengilley, 1987.)

Mergers and TPC non-accountability. What is required in mergers is a system that is efficient, and accountable.

We have a system that is efficient insofar as the Trade Practices

Commission's decision whether or not to prosecute is concerned, but that is not accountable in this field.

In mergers what the court thinks is ultimately irrelevant. The court has been largely unable to adapt procedures to hear substantive matters within appropriate time constraints, and the APM litigation (*TPC* v. *APM Investments Pty Ltd & Fibre Containers* [1983] ATPR 40-403; *APM Investments* v. *TPC* [1983] ATPR 40-404; *Visy Board Pty Ltd* v. *A-G* [Cwth] [1984] ATPR 40-448) demonstrates the point I make (for observations on the history of this litigation see Pengilley, 1984). The Commission's authorisation procedures are just as bad in terms of timing. Thus, what it is all about is the Commission's view of its prosecution role, and this is something we just do not know. Because the Commission is the only party that can realistically take court proceedings for breach of the merger section, its opinions on matters such as market and dominance constitute the *de facto* law in this area. It is most important that this law be known to us all. The previous clearance provisions and the previous and present authorisation provisions each mandate disciplined reasoning by the Commission, which is necessarily available for criticism and commentary.

I do not suggest a return to the previous system of clearance. As stated, I believe that authorisation is not an available option for anything but the most friendly, non-volatile company merger. I believe that the present negotiation basis in order to obtain an undertaking from the Commission as to non prosecution — the informal 'clearance' as some call it — operates well as a matter of pragmatism. My concern is that the Commission is not seen to be acting in a disciplined manner or consistently, and that its decisions are often seen to be unexplained. Regrettably, no one is really in a position to comment on or criticise the Commission's decisions because no detailed reasoning — only a most generalistic press release — is provided by the Commission. One gathers the impression all too often that informal negotiations, rather than disciplined reasoning, governs the result. This cannot be in the best interests of company merger policy in Australia. Neither can it be in the best interests of those who want to know what the law really is (or at least what the Commission thinks it is). Nor in my view can it be ultimately in the best interests of the Commission, which is seen as involving itself in a non-accountable, 'clubby' negotiating process.

Some of these aspects are of vital importance. I cite three mergers as examples.

Coles/Myer. The Coles/Myer merger produced what is said to be the twelfth largest retail chain in the world. The Commission put out various statements as to why this was allowed. I thought the Commission held the market to be 'the Australian retail market' — a conclusion that seemed somewhat strange on traditional market analysis but that seemed to me clearly to be the conclusion from the Commission's press release. I have since been told by various people that that is not in fact what the Commission thought the relevant market to be. The Commission says that it employed a consulting economist on the matter. Great, but what did the economist say? I have yet to find out — as has the rest of the community. This decision is probably one of the most important ever given by the Commission, and it has huge ramifications. (The Commission may of course be quite right in what it decided, and I do not here enter into this debate.)

We are also treated to secrecy in relation to one of the undertakings that was part of the Commission's determination: that it would 'vigorously' watch the activities of the merged group in terms of s. 46 of the Trade Practices Act. Frankly I thought at the time, and I still think, that this statement was never going to be implemented in any realistic way. It would be interesting to know at least what the Commission has done in this area, even if we will not be told the results of what it has done.

Bell/BHP. The Bell/BHP merger was objected to by the Commission against a highly volatile political background: the transfer of dominance provisions to be legislated in s. 50 (largely in accordance with the terms of a prior Commission Guideline on this point) were being blocked in the Senate. The Commission decided to object to the merger. This decision was quite contrary to its prior Guideline that there was nothing wrong with a pure transfer of market power. There has been no detailed reasoning provided as to where this case varied with the Commission's prior Guideline. Because of the silence of the Commission, many people drew innuendos of a shadowy political nature. This whole exercise contributed nothing to certainty in the law, which Dr Williams's paper so rightly states is important. Nor did it assist the Commission's credibility as an independent regulator or as a party prepared to abide by the Guidelines it had issued to the public. A more detailed, tightly reasoned statement would have helped everyone in understanding what the Commission was doing.

Ansett/East-West Airlines. The Ansett/East-West merger was probably the most critical merger in the aviation industry since the aviation mergers some decades ago when Ansett took over ANA and Butler Air Transport. But the whole thing seemed to be nothing more than a somewhat clubby negotiation. Perhaps these negotiations were very tough — but no one knows. It surprised me that Ansett was allowed to obtain through merger the major stop-off point that was a danger to its Sydney-Melbourne trunk route — that is, Albury, though which East-West was providing significant competition to the majors between Sydney and Melbourne; plus the hub of the East-West network, Sydney-Tamworth; plus the repair facilities at Tamworth for all the aircraft.

My point in the above observations is that the perception of what goes on is what matters — not the actuality. People do not like to live in a state of ignorance. As Dr Williams points out, this encourages lack of certainty. From the Commission's point of view, people will generally assume the worst if they do not know the true facts.

I do not believe in a return to full authorisation or full public disclosure. However I fail to see why the Commission cannot record in detail in relation to important mergers what its views are, what its definition of the market is, and how it sees the various questions of dominance. Reasoning along the above lines could be available after the merger is either consummated or cancelled. At this stage, it seems to me that no one can be disadvantaged commercially by this, the information gap is no longer there, the Commission is forced into a disciplined reasoning process, and many of the criticisms currently levelled at the Commission can be overcome. If the Commission does not adopt this view, it seems to me quite likely (and indeed quite proper) that some legislative obligation will be imposed upon it to do so. The Commission can head this off by acting innovatively in advance. I do not suggest this course for all mergers. However, the more important mergers clearly merit this treatment.

Market Definition

Dr Williams talks about lawyers' obsession with market definition. I must say this does not worry me. I think lawyers do use it as a tool and not as he suggests. The fact that market definition was decisive in *Queensland Wire v. BHP* suits me fine, though I am not sure that Dr Williams's conclusion is correct. I would have thought at first instance, and probably also on appeal (but it is difficult to know what was decided on appeal), that the real question was not the market but whether there was any taking advantage of market power. One cannot object to an obsession with market definition in the terms of the criticisms levelled in Philip Williams's paper. One can object if lawyers get it wrong — but this is another question.

Conclusions

I commend Dr Williams's paper. However, until we face those things we are reluctant to face, we will not have any long-term solutions to the problems he states. He gives us the theoretical basis on which we have gone wrong.

but we must face it that something has to be done about the system itself because it is the system that causes these results. The system gives rise to the theoretical incorrectness of which he speaks.

Incidentally, my views expressed here are not new. They have been much the same since 1979. I had no supporters then; I suspect I might have quite a number now.

In due course we must rationalise all this inconsistency of approach between the Tribunal and the Court; between the strict rules of evidence and procedure in the Court and the Tribunal's ability to ignore these; between the obvious relevance of survey evidence and the Australian Court's tendency to reject it; between the status of economists as expert opinion-givers and the rejection of their evidence as hearsay, and so on. The system is internally haemorrhaging in trying to do the same thing in various different ways. No doubt others will see it differently, and I will once again be told of the virtues of the present system and the failures of my ideological approach. For myself, I think perhaps a little ideology is not out of place, and I think the lack of it is what has given rise to many of the problems discussed in Dr Williams's paper, which he addresses so admirably.

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Comments on Philip Williams

Peter Swan

While I congratulate Dr Williams on the vividness of his illustrations, I'm critical of some of his examples and the conclusions he draws from them.

In particular, I'd like to take issue with his rejection of the approach of George Gunton, a forerunner of the Chicago School, who argued, first, that where there was perfect freedom of entry potential competition would be a major restriction on the anticompetitive behaviour of incumbents, and second, that the major barriers to entry are usually created by government. Not surprisingly, governments have exempted many statutory monopolies from the purview of the Trade Practices Commission.

Take Dr Williams's example of the Auckland Regional Authority restricting the number of car rental operators at Auckland International Airport. He agreed with the High Court of New Zealand that more operators should be allowed to compete in the airport market because the restriction to two operators — Hertz and Avis — was anticompetitive. But we have to ask what the purpose of the airport authority is. Presumably, its purpose is to provide airport facilities at the lowest possible cost. The New Zealand Commerce Commission surely has a legitimate interest in ensuring that the

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authority lets its concessions so as to earn the highest possible rent, as a way of keeping down the cost of the facilities. This will reduce the number of concessions at the airports. But the services they provide are bought mainly by businessmen who value the airport services most highly; this lowers the cost of take-off and landing charges for marginal passengers who place less value on them. The less revenue comes in from the concessions, the higher the take-off and landing charges will be for all passengers. The issue here was not really about monopoly power, but about the right of the organisation to dispose of its property or enter into contracts so as to cross-subsidise its operations as it sees fit, that is, to look after the interests of all constituents and not just those that value their time and convenience the most.

Another example is the opposition of the Trade Practices Commission to the actions of the Transport Workers Union and the oil companies in trying to exclude the independent wholesalers. Once again, the real issue here is the monopoly power of the TWU, which, however, lies outside the powers of the TPC. Only if a secondary boycott were involved could the TPC step in. The point is not so much the fact of a horizontal agreement (which I would oppose) but that, in the absence of the monopoly power of the TWU, the agreement would be unenforceable. The Trade Practices Commission can do very little to attack the root cause of the problem.

As for the chainsaw example, I am not very convinced by it, since it seems to me that the manufacturer would include the cost of the warranty in the cost of the chainsaw itself, so that the discounter would be paying for the cost of the warranty services whether or not the actual servicing was done in the country by other agents or by the discounter.

I would also disagree with Dr Williams's opposition to Bond's and Swan's acquisition of Castlemaine-Tooheys. If the TPC hadn't allowed that takeover, we would be much more likely to have a single dominant supplier in Carlton and United Breweries. Then there's the 'whole milk' — i.e. drinking milk — monopoly — the fact that we pay two or three times as much for whole milk as for manufacturing milk for cheese-making etc.; there's the egg monopoly; minimum wages that create unemployment; tariffs and quotas that exacerbate poverty; the protected monopoly position of many professional groups; and so on. All these issues are outside the purview of the Trade Practices Act. My main point, then, is that Dr Williams hasn't really demolished the work of George Gunton and the Chicago School; what they have to say is still highly relevant. Unless the Trade Practices Commission is given the power to override all government and politically-inspired monopolies, consumers are going to need all the help they can get from 'potential' competition and contestable markets.

I drink to George Gunton! His voice still needs to be heard above those shrill voices of the vested interests.

Comments on Philip Williams

Alan Bollard

Philip Williams's paper surveys how competition is being regulated in Australia and New Zealand, and how competition law is being interpreted in commissions and courts there. He early on poses his argument in efficiency terms, and this invites the question 'how do we know when there is an increase or a decrease in efficiency from regulation?' This question is never satisfactorily answered.

I think one reason is that Dr Williams sidesteps completely the issue of welfare, that is, whether society is better or worse off from intervention. As he says, economics is concerned with whether resources are allocated efficiently, but he does not discuss sufficiently how we can know when this occurs. He says the standard used to assess this in economics is the 'dollar votes of consumers'. I agree that this is the core of the issue, but it does oversimplify. Consumers, employees and producers also have political votes where they register their feelings, tastes and vested interests. Government enacts legislation or regulation to satisfy these, at least in principle, and to me this was clear in the early political comments on the New Zealand Commerce Act.

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The core of Dr Williams's paper is the implications of Hume's law that consideration of resource allocation for efficiency reasons should be divorced from distribution of welfare and income. This is a useful focus for the paper as it reflects the current political debate raging in New Zealand inherent in Rogernomics versus Langenomics. Hume's law of course says nothing about how efficiency and equitable distribution should be achieved, although Dr Williams suggests that it does. In fact, in practice it is difficult to see such a clear distinction between efficiency objectives and distributional ones, although I agree with the principle that courts and commissions should be aiming for the first, not the second. (For a much deeper analysis of the highly complex relationship between efficiency and welfare in a competition application than Williams provides, see Greer, 1989.)

I enjoyed Dr Williams's historical account of antitrust thinking and have no problems with his arguments on competition, efficiency and profits.

Regarding horizontal and vertical restraints, the Williams paper merely reflects the standard economist's view. Horizontal agreements that involve collusion to limit competition could be bad; vertical agreements are less likely to be, typically causing concern only if they have horizontal elements in them. Vertical restraints (RPM, exclusive dealing arrangements, third-line forcing, ties, bundling, etc.) may be devices for: collusion among retailers; collusion among manufacturers; or improving the efficiency of the distributional chain.

If they are imposed independently by one manufacturer in his own interests, it is likely to be for the third reason, usually because the product involved has some informational, servicing, stocking or selling features that demand special characteristics in the distributional chain in order to restrain free riding by others. It is likely that most vertical restraints fit under this heading and do not cause competition concerns. It should also be noted that such vertical agreements are only one of a number of ways, including vertical integration, to organise. Thus by regulating against them or by prohibiting them, regulators may be encouraging takeovers without meaning to.

Dr Williams argues against *per se* prohibitions and practices and prefers general assessment under ss. 27 and 36. I would agree with this. In New Zealand resale price maintenance is *per se* prohibited for historical reasons, though this prohibition is being reconsidered in the Commerce Act Review. Typically a *per se* rule implies high compliance costs, whereas a s. 27/s. 36 rule could imply high administrative costs.

Dr Williams criticises what he calls an obsession with market definition. As he says, market definitions must be used only as a tool in identifying competitive pressures. Our attention should not be on markets but on demand, supply, cross-elasticities and other behavioural characteristics within them. However, I would note from experience that I have found market definition to be a useful structure for focusing commissions', courts', economists' and judges' arguments within a single framework. We may carry market definition too far, but without it we could be in worse strife. I think the problem is that lawyers want market boundaries to be precisely defined, whereas economists using cross-elasticities take a continuous approach.

Dr Williams is in some danger of overstating his case on public and private benefit. In my view the Commerce Commission should not value benefits to consumers above those to other parties such as shareholders, but should be looking at net benefits. I cannot argue about the role the Australian Trade Practices Commission has filled, but my interpretation of Commerce Commission decisions is that they have not consistently been trying to value non-shareholder interests more highly. As I interpret their decisions, they recognise that a merger attempt automatically signals net benefits to shareholders and therefore this case does not have to be spelt out in detail. But it cannot be assumed that such an application also benefits consumers and other parties automatically; therefore these effects must be assessed. If there are costs to consumers but they are outweighed by benefits to shareholders, the merger could still proceed. In taking this wide view the Commerce Commission is only following s. 3(3) of the Act.

In quoting from the Commerce Commission's decision on the Fletcher Challenge Limited/NZ Forest Products case, Dr Williams is at a disadvantage from not being closer to the proceedings. My memory is that Fletcher Challenge Ltd was required to prove a net public benefit from the merger, and effectively said that this was self-evident from shareprice movements. Thus they had not considered in depth the interests of other parties and therefore were unable to weigh net benefits.

I do not argue that the Commerce Commission should use distributional weights; rather that it should take all costs and benefits into account. One might perhaps loosely interpret the Commission's weighting procedure not as implying that certain class interests are more important than others, but rather as a probabilistic rating of the likelihood of these potential benefits (a) being recognised, and (b) getting through to the classes concerned (this being problematic because of either rent-taking behaviour or market rigidities). Pickford (1989) examines the use of weighting in several Commission cases. It should be noted that a stock market exists to allow instant and efficient weighing-up of shareholder interests. Product and factor markets do also exist, but they could not be considered as effective instruments for allowing an instantaneous evaluation of consumer and employee benefit on the occasion of a merger. The Commerce Commission, however, must weigh up all these effects.

I find Dr Williams's conclusions somewhat disappointing for three reasons: they are self-evident; they depend on anecdotal evidence; and they are statements rather than proven conclusions. I broadly agree with his conclusions but do not consider them proved in this paper. In addition, he offers no practical guidance as to how regulators should address the crucial problem of how to take non-shareholder interests into account in mergers.

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Comments on Philip Williams

Stephen Jennings

The main message from Philip Williams's paper is that clear policy objectives are essential if competition law is to provide net benefits, rather than impose net costs on society. He argues that those objectives, once determined, must be accurately reflected in any competition legislation and in the constructs and methods of analysis adopted by regulators.

Any clearly stated and rigorously defended view on the 'appropriate' objectives of antitrust legislation necessarily involves a value position and analysis to demonstrate the relationship between competition law and the value position held. Unlike many contributions to the competition law debate, Philip Williams's paper addresses both of these issues. This is very important since it is virtually impossible to have a fruitful policy debate on competition law unless people clearly specify the values and analytical bases for the positions they take. Implicit theorising and vaguely specified concerns, or lack of concern, regarding economic organisation do not meet these requirements.

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I agree with Dr Williams that economic efficiency is the most appropriate objective for competition law. The form and method of economic organisation adopted is fundamental to the way resources are allocated between competing uses. Regulations such as the Commerce Act, which directly affect the way economic activity is organised, stand to have a major bearing on the extent to which the economy is able to meet those competing demands and respond to change.

While objectives other than efficiency are sometimes proposed as valid concerns for competition law, these are generally met more effectively through other instruments of government policy. The reasons for this are twofold. First, trade practices and mergers and takeovers have little systematic impact on the non-efficiency objectives most frequently proposed as goals for competition law. As a result, competition law cannot be readily targeted to the achievement of those objectives. In most cases other instruments of government policy may be used to achieve these objectives more directly. Second, any attempt to achieve non-efficiency objectives through competition law is likely to create confusion and uncertainty and to conflict with the objective of maximising economic efficiency.

Two points raised by Dr Williams warrant particular emphasis. The first is that competition is valued not as an end in itself, but because it creates incentives that encourage the efficient allocation and use of resources. Unfortunately, because the objectives of competition law are often phrased in terms of promoting competition, there is a tendency for the underlying efficiency objective to be lost and for competition, in the sense of maximum rivalry or simple competition models, to be pursued as an objective in itself. Adopting standardised competition benchmarks will inevitably impose major costs on the community. A diverse and flexible menu of contractual arrangements and organisational forms is essential if market participants are to minimise the costs of operating in a complex and uncertain world.

Second, I would like to emphasise Dr Williams's comments regarding the public benefit test and its application in New Zealand. The interpretation of public benefit adopted by the Commerce Commission clearly departs from the criteria of economic efficiency. Further, although the concept of public benefit has been discussed in the Goodman Fielder/Wattie, Whakatu, Amcor/NZFP, and Fletcher Challenge/NZFP cases, the Commission has failed to isolate the values or objectives the public benefit provision seeks to achieve, or to demonstrate that the Commerce Act is a rational means of pursuing those ends. While the responsibility for this state of affairs probably rests largely with the legislation, the fact remains that the present application of the public benefit test can be expected to confuse and compromise the objective of economic efficiency without furthering any other policy objectives in a cost effective way.

My main criticism of Philip Williams's paper is the excessive attention, in terms of length and emphasis, he devotes to regulation in a world in which, in his words, 'regulators are omniscient and regulation is costless'. His discussion of horizontal agreements, abuse of monopoly power, vertical restraints, and mergers are all made under that heading. The only recognition he gives that regulation may be less than perfect relates to the costs of litigation, the market definition exercise, and the pursuit of goals other than economic efficiency.

A far broader perspective is desirable for assessing the costs and benefits of competition laws and determining the optimal form of intervention. Because the real world is plagued by uncertainty, information costs and incentive problems, both market and regulatory processes are highly imperfect when measured against simple theoretical benchmarks. The guiding principle of regulatory economics is that, in making policy decisions, unachievable theoretical benchmarks are irrelevant; instead, policy-makers need to assess the relative attractiveness of achievable real world outcomes.

In this regard, Dr Williams does a good job of summarising the theoretical efficiency costs of particular market structures and contractual arrangements, and of identifying the potential benefits of interventions to reduce these costs. However, competition laws are themselves highly imperfect, and regulatory intervention gives rise to a series of new costs — many of which are not mentioned by Philip Williams.

Most obvious of these are the direct costs of administering and complying with competition laws. In the New Zealand context these costs include the human resources used in New Zealand's growing antitrust industry and the considerable amount of management time taken in complying with the Act.

Competition laws also become a weapon in the competitive process. Just as firms attempt to strategically raise entry barriers in the manner discussed by Dr Williams, they also strategically use competition laws to raise rivals' costs or lower their efficiency by challenging particular contractual arrangements or attempting to block mergers and takeovers. Similarly, underperforming management teams can use competition law to block takeovers designed to replace them, thereby lowering the effectiveness of the market for corporate control.

Finally, but perhaps most importantly, competition laws inevitably deter or preclude some efficiency-enhancing practices. Many business practices are incredibly complicated and not fully understood, even by the people using them. Even when they are well understood, the information required to fully assess their impact is often considerable. These issues are compounded by the difficulties in aligning the actions of self-interested regulators with the wider community interest.

Any assessment of the achievable outcomes under alternative competition law scenarios must incorporate these costs of intervention.

Regulating Competition: A Common Approach

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Regulating Competition: A Common Approach

Daniel Oliver

I. INTRODUCTION

The topic of my paper is 'Regulating Competition: A Common Approach'. My area of expertise is of course the Federal Trade Commission (FTC) in the United States, but I also want to touch on the similarities that our approach to competition matters bears to yours. An important initial question — which I am asked frequently — is whether in fact we need a Federal Trade Commission in the US. My answer is 'yes', but that answer assumes that the Commission acts as it does today: protecting consumer interests.

That philosophy, in my view, should emphasise the point that the free market is the best mechanism for maximising consumer welfare. Competition produces the optimal allocation of society's resources, and unwarranted restraints on competition reduce consumer welfare. But adhering to this principle is not warranted solely by matters of competition policy. History teaches us that political freedom and economic freedom are inextricably intertwined, and those of us who are concerned about political freedom must be vigilant in defence of economic freedom.

Regrettably, today it is government, an institution that purports to serve the people, that most often acts to restrict the competitive nature of the free market. It is government that interferes even when there is no market failure.

It is government that forestalls or destroys the economic, social, and political benefits of free and unfettered competition. And the consequences are far-reaching. Free market principles serve all nations equally, and we cannot expect international trade to function efficiently until these principles are applied on a global scale.

Although these truths should be self-evident, the history of antitrust enforcement in the US demonstrates that they are not. In earlier times, government antitrust enforcement emphasised unwarranted intervention, prompted by economic theories that we now know to have been erroneous. In fact, in the old days antitrust lawyers used to tell this 'joke': If a seller raised his prices, that was monopolisation. If a seller lowered his prices, that was predation. And if two sellers charged the same price, that was collusion.

II. THE FEDERAL TRADE COMMISSION'S PHILOSOPHY

Fortunately, over the past ten to 15 years, a number of lawyers, economists and commentators — many associated with or influenced by the University of Chicago — have been instrumental in persuading courts and enforcement authorities to abandon precedents that damage the economy. But while most of us have welcomed the age of antitrust enlightenment, others have mourned the 'death' of antitrust and advocated a 'counterrevolution'.

In fact, however, the FTC's current policies now reflect mainstream antitrust thinking. Our mission is to protect consumers, by intervening when — but only when — a business practice is likely to reduce consumer welfare. We do not seek to advance any political or social goals that are not pertinent to consumer welfare. The debate as to the goals of antitrust is over, and the good news is that consumers have won, hands down.

Limiting our objective to protecting consumers gives us a workable focus. If we were instead to pursue a multitude of diverse and inconsistent objectives, we would create a diverse and inconsistent — and ultimately unacceptable — antitrust enforcement policy. How much fragmentation would be required? Would we have to break up existing businesses in concentrated industries even if their only crime was their efficiency? And at what cost to consumers would we protect small businesses? At any cost? Clearly, the only practicable solution is to rely on rigorous economic analysis to protect consumers.

The complaint we usually hear about this approach is that our economic analysis is driven by a political predisposition. Now it is true that political and economic freedom are closely related. But it is an economic predisposition that drives our economic analysis: free markets are the best way to maximise consumer welfare, and the government should not interfere without evidence of anticompetitive practices that are likely to reduce consumer welfare. Thus, we do not assume, without evidence, that businesspeople devise strategies that are deliberately anticompetitive and intended to exploit consumers. We do not assume, without evidence, that a merger or acquisition will reduce, rather than enhance, consumer welfare. We do not assume, without evidence, that entry barriers are usually high, and that market power will persist. In the secular world of antitrust, we approach our enforcement responsibilities with a principled agnosticism.

III. LEGISLATION

I would now like to give you a more detailed idea of how we translate these principles into action. The oldest of the relevant US antitrust statutes is the Sherman Antitrust Act, passed nearly a century ago. Section 1 prohibits 'every contract, combination ... or conspiracy in restraint of trade', and, as amended, makes every violation a felony warranting fines of up to US$1 million and jail terms of up to three years. Section 2 forbids monopolisation, attempts to monopolise, and conspiracies to monopolise, and prescribes similar penalties.

The Clayton Act, passed in 1914, is most important for the limitations it imposes on corporate acquisitions. Section 7 prohibits acquisitions that may substantially lessen competition or 'tend to create a monopoly'. Section 2, which in its amended form is known as the Robinson-Patman Act, prohibits, in certain circumstances, 'discriminatory' prices or other considerations in connection with the sale of goods. Section 4 permits private parties to secure treble damages for antitrust violations satisfying certain criteria.

Congress also created the FTC in 1914. Section 5 of the Federal Trade Commission Act condemns unfair methods of competition and unfair or deceptive acts of practices. 'Unfair methods of competition' include most actual and some incipient violations of the Sherman and Clayton Acts.

In addition to these statutes of more or less universal applicability, Congress has created a host of administrative agencies that, directly or indirectly, affect competition in industries such as railroads, trucking, aviation, shipping, securities, broadcasting and telecommunications, energy, banking and international trade. However, dissatisfaction with the consequences of empowering federal regulators to substitute their interpretation of the 'public interest' for the workings of the marketplace has led in recent years to a gradually escalating enthusiasm for deregulation.

One of the best examples to date came in 1984. In that year the Civil Aeronautics Board, which once ruled the skies with an all too visible hand, disappeared into the sunset and left the airlines to determine entry and pricing in response to competitive, not governmental, dictates. The results, measured by savings to consumers, were spectacular. A report prepared by economists in the FTC's Bureau of Economics indicates that, as a result of full deregulation, fares have fallen about 25 per cent, travellers now pay discount fares 90 per cent of the time, and the number of departures has increased 27 per cent. In addition, the total number of passenger miles flown has increased substantially, from 183 billion in 1978 to 302 billion in 1986, without any adverse effect on airline safety. Our success with airline deregulation has led to greater reliance on free markets in other industries, such as trucking and telecommunications.

Deregulation, of course, is not confined to our hemisphere. While we may have taken the lead in aviation and other forms of transport, Australia is to liberalise the Two-Airlines Policy. Moreover, Australia has gone probably further than any other country in loosening regulatory restrictions in banking and financial services.

The American State governments also intrude in the marketplace; many States have some form of antitrust law patterned on the Sherman, Clayton, or FTC Acts. They have literally thousands of boards, commissions, and agencies that license and regulate everything from hairdressers and beekeepers to osteopaths and lightning-rod installers. Although these entities profess to protect public health and safety, they frequently do little more than stifle commerce, producing devastating effects on the level and intensity of competition in the markets they control. An example we have all had some experience with is the taxi industry, where licensing requirements and limitations unrelated to driver competence frequently create significant and economically unjustified barriers to entry. Thus, for example, in New York City a person needs a $100 000 medallion to drive a taxicab.

IV. ENFORCEMENT

Enforcement of the antitrust laws at the federal level is shared between the Department of Justice and the FTC. The Commission is authorised to seek injunctive relief against prospective violations of the FTC Act, conduct administrative hearings, and issue cease and desist orders. At the State level, the State attorneys-general are authorised to enforce State laws in State courts. Finally, the States and private parties may seek damages or injunctive relief in federal courts for violations of federal antitrust statutes.

Now, in a more perfectly ordered world, all the government authorities with enforcement powers would take and follow a truncated version of the Hippocratic oath for physicians: 'Do no harm'. In the lexicon of the regulatory agency, that means '*de minimis, maximus*'; that is, 'he who regulates least, regulates best'. At the FTC, we pursue that principle through an 'appropriate' level of enforcement, that selectively prevents anticompetitive practices without impeding free market competition. Our program focuses on five major areas: mergers and acquisitions; distributional arrangements; exclusionary practices; horizontal restraints; and competition advocacy. I would like to describe some of our recent initiatives in each of these areas.

Mergers

The US first enacted merger control provisions in 1914, but the modern era of merger enforcement dates from 1950, when s. 7 of the Clayton Act was significantly strengthened. The effort to establish an economically sensible liability standard was long hindered by economically unsound judicial principles. One such principle was that if a merger produced increased market concentration, it was virtually *per se* anticompetitive. In the Brown Shoe case of 1962, and for years thereafter, the Supreme Court relied on this principle without considering other crucially important mitigating factors, such as the absence of barriers to entry. For example, in *United States v. Von's Grocery Co.* (1966) 384 US 270, the Court sustained the invalidation of a merger in the unconcentrated and highly competitive Los Angeles retail grocery market, between two firms that together accounted for only 8 per cent of market sales. Considering how fiercely competitive most retail grocery markets are, and the virtually complete absence of barriers to entry in the Los Angeles area at the time (see 290-301, Stewart J dissenting), we can appreciate how misguided the Von's Grocery case was. And there were many other regrettable examples. This pattern led Supreme Court Justice Potter Stewart to lament that the 'sole consistency' he could find 'in litigation under [s.7 of the Clayton Act was that] the government always wins' (at 301, Stewart J dissenting).

We now know that higher concentration frequently reflects nothing more than the realisation of beneficial scale or other efficiencies. Consequently, our merger analysis now emphasises a much more comprehensive evaluation — in dynamic rather than static terms — of prospects that a proposed merger will injure competition. Beginning with the Supreme

Court's decision in the case of *United States* v. *General Dynamics Corp* (1974) 415 US 486, the courts have increasingly adopted the same approach.

Great care is required to identify the relatively few mergers that may substantially lessen competition, without deterring or prohibiting the far more common, competitively desirable transactions. One approach to merger law enforcement that I categorically reject is the numbers game — the notion that any particular number of merger challenges is good or bad. Instead, the Commission and the Department of Justice now follow rigorous enforcement standards, which are reflected in the merger guidelines that each agency has issued (Federal Trade Commission, 1982; US Department of Justice, 1984). These guidelines permit firms to analyse prospective acquisitions in light of the factors that are likely to control the government's enforcement decisions.

Acquisitions may substantially lessen competition by increasing the likelihood either that a group of firms will be able to increase prices above competitive levels through explicit or tacit collusion, or that the acquiring firm will be able to exercise monopoly power. Several factors are crucial to this analysis, and they are detailed in the merger guidelines. The first step is to define the relevant product and geographic markets; that is, the competitive arena within which the effects of the merger will be felt. The issues we consider include: From whom can consumers purchase the product in question? Can other products be substituted for it, and at what price? Are there other firms that could begin producing the product within a reasonable time? In other words, we want to know what alternatives consumers will have if the merged firm raises prices to supracompetitive levels.

Once the relevant market has been identified, a number of structural factors must be considered. Market shares and concentration levels are, of course, relevant. But in virtually every case our analysis cannot end with market share numbers; other factors must be considered. In particular, the Commission has determined that an acquisition cannot have anticompetitive effects — and thus cannot violate the Clayton Act — in the absence of barriers or impediments to entry (see *Echlin Mfg Co.* [1985] 105 FTC 410, 484, 487; *accord, e.g. United States* v. *Waste Management Inc* [1984] 743 F.2d 976, 982-3; *United States* v. *Calmar Inc.* [1985] 612 F.Supp. 1298, 1305-7 [DNJ]). Barriers to entry in the Stiglerian sense are additional long-run costs that were not incurred by incumbent firms but must be incurred by new entrants. Impediments to entry are conditions that delay entry for a significant period of time, and allow the exercise of market power in the interim. If outside firms can enter the relevant market easily, and thwart any effort to raise prices above competitive levels, an acquisition that increases concentration levels cannot injure competition.

Product homogeneity constitutes another relevant factor. Within a relevant product and geographic market, differences along quality or other dimensions may differentiate brands from one another. Firms will find it more difficult to reach and sustain an anticompetitive consensus on price to the extent that this sort of product differentiation is high, and the likelihood of anticompetitive consequences will therefore fall. Interfirm cost differences, the number of buyers and sellers, and the stability of market shares over time must also be considered, in order to ensure that the likely competitive consequences of any particular acquisition are assessed as accurately as possible.

One aspect of our market analysis that deserves special attention is foreign competition, a fact of life to which Australians are not strangers. There was a tendency in the past for Clayton Act analysis to stop at national borders, but today we, like you, are much more sensitive to the actual and potential competition represented by imports. Mergers are rarely a purely domestic phenomenon anywhere in the world. Consequently, in defining markets and measuring the likely competitive effects of a merger, we routinely consider not only the products currently shipped into the US but also the foreign capacity that might be devoted to the same or competitive products in the event of a domestic price increase. It is, of course, sometimes difficult to assess the present and future effects of quotas, tariffs, and other voluntary or involuntary restraints. But in every case, we attempt to assess the likely economic effect of foreign competition.

Our approach to mergers is thus similar to the approach taken by our colleagues at the Trade Practices Commission. To the extent that the Australian statute might be considered more 'lenient' than ours, the difference might be explained by the relatively smaller size of most Australian markets and the unavoidably greater levels of concentration that result. But within the parameters established by statute, the methods of economic analysis that should be used, and the structural, behavioural, and performance factors that should be considered, are very much the same. Identifying the 'field of rivalry', considering competitive factors beyond market share, and paying special attention to the role of imports — in all these areas the US and Australia are fraternal, if not identical, twins.

Of course, the fact that we consider all relevant economic factors in determining whether or not to act against a particular acquisition does not alter my more general presumption that a dose of the free market rather than of bitter governmental herbs is usually the best medicine. Thus, the purposes of both our statutes are most efficiently served by the minimum degree of intervention needed to protect the competitive process. Free and unfettered competition for the control of corporations and the assets they own is essential to a vigorous and healthy economy. Consequently, an important point of similarity between our approaches is our willingness to permit acquisitions to be consummated if they are modified to eliminate their anticompetitive aspects, as a preferable alternative to invalidating them altogether. Last year, for instance, the TPC investigation of the acquisition of East-West Airlines led to undertakings by the parties to divest certain assets and operations. Similarly, when the American subsidiary of L'Air Liquide sought to acquire another industrial gases producer, the FTC authorised the staff to seek a preliminary injunction to block the deal. However, we subsequently accepted a consent agreement that allowed the acquisition to proceed but required the divestiture of a variety of assets.

Management-Resisted Takeovers

Another aspect of the merger game has policy implications here as well as in the US. In recent years, the American fondness for takeover efforts has found increasing favour on the international stage. Indeed, some of the game's more accomplished players are Australian. These takeover efforts are commonly referred to as 'hostile' takeovers, but that is a misnomer. They should rather be described as management-resisted takeovers, because the only persons who typically oppose them are the incumbent managers who expect to lose their jobs if the takeovers succeed.

Management-resisted takeovers are a critically important mechanism for facilitating the efficient movement of assets to their highest-valued uses. It is unfortunate that the colourful vernacular associated with these efforts has given them an unsavoury image. Corporate 'raiders' sell 'junk bonds' to raise funds so that they can destroy the finest firms in the US, unless their targets can find 'white knights' to protect themselves or pay off the raiders with 'greenmail'. In fact, management-resisted takeovers are nothing more than a way of disciplining less efficient corporate managers. A takeover attempt is launched because the bidder believes that the value of the target's stock could be increased by more effective or innovative management. The bidder typically offers a premium to obtain controlling stock, expecting to oust existing management and deploy the firm's productive assets more efficiently. It is possible, of course, that a successful bidder will not be able to make the acquired firm more efficient. However, the government is in no position to second guess the judgment of those who have large sums of money at risk in these matters. The free market does not have to work perfectly to work better than the government.

These transfers of corporate control usually benefit the target company's shareholders and the economy as a whole. Shareholders secure substantial premiums over the pre-offer market price of their shares, and the threat of takeovers motivates incumbent managers to improve. Our economy benefits both from the transfer of corporate control to more efficient managers, and from the incentives for better managerial performance that the threat of takeovers creates.

The Commission therefore attempts to ensure, as much as possible, that its investigative activities do not affect the outcome of takeover contests. We are especially careful to minimise the delay caused by an investigation, where it could effectively decide the winner in a hostile contest. Thus, although Commission investigations of management-resisted takeover efforts are thorough, they are managed very closely to ensure that they proceed as rapidly as possible.

In the US, as in Australia, some have asked whether the Commission's merger analysis should include considerations of groups such as employees and local communities. But the Clayton Act requires us to focus on how a merger will affect consumers generally. Unless a merger is anticompetitive, we cannot attempt to halt it simply because it affects particular groups in particular ways. And even if we could, it would not be good policy to do so. If our dynamic economy is to continue to grow, firms must be permitted to reallocate resources to their highest-valued, most efficient use. They may do so through internal reorganisations, or by acquiring — or being acquired by — other firms. Mergers, like other forms of reorganisation, are thus usually nothing more than a way of making essential economic corrections.

No one would argue that the competitive process offers protection from business failures, plant closings, and layoffs. When this happens, of course, the cost is painful to some individuals and groups. Nonetheless, we know that interfering with competition leads to results that are ultimately much more painful. The benefits of competition to society as a whole far outweigh the costs to individuals. In that conclusion, we share the view of the Trade Practices Commission.

Vertical Distributional Arrangements

The Commission also addresses vertical distributional arrangements that may violate s. 1 of the Sherman Act or the Robinson-Patman Act. Our enforcement efforts in these areas should be guided by the principle that these arrangements usually improve consumer welfare, and should not be prohibited without a rigorous economic analysis of their competitive effects. In the past, the government frequently challenged vertical arrangements that benefited consumers merely because competitors experienced some dislocation. But effects on individual competitors are not particularly relevant. The crucial question is rather whether a particular practice injures competition. The result of this change in focus is that we bring fewer vertical cases, but that is perfectly acceptable. The truth is that most vertical arrangements do not have anticompetitive effects.

Nevertheless, because of the current state of the law in the US, vertical arrangements must be divided into price and non-price categories for separate analysis. Fortunately, it now appears that the Commission and the courts agree on the proper standard to use in analysing non-price vertical arrangements. These arrangements usually promote competition and are not likely to foreclose markets in a competitively significant fashion unless they are used by firms with substantial market power.

Agreements to implement certain vertical price arrangements — that is, agreements to maintain resale prices — remain *per se* illegal in the US. But an extensive body of scholarship indicates that they are not usually likely to injure competition. And although the Supreme Court found it unnecessary to reconsider their *per se* illegality three years ago, it may address the question directly in the *BEC* v. *Sharp* case, now pending before the Court. Unfortunately, proposed legislation in Congress, if enacted, would worsen the current situation by allowing juries to infer the presence of a conspiracy to maintain resale prices merely because a manufacturer terminates a dealer after receiving complaints from other dealers.

I understand that s. 48 of the Australian Trade Practices Act condemns resale price maintenance absolutely and, unlike other vertical practices, does not allow a notification to the TPC. However, Hanks & Williams (1987) recently completed a detailed critique of the *per se* approach of s. 48, drawing on current economic analysis of the issue, which I commend to you.

Price Discrimination

With respect to price discrimination, my view of the Robinson-Patman Act begins with the Supreme Court's admonition that 'the Robinson-Patman Act should be construed so as to ensure its coherence with "the broader antitrust policies that have been laid down by Congress"' (*United States* v. *United States Gypsum Co.* [1978] 438 US 422, quoting *Automatic Canteen Co.* v. *FTC* [1953] 346 US 61, 74). I have in the past suggested that Congress review the Act, because — as the Commission itself recognised recently — it is a 'protectionist, non-efficiency oriented' statute (*General Motors Corp.* [1984] 103 FTC 641, 695-6). Unfortunately, in the past the Commission not only used the Act to prohibit pro-competitive practices, but also used s. 5 of the FTC Act to prohibit conduct that violated the 'spirit' but not the letter of the Robinson-Patman Act. For example, in the 'buyer inducement' cases of the 1960s and early 1970s, the Commission used s. 5 to apply the *per se* standard for seller liability established by the Act to buyers who had solicited allegedly discriminatory promotional allowances. Fortunately, the Commission has more recently determined that s. 5 should not be used to prohibit most practices that do not expressly violate the Robinson-Patman Act unless they actually injure competition (see *General Motors Corp.* 103 FTC at 700-1).

Exclusionary Practices

With respect to exclusionary practices, the Commission relies on s. 2 of the Sherman Act, as enforced through s. 5 of the FTC Act. Section 2 prohibits monopolisation, attempts to monopolise, and conspiracies to monopolise. Predatory pricing is probably the most commonly alleged practice of this sort, but its treatment has undergone a profound revolution. Before the mid-1970s, most judicial analyses relied on the 'deep pocket' myths that have beleaguered antitrust since its inception. According to this lore, firms with deep pockets could and would reduce prices to 'cut-throat' levels, willingly accepting short-term losses in order to destroy rivals and gain market power. Amazingly, only a few brave scholars had the temerity to ask why low prices for consumers represent a competitive problem.

What the revolution did, first in the academic journals and then in the courts and enforcement agencies, was to insist on systematic analysis and supportable answers. The US Supreme Court has now recognised that '"predatory pricing schemes are rarely tried, and even more rarely successful"' (*Cargill, Inc. v. Monfort of Colorado, Inc.* [1986] 107 S.Ct. 484, 495n.17, quoting *Matsushita Electric Industrial Co., Ltd v. Zenith Radio Corp.* [1986] 475 US 106 S.Ct. 1348, 1357-8). Moreover, the Commission and the courts now consider factors such as entry barriers and available capacity to assess whether pricing below cost could be a rational strategy. Low prices are now properly viewed as a desirable consequence of vigorous competition, not as a suspicious artifact of predatory conduct. Consistent with that view, the Commission has determined that sales at prices equal to or above average variable cost should be strongly if not conclusively presumed to be legal, regardless of the market power or intentions of the respondent involved or the duration of the pricing in question (*International Tel. & Tel. Corp.* [1984] 104 FTC 280, 403-4; see also *General Foods Corp.* [1984] 103 FTC 204).

Non-price predation may represent a more fruitful line of inquiry. It consists of strategic behaviour that is intended to raise, and has the effect of raising, the costs of rival firms. It may be a much less costly exclusionary strategy than predatory pricing, because the prospective predator need not reduce its own prices; instead, it forces rival firms to raise their prices.

True to the principle that the state is the worst enemy of competition, the best examples of non-price predation probably arise through the abuse of regulatory or judicial processes. As an example, last year the Commission accepted a consent agreement to settle a complaint that a firm had illegally used 'sham litigation' in an attempt to monopolise the rental market in one-way moving equipment. The complaint alleged that the firm had deliberately abused the judicial process by interfering with a rival's bankruptcy and reorganisation proceedings. Under the agreement, the company will not initiate or participate in any judicial or administrative proceeding intended to harass or injure any competitor or potential competitor (*AMERCO et al.* Docket No. 9193 [complaint filed 24 June 1985; final consent order accepted 19 May 1987]).

Horizontal Restraints

With respect to horizontal restraints, the Commission vigorously enforces the *per se* prohibitions of s. 1 of the Sherman Act — through s. 5 of the FTC Act — against price-fixing and other forms of demonstrably anticompetitive horizontal behaviour. This is a policy of rather ancient vintage. Before the turn of the century, the Supreme Court determined that 'naked' price-fixing and market-dividing agreements are *per se* illegal. The rationale for this rule is well known: such agreements, when found in isolation, have virtually no purpose other than to harm consumers. The Court has more recently recognised, however, that when such agreements are ancillary to economic integration, they should not be condemned as *per se* illegal, because joint ventures and other forms of economic integration frequently enhance efficiency and increase output. Thus, for example, in the case of *Broadcast Music Inc.* v. *Columbia Broadcasting System* (1979) 441 US 1, 24-5, the Court determined that the rule of reason should be applied to a joint venture that sold a blanket but nonexclusive licence to use the music of thousands of composers, and remanded the case for an evaluation on that basis. If, however, a 'quick look' reveals that such agreements have no efficiency justifications, they may nevertheless be prohibited without a full-fledged analysis under the rule of reason.

The Commission has also pursued anticompetitive restraints adopted collectively by competing professionals. These restraints may result from the actions of private trade associations, but State licensing boards may also sanction or impose objectionable restraints.

Competition Advocacy

In addition to the law enforcement efforts I have described, another important part of the Commission's program focuses on the likely effects of governmental regulation on competition and consumer welfare. To that end, the Commission has a very active competition advocacy program. The Commission staff frequently comments on competition issues in response to invitations from State, local, and federal agencies, and in administrative hearings and court proceedings. These comments complement our direct enforcement activities, and can frequently achieve results more quickly and more efficiently than litigation. Last year, the Commission authorised its staff to file more than 100 comments addressing competition and consumer protection issues in numerous State and federal forums.

One prominent example involved the sale of milk in New York City. Entry into New York City milk markets was restricted by a State licensing law. Because only five dairies had licences, New York City residents had to pay some of the highest milk prices in the nation. In 1986, a New Jersey dairy applied for a licence and, at about the same time, the FTC staff submitted an economic report to State officials discussing the adverse effects of the milk licensing system. The agriculture commissioner initially granted the New Jersey dairy a licence to sell milk on a trial basis in one section of the city. Milk prices there almost instantly fell by forty cents a gallon. However, the Commissioner ultimately refused to extend the licence to other areas on the ground that 'destructive competition would result'.

Perhaps due in part to our efforts to publicise this absurd decision, the agriculture commissioner resigned, and a few days later a federal judge overturned his licence denial. New York City milk prices immediately plummeted. What is really encouraging is the prediction that the breakup of the milk cartel will save New York City residents up to $US80 million per year in lower milk prices. More recently, the Commission staff has advised the New York State assembly to dismantle completely its county-by-county licensing and price regulation system.

Of course, our advocacy program would not be a comprehensive mechanism for promoting consumer welfare if it did not address governmental regulation of international — as well as intrastate and interstate — trade. As I mentioned earlier, governmental interference with freely competitive international markets can have devastating and often ludicrous effects. Whether it is quotas on steel, antidumping duties on computer chips, or allegedly voluntary restraints on automobiles, consumers of all nations eventually and inevitably must pay the price for policies that protect competitors at the expense of competition. Protectionism is as intellectually responsible as rain-dancing, but far more damaging. For example, saving each $US28 000 job in the steel industry costs consumers $US125 000 (*Washington Post*, 22 March 1987, p.H-8; FTC estimate of $114 000 in 1983 dollars, adjusted for inflation to 1986 dollars). By one estimate, US consumers paid $65 billion last year for the illusory benefits of trade restrictions. But US consumers are not the only losers from governmental interference with free markets. The US Export Enhancement Program releases stockpiled commodities to private firms for sales overseas. As a result, producers of Brazilian chicken, Australian barley and Argentine grain have lost billions of dollars in sales.

Complete consistency and devotion to competitive principles may be too much to expect in international trade any time soon, but this is an area of great importance to our competition advocacy program. For example, during the past year, the Commission staff advised the International Trade Commission that continuing present import tariffs and quotas for specialty steel could cost American consumers $44 million annually. Our calculations also showed that each job protected by quotas in that specialised part of the steel industry costs consumers an average of $83 000 per year. Restricting specialty steel imports can also adversely affect competition in the domestic industry.

V. CONCLUSION

As Chairman of the FTC, my primary objective is to protect American consumers. And when I say consumers, I mean not only individuals, but also the thousands of businesses that purchase goods and services in thousands of upstream and downstream markets. Our effort to protect consumer welfare requires an active, but appropriately focused, enforcement program against anticompetitive private business practices. It also requires an extensive campaign against governmentally imposed restraints on competition. I firmly believe that when government officials everywhere recognise regulation for the 'racket' that it is, they will support the approach I have outlined here. If this be revolution, let us sustain it on behalf of the consumers of the world.

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Australian Competition Law: Administrative Policy and Practice

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Australian Competition Law: Administrative Policy and Practice

W.R. McComas

I. INTRODUCTION

Before embarking on my theme I must set the stage, for our appreciation of why and how one administers the law as one does will be the better for an understanding of the relevant setting.

Any competition law, whether it deals with anticompetitive practices (price-fixing, restrictive agreements, tying arrangements, abuse of market power) or mergers and acquisitions, is an element, one of the practical manifestations, of national economic and social policy. That element of policy is founded upon the principle that a sound economy is an efficient economy and that competition promotes efficiency, which in its turn is beneficial to society and thus in the public interest. It follows that a law that encourages competition will, if effective, be conducive to the attainment of those commendable goals.

When Adam Smith spoke of the discipline exerted by the 'invisible hand' of the marketplace, he made a basic assumption that the marketplace was competitive. When some modern economists speak of a deregulated or free market, they too must be taken to be making the same assumption. History and experience have shown that, given total freedom from formal regulation, markets are rarely free in the sense of being wholly competitive — which I take to mean that each participant relies upon his own skill, the quality of his product and the excellence of his service to attract custom, leaving it to the forces of supply and demand to determine price. Without formal regulation, the freedom of the marketplace has more often than not been curtailed by what I might describe as self-regulation, where individual firms or groups of firms have found it convenient to even out the more difficult or more forceful elements of competition to create what has somewhat euphemistically been described as 'an orderly market'.

Given that it is a universally accepted principle that the maintenance and preservation of competition is an economic good, and recognising that a wholly free marketplace will not ensure that state of affairs, rules are reasonably necessary to achieve the desired objective. If economic efficiency is achieved primarily in a competitive market, and if business practices, left alone, might have a tendency to interfere with the maintenance of a competitive market, so the enactment of statutory rules to regulate undesirable business practices is reconcilable with the primary goal. This must always be qualified by the proviso that the rules are suitably adapted to the market they are intended to regulate and not simply imported from another economy, and by the further proviso that they are capable of being, and are in practice, administered in step with the commercial realities of the marketplace. Because there must always be exceptions to rules expressed in general terms, so provision must be made to cater for them in circumstances where there is sufficient justification.

Now, these principles are expressed in plain terms. Indeed, they express in simple words extremely complex propositions, for it is one thing to state the principles and quite another to administer them as a practical matter.

In the same vein, one must not be misled by the simple and general language used in our competition law to express the economic concepts it embraces. Those concepts are imprecise, and thus are not capable of being expressed in language as precise as one might find in others of our laws. Any attempt to do so would be counterproductive, and yet it is the absence of precision that requires the regulatory authority to adopt and implement a practically-oriented administrative policy.

II. AUSTRALIAN COMPETITION LAWS

Modern competition law (that is recent competition law) has existed in Australia now for a little over 20 years. The first seven of those years saw the operation of the Restrictive Trade Practices Act 1965, which became effective in 1967 and was somewhat modified in 1971. Although it was described as an ineffectual piece of legislation, the Act had the effect of bringing to notice a multitude of restrictive trading agreements and practices that had, quite legitimately at that time, become widespread in business practice untrammelled by common law.

The common law took the view that the public had an interest in every person being able to carry on his or her trade freely and that, absent other persuasive factors, all interference with that freedom, all restraints upon it, were contrary to public policy and void (*Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co.* [1894] AC 535 per Lord Mascnaghten at 565; *Mason v. Provident Clothing and Supply Co.* [1913] AC 724). So far as competition restraints were concerned, the common law might be said to have encouraged restrictive business practices. In 1893, for example, the Supreme Court of New South Wales concluded that an agreement to limit competition by 'equalising the distribution of the demand for bricks among the producers thereof' was valid although its effect might be to maintain the price of bricks (*Sydney Brick Co. v. Speare* [1893] 14 NSWLR Eq.350).

The 1965 Act took its inspiration from the United Kingdom Restrictive Trade Practices Act of 1956, and indeed had it not been for a change of government towards the end of 1972, proposals ventilated earlier in that year by the outgoing government would have followed even more closely the UK precedent. In 1972 it was proposed to introduce legislation for the regulation of mergers and acquisitions by the introduction of a Monopolies Commission along the lines of the Monopolies and Mergers Commission of the UK.

In 1975 the present Act was introduced: a sophisticated piece of legislation that borrowed from the United States and European Community jurisdictions for provisions designed to regulate specified anticompetitive business practices, abuse of monopoly power, and anticompetitive mergers and acquisitions. The Act has since been reviewed twice and amended in the light of experience of the Act in operation.

Over the 14 years of its application, our current competition law has developed with some relative speed compared, for example, with the progress in the US. There, antitrust laws have existed for most of this century and I suggest that they do not yet have a settled meaning in areas other than those represented by *per se* offences. True, development in Australia has not described a smooth and consistently rising curve, but this is not surprising given the need to apply the provisions of the law to dynamic business situations and given the dearth of lawyers, whether at judicial, practitioner, or academic level, and of economists, at whatever level, who are comfortable with concepts of the law and their application. There is, however, a nucleus of informed persons, and the appointment of appropriately qualified persons to judicial and regulatory positions will see it grow.

There has been a growth in understanding of the law by businesspeople. While they are understandably reluctant to accept any constraints upon their freedom, businesspeople by and large have come to respect and abide by the proscriptions of the Act. The myopic mewings of certain special interest groups who affect a concern about the Act and its administration demonstrate that they do not appreciate the significance of that fact. They fail to appreciate that an efficient, competitive industry is beneficial to society and to consumers. Too frequently they choose to overlook, if they ever appreciated it, the significance of the point made by the then Attorney-General when he said in the Senate in November 1973:

> [Restrictive Trade Practices] cause prices to be maintained at artificially high levels. They enable particular enterprises or groups of enterprises to attain positions of economic dominance which are then susceptible to abuse; they interfere with the interplay of competitive forces which are the foundation of any market economy. (Australia, Senate 1973, *Debates*, vol. S28, p.1872)

The interests of consumers are best served by a competitive marketplace, and anticompetitive practices are just as unfair as those undesirable business practices proscribed in Part V of the Act, which is particularly directed to consumer protection.

The policy upon which the competition provisions of the Trade Practices Act are based takes an economic stance perceived to be consistent with the requirements of the community. It gives priority to competition, but within that policy objective it encourages efficiency and development, and does not seek to serve populist objectives. In doing so it recognises that to surrender to populist goals by imposing too many restraints upon business would be to proliferate business and legal uncertainties, and thereby interfere with the attainment and maintenance of economic efficiencies.

Inject those propositions with a practical serum that recognises: that business conduct is not governed by altruism but by the profit motive; that effective and aggressive competition will lessen the effectiveness of others in the market; that growth in size to large proportions of itself is unobjectionable; and that concentration, particularly in Australia, is to some extent inevitable. Then one begins to comprehend where the practical balance must lie. The serum itself is encapsulated within the provisions of the Trade Practices Act. It may be injected mainly by the authority charged with the administration of the Act, the Trade Practices Commission, as it formulates and implements policies attuned to the realities of the marketplace.

III. ADMINISTRATIVE POLICY

The administrative policy of the Trade Practices Commission has been to accept as axiomatic that competition is an economic good, and that restrictive business practices may be harmful if they cause substantial economic harm in the community, that is to suppliers, buyers and consumers. The Commission is concerned with preserving effective competition, and this requires that 'prices should be flexible, reflecting the forces of demand and supply, and that there should be an independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers' (*Re QCMA* [1976] ATPR 40-012 at 17 246). It acknowledges the important role of the economist in the application and development of the law, but accepts that economic opinions must be applied 'in a practical way to accommodate the concern of the Act with business and commerce' (*Outboard Marine Australia Pty Ltd* v. *Hecar Investments (No.6) Pty Ltd* [1982] ATPR 40-327 at 43 983).

The Commission also acknowledges that due allowance must be made for the particular social, business and economic climate in which it functions. Those elements of society at large are fundamental, and thus the administration of the Trade Practices Act has catered for perceived needs and not for the wishes or ideals of any particular institution, political or otherwise, or for any one group of interests. A fine balance therefore must be struck between the ideals of a vigorous competition policy and the fact that business in Australia faces particular problems of small markets, huge geographical expanses, and significant import competition.

Buyers (whether for resupply or for consumption) demand as their entitlement the best they can afford, and it is recognised that, in order to be competitive both on domestic and international markets, business must gear itself to apply the latest technology and the utmost in efficiency. The Commission accepts that in such circumstances, and particularly at this stage of Australia's economic and industrial development, it is almost inevitable that manufacturers will need to equip with plant that may not be fully utilised. To obtain the utmost in efficiency and allocation of resources, industries will tend to become more concentrated in order better to compete with imports, which in many sectors have provided significant competition to Australian industry, and on international markets. The Commission therefore has reacted sympathetically to industry rationalisation proposals that offer demonstrated economic benefits, and to the extent that it is able it has encouraged such proposals consistent with its intention to see to it that, absent very persuasive reasoning, no one corporation or group of corporations should be permitted to achieve a degree of market power that will stifle effective competition.

These administrative policies are entirely in step with the policies of the Act. They reflect a pragmatic application of the legislation, which, be it remembered, has received bipartisan support since it first came into force in January 1975.

Any regulator who chooses to administer the law as he or she thinks it ought to be, rather than as it is, is not worthy of the position. Such a regulator will contribute more to business and economic uncertainty than to the public good. Regulators are not there to pursue those populist goals to which I referred earlier, but to administer the law within its parameters, fairly and objectively.

From a practical point of view the Trade Practices Act is remarkably tolerant about how its provisions are to be administered. In express terms it places very few limits on the discretions of the Trade Practices Commission in what it does and how it does it, which forces the Commission to behave with responsibility and balance, objectively and fairly, and not to be driven by political or special interest considerations. It is not always easy to tell a complainant that, except in the face of predatory conduct by a corporation possessing a substantial degree of market power, the Act is not concerned with competitors but with competition, but that is the reality of the situation.

Equally, it is important to accept that, in dealing with predatory market conduct, the size of the corporation complained of is not the determinant. This is well demonstrated by two recent decisions of the Federal Court of Australia. One case, *Mark Lyons v. Bursill Sports Gear* (1987) ATPR 40-809, concerned the discontinuance of supply by a medium-sized supplier of a certain brand of ski shoes to a discounter. The brand, to which the supplier had exclusive rights in Australia, represented some 30 per cent of the relevant market. The Court found that the supplier possessed a substantial degree of market power and that, in refusing to supply, its purpose was to deny competitive opportunity to the discounter.

The other case, *Queensland Wire Industries v. Broken Hill Proprietary Company Limited* (1987) ATPR 40-810, concerned the refusal of BHP to supply a certain type of steel bar to a Queensland company not previously supplied but wishing to enter the market. Despite the fact that BHP certainly possessed the requisite degree of market power, the Court declined to attribute to BHP the necessary predatory purpose in refusing supply, endorsing the well-held tenet that, absent other factors, the Trade Practices Act will not force a person to do business with another if he choose not to.

Queensland Wire Industries unsuccessfully appealed the decision of the Court of first instance to the Full Court of the Federal Court of Australia

(1988 ATPR 40-841). It sought and was granted leave to appeal the Full Court's judgment to the High Court of Australia, and there Queensland Wire Industries succeeded. The decision of the High Court is correctly described as a 'landmark' in its interpretation of s. 46 of the Trade Practices Act, particularly in holding that if a corporation is found to have a substantial degree of power in a market for goods or services and is also found to have one or more of the proscribed purposes, it is taking advantage of its market power if it uses that power for one or more of those purposes. No pejorative overtone is imported by those words, and questions of intention simply do not arise. As Deane J observed at 40-925: 'of themselves, however, the words "take advantage of ... power" are morally indifferent'.

IV. TAKEOVERS

Of course size attracts attention, and the Commission's decisions in relation to large takeovers in recent years have received much attention and some criticism. Some takeovers involving the media have become particularly notorious, and indeed have almost achieved the status of a serial where everyone awaited with some anticipation, perhaps trepidation, the events of the next episode.

In its practical administration of the Act as it bears upon mergers and acquisitions, the Commission has consistently taken the view that it should not unnecessarily interfere if an apparent result of dominance in the market may be removed by appropriate divestiture. It is common for persons proposing takeovers to offer divestiture rather than face court proceedings. In circumstances where the Commission has been prepared to accept such offers, it has usually secured performance of the undertakings by appropriate documentation depending for its solemnity upon the circumstances. In only one case to date is performance of the divestiture undertakings proving to be difficult, not by actions of the corporation that gave the undertakings, but by the regulatory processes of other authorities and the tardiness of other interested parties.

This practice has not been without controversy. Indeed, inasmuch as its pursuit has identified the Commission as something of an economic regulator, it has been strongly questioned by those who would prefer to limit the Commission to the role of a litigation-oriented enforcement authority. The practice is not limited to the Australian Trade Practices Commission — the 'fix-it-first' policy of the US Justice Department has received similar reactions. A recent article, however, puts the matter in perspective so far as the Trade Practices Commission is concerned. Of the Anti-Trust Division's policy the author said: 'In short the Anti-Trust Division's "regulatory conduct" is unquestionably more prompt, less costly and more efficient than full-blown adjudicatory proceedings' (Sullivan, 1987).

There have been numerous calls for the Trade Practices Commission to conduct inquiries into particular takeovers to determine whether or not they are in the public interest. Such entreaties demonstrate an extraordinary lack of knowledge of the Trade Practices Act. The Act confers no such power upon the Commission, nor can the Commission of its own motion take such a step. Equally there is no power in the Attorney-General to order the Commission to hold such an inquiry. Of course public interest is a feature of any discretionary decision-making process, and I believe the public interest is best served by avoiding unnecessary litigation in respect of takeover activity. Those who call for such action do not appreciate the disruption it can cause: employees become uneasy about their future, efficiency suffers, competitors take advantage of the situation to enlarge their own businesses, and costs, both direct and indirect, escalate enormously.

These are real issues and cannot be ignored in the public interest.

Furthermore, it is sometimes overlooked that the public interest itself is reflected in the laws that Parliament has seen fit to enact. Thus it is my firm view that, if it can be shown that the public interest is no longer served by having a tolerant takeover provision such as we do have in the Trade Practices Act, it is up to the government, and in its turn the Parliament, to act accordingly.

As a practical matter, the Commission has not hesitated to institute court proceedings or threaten to do so where it has become apparent that opportunities for an alternative approach do not exist, or have not been found sufficiently attractive to the parties concerned. For example, *Trade Practices Commission* v. *News Limited & Ors* concerned the then proposal of News Limited to acquire certain businesses and assets of John Fairfax & Sons. The case was discontinued following a very substantial modification to the proposals of News Limited. Another case, *Trade Practices Commission* v. *Australia Meat Holdings Pty Ltd & Ors*, sought orders for the divestiture by Australia Meat Holdings of the shares of Thomas Borthwick & Sons (Australia) Ltd. The Commission's action succeeded (1988 ATPR 40-846). A subsequent appeal by Australia Meat Holdings to the Full Court of the Federal Court of Australia was dismissed (1989 ATPR 40-932), and a subsequent application for leave to appeal to the High Court of Australia was disallowed. Substantial assets of the target company are to be divested.

Other proceedings that were threatened or instituted during the course of my chairmanship did not proceed to full hearings simply because the persons concerned either abandoned their proposals entirely, or modified them such that it was possible to discontinue the proceedings. In one case, the proposed acquisition by Bell Resources of shares in the Broken Hill Proprietary Company Ltd, the law was changed after the proceedings were instituted. At the time the case was instituted, s. 50 of the Trade Practices Act forbade the acquisition of the shares of a dominant firm. The Commission's proceedings stayed the proposals pending the outcome of consideration by Parliament of amendments to s. 50 to remove the proscription. The amendment was duly passed and came into force in the form of s. 50(2C) of the Act in June 1986.

V. MERGER PROVISIONS OF THE ACT

I would say something about the present merger provisions of the Trade Practices Act.

In an economy such as Australia's, which in sophisticated world trading terms is still developing, unnecessary constraints upon expansion by way of takeover will inhibit rather than encourage that desirable economic state of industry efficiency and competitiveness. At the same time, a law that tolerates concentration to the point of duopoly must be kept constantly under review, because it is not at all unlikely that eventually one of the two firms in an industry will achieve supremacy over the other, and achieve a degree of market power that is properly regarded as undesirable.

The dominance test does not lend itself to a clear and universal interpretation. It depends upon the particular circumstances of the market under examination for its application in any given case. It tends towards a structural rather than a behavioural market analysis but does not preclude the latter. Indeed, the way it has been administered by my Commission supports the need for behavioural analysis in order to form an objective appreciation of any given case and to form a view as to its likely consequences. (Guidelines for the Merger Provisions of the Trade Practices Act were published by the Trade Practices Commission in October 1986.)

The penalty to be accepted for such tolerance by the law is that market dominance is a fairly low threshold test and will allow many takeovers that in competition terms might otherwise be challenged. It is not industry-specific.

It might be argued that recent past government economic policy of industry efficiency and competitiveness is relatively short term. If it leads in the longer term to a duopolistic or oligopolistic commercial and industrial society, it might not be beneficial to the public, for the more entrenched such a situation becomes, the less likely it is that there will be sufficient competitive discipline in the market to ensure the maintenance of a desirable degree of efficiency.

I think it is becoming evident that, making due allowance for the extravagances of the media and the emotional outbursts of persons wishing to serve particular interests, there is some public disquiet at the degree of concentration taking place within industry generally and within some particular industries, and perhaps it is time to consider whether the policy should be reevaluated.

There are a number of alternatives.

There are, of course, those who suggest that in the field of takeovers there should be no regulation whatsoever, that companies should be allowed to merge as they wish, leaving it then to regulation to control resultant market power to avoid its abuse. Though they are superficially attractive, I do not hold with those views. If, as I would propose, competition is an economic good and an economic necessity, it is anathema to that proposition that the ultimate concentration of ownership of industry should be permitted by merger, for that would be the logical extension of the principle that there should be no control of merger activity.

Another alternative is to let politicians decide which takeovers should be the subject of examination. That too I reject, for I do not believe that any lasting benefit can be achieved by selectively examining particular takeovers according to what might be seen to be political expediency. Without attributing a shallow approach of that kind to the UK, it is nonetheless a criticism voiced within the professions in the UK that references to the Monopolies and Mergers Commission of particular takeovers can have a political foundation, rather than one based on economic considerations.

Any modification to our current law should, in my view, enable takeovers to be adjudicated according to specific criteria. I believe businesspeople and their advisers should be able to look at the law and judge for themselves whether they are within it or might offend it, and in the latter case to seek guidance, from either the regulatory authority or their own advisers, as to their course of conduct. I do not hold with a criterion of 'public interest'; it is an amorphous, undefinable concept, and that criticism is frequently levelled at the yardstick that must be used by the Monopolies and Mergers Commission in its deliberations. Equally I do not believe in the statutory enunciation of a narrow threshold test with an administrative policy, by direction or otherwise, designed to take a lenient view. That can only produce uncertainty in instances where, on some particularly expedient occasion, it might be seen as administratively or politically appropriate to enforce the law according to its terms.

Accepting that a highly concentrated market is less conducive to competition and efficiency, I would like to see a test that selects for examination takeovers that reduce the number of competitors below a particular level and result in the merged entities having more than a stipulated market share. Those cases would be examined to determine whether or not they would, if allowed, result in a public detriment. Detriment would focus primarily upon competition issues, and the concept would be no stranger to the Trade Practices Act in that certain authorisation tests now written into the Act require a balancing of public benefit against the (public) detriment brought about by any lessening of competition (e.g. sub-section 90(6)).

If we are going to review the adequacy of our competition takeover laws, I believe the review should extend not only to the Trade Practices Act but should include the Foreign Takeovers Act, the provisions of which, unlike the Trade Practices Act, do lend themselves to political judgments. Any such review should, in my view, be undertaken by an admixture of expertise in law, economics and business. Let such a concentration of disciplines and experience report upon its deliberations to government, and let the government in its turn decide its preference and put it to the Parliament for consideration. In the meantime, the law as it is should continue to be administered according to its legal and economic concepts 'in a practical way to accommodate the concern of the Act with business and commerce' (*Outboard Marine Australia Pty Ltd* v. *Hecar Investments (No.6) Pty Ltd* [1982] ATPR 40-327 at 43 983).

VI. CONCLUSION

I have had a unique experience in heading the Trade Practices Commission through an unprecedented level of economic change — unprecedented not so much in the frequency of events, but in their magnitude and impact. I do not expect this level of activity to lessen, which I believe adds some force to my suggestion that it may not be too early to review experience and plan for the future.

My term has not been without controversy, which I believe in a dynamic area such as the competition law of this country is not only to be expected but, insofar as it is constructive, is healthy and welcome.

I am pleased to have had the opportunity to make some contribution to the development of this important law and leave it to ensuing events to determine the effectiveness of my actions and those of the Commission under my chairmanship.

Reference

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Regulating Competition: The New Zealand Experience

John Collinge has taught law at universities in both England and Australia and has practised commercial law in Australia for seven years and in New Zealand for 14 years. He has published a number of books and articles on competition, consumer and contract law, including *Restrictive Trade Practices, Monopolies, Mergers and Takeovers* (1982), which won the Legal Research Foundation prize for best publication that year. He has had a quasi-judicial and administrative role as Chairman of the Commerce Commission. He is also known in national politics (as President of the National Party), local administration (as Chairman of the Auckland Electric Power Board), commerce (as a company director), and sport (as a former Captain of New Zealand Universities Cricket XI).

Regulating Competition: The New Zealand Experience

John Collinge

I. INTRODUCTION

I am very grateful to have an opportunity to discuss some experiences of the New Zealand Commerce Commission under the Commerce Act. I will first discuss some of the objectives the Commission has been endeavouring to achieve since it became involved with mergers and takeovers in a significant way in 1983. It is perhaps timely to review what the Commission has achieved to date. I will also discuss some of the criteria developed under the Act, and how the Commission has approached the resolution of issues. Finally, I will depart from my original intent and canvass issues relating to harmonisation of our monopoly laws between Australia and New Zealand since there has been much comment on that topic recently. I concentrate upon the control of mergers and takeovers by way of example only because most of the New Zealand experience to date is in that area.

II. SOME COMMISSION OBJECTIVES

Principles and Consistency

One of the primary objectives of the Commission has been to develop principles that can be consistently applied. It has done this particularly in its written decisions, which have been very carefully prepared. The principles laid down in these decisions are soon to be extracted and published in the form of guidelines, which it is hoped those dealing with the Commission will find useful. Consistency in application of principles by the Commission can only be aided by such a process. With an Act in which exceptionally broad discretions are delegated by Parliament to the Commission, it is important that exercise of these discretions be transparent and not capricious or arbitrary.

Openness and Confidential Information

Another objective of the Commission has been openness in its decision-making. Decisions related to whether competition is or is likely to be foreclosed, or whether a concern has the market power to foreclose competition, are of substantial public moment, as are decisions relating to public benefit. Our draft determinations are publicly available, our conferences are in public, and our decisions have to be in writing. Decisions made behind closed doors do nothing to promote confidence in the system no matter how good those decisions might be. Coupled with this openness is an equal determination to protect information that is properly confidential. The confidence of those dealing with the Commission in this respect is very important if the Commission is to continue to receive their full cooperation.

Fairness

Fairness is another objective, in the sense of providing procedures whereby the propositions of the applicants can be challenged by those having an interest in the matter and vice versa. This obviously has value to the parties but also to the Commission in that it gets the benefit of the input of persons interested from the widest possible range of perspectives. The Commission has been under pressure to make its decisions purely administratively. This is based upon the proposition that the Commission has an administrative and not a quasi-judicial role in making its determinations. In fact, although the matter has yet to be tested in court, the Commission's procedures are administrative but its decision-making responsibilities are very much quasi-judicial. Further, it is one thing to lose a contest but it is worse to be deprived of the opportunity to participate in the first place.

The procedural fairness of the system provides the benefit to the Commission of better and more balanced information upon which to work. The conference procedure has been particularly pleasing. The conferences, as those who have attended them will know, tend to become industry gatherings. It is extremely hard for companies to pull the wool over the Commission's eyes in front of other participants in the industry, even if they were minded to do so. When there is a conflict of evidence, the Commission also has the resources of its investigating officers and the power to call for evidence on oath. In practice there is usually an industry consensus as to the facts, and the issues usually contested are in relation to the competition or public benefit implications of those facts.

On occasions, the draft determination procedure has been misunderstood. The idea that the draft determinations are the views of the Commission is difficult to dislodge. In fact, the purpose of the draft determination is to highlight the issues and to demonstrate the areas with which the Commission would like further assistance. The Commission goes into a conference with a totally open mind on the facts and issues in question.

Speed of Resolution

Speed of resolution is also an important objective, because delays in decision-making can themselves restrict competition. Over the six months to 30 September 1987 for example, the average time taken to give 207 clearances for merger and takeover proposals was 13.2 days. Of those that had to be considered in more depth, one took 26 working days, three between 50 and 80 days, and five took 100 days. The Commission is very careful not to 'roll over' applications beyond the initial 20-day period unless there is a good reason in the form of serious competition issues to be decided. The time taken for its decision-making process, often in extremely involved and complex cases, compares favourably I believe with other countries, and at least there is a statutory time limit of 100 days in New Zealand.

Some idea of the scale of an inquiry may help to give an understanding of what is involved. In Goodman Fielder/Wattie (Decision No. 212), 15 separate product markets as well as the foodstuffs market generally were analysed in detail. Fifty-eight interested parties were consulted during the initial investigation. Thirty-two received copies of the Commission's draft determination before the conference was held. The matter involved a huge volume of written submissions: 1400 pages from the applicants alone. At the conference, which took place ten days before the deadline for a decision (or after approximately 90 working days), new evidence was given to the Commission, particularly by the applicants in respect of their public benefit case. At the conference the application was hotly contested by a large number of objectors, and a wide range of interests in a significant number of industries had to be heard and considered in detail. The issues were not only the normal ones relating to market power but also included public benefit, economic efficiency and the Australia-New Zealand Closer Economic Relations Trade Agreement (CER). There were, for example, questions such as whether the privilege of monopoly should be granted in return for international advantages, and the extent of public benefits from investments offshore at the expense of local economic activity. These were major and novel issues that required careful consideration on the facts of this case. The investigations and proceedings took the full 100 working days (or 20 weeks) allowed by the Act.

The applicants appealed to the High Court, which kept the parties, who were in a high degree of conflict, to a tight timetable. The Court of Appeal's determination, which was given within two weeks, was exceptionally expeditious. Together, the appeals took approximately three months. The Commission, upon receiving the proposal back for reconsideration, bore in mind the words of the High Court in relation to the significance of the divestments and requested its officers to proceed with priority given the necessity to do a thorough job to protect the general public interest. The revised proposal was researched, investigated, further amended and the decision given in eight weeks. The decision was announced in advance of full written reason for the convenience of and at the request of the applicants. Although the applicants have stated that the determination took a year, the time actually taken for consideration of the two proposals by the Commission was 20 working weeks and eight weeks. The Commission considered that its staff had worked extremely hard and diligently for the proper protection of the general public interest, and that the criticisms of delay in relation to the proceedings before the Commission were hardly warranted in the circumstances.

III. CRITERIA: THE COMMISSION'S APPROACH

Dominant Position

The criterion to be applied in terms of the Commerce Act in assessing mergers or takeovers is simply described as the acquisition or strengthening of a dominant position in any market. 'Dominant position' was held by the Commission in News/INL (Decision No. 164) to be the possession of market power that enabled a company 'to make significant business decisions, particularly those relating to price or supply, without regard to the competitors, suppliers or customers of that person'. The definition was elaborated in Magnum/DB (Decision No. 182) and is worth repeating here. There must be:

sufficient market power (economic strength) to enable a dominant party to behave to an appreciable extent in a discretionary manner without suffering detrimental effects in the relevant markets.

This interpretation has since been approved upon a review to the High Court. 'Dominant position' is a stringent test on any viewpoint, and it follows that there are likely to be relatively few cases, even in New Zealand, where, as a result of a merger or takeover, a dominant position is acquired or strengthened. In fact, the test has been challenged by those who say that it may be unduly stringent. A less stringent test would be the one recently described by Charles F. Rule of the United States Department of Justice — 'only those acquisitions that are likely to lessen competition substantially, and thereby harm consumers by increasing the ability of one or more firms in the affected industry to exercise market power'. Had the Act intended us to use this lesser test in New Zealand, it would hardly have used the words 'any person who is in a dominant position'. Clearly there is a policy issue here for future resolution.

Market Share

It follows from the Commission's interpretation as expressed above that intervention does not depend upon the size of the merged concern, upon the number of conglomerate activities engaged in, or upon whether the dominant position is abused. In assessing market power, both structural and behavioural factors are assessed and the list of relevant factors is not a closed one.

Market share is, according to the Act, one factor to be taken into account. However in practice market share tends to be a trigger to further investigation, and at the end of the day it is not so much market share that is the deciding factor, but the existence of competitors or potential competitors to provide an adequate discipline. This could come from imports, substitute products, new entrants, etc.

Other countries often have a specific trigger point at which a market share becomes suspect, but the Commerce Commission has resisted this. There are good reasons why the Commission has been cautious with market share figures. In a number of cases it has allowed acquisitions that gave the merged concern a very high market share, on the grounds that there are other factors that provide a discipline. Thus, in News/Taranaki News (Decision No. 176), the costs of entry appeared minimal notwithstanding the 100 per cent market share; in Fletcher Building Products/UEB (Decision No. 177) it was clear that imports would produce a sufficient discipline. Second, there are often historical reasons in NZ why market shares have been traditionally high — under a strictly regulated regime for example — but such shares would not necessarily continue into the future with deregulation. Oddly, it is sometimes said that New Zealand is relatively strict on mergers and takeover proposals. In fact it is probably the reverse. One can hardly imagine a merger that gave the combined concern 100 per cent of the market being approved overseas. Conversely, the NZ approach is not 'soft' on monopolies: it simply recognises the small NZ market and how exposed it is to external factors in particular.

Intervention Is Sparing

Practical experience has underscored that the dominant position test is a high one. To date, the Commission has found this test to be satisfied in only three types of situations:

(i) Where the only two concerns in the market wish to join together: for example, the transformer market in Cory Wright & Salmon/Tolleys (Decision No. 118). A slight variant is where the only two national concerns wish to join together and the competitors are local only and have a small market share: for example, ice cream in Wattie/Taylor Freezer (Decision No. 127).

(ii) Where one of the participants to the proposal already has a dominant position in one market and where downstream acquisitions are likely to create dominance in another market, for example, kraft paper and containers made therefrom in Amcor/NZFP (Decision No. 208).

(iii) Where a concern, usually having a significant market share, captures the essential inputs for that market, thereby forcing its competitors to purchase their supplies of raw materials from it: for example, yeast and flour for bread in Goodman Fielder/Wattie.

These examples give some guide to the broad circumstances in which the NZ Commission has intervened, and support the proposition that intervention in New Zealand is sparing in comparison to other countries. For example, in New Zealand, the prospect of intervening where a merged concern had 35 per cent of the market, for example Guinness/Distillers (UK) (AUR decision) in relation to Scotch whisky, is remote.

Competition vs Public Benefit

The preamble of the Act clearly gives primary emphasis to the promotion of competition; this is seen as a beneficial policy, unlike the lessening or elimination of competition. However, in certain circumstances public benefit may take precedence over competition if the Commission determines that any detriment from any lessening of competition found to result from the restrictive practice, or the merger or takeover, is outweighed by a public benefit arising therefrom. Thus the Act recognises that other policies, in appropriate circumstances, outweigh competition as a policy.

There can be little doubt, however, that the Commission in the course of its decisions and activities has laid down a strong general message for the first time in this country. The message, which the Commission believes is also enshrined in the Act, is that its job is to protect and foster competition in NZ markets. In so doing, it is endeavouring to foster the traditional cornerstone of our economic organisation; the best means of ensuring economic efficiency and performance of NZ companies; an alternative source of supply for purchasers of goods; and protection of competition and choice for the consumer.

This is not an antibusiness objective — although it may be so regarded by those who seek to monopolise by mergers or takeovers or to engage in anticompetitive cartels. It is a pro-business objective that ensures that businesses are not deprived of choice or commercial opportunity. Further, it is not a dogmatic message that competition is always the only goal to achieve. There may in some circumstances be wasteful competition, and there may be weighty matters of public benefit that mergers or takeovers can assist. But on the facts before it to date, the Commission has in general been persuaded to adopt the view that favours competition in NZ markets.

Underlying Objectives: Economic Efficiency and Consumer Welfare

It is important to recognise that the essence of the Commission's function under the Commerce Act is to further consumer welfare through competition. That is not antimerger: mergers are a legitimate process of producing efficiency. The decisions by entrepreneurs as to the benefits of mergers (and it is clear today that they are not always right) should not be second guessed unless the private gain is at the expense of the public through the creation of a dominant position in a market. Only then can the Commission intervene. Further, the Commission can allow mergers that create a dominant position only when public benefit results. It is often not appreciated that this is a safety valve and not a means of striking down a merger.

The Commission has no broad-based public benefit role. At its core the Act recognises that the free market economy, unimpeded by private restraints, is the best means of maximising our economic welfare. In practical terms this means maximising consumer welfare. Again from Charles F. Rule of the US Department of Justice, it is the threat to the economic fruits of competition — consumer welfare — with which we should be concerned. What are the Commission and the Act trying to achieve? Currently the best short answer I can give is 'to maximise consumer welfare as the result of economic efficiency', but tempered with enough flexibility to adopt another policy should that be necessary to maximise the public benefit to New Zealand. Of course, there may be genuine and unresolvable disagreement as to what the benefit is in any particular case.

Domestic vs International Competition

Very often, the elements of benefit and detriment that are presented to the Commission are based on a choice between domestic competition and internationalisation. The Commission often has to assess the implications of different aspects of government policy. The starting point for the Commission is the promotion of competition in NZ markets. But, as indicated, it may properly consider other benefits, including, for example, the benefits arising from off-shore investment.

While much public comment has been made about the benefits of rationalisation, the benefits of competition in domestic markets, particularly in terms of costs and prices, should not be underestimated. Domestic competition is the key to an efficient economy. It is necessary to protect commercial users — every businessperson knows the importance of having an alternative supplier — and it is the best protection for the consumer. A competitive domestic economy is, I suggest, the best springboard for international competitiveness — not the featherbedding of a monopoly at home.

In resolving conflicts between the two policies, the Commission makes a pragmatic judgment on the circumstances of each case. The judgment is not made on doctrinaire or policy grounds. It is made by a jury of persons with different backgrounds and skills. It is for the applicants to show that some other public benefit tips the scales against a decision in favour of domestic competition. It is not too great a burden, for those who wish the privilege of a domestic monopoly, to have to justify it. Further, if the decision should go against the applicants, there is still the possibility that both objectives — internationalisation and domestic competition — can be met by making appropriate divestments. Let us hope that this is increasingly seen as a means of achieving both objectives in the future.

Flexibility

The Commission has been fortunate in being able to observe some experiences overseas, and is now in the unusual position for New Zealand of having significant recorded experience in the analysis of mergers and takeovers.

Although our principle of dominant position is similar to the tests applied overseas, its application in New Zealand must suit local circumstances and meet local needs. This applies not only in relation to our competition assessments but also in relation to our view of public benefit here. We must take account of our small market in international terms, of the fact that our frontier barriers are generally low, and of our need to export to maintain our wealth.

I do not believe that the Commissioners should be economic visionaries, or that we should commit ourselves to any economic theory. Our job is to listen to what theory can teach us and then to make pragmatic judgments on the basis of the facts of each case. In so doing we should continue to be influenced by developments and receptive to change as circumstances change.

IV. HARMONISATION

Harmonisation of business law between Australia and New Zealand means not slavish copying but the removal of impediments that inhibit free trade between the two countries. It is not necessary that the laws of the two countries be identical, but merely that they facilitate free trade.

Harmonisation is an objective in the CER Agreement, and I am pleased that the two Prime Ministers have reaffirmed the objective of advancing the timetable for lowering the frontier barriers of licensing and import duty. Certainly, monopoly laws in Australia and New Zealand should be reviewed as part of this process. But whether our monopoly laws in relation to mergers and takeovers need to be brought closer together is another question that I would like to examine in more detail.

Comparison of Monopoly Laws

Let us look at the differences between monopoly law in Australia and New Zealand, leaving aside minor drafting differences. First, both countries adopt the same primary criterion: the test of dominance. In both countries this is a test of market power. Second, both examine whether dominance exists in any market within New Zealand, or in Australia or a substantial part of Australia. This is usually but not exclusively taken in Australia to mean in a State market or in a special geographic market, for example the Riverina. In New Zealand, depending upon the industry, provincial markets have been considered and often the upper and lower halves of the North Island have been separated as the facts (i.e. non-interaction between the markets) have dictated. Third, the judgments in each country are made in the first instance by similar institutions; both Commissions have Commissioners of multidisciplinary backgrounds selected from the private sector. Fourth, the guidelines laid down by the two Commissions in applying the tests are, as far as I can assess, virtually indistinguishable.

In both countries, examination is made of actual or potential competition from imports, substitutes, new entrants, etc. The only difference of any moment that I can detect is that the procedures are different, with Australia having a 'strike down' system and New Zealand an 'advance clearance' system. This, however, is only a matter of procedure affecting the method of disposition and not the final outcome. There is no substantial difference between the laws of the two countries in this area.

Looking then at how discretions are exercised in each country, I will give a brief outline of three relevant cases.

Goodman Fielder/Wattie. The first case is Goodman Fielder/Wattie (Decision No. 212), which was a proposed merger between an Australian company having major interests in the food industry in New Zealand and a New Zealand company. The NZ Commerce Commission found that the merger would create a dominant position, i.e. a lack of effective competition, in various markets, such as yeast, flour, bread, and chicken meat, in New Zealand. As against this, it was argued, among other things, that the merged concern would create a bigger base in Australia so as better to meet international competition, and in particular that improved exports would flow therefrom. The Commission accepted that this could be a benefit. But because little information was produced as to the practical feasibility of these claims or as to how this would impact upon the NZ public, the Commission found that the alleged benefit did not outweigh the considerable detriment that was found to exist from the lack of competition in domestic markets. For example, it appeared that bread prices were significantly higher in areas where the group had limited competition.

The sequel to this finding was that the applicants decided to divest certain businesses in respect of the markets in which they had a dominant position. In that way the applicants sought to rectify the matters that the Commission perceived to detract from domestic competition, while simultaneously obtaining the benefits of internationalism. The importance of the case is the demonstration that companies can expand offshore without damage to the domestic market.

Because Wattie did not have significant Australian interests, and because of the other food producers in Australia (many of whom are multinationals), the Australian Trade Practices Commission did not attempt to prevent the merger there. When the Fielder/Gillespie/Davis proposal was examined in Australia it was dealt with in similar fashion to New Zealand: the Trade Practices Commission required divestment of certain brands of edible oils to take the merged concern's market share from 70 per cent of the Australian market to, I believe, some 50 per cent.

Amcor/NZFP. The applicants in Amcor/NZ Forest Products (Decision No. 208) sought approval for a joint venture in the pulp and paper industry between an Australian company and an NZ company. The Commerce Commission found there to be an absence of effective competition in the production of kraft paper and that the merger would place the merged concern in a dominant position in the market for container manufacture from kraft paper — essentially cardboard boxes. The merged concern would have had 100 per cent of kraft paper manufacture and control over 67 per cent of the container market. It would have been in a position to monopolise the rest of the container market as the only independent manufacturer had to purchase primary raw material from it. There was no realistic alternative supply.

As in the previous case, the argument was made that the larger Australian market base would make the merged concern a realistic competitor in world markets. The Commission found that significant detriment was likely to occur from the lessening of competition, but that the benefits accruing to the New Zealand public projected from this proposal were realistic and impressive and likely to be enhanced by the addition of the Australian company.

On balance, the Commission had a difficult decision in declining the proposal and said so. It was open to the parties to divest themselves of Kiwi Packaging (a container manufacturer owned by Amcor) so that the Commission's concern about dominance could be met and internationalism advanced. It was perhaps disappointing that the applicants did not decide to take this approach; but that, I emphasise, was a decision entirely for them to make.

In Australia there was quite a different set of facts. Instead of one kraft paper manufacturer there were three — Amcor, Visy and Smorgon — each of which was also engaged in container manufacture. Thus the Trade Practices Commission was not concerned in Australia with the merger of Amcor and NZFP, which had relatively little involvement in Australia in any event.

Fisher & Paykel/Email. The next case was in Australia. Fisher & Paykel (an Equiticorp subsidiary) made a bid for Email. As these were the two significant companies in the sale and distribution of whiteware in Australia, the Trade Practices Commission blocked this merger in view of what might be said to be a fairly obvious threat to competition in Australia in that industry.

The NZ Commission also had an application from Feltex (an Equiticorp subsidiary) to buy out the existing shareholdings in Fisher & Paykel — mostly owned by family interests. The Commerce Commission found that at that time the Equiticorp group had no other whiteware interests in New Zealand and hence that the proposal did not affect competition in any way. It was a simple transfer of the shares in the company (which admittedly had a very strong position in the NZ whiteware market) from one shareholder to the other. Market power, if any, existed entirely independently of the merger.

Decisions in Harmony

It has been said that because Australia and New Zealand have different perspectives on the same transaction, there is a conflict between them. However, as demonstrated above, the facts are very different in each country. I think it is fair to say, without being privy to all the details, that both Commissions would probably have made the same decisions had the circumstances been the same in each country.

There will no doubt be an increasing tendency for mergers to have Australasian implications, and for both Commissions to be involved for their separate jurisdictions. In this respect the two Commissions have kept very closely in touch with each other, both at member and officer level. We have been aware of the issues being dealt with in Australia and they likewise. While each has respected the other's responsibility to make its own decisions, there have been detailed communications and information exchange with each other. There is no need to rely on a nod or a wink.

There are at least two reasons for this close cooperation. With low trade barriers between the two countries, it is clear where competition or potential competition is most likely to come from. Further, both Commissions have been conscious of avoiding potential problems should their decisions conflict.

For my part, I would like to pay tribute to the retiring Chairman of the Trade Practices Commission, Mr Bob McComas, who in addition to bringing to the task a commendably practical approach, helped forge a close relationship between the Trade Practices Commission and the Commerce Commission.

One Market or Two Markets?

The next question is whether the Commissions should really be looking at one combined market — the Australasian market — in their respective determinations. According to the wording of the NZ Act — any market 'for goods or services within New Zealand' — the Commerce Commission can only take into account the NZ market in making its decisions. A similar position applies in Australia. However, when considering the NZ or Australian markets it is impossible and impractical not to consider the influences upon that market from outside. The Commerce Commission must look at the impact of Australian imports when evaluating the NZ market, and it must (especially in the light of CER) assess competition in New Zealand in the light of licence-free and duty-free imports from Australia. In fact, both Commissions routinely look at the competition that might be offered from imports of Australian and NZ goods; a quick examination of the decisions of the Commerce Commission will confirm this in New Zealand's case.

But we have found, based on industry evidence, that many goods cannot compete as imports with their NZ counterparts for reasons such as cost of raw materials, transport, legislative restrictions, etc. For example, the bread bakers of Brisbane simply do not compete with those in Wellington. Based on equally unanimous evidence given to the Commerce Commission, Australian-made hot water cylinders could not possibly compete with NZ-made cylinders in the NZ market because of the exorbitant costs of transporting the air inside the cylinders across the Tasman. Uncooked chicken meat cannot be imported into New Zealand because of sanitary regulations. On the other hand, in the pet food market, where one company has some 70 per cent of the NZ market and very little Australian pet food is sold here presently, offal and canning costs in Australia are lower than in New Zealand and canned pet food is transportable relatively cheaply. With the lowering of frontier barriers into New Zealand for such products, imports of Australian pet food appear to be a sufficient discipline upon the NZ market notwithstanding the market share of the local company. In this case the market is, I believe, in fact an Australasian one.

My point is that markets are distinguished by their facts and not by any artificial boundary. Should we sanction a monopoly in the South Island for bread just because the North Island has another player? Should we sanction a monopoly in New Zealand because there are other companies in Australia? The answer may be 'yes', but only if those other companies can in practice produce an adequate discipline on the monopoly concern.

Antidumping Legislation as a Barrier

The Commission is sometimes asked to sanction the acquisition of a monopoly in New Zealand solely upon the grounds that there are competitors in Australia. The kraft paper manufacture/container industry is particularly instructive in this respect. In Amcor/NZFP it was accepted by both NZFP and

Amcor during the whole of the hearing that Amcor could not compete in New Zealand in the kraft paper market because of antidumping legislation. NZFP could not compete in Australia for the same reason. To say in these circumstances that we should allow a dominant position in the New Zealand market because there is a competitor in the Australian market is absurd. In those circumstances, even if the market was defined in the Commerce Act as any market within Australia and New Zealand, both Commissions would still distinguish (as the facts dictate) geographical areas where transport, legislation or other considerations prevent competition between them.

Public Benefit and Closer Economic Relations

A monopoly may be sanctioned by the Commission if public benefit flowing therefrom outweighs the detriments from the lessening of competition. That CER objectives may constitute a public benefit is beyond question. CER objectives have the support of both governments. Three main CER arguments have been put to the Commission and I deal with each in turn. But first let me say that the primary objective of CER — working towards a free trade area — is very much consistent with the Commerce Act. An environment of free trade depends upon the premise that no individual or group of individuals will be able to lessen competition by merger or restrictive trade practices. In other words, government regulation, once dismantled, should not be replaced by private sector regulation. Thus, local competition law, whether Australian or New Zealand, runs very much in tandem with CER. By the joint policy of lowering frontier barriers and encouraging domestic competition, the objective is to make businesses more efficient at home and, hence, to make them more competitive overseas.

Rationalisation. One of the arguments in favour of CER is that improved efficiency between Australian and NZ enterprises would result from rationalisation. This argument is put in the context of the lowering of the frontier barriers under which the industries grew up, and the need, following the virtual removal of frontier barriers between Australia and New Zealand, to be efficient so as to compete with imports and to encourage exports. There is no doubt that these are valid objectives and as such should be encouraged. But again, in terms of the Commerce Act, the benefits must be examined in relation to their impact on the NZ public. In this respect some say there is a conflict between the Commerce Act and CER. However, if an NZ industry was lost to Australia as a result of rationalisation, that should not be looked at entirely in isolation. There may be other gains to New Zealand.

More usually, the issue arises where rationalisation takes the form of a company producing one product in Australia and another product in New

Zealand for the combined Australasian market. The view taken of this cannot be too short-sighted as it may be a real net gain to New Zealand. But the claim needs to be examined to assess the real extent of the benefit.

I think I am correct in saying that the Commission has accepted all of the specific CER arguments put to it, except perhaps in Goodman Fielder/Wattie, where it was argued that there would be a benefit to New Zealand in retaining the head office company in Sydney. In order to have weight, the argument must be specific and show how the NZ public benefits.

Exports. It has often been argued that increased exports resulting from a practice or merger proposal will provide a substantial benefit to the public by improving the balance of payments. However, with a floating exchange rate exports take on a slightly different hue than previously. It is now argued that exports simply affect the rates of exchange, which in turn provide the appropriate market signals.

Even though the current account benefit from exports is not so important, there can, I believe, still be increased productivity benefits. It has been said that exports are the 'engine room' of economic prosperity: they enable us to buy a greater variety of goods from overseas and hence raise our standard of living. The Commission has accepted such general effects, essentially increased productivity, as public benefits in Amcor/NZFP and also in Goodman Fielder/Wattie. If exports are fostered, this may improve resource utilisation, employment, regional development and so on in New Zealand. It was these benefits, fostered by Amcor assisting with access to markets overseas, that impressed the Commission in Amcor/NZFP. In Goodman Fielder/Wattie, on the other hand, the Commission found there to be insufficient evidence as to whether the alleged increased exports were feasible, both in terms of increased sales overseas and in terms of ability to produce the goods at the requisite price. Ultimately, it depends upon whether sufficient evidence is presented to convince the Commission that serious export proposals exist, that they are realistic, and that there is a probability that they will provide benefit, general or specific, to the NZ public.

International competitiveness. Another argument that has surfaced regularly recently is that the proposal in question will assist international competitiveness. In particular, in respect of a merger of an Australian and NZ concern, it is asserted that a wider base market, i.e. an Australasian market, will assist this. It is argued that an Australasian concern, though large locally, is in fact invariably small and insignificant in world terms, and that size is necessary to meet the competition. A further refinement of this argument, used in Goodman Fielder/Wattie, is that size is necessary to obtain borrowings overseas in order to bid for companies overseas.

There is little doubt that this outward-looking approach can be of public benefit. It does not make sense to ignore the world trend of rationalising companies; the merger boom is not confined to New Zealand. But again, in terms of the Commerce Act, applicants must show how this benefits the public of New Zealand. For example, improved competitiveness overseas is very much in line with the pro-competitive objectives of the Act, and internationalism can improve performance back home as NZ executives and staff are exposed to world competition.

However, the effects of internationalism may vary. What does competitiveness overseas mean? Does it mean buying distributive outlets to promote New Zealand goods? Or does it simply mean buying shares in a company overseas, with benefits being limited to improved dividends for the shareholders? Once again, it is not enough simply to claim benefits from internationalism; they may differ markedly from case to case. It is necessary to show, in particular, the extent to which they are likely to impact upon the NZ public. On the other hand, it will not particularly impress the Commission if the proposal is likely to cause the domestic market to subsidise the international market; or if it is really a defensive measure to protect the participants against competition in the domestic market from imports into New Zealand.

Is Monopoly Law Harmonised?

Thus, the monopoly laws relating to mergers and takeovers in Australia and New Zealand are for most practical purposes the same. They are certainly complementary and, as administered, do not give rise to conflicts. Decisions on trans-Tasman mergers have been adverse on one occasion only in each country to my knowledge. The immediate result in each case was a restriction upon overseas investment (by Amcor in NZFP and by Equiticorp in Email). It would be difficult to say whether this caused an impediment to trade between the two countries, as many other factors also affect trade. There is the opportunity in both countries to achieve the mergers notwithstanding the adverse decisions if appropriate divestments are made. Further, the applicants could try to make a persuasive case that CER and other 'public benefit' objectives can outweigh the loss of domestic competition.

In practice, Australian and NZ laws impose a very high test before a dominant position can be found. The impact of monopoly law upon trans-Tasman acquisitions is likely to have been slight indeed. In these circumstances, monopoly laws do not seriously impede free trade between the two countries. In my view, there is really no need for harmonisation of the monopoly laws between Australia and New Zealand: they are already harmonised. That does not mean that the approach and principles common to both legislations should not be reviewed.

Antidumping Legislation

Accordingly, what do those who call for a 'single market' between Australia and New Zealand really mean? Are they thinking of political or economic union? They do not appear to be talking of common external tariffs, nor common exchange rates, nor a common taxation system, nor a loss of political or economic sovereignty for either country. For the purposes of this paper, I assume they mean the furtherance of free trade through the removal of impediments to free trade between the two countries. Given that monopoly law is not one of those impediments, then antidumping legislation and governmental preferences appear to me to be the two most likely inhibitors of free trade. If antidumping legislation is significantly changed, then obviously some industries will have to make pricing adjustments in order to be competitive in trans-Tasman markets.

Those who defend antidumping legislation claim that it is designed to discourage unfair competition. Let us look at this proposition in a little more depth. Broadly speaking, antidumping laws impose duties on imports that injure the domestic industry. Duties are set at the level necessary to offset the amount by which the import price is less than the price charged for equivalent goods in equivalent circumstances in the home market.

Generally speaking, however, antidumping laws fail to effect the rationale they are based on. First, they ignore the question of whether the imported goods are deliberately priced lower simply to compete more effectively with local products. Second, the mere existence of a differential between a local price and the import price is often taken to prove 'injury to the industry' without regard to the fact that there may be many firms more efficient in the industry than the complainant. Third, antidumping law does not require any injury to the local company in competitive as distinct from monetary terms. It is ironic that some of our largest and most capable companies, often fully owned by multinationals, are frequent complainants in antidumping cases. Do they really need protection?

Fourth, antidumping laws in many countries operate in a protective, often blatantly political way. There is also more subtle or indirect political interference as ministers are asked to protect the local 'good guy' against the overseas 'predator'. Fifth, economic thinking in recent times has clarified that we need not be concerned with predatory pricing unless it is possible to alter the structure of the market so as to maintain ultimate gains sufficiently long to recoup the costs of the predation. In antidumping legislation, this concept is irrelevant — the countervailing duty is imposed notwithstanding that the dumping firm could never hope to recoup its losses through higher prices. Sixth, antidumping laws look at fully allocated costs, which of course ignores the reality in the marketplace of marginal cost pricing.

In short, antidumping legislation is at best an extremely coarse mechanism for ensuring fair competition. At worst, it can be totally protective, anticompetitive and anti-free trade. Without wishing to appear overly enthusiastic for price discrimination laws in lieu of antidumping laws, I do believe that price discrimination laws can focus more closely upon whether there is a real price differential and whether it is likely to do competitive harm.

I do not wish to be taken as drawing a final conclusion on the desirability or otherwise of antidumping vs. price discrimination legislation. That debate needs much more attention than I have given it here. The question will be a primary focus of debate in the next round of CER negotiations.

V. CONCLUSION

Do those who call for a 'single market' want to review the antidumping laws so as to promote competition? Or do they still want the protection provided thereby? Should Australians and New Zealanders be treated as 'nationals' for the purposes of such legislation? To what extent are the consumer and efficiency generally likely to be affected? What dislocation is likely to be caused to any particular industry? Are there questions of local loss of employment? I look forward to the ongoing discussion of these questions. In an attempt to more specifically focus the debate, I put forward the following:

'Single market' has become a catch-cry between Australia and New Zealand. I think the point really being made is this: Let us each have more understanding of the other's laws and systems, and let us have more cooperation. That is unquestionably a valid objective.

It does not make much sense to talk of a 'single market' in a vacuum. What is the objective? Furtherance of a free trade area? Economic union? Political union? Or a hybrid notion? People should say what their agenda is. It is not particularly helpful simply to assert 'I am a big market man'. Is the 'single market' a way of disguising requests for political or economic union?

The immediately achievable objective is in my view the furtherance of a free trade area by the removal of impediments to trade between the two countries. That is where most effort should be concentrated — it is a short-term achievable goal. Of course, that is not to say other forms of cooperation should not be debated and explored.

Harmonisation (i.e. the removal of impediments on free trade) can be achieved if laws are complementary; it is not necessary that they be identical. Slavish copying of Australian laws by New Zealand should not be contemplated, and vice versa. On this definition, I believe that our monopoly laws are already harmonised.

If the 'single market' objective is pursued then it must apply in a total context of trade between the two countries and not only to monopoly law. It must also apply, for example, to foreign investment regulations, restrictive trade practices, and so on. Let us be consistent and not selective. Among the most serious practical current impediments to free trade are, I believe, antidumping laws and government preferences.

Antidumping laws are at best a coarse mechanism to promote fair trade, and consideration needs to be given to whether price discrimination laws should replace them between Australia and New Zealand.

Many of the advocates in Australia of a 'single market' have centred their arguments on monopoly law. Presumably, they are hoping to avoid such laws by endeavouring to widen the market. Unfortunately for them, that won't work. Competition analysis looks at real or actual geographic markets and not artificial ones. That applies equally to Australia and New Zealand and will always apply no matter who administers the legislation.

Comments on Daniel Oliver and W.R. McComas

Comments on Daniel Oliver and W.R. McComas

Geoffrey de Q. Walker

My first point is perhaps something of a quibble. Mr McComas argues that history shows that unregulated markets are seldom competitive. This belief has conditioned a great deal of our thinking. We've tended to believe that in the 19th century the law was favourable to monopolies and cartels, but historians are beginning to reappraise that view. It's now thought that the law was inactive in competition policy precisely because the market was indeed very competitive; where monopoly power did emerge it tended to be quickly eroded by continuing technical change. If this reappraisal is accurate, it may affect our attitude towards the need to regulate for competition today.

Mr Oliver is right, I believe, to stress the similarities between the approaches of the Federal Trade Commission and the Trade Practices

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Commission. My own experience with the Commission confirms his point. It was only in the area of price discrimination that Australia didn't go along with the FTC position. We never really accepted the antidiscrimination ethos embodied in the Robinson-Patman Act. I was also interested in the continuing commitment expressed by Mr Oliver to proceeding against horizontal price-fixing agreements. This goes against the belief expressed in some quarters that antitrust has been all but destroyed in the United States. On the contrary, the FTC seems to have rejected the radical view that even horizontal price-fixing need not be detrimental if there is freedom of entry. It may be true that no price-fixing agreement can long survive without some kind of government support; but it can certainly last long enough to harm consumers both directly and by creating an anticompetitive ethos. This is a particular risk in Australia where, because we have a smaller economy, the options are fewer. Import competition for goods is hampered by factors such as the monopoly power of the waterfront unions and tariffs; and the importation of services is hampered by strict immigration laws and union policies on the accreditation of qualifications.

At the same time it's interesting to note the continuing development in the US of the exception for price agreements that are ancillary to integration, as in the *Broadcast Music* case. That principle of course goes back at least to the *Morgan* case in the 1940s, but its increasingly formal recognition does help overcome the logical absurdity under which any partnership agreement is theoretically unlawful *per se* as a price agreement. In Australia this proposition is built into s. 45A as an exception.

The TPC does not share the lenient approach towards resale price maintenance that is now favoured by many American economists and, I believe, by Philip Williams. The arguments are persuasive, but they do depend on perfect knowledge by regulators and costless regulation. In Australia, the historical fact is that price competition on a wide scale did not emerge until vertical price fixing practices had been either subverted by direct action (the emergence of competitive suppliers) or stamped out by s. 48. The pervasive habit of practising resale price maintenance creates an environment in which it is difficult for horizontal price competition to emerge. Even the exception in the Trade Practices Act for **recommended** resale prices has had the effect in several markets of reducing horizontal price competition. We have imperfect knowledge about how tacit price collusion comes about, but we do know that it emerges where vertical price-fixing practices are allowed.

It's also interesting to note Mr Oliver's continuing support for the concept of 'market definition' as a necessary step in proving market dominance. Dr Williams's view is that it's a useful step but not a necessary one;

he would prefer to look at the behaviour of firms in the relevant context. But from a legal point of view, how does one know which firms one is supposed to be examining? There has to be some way of identifying the relevant parties, at least in some prima facie fashion.

The present state of the mass media market is a cause of widespread concern, and the TPC has been reproached on occasion for allowing that market to develop the way it has. But it is really the result of the wording of the present legislation. Given Australian industry's high degree of dependence on government favours for its prosperity, there may, regrettably, be a case for further legislation to divorce media interests from other industrial interests. It was notable that during the campaign against the proposed identity card system there was an almost complete media blackout on the case against the card until August 1987. The only exception was radio, which is, of course, the small business sector of the mass media.

Mr Oliver is, I think, right to believe that the last battles against monopolies and cartels will take place in the sphere of government regulation and other forms of intervention in the market. At this point I would like to voice a complaint against the recent administration of the Trade Practices Act. I believe the Commission should be more active in the domain of competition advocacy as described by Mr Oliver. It has the power to do so under s. 28(1)(d) of the Act (liberally interpreted). As George Stigler said, competition is the patron saint of the consumer. But all too often that fact is neglected in the debate surrounding the question of regulation for competition. The TPC does have a sound and balanced view of the role of competition. That indeed may be the reason why the consumer standard-setting function has been taken away from it: one consequence of the TPC operating both the competition and the consumer-protection functions was that the former moderated the paternalistic excesses of the latter. Competition advocacy is also needed to counteract the bias in the media, which tend to view competition as chaotic and destructive. I'm confident that respect for the individual's ability to make sensible market decisions will prevail.

Competition Policy in Regulated Markets

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All three authors are contributors to R. Albon & G. Lindsay (eds), *Occupational Regulation and the Public Interest* (1984).

Competition Policy in Regulated Markets

John Logan, Frank Milne, and R.R. Officer

I. INTRODUCTION

In this paper we begin by briefly addressing the question of whether trade practices legislation is necessary for the efficient functioning of a free market system that is unhampered by government regulatory controls. We then endeavour to show how government regulation that is introduced for purposes other than the control of trade practices can give rise to anticompetitive behaviour as a side effect of the regulation itself. This leads to certain conclusions that might be relevant to competition policy in those markets that are the target of government interventionist policy. Under the heading of government intervention at the microeconomic level, we include compulsory licensing, tariff protection, the sanctioning of union activity, government monopolies such as Telecom, as well as agricultural marketing authorities. Space precludes us from a detailed examination of each of these instances of regulation, so instead we focus our attention on one particular class of market: the markets for professional services. However, our analysis can be applied also to other areas of regulation, with suitable modification.

II. TRADE PRACTICES LAW AND FREE MARKETS

Trade practices legislation, in Australia as well as the US and the UK, is, in the main, directed at market behaviour that is considered to impose social losses by restraining trade that would otherwise flourish in an open and competitive marketplace. These 'restrictive trade practices' are the focus of government intervention because they are thought to result in a misallocation of resources, which imposes losses on (or denies benefits to) consumers through higher prices, as well as harming producers and sellers who, it is claimed, are denied access to their respective markets.

Competition policy is for the most part aimed at preventing three broad categories of behaviour: monopoly control of a market, collusive practices to raise prices or divide markets (or to otherwise restrict competition), and exclusive dealing. In Australia, trade practices legislation is also concerned with consumer protection and with 'unconscionable conduct', which, according to the Trade Practices Act Review Committee, is the result of a 'general disparity of bargaining power between sellers and buyers' (1976:9.56-9.62). Here we are concerned with the more traditional restrictive practices that have been of interest to the Australian Trade Practices Commission (TPC).

Over recent years there has been increasing criticism, particularly from the US, of the role trade practices legislation has played in the market economy (for example, Dewey, 1959, 1979; Williamson, 1975; Posner, 1976; Bork, 1978; and Armentano, 1982). We now consider some of the arguments that have become standard in the literature. These arguments cast doubts upon whether the benefits of trade practices legislation outweigh the costs if one accepts, along with the Swanson Committee, that 'the needs of the community ... are effectively satisfied through the operation of the market mechanism in which the driving force is competition' (Trade Practices Act Review Committee, 1976:10.41).

Monopolies Are Not Inevitable — And Not Inevitably Bad

First, there is the popular misconception that collusion and monopoly control of the marketplace will inevitably emerge as the dominant feature of a free market economy. The kinds of monopoly control that are anathema to trade practices regulators stem from 'monopoly power'. But if we define monopoly power as the power to arbitrarily restrict offers of attractive opportunities to trade and to undertake market adjustment (Armentano, 1982:42), then monopoly power is precluded by the ground rules under which a free market operates. That is, under a system of effective property rights, anybody is free to engage in mutually beneficial trade, and this includes the right to offer alternatives to buyers whenever some seller attempts to 'exploit' monopoly power, for instance by raising prices. Naturally, every seller would like to possess a monopoly in his or her particular product because of the wealth-generating opportunities available in a truly monopolised market. However, in most instances this natural desire is thwarted by the inevitable entry of competitors who produce and sell the same product or a close substitute. If competitors are in short supply on the domestic market, the threat of competition from imports imposes an upper limit upon the prices that a domestic monopolist can charge. Even if the domestic seller prices below this upper limit, so that the business has the appearance of a monopoly, the seller's market behaviour is constrained by the threat of entry, provided that entry is not precluded by coercive factors from outside the marketplace. Of course this upper limit on price can be raised by tariffs or other trade protection that limits competition from imports.

In the same way, a seller can gain the appearance of a monopoly by consistently pricing below the lowest unit cost among his or her competitors. In some quarters this might be attacked as 'predatory pricing', but in fact the predation has succeeded in delivering to customers a product at the cheapest price. An injunction under trade practices legislation to force the single seller to alter the way he or she does business would also force higher prices upon consumers and deliver an indirect subsidy to higher cost producers. Thus it is possible for trade practices activity to distort an efficiently functioning free marketplace. In addition, 'true' predation, that is, pricing by a large firm below the minimum unit cost of lower-cost competitors so as to capture the entire market in the event of their exit, can be shown to be a hazardous enterprise at best, and is quite likely to diminish the wealth of shareholders of the predator (Bork, 1978:149-54).

A 'natural' monopoly is said to exist where the juxtaposition of market demand and cost structures permits no more than one firm to continue in business. The standard theoretical approach to natural monopolies implies that the fortunate possessor of such an advantage has a definite incentive to raise prices, or to price discriminate and engage in multipart pricing in order to maximise wealth (note that such behaviour does not result in allocative inefficiency; its purpose is to transfer consumer surplus to the producer). This is presumably the rationale that lies behind rate regulation of public utilities in the US, and public ownership of utilities in Australia. We will be noting below that public ownership is one of the prime sources of anticompetitive behaviour in an economy that is otherwise based upon free market competition. However, at this point we should note that recent work implies that if a natural monopoly market is contestable — that is, it is cheap to enter and exit from the market (Baumol et al., 1982) — then the natural monopolist is constrained by the threat of entry to charge no more than the least unit cost, including entry cost, of potential entrants. As for the monopolist in an open economy, it is potential competition that constrains market behaviour. Furthermore, the conditions that create a natural monopoly might occur less frequently than was once thought, as is evidenced by the entry of competing electricity utilities into local markets in the US, where this is permitted by law.

Market Power

Another concern of trade practices legislation, which is related to monopoly but falls short of it, is the question of 'market power' in markets with more than one seller. Not only have courts found it very difficult to define precisely the market that is relevant to individual cases, but they have also had difficulty defining 'market power' and deciding when it is 'excessive'. If market power is taken to mean that demand for a firm's products is less than perfectly elastic, then the vast majority of business firms possess some degree of market power, from the corner store through to the large multinational corporation. This definition of market power means that a seller can raise price without losing all of his or her sales. The strength of the market power possessed by an individual seller could then be measured by the elasticity of demand facing the seller: that is, by the percentage fall in sales that follows a 1 per cent rise in price.

A complete absence of market power exists only in the fictional world of the elementary economics textbook, and even then only in the early chapters. In the world of reality buyers need to search for their best deals, and products are differentiated by location, quality, and so forth. As a consequence, almost all business firms will find that they have at least some market power.

But buyers also possess 'market power' in that they can withdraw their dollar votes at higher prices and redirect them towards competitors, thus severely limiting the market power of individual firms. The degree of market power that buyers possess depends upon the **potential** availability of other sellers of the same product, or of sellers of close substitutes.

When the conditions of the free market are set aside by government regulation, the market power of consumers is limited for want of alternative sources of supply. This limitation of buyers' market power by means of government regulation is an important source of social losses from restricted competition. Again, if a firm were successful in the unceasing scramble for enhanced market power, and as a result increased its market share to a level that triggered scrutiny by the antitrust regulators, it could have done so only by offering buyers a better product, a lower price, improved quality, superior after-sales service, or whatever. It is **buyers,** in a free market environment, who reward the superior performance of firms that provide them with the benefits of preferred goods or services. The regulators, rather than castigating such behaviour, should perhaps instead award the firm in question with a certificate of merit.

In addition, the accepted view that concentration (setting aside the problem of effective measurement) yields super-normal profits has been severely questioned in the professional literature (see, for example, Phillips, 1976). Court action that requires a firm to reduce its market share (through divestiture or some other means) in fact shields the less efficient but smaller firm from the heat of full open market competition. In the opinion of the Trade Practices Act Review Committee, 'the economically weak should be protected against the unfair or predatory acts of the economically strong' (1976:10.42). Are we to interpret this to mean that inefficiency must be protected?

Mergers and Takeovers

Another area of business activity that has received the detailed attention of trade practices legislation is mergers and takeovers. Merger and takeover activity has been extensively discussed in recent works by Dodd & Officer (1986) and Bishop, Dodd, & Officer (1987). This literature concludes that open market mergers or takeovers can succeed in general only if they bestow benefits upon the parties concerned, and this again depends upon offering benefits to customers or reducing costs of production, or both. The literature on transaction costs and internal markets (Coase, 1937; Williamson, 1986) highlights the cost-saving incentives that confront the firm in its search for optimal size and structure. Naturally, a merger or takeover can be expected to damage the incumbent management of an inefficiently managed target firm, and so we often observe quite intense opposition from that quarter. If that opposition is successful, then society loses the cost-reducing gains from rationalisation within the merged firm.

Collusion

Collusive behaviour is regarded with considerable disapproval in trade practices legislation. The spectrum of collusion includes behaviour ranging from clandestine agreements to fix prices or market shares, through to 'conscious parallelism', when firms in an industry adopt a 'golden rule' of business strategy that may be paraphrased as 'act unto other competitors as you would have other competitors act unto you'. The enormous literature on this subject raises serious doubts about whether collusion can ever amount to more than temporary agreements that collapse under the rigours of the competitive marketplace, for several reasons.

First, any competitor can raise demand by 'chiseling' on price, provided his or her fellow conspirators stick to the agreement and do not cut price. This gives every member of the agreement an incentive to break that agreement. Second, collusion to raise prices means there must also be a concomitant reduction in sales because of the market power of consumers. But each seller's optimal production flow depends upon his or her individual marginal costs compared with marginal revenue, and cost structures are likely to differ among firms. Therefore, deciding how the reduced flow of output is to be divided among the parties to the collusion is likely to be difficult, and this adds to the agreement's fragility. It becomes increasingly fragile if market conditions turn against the product that is the subject of collusion, as for example during a general economic downturn ('Some fool will always cut price'). Also, colluders need to keep a sharp eye out for the entry of new sellers who are not parties to the agreement, and, in particular, sellers of substitute products.

We emphasise however, that there are circumstances in which a permanent cartel is possible. In the next section we show how de facto collusion can succeed, but its success usually requires the assistance of government.

Vertical Agreements

One other major area of alleged anticompetitive practices that has been the concern of legislation includes resale price maintenance (RPM), exclusive franchising to divide markets, and tying arrangements. A large body of literature now questions whether these practices in fact produce social loss (see for example Posner, 1976; Bork, 1978). On the contrary, a case can be mounted to show that the opposite is more probably the case, especially under free market conditions.

For example, there is the well-known argument that RPM and exclusive franchising are devices that enable competitive market forces to solve a free rider problem without coercive government intervention. Briefly, this happens when manufacturer or wholesaler does not want to operate dozens of retail outlets, but does want to offer other services alongside the product itself, simply because of revealed customer preferences. Such services might include after-sale service, product marketing that informs potential customers about a new development, and so forth. Retailers, on the other hand, might find that it would pay at least some of them not to offer the extra services, but instead to cut price to attract sales, and to rely upon others to incur the costs of providing the additional services. This free ride can result in a suboptimal supply of repairs and other services. One answer is to provide an exclusive franchise (especially for new products), and another is RPM in markets where customers are reasonably mobile (Posner, 1976:Ch.7). Of course, if the manufacturer is not sensitive to customers' preferences, or if additional services are not in demand, then the manufacturer simply sets his or her optimal prices to the retailer without needing to incur the costs of monitoring and controlling retailer competition.

Finally, in respect of tying arrangements, we note that it is simply not possible for a seller to charge any more than the sum of customers' valuations of the tied products, for otherwise it would pay other competitors to offer the products unbundled (for further analysis on tied products, see Bork, 1978:Ch. 19).

Summary

We have endeavoured to cast some doubt upon the need for trade practices legislation under free market conditions. We have pointed to circumstances in which trade practices regulation can have the effect of protecting high-cost producers and sellers. Given the costs of compliance, of litigation, and of the bureaucracies involved, it is not entirely clear that trade practices and antitrust activity bestows a benefit upon society that is worth the cost.

On the other hand, whether or not the areas of alleged anticompetitive behaviour are in fact anticompetitive in the long run remains the subject of continuing debate in the professional literature. For example, the recent debate on vertical agreements (Mathewson & Winter, 1987; Schwartz, 1987; Comanor & Frech, 1985) illustrates how conclusions about the implications of corporate behaviour for social gains or losses depend upon the particular model in which the arguments are embedded. The debate on the potential social gains from trade practices legislation is, in this respect, a debate about which model most closely approximates the real world of corporate behaviour and its consequences for consumer welfare. In addition, research over the last decade into the relationships between competition and market structure has raised doubts regarding the utility of the traditional textbook theory of competition as a benchmark for trade practices policy. We cannot even predict with any certainty whether particular trade practices policies will raise or lower social welfare (Stiglitz, 1986:xxi-xxii).

Moreover, if we assume that the outcome of the debate on models leans towards a free market, unconstrained by trade practices legislation, there remains the issue of timing. How long is the 'short term', during which corporate behaviour is successful in damaging consumers through reduced competition, and before competitors enter the market? We argued above that collusive agreements 'eventually' lapse unless they receive the support of government. The role for policy is to decide whether the social losses sustained in the short run are sufficiently large to justify intervention, and this depends not only upon the magnitude of consumer losses, but also upon the period of time over which they are sustained. Our point is that it is doubtful that positive social gains inevitably result from applying trade practices legislation to every instance of alleged anticompetitive behaviour that falls within the definitions enshrined in the Act.

We now turn to consider circumstances in which anticompetitive behaviour can arise as a more or less permanent phenomenon within a market economy. We concentrate our attention upon the markets for professional services, because regulations that sustain anticompetitive behaviour are plentiful there, and also because the problems of consumer ignorance are often more obvious than they are in other markets.

III. REGULATED MARKETS: THE PROFESSIONS

In order to highlight the areas from which anticompetitive activities might be expected to emerge because of government regulation, we first apply some basic microeconomics to the professional marketplace. We outline two different scenarios for a profession: the first is a competitive market without any government regulation; while the second involves some government intervention in the form of licensing by a professional cartel, where the cartel is backed by the power of government. In a later section we look at systematic government regulation of the profession by controls on professional behaviour. In each scenario we provide some predictions (or at least rationalisations) of professional and government behaviour, and we include some brief examples and illustrations of the arguments.

The Competitive Profession

The market for professional services can be analysed in the same way as the market for any other good or service, using the basic tools of supply and demand. In a professional market (for example, for accountants, lawyers, doctors, or economists), there is a demand curve for professional services from consumers and firms, and a supply curve of services provided by members of the profession. Assume that the market is competitive and that there are no restrictions on entry into the profession.

The market clearing price, or fee, will normally change whenever there is a change in one or more of the underlying parameters that determine the position of the demand or the supply curve. Adjustments in the market clearing fee that professionals can charge to 'meet the market', together with any changes in the amounts of services sold, will naturally affect the incomes that practising professionals earn. For example, if there is an unexpected entry of new competing professionals, then the supply curve will shift to the right, reflecting the greater number of suppliers at each price. The consequence is lower fees, with a concomitant loss in wealth to established professionals. Those who were marginal in the profession will leave, seeking more attractive opportunities in other jobs, retirement or emigration. This exodus of some professionals will mitigate the fall in fees, and their final level will be determined, in our model, where demand and supply intersect at a new, lower, market clearing price.

Our model so far applies only to professional services of a given 'quality'. But qualities of services differ within almost any profession. We can extend our simple model to incorporate different qualities of services by considering them as different markets. These different qualities are partial substitutes for one another, and for some consumers they are perfect substitutes because quality differences are unimportant to them. However, when consumers identify a particular service as one of higher quality at the same price, they will prefer it to one of lower quality. Suppose for simplicity that in some profession there are just two qualities of service possible.

First, consumer preference will place the demand curve for the high-quality service further to the right than the demand curve for the low-quality service. Second, producing a high-quality service is in many cases more costly than producing a low-quality service. For example, a doctor might deliver a higher-quality service by spending more (valuable) time with the patient, or might be more knowledgeable because of more training or experience. If producing the high-quality service is more costly, then the supply curve of the high-quality service will lie above that of the low-quality service. The intersection of the demand and supply curves in each of the separate, but closely related, markets is likely to produce a market clearing price for the high-quality service that is above the market clearing price for the low-quality service.

Notice that in terms of this model, the fee structure reflects both consumers' relative values at the margin of the different qualities and the relative marginal costs of producing them. If for some reason the cost of the high-quality service rises even further (for example if extra training were 'required', or became more expensive), then supply curve for the high-quality service will shift up, and so will its market clearing fee. This will have secondary effects as consumers begin to switch their demand towards the substitute, cheaper, low-quality service, thus driving up its price also. Thus changes in the conditions of supply and demand for a professional service of a given quality can have effects that pervade the entire market for that profession's service.

Our discussion of service quality assumed that consumers can distinguish between qualities. In reality this may not be easy for a consumer, especially for one who buys only a small amount of the professional service during his or her lifetime (e.g. the services of a brain surgeon). How would the market respond to such a problem? The consumer desires information about the quality of the service, hence one would predict the development of information markets. Of course, some information services are commonplace — for example newspapers and television. But for more specialised information people seek consulting services from a stockbroker, a tax agent, or other professional who specialises in the production and sale of this kind of information. In some cases a professional offers his or her own specialised services (auditing, legal representation, or medical procedures) bundled together with the information function; in this case the professional acts as an agent for the consumer. In a free market environment, agents are forced by competitive pressures to recognise that their own interests are best served by placing themselves as much as possible 'in the place of' the client when offering advice and other services. That is, open market competition among agents results in clients receiving the advice that they would give themselves, had they the same knowledge and expertise as the agent. All market participants gain from these arrangements: consumers can purchase professional advise far cheaper than they could produce the same information themselves, and agents reap part of the production gains from specialisation as income.

Of course, information is a commodity that is difficult to define precisely, so that in contracts where parties buy and sell information services there is a clear possibility of fraud or misrepresentation. Consumers can attempt to extract warranties, guarantees or insurance for non-performance that are enforceable through the courts. Sellers of information can compete by offering different bundles of information services and guarantees in response to consumers' revealed demands. For the same reasons given above in the discussion of market clearing fees for services of different qualities, the market clearing price of a 'safe' service will be higher than for the same service with a lesser guarantee, or higher than one sold by a professional who has not invested in establishing a reputation for quality.

Another possibility is for professional services to be sold with built-in guarantees of quality. For example, professional associations can guarantee the quality of their members' services. The association can be viewed as a corporation that oversees the services of members. The tighter its quality control (and therefore the more expensive its policing methods), the higher will be the market value of the services of members of that association. Accounting organisations and medical colleges are two examples where associations at different levels in the profession provide different levels of status (or signals of quality in the profession).

In order to produce saleable professional services, a person must normally undertake some academic or intensive experience-based training, and this can be a considerable investment in human capital. The accumulation of skills is time-consuming and is also expensive in teaching resources. In a free market, one would expect to see educational services demanded and purchased by potential professionals, and by existing professionals renewing their 'capital' in refresher courses or seminars. Because there are no barriers to entry to the profession, one would expect to see professionals with a variety of educational backgrounds and, in some specialisations, no academic specialist training at all. In an open market the only constraint is the buyers' power that discriminates among competing professionals: if the professional cannot meet the market in providing a certain quality service at its market price, then he or she won't find it profitable to continue in practice.

At least some new trainee professionals will choose as their particular career the one that promises the largest returns (including non-monetary returns). In addition, established professionals on the margin of choice will tend to leave for better alternatives once their own profession is in decline. Therefore professional incomes and returns on investment in training will respond predictably to changes in market circumstances. Adjustments in a dynamic market environment through the entry or exit of professionals will ultimately drive the rate of return that any professional earns on his or her investments in training towards a normal competitive rate. In the long run any economic, or 'super-normal', profits (or economic losses) evaporate in the heat of market competition (Becker, 1964).

We stress that these adjustment processes take longer than they do in other asset markets, first because the professional's personal capital embodied in training and acquired skills is not transferable, and second because it often takes a long time to acquire training and experience. Naturally, some professionals appear to earn 'super-normal' profits over almost all of their professional careers, but these can frequently be identified as a market return to superior, non-reproducible, natural ability in respect of the professional's chosen practice. These larger rewards are really an economic rent analogous to the additional rent received by an owner of a favourably located plot of land. We will return to the question of returns and super-normal profits in the context of regulated markets.

The Closed Profession

Now consider the case where there is regulation of entry by the profession itself. Unless this entry regulation is enforced by the government, it cannot be effective. Thus, the important questions to ask are: why does the government enforce the barrier to entry, and what are its consequences? Because it is the consequences of regulation that are relevant to trade practices activity, we are concerned with the effects regulations have in the professional marketplace, rather than with the political question of why they were introduced in the first place.

When the government enforces professional regulation, it directly enables established members of the profession to form a cartel and to restrict entry by imposing artificial barriers in terms of educational requirements. The existing members benefit through the rise in the market clearing price of the professional service, as the flow of new entrants is reduced. An additional factor to consider is that, as service prices rise, at least some of the protected professionals may elect to give up a portion of their higher incomes for nonpecuniary returns such as extra leisure hours; for example doctors find that they can now 'afford' an extra afternoon on the golf course. Although this activity is now more costly at the margin, because the professional forgoes a higher fee than before the market was closed, elementary theory predicts that there is probably some price rise beyond which one chooses to substitute leisure for extra income, and this appears to be confirmed in the literature. This response by members of the profession further restricts the supply of services in the closed professional marketplace, and thus places additional upward pressure on the market clearing price.

Applying our simple demand and supply model yields the results illustrated in Figure 1, in which the supply curve of services is shifted leftwards as a result of the restricted supply of professionals, and the possibility of reduced flows of services from established members of the professional cartel.

The competitive price P^{**} is raised to the cartel price P^{*}, where the restricted cartel supply curve intersects with the demand for professional services. Existing members, who supply the amount Se, benefit from the

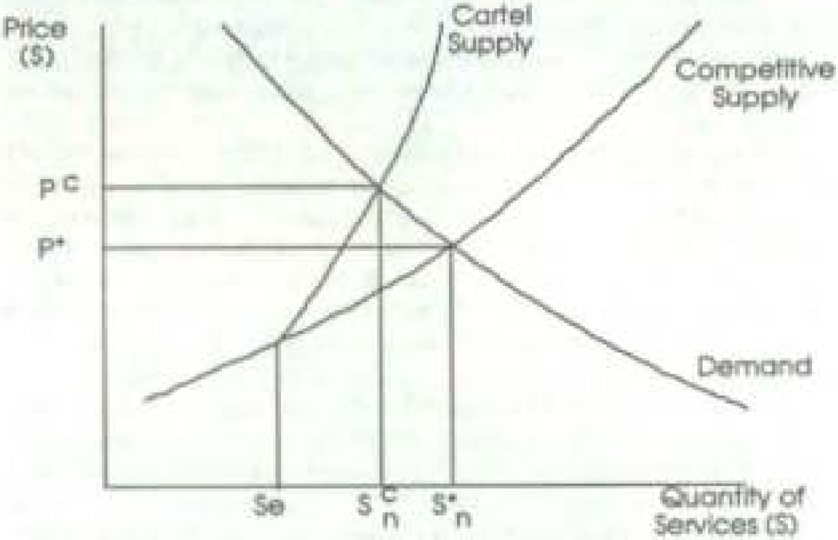

Figure 1

reduced supply of new entrants, from S^*n to S^cn. The losers from the introduction of the cartel are consumers, who now pay higher prices for the same quality service, and potential entrants, who find it more difficult (i.e. costly in time and effort) to enter the profession.

Indeed, the cartel price makes the profession an attractive proposition were it not for the increased entrance costs in terms of educational fees and income forgone throughout the extended training period. Just as market adjustment competes away any super-normal profit in the case of the open profession, we can predict that competition for places will drive up the entrance costs (including non-monetary costs) until, ultimately, new entrants again earn a normal return on the training in which they were required to overinvest under the entry regulations (Logan, 1984). It is indeed ironic that closing a market to create an environment in which the threat of entry is weakened is of absolutely no benefit to subsequent professionals in the long run. 'Founding' members of the new cartel who are protected by a grandfather clause acquire a once-and-for-all gain in wealth.

In addition to losing from the higher prices for services that are still purchased (i.e. S^cn volume of services) after the formation of the cartel, consumers also lose on the extra services (i.e. S^*n minus S^cn volume of services) for which they had been willing to pay at least as much as their marginal costs of production, but not as much as the cartel price P^c.

Equivalently, closed-out sellers lose because they are prevented from offering these services, which consumers had once demanded at a price that at least covered costs. These losses from production and exchange that vanish under the entry restrictions are referred to as the 'deadweight loss' of the market closure.

We remarked above that competition to gain access to the cartel would compete the costs of entry upwards until no economic profit remained. To the extent that these extra costs produce little that is of value to the consumer (for example, queuing for a 'post', or enforced training that is largely irrelevant to the efficient performance of one's professional duties), the higher consumer prices are exchanged for no extra benefit, except perhaps (short-run) gains to specialists in the training industry. This makes the deadweight losses from the enforcement of entry restrictions correspondingly larger. We recognise that extra enforced training probably does enhance the 'quality' of a professional's services, but the relevant question is whether the extra quality is worth the extra cost. In a free market consumers would demonstrate their own evaluations by voluntary dollar votes. Towards the end of the paper we return briefly to the question of whether consumers should be proscribed from making some of these choices.

There are further effects of legal market closure and professional self-regulation. They can be used to enforce profitable monopolistic price discrimination schemes that would collapse under competitive conditions. Legislation that controls the rules of entry also often includes rules that prohibit certain kinds of professional conduct by practising members. Interestingly, one of the more frequently proscribed forms of conduct is advertising or 'touting' for custom. This restriction strikes at the heart of effective competition among practising professionals. Advertising is often an effective way of overcoming some of the problems of limited consumer information about prices, professionals' specialities, quality, location, and other important dimensions of professional services. Restricting the flow of consumer information raises consumers' costs of searching for a preferred professional, or for an alternative professional in case their first choice was a mistake. Precisely because of this, closed market cartels often seek the protection of the law from competition in the delivery of effective consumer information, and this in turn creates for incumbent members the advantage of the quiet enjoyment of their several local monopolies over their established portfolios of clients. It also protects to some extent the mediocre professional from the competition of professionals of greater ability who are endeavouring to enter the market once they have acquired the entry qualifications.

It is therefore questionable whether the average quality of service offered in a closed and regulated professional market is any improvement upon the quality of service that results from free market competition — even allowing for the enforced extra training that, it is claimed, produces professionals of Rolls Royce quality. And even if members of a regulated profession are the 'best that money can money', **are they worth the cost?**

Furthermore, once entrenched, a legal cartel tends to become a permanent fixture in an otherwise competitive environment because it creates incentives that impede any effective deregulation of a professional marketplace. Consider a market in which entry and other anticompetitive restrictions have been in force long enough for professionals to be earning just a normal rate of return on their investment in acquiring the entrance qualifications. Suppose that the relevant legislation were repealed so that the ground rules shifted to free entry and unrestricted competitive behaviour. In terms of our model, the market clearing price for services would fall in the short run as a result of intensified competition among existing members, and would fall further in the longer run as new professionals entered, especially those who would have been excluded under the previous entry conditions. Lower prices would lower incomes, and so we might see many professionals working longer hours and at hours more convenient to their customers, rather than at hours tailored to their own preferences. Less midweek golfing could be expected. Because incumbent professionals would have already completed their training, their entry costs would be unavoidably sunk, and so they would have a diminished incentive to exit the profession, even though their lower incomes would yield a below normal *ex post* rate of return on their prior investment. For the same reason, trainees who had completed enough of their course of studies to enter the market, and who did not desire additional investment in quality enhancement given the anticipated rate of return, would simply exit from training and enter the marketplace. Prices would therefore fall towards their new market clearing level faster than they once rose in response to the higher entry costs that were originally imposed by law. The *per capita* losses that deregulation would impose upon exising members of a professional cartel would probably far outweigh the *per capita* gains to consumers of cheaper services. Professional associations could be expected to lobby intensely opposing deregulation, or to advocate proposals directed at diverting the energies of the relevant government bureaucracies into channels that minimise the harm to members. There are therefore incentives that drive political processes in ways that tend to entrench an established professional cartel.

Clearly, legislative regulation of professional markets, of the kind just outlined, sanctions and sustains anticompetitive behaviour that, in other markets, would attract the close attention of the trade practices investigators. The relevant question is, then, whether there are social gains from regulating the professions that outweigh the social losses from a closed market and anticompetitive behaviour within that market.

IV. IS THERE A PUBLIC INTEREST ARGUMENT FOR REGULATION?

A public interest argument would explain the regulation as an attempt to more efficiently allocate resources, and so requires a presumption of some type of 'market failure'. The most common argument is that the service produced by the profession is so complex that consumers cannot discern different qualities of service until after the contract has been completed (for example, medicine or motor vehicle repairs). Thus, it is argued, the profession can protect the consumer by setting high standards of entry to exclude incompetent practitioners. For this argument to be valid, information markets must be the source of market failure: otherwise consumers, with the aid of information services and legal guarantees, would be able to distinguish between the more expensive high-quality services, and the cheaper lower-quality services.

We have shown how consumers' lack of information encourages the development of competitive information markets. However, there is considerable controversy among economists about how information markets operate; for example, they often have large fixed costs, and there are incentives for producing misleading information. But if it can be shown that the hypothesis of competitive information markets (with no, or negligible, externalities) predicts real world behaviour better than the market failure hypothesis, then the public interest argument for intervention fails. Alternatively, if one can demonstrate market failure then the public interest argument must show why self-regulation is the most efficient form of regulation. Although we are not convinced that information markets are so clumsily inefficient as is often implied, suppose that we concede inefficiency and consider how to eradicate it.

Professional bodies have argued that they should regulate their professions because they are the best qualified to judge the services provided. Accepting for the moment this hypothesis, let us look at self-regulated bodies to see if the quality of the service is improved in an efficient way. Unfortunately for the public interest argument, the evidence is not very encouraging. Most self-regulated professionals have not, historically, shown much enthusiasm for continuous quality control. For example, when self-regulation is first imposed, almost invariably there is a 'grandfather clause' that exempts existing members of the profession from the rigours of the new entry standards. Furthermore, entry requirements often seem to have little to do with improving the quality of members' subsequent services. Once in the profession there is often little attempt to enforce quality standards on the member, although professional bodies will try to extend the ambit of the regulations to capture competitors who produce close substitutes but are presently outside the reach of the relevant legislation. Usually few refresher courses, if any, are required, and effective advertising is banned or regarded as bad form (as it is in medicine or the legal profession). This latter restriction limits consumers' knowledge in the choice of members of the profession, and therefore reduces the average quality of services purchased by consumers.

In summary, the public interest hypothesis is inconsistent with the observed behaviour of self-regulated professions. Although these bodies usually claim they are protecting the consumer by imposing standards, their actions are not wholly consistent with this claim.

V. CAN CONSUMERS BE PROTECTED BY DIRECT GOVERNMENT CONTROLS?

Direct controls on the services provided by professionals fall under the general heading of consumer protection laws. The Trade Practices Act now contains extensive sections on product safety, bait advertising, misleading representation, and product information standards. Individual State legislation is also concerned with consumer protection, and includes controls over builders, real estate agents, hire purchase companies, and so forth. Advocates of these laws argue that they are also in the public interest, protecting the consumer from fraud and ignorance. In other words, public interest theory would predict that the government introduced these laws to help correct deficiencies in information markets. Because the modern world is becoming increasingly complex, consumers require greater information and protection from unscrupulous suppliers of goods and services, despite the increasingly massive flow of information with which consumers are continuously bombarded in our era of enhanced communication. Almost always, advocates of this kind of policy intervention argue for regulatory government agencies to do the intervening, and to impose stiff penalties on those caught breaking the regulations.

The public interest argument for consumer protection laws has instant mass appeal. Unfortunately it fares less well in the cold light of evidence (for example, see Stigler, 1975:Ch.4). One real difficulty with the theory is how to regulate. All too often the regulatory agency is 'captured' by the industry it is supposed to regulate, and the agency becomes a de facto enforcement agency for a closed industry. Examples are easy to find. Until the deregulation of airlines in the US, the Civil Aeronautics Board restricted entry and supported high cartel prices. Australia's Two-Airline Policy for domestic flights (due to lapse in late 1990) is another example of regulatory capture. Other examples are found in the regulation of stock markets or taxicabs. The usual response by public interest theorists to this evidence is that the regulatory system is defective and should be improved by audits, reviews, and public scrutiny: the remedy is more regulation.

Some regulations do benefit some groups of consumers, but often they disadvantage others. For example, health insurance schemes under government regulation often have premium structures that do not reflect the actuarial risks of different groups seeking insurance — there are cross-subsidies between risk classes. Effectively, these schemes are a combination of insurance and wealth transfers between consumers (with some implicit side payments to producers in the health industry and health fund bureaucrats). Another example is product safety regulations. Producers are forced by regulation to sell products of higher quality (at higher prices) than are desired, at the price, by certain groups of consumers. These disadvantaged consumer groups lose the opportunity to buy cheaper, lower-quality products. As an example from the professions, medical practitioners in the US can face heavy penalties for malpractice and negligence in treating patients. Consumers cannot opt for cheaper services that are sold with disclaimer clauses, and so the effect of these 'consumer-oriented' decisions by the courts has been to raise medical fees for everybody, in order to cover the larger premiums necessary to insure doctors against court actions. Fees have also risen to cover the increased resource costs incurred by doctors who order detailed diagnostic tests to safeguard themselves from charges of negligence. Given the higher cost of medical services, borne by all consumers, that follows from the actions of the courts, it is debatable whether most consumers would consider themselves to be really better off.

In summary, some consumers may be 'protected' by direct government controls, but generally at the cost of benefits forgone by other consumers — or by taxpayers, who are always the providers-of-last-resort when producers demand free product certification, trainees clamour for free education, bureaucrats demand larger budgets, and consumers demand subsidised prices. On the other hand, a free market would be expected to generate a set of warranties and guarantees that consumers prefer, given the attendant price, and in fact we observe lengthier warranty periods for more complex products such as computers, hi-fi equipment, and so on.

We do not wish to dismiss the consumer protection argument, especially as the free market argument for optimal information production has not yet been rigorously established in the theoretical literature. On the contrary, there are theoretical studies that show that information markets may not work efficiently, in particular that information may be underproduced because of its public good attributes (that is, once produced, an element of information is cheaply — in the limit, freely — available to all), and so some consumers can free ride on the production of others. In this event, it may be cheaper and more efficient for the government itself to produce the information that consumers value, by enforcing certification standards, product quality standards, and the like.

VI. OTHER REGULATED MARKETS

In this section we provide other examples of regulated markets in Australia where government enforcement of controls over suppliers' behaviour has the effect of sustaining anticompetitive activity.

Our first example is the government's sanctions of union activity, especially in respect of the threat to strike, and of actual 'legal' strikes. In the case of professional labour markets entry is restricted in the gentlemanly fashion of enforced educational requirements, whereas in many other labour markets entry may be restricted by direct union practices (for example, 'no ticket, no start' rules on building sites), or by unions indirectly when they campaign for higher wages and use the strike threat as the ultimate weapon of coercion. The first point is that this anticompetitive activity has the effect of restricting employment, even in open unions, because higher labour costs stimulate substitution in the long run by firms towards more capital-intensive modes of production, while in the short run consumer power restrains sales whenever firms attempt to pass on their higher labour costs in the form of higher prices. The second point is that the power of the strike rests in the ability of a union to prevent its targeted firms from hiring substitute labour, and this is what receives the sanction of government protection 'in the interest of peace and industrial order'.

Second, federal, State, and local governments own and operate their own monopolies. Examples are Telecom, Australia Post, and State electricity authorities. That government monopolies engage in anticompetitive 'misuse of monopoly power' is clear from observing that most have pricing scales that combine price discrimination across customers with multipart pricing of each customer (for example, the telephone 'rental' extracts some of the consumer surplus from trade in telephone calls), thus extracting double monopoly gains. If customers were able to resell the products, say by subleasing private telephone lines, reselling electricity to neighbours, and so forth, the government's monopoly power to price discriminate and multipart price would be partially broken. However, reselling is prohibited by law in most instances. Furthermore, potential cost-effective market entrants find themselves excluded from entry by legislation that supports the government's monopoly.

Finally, many industries are protected from import competition by tariffs, quotas, local content schemes, and other similar government restraints upon trade. This enables local protected firms to raise prices to cover the costs of resources that are inefficiently allocated to the production of the protected commodities. The excess burden of tariff protection has been well known for many years, and is discussed in any elementary text on international trade.

VII. INCONSISTENCIES IN THE AUSTRALIAN APPROACH TO TRADE PRACTICES

We now briefly consider the anomalous situation that many of these restrictive government practices are exempted from the ambit of the Australian Trade Practices Act. We point to several sections of the Trade Practices Act, as presently constituted, as examples of instances where anticompetitive behaviour can avoid the attention of the TPC.

Collusion

Section 45 of the Act is ostensibly aimed at preventing groups who are selling the same services, and therefore could be expected to be in competition with each other, from colluding in some form of conspiracy against buyers. Yet in major sectors of the economy sellers are actively encouraged, subsidised, and even forced by government legislation, to form cartels to market the goods and services they provide. We refer here to the various individual unions, the union movement in general, and to attempts at 'orderly marketing' that abound among primary producers, all of which are exempted from the rigours of the trade practices legislation. In agricultural marketing authorities, legal restrictions are normally placed upon the freedom with which producers may trade.

Monopolisation

Section 46 of the Act outlaws monopolisation. But the government tolerates and actually protects private monopolies in some cases. In recent years, the increase in demarcation disputes between unions striving to expand their domains of influence supports the point that monopolisation is the intent of union management. Another example of government protection of private monopolies is the restrictions placed upon entry of new television stations seeking to exploit remaining transmission frequencies. The value to existing networks of protection from competitive entry is indicated by the market value of existing television licences.

Exclusive Dealing

Section 47 prohibits exclusive dealing. But buyers are legally prevented from purchasing wheat that is not from the Australian Wheat Board, or eggs that are not from a State Egg Board. In fact a NSW egg producer has been gaoled for refusing to eliminate his 'excess' hens. Similarly, many labour services are restricted to union members: stevedoring must be performed by members of the Waterside Workers' Union (in which membership has traditionally been handed down from father to son), and it is a rash private builder who employs nonunion labour. None of these restrictive trade practices comes under the scrutiny of the Trade Practices Act or is required to undergo the rigours of an Authorisation Test.

Resale Price Maintenance

Section 48 concerns resale price maintenance. As we have shown above, there are certain advantages to permitting this particular business strategy. It is interesting, then, that s. 48 is applied in a discriminating manner in this country. Examples of exempted practitioners of RPM are State trading monopolies, unions (again), and the various orderly marketing groups that receive the support of the government.

Price Discrimination

Section 49 proscribes price discrimination that is unrelated to costs. Yet we observe persistent price differences between whole milk and manufacturing milk; between domestic, commercial, and rural users of electricity; and between the prices for mailing articles depending upon whether they are deemed to be fourth class or 'ordinary' mail. Cross-subsidisation, and therefore price discrimination, abounds among statutory authorities and marketing boards.

Mergers

As a final example, s. 50, on mergers, ignores the fact that government has encouraged coalitions such as unions and trade associations to amalgamate into even larger groups so that it can deal with just one industry 'leader' in the relevant group. This might reduce communication costs between the government and sellers, but it imposes on buyers the inevitable costs of cartelisation, which is enhanced by the formation of industry coalitions.

VIII. SUMMARY AND CONCLUSIONS

We began this paper by referring to recent studies that have cast reasonable doubt upon some of the basic assumptions that form the theoretical foundation of Australian trade practices legislation. Apart from natural monopoly situations that are not contestable, we argued that under free market conditions, sellers certainly have an incentive to attempt to create super-normal profits through anticompetitive strategies; but to the extent that these strategies are successful, their effects generate countervailing forces that eventually eliminate those extra profits.

In markets that are predominantly free of government intervention or protection, the first question that follows from our discussion is whether or not the *per se* prohibition of certain restrictive practices (for example, RPM) should remain, or whether they should instead be subject to the rule of reason. The second question refers to the timing of market entry in response to attempts by (some) sellers to raise profits through restrictive practices. Given that market adjustment takes time, super-normal profits will normally persist over some short-run period, the length of which will depend upon the relevant circumstances. The questions are then: Is assiduous regulatory activity likely to be cost-effective in eliminating the short run social losses, while preserving the long-run gains from market adjustments in a dynamic environment? Would a superior strategy be simply to allow the market to work unfettered, at least in areas in which countervailing adjustment is likely to be rapid? How probable is it that the complexity of dynamic changes misleads the regulators into incorrectly identifying instances of market behaviour as anticompetitive, and so initiating procedures that diminish social benefit?

We contend that those responsible for administering regulation in respect of anticompetitive behaviour are inclined to overreact to circumstances in which this type of behaviour is alleged to occur. Not only the Trade Practices Commission but also other agencies, for example State consumer bureaus, apply competition regulations with excessive zeal. Perhaps the pace of regulatory activity reflects an impatience for the benefits of competition that a free and open market will bring to bear on anticompetitive practices. But the benefits of the free market take time to be felt. In a market economy continuous change generates economic profits and losses as an essential part of market adjustment; indeed, this is how a market system works to accommodate a dynamic environment. Short-run above-normal profits are simply one of the costs of adjustment — costs that are frequently high for rapid adjustment, but decline for adjustment that takes place over a longer period of time (one consequence of this is that some factors of production are relatively immobile in the short run). These adjustment costs create the so-called 'barriers to entry' of economies of scale, financial strength, unique product, and locational advantage. However, barriers to entry that are not created by government regulation, are, in general, ephemeral in a free market environment. The point is that competition is not necessarily an instantaneous process, nor are its effects.

Interference in the competitive process that results in a restructuring of the growth possibilities for specific firms is quite likely to impose more costs on society than the temporary presence of exploitable market power. For example, the car-hire industry took the TPC to Federal Court seeking to overturn the TPC's prohibition of complementary air and car-hire services. The Court found in favour of the industry practice. Competition prevailed in spite of what, at first sight, might have looked like an attempt to erect a barrier to entry in the form of scale economies and locked-in complementary services. Consumers, on the other hand, reap at least part of the efficiency gains from these so-called 'barriers'.

To understand why the TPC and other agencies engage in overregulation, we need to analyse the internal dynamics of regulatory bureaucracies, on which there is an extensive literature. Space precludes us from pursuing this fascinating line of inquiry here. However, the points we have raised in this paper could usefully caution the TPC to exercise a certain temperance in its approach to its own regulatory activity.

Finally, we have highlighted areas of anticompetitive behaviour that can persist in the long run because they are buttressed by government legislation that regulates market behaviour for reasons such as consumer protection, 'orderly marketing', and so forth. Although some claim that government regulation of this kind is founded upon laudable principles, nevertheless it has side effects that are frequently in restraint of trade. We have used the example of the professions to establish this point, but we also referred to other areas of government control of markets that are exempt from the ambit of Australian trade practices legislation.

We do not wish to enter into a debate over whether the TPC is the agency that would be best suited to examine restrictive government practices, nor on the other hand do we wish to be seen as promoting additional government activity. However, we feel that there is sufficient evidence, from several studies, about the effects of marketing boards, government monopolies, and the behaviour of certain unions, to indicate that avoidable social losses are large enough to warrant some kind of investigation with a goal of seeking remedial policies. A general examination of government restrictive practices would be a timely adjunct to the flourishing debate on the privatisation of certain government monopolies.

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CER and Competition Policy: A Need for Harmonisation?

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CER and Competition Policy: A Need for Harmonisation?

Thomas G. Parry

Background

The Closer Economic Relations (CER) Agreement between Australia and New Zealand emerged in 1983 from the previous New Zealand Australia Free Trade Agreement (NAFTA). The CER Agreement is designed to provide a framework within which there will be free trade in goods between the two countries, subject to adequate safeguards against unfair competition. The main elements of the CER Agreement involve the phased removal of tariffs for most products in the short term, and of tariff quotas and import licensing by 1995.

The CER Agreement also provides for the examination of other measures that can affect trade between the two nations as well as broader questions of closer cooperation in investment, transport and standards.

The practice of competition policy in the two countries is directly relevant both to trade in goods and services between the two countries and to trans-Tasman investment. Indeed, business law, including trade practices and mergers, has been identified by both business and governments as an area requiring closer attention within the CER Agreement.

Competition policy is primarily exercised by the Trade Practices Commission (TPC) in Australia and the Commerce Commission in New

Zealand, though other instruments of government, such as foreign investment authorities in both countries and the Industries Assistance Commission in Australia, can play a role in the area of competition policy.

The New Zealand Commerce Act 1986 and the Commerce Commission have been in place for a shorter time than the Australian Trade Practices Act and the TPC. As a result, there are relatively few examples of decisions by the Commerce Commission and the NZ courts under the new Act on which to draw firm conclusions about differences between the two countries. However, there are sufficient differences between the Acts and some recent major decisions to suggest that there may be problems for CER in the area of competition policy.

There has been considerable publicity surrounding some of the larger recent proposed trans-Tasman mergers. Certain decisions by the TPC and the Commerce Commission highlight the potential for harmonisation in aspects of competition policy within the CER framework. In addition to mergers and takeovers, there are other features of competition policy covered by the two countries' restrictive practices legislation that have implications for CER.

In terms of competition policy, trade practices can be divided into provisions relating to the control of conduct by firms that is considered anticompetitive, and provisions designed to control the structure of a nation's markets within which buyers and sellers interact.

Anticompetitive Conduct

The approach to anticompetitive conduct is much the same in both countries. General conduct by firms that has the effect of 'substantially lessening competition' is covered in both the Trade Practices Act (s. 45) and the Commerce Act (s. 27), as are specific forms of conduct. With regard to general anticompetitive conduct, the wording of the two Acts is very similar. That is, conduct that 'substantially lessens competition' in a market is prohibited. Potentially important issues arise with respect to the interpretation of 'market' and 'competition' in both the conduct and the structure provisions of the Acts, and these are discussed below.

In addition to the prohibition, subject to authorisation by the (Trade Practices or Commerce) Commission, of any conduct that substantially lessens competition, specific practices are also covered by the conduct sections of the two Acts. Price-fixing and resale price maintenance are *per se* illegal in both countries. The misuse of a 'substantial degree of power in a market' (Australia) or 'dominant position in a market' (New Zealand), though allowing for the possibility of authorisation, is also illegal.

Exclusive dealing is *per se* illegal in Australia, but is not explicitly identified as a form of anticompetitive conduct in New Zealand. There is good reason to believe, however, that exclusive dealing would be caught in New Zealand under the more general anticompetitive practices that substantially lessen competition or involve the abuse of a dominant position, which are proscribed under the Commerce Act (for example, ss. 27 and 36). With the exception of exclusive dealing, the two countries' approaches to restrictive business practices are very similar. Indeed, given this similarity, there may be a case for replacing the antidumping provisions, particularly as used by firms in Australia, with control under the existing restrictive business practice legislations.

Anticompetitive Structure

More significant differences between the approaches in Australia and New Zealand, as well as potential problems in relation to CER, arise in the area of mergers and takeovers.

The most fundamental difference lies in the procedures for dealing with mergers and takeovers. In New Zealand, mergers and takeovers falling within certain categories (mainly threshold levels of shares or dollar values of assets) require approval from the Commerce Commission. In Australia, the TPC initiates action in the event of mergers or takeovers that it believes may result in or increase dominance in the market. In Australia there is no requirement of notification for 'clearance' purposes, though many companies do engage in dialogue with the Commission in order to structure a merger/takeover that the Commission believes will be acceptable under s. 50.

The New Zealand procedure involves a requirement for mergers and takeovers beyond a certain asset value to be notified to the Commerce Commission. The Commerce Commission must either establish that the merger/takeover would not result in or increase market dominance (clearance of the merger/takeover by the Commission) or, if the merger/takeover fails the dominance test, determine that the merger/takeover would lead to a benefit to the public that warrants the granting of an authorisation by the Commerce Commission.

No clearance provisions for mergers/takeovers exist in the Australian Trade Practices Act, though authorisation procedures, similarly involving a public benefit test, do apply.

Apart from these procedural differences, both countries apply the 'higher threshold' test of 'dominance' with respect to mergers and takeovers, rather than the 'lower threshold' test of 'substantially lessen competition'.

Definitions: Competition in a Market

The determination of market boundaries and the nature of competition within the market so determined have been the subject of considerable legal and economic debate. This is not the place to explore that debate. In the context of CER issues, however, there are differences in the definitions of key terms in the two Acts, and, more importantly, in emerging interpretations which are the cause of some possible concern.

'Competition' is defined in the New Zealand Commerce Act as meaning 'workable or effective competition' (s. 3(1)). In the Australian Trade Practices Act, 'competition' is defined as no more than 'competition in a market' (s. 45(3)). The singularly unhelpful definition of competition in the Australian Act has been compensated for to some extent by reliance on the Trade Practices Tribunal's view of the criteria for assessing competition in *Re Queensland Cooperative Milling Association Limited* (1976) 8 ALR 481, which reasonably approximate 'workable or effective competition'.

Both Acts explicitly allow for **actual** competition from imports in determining the effect on competition in a market. Importantly, only the New Zealand Act explicitly allows for **potential** competition from imports of goods and services (s. 3(3)). In view of the findings with respect to 'dominance' by the New Zealand Commission in recent proposed mergers (the original finding in Goodman Fielder/Wattie [Decision No. 201A], and Amcor/NZ Forest Products [Decision No. 208]), there may be some doubt as to whether the Commerce Commission has fully acknowledged the role of actual and, more importantly, potential import competition from Australian firms in the relevant market.

The two Commissions still follow an approach based on separate national markets, while allowing for actual (and, to a lesser extent and explicit only in New Zealand, potential) trans-Tasman import competition in determining the question of competition (and, thereby, 'dominance') in the identified market. In Amcor/NZFP, the Commerce Commission found a problem of dominance with respect to Amcor in New Zealand, and was unable to find any public benefit grounds for authorisation. The same proposal was determined not to have any dominance problems in Australia by the TPC. Clearly, the application of a trans-Tasman spatial dimension to the 'market(s)' (whatever that market may be) would have lead to a quite different outcome.

There is a good case for arguing that, in the context of CER, a single spatial dimension, encompassing Australia and New Zealand, should be applied to the 'market' considered by both the Australian and New Zealand Commissions — that is, a wider trans-Tasman market for goods and services within which competition (and the question of dominance) can be assessed.

(As an important aside, this is not an argument for the explicit recognition of Australian and New Zealand sub-markets. The concept of 'sub-market' has unfortunately been constructed as a legal device in order to permit the competition question to focus on artificially narrow markets. Sub-markets do not exist as such in economics. If demand- and supply-side substitution evidence points to a separate market, then that is the market. A part of that market is simply that; not a separate market or a 'sub-market'. Recognition of trans-Tasman economic integration requires proper recognition of the Australia-New Zealand spatial dimension in a market.)

'Market' is defined in both Acts with regard to goods or services within each individual country. It is with respect to 'competition' proper that imports, and hence trans-Tasman trade, are included. 'Market' is defined somewhat more fully in the Commerce Act, which explicitly requires the application of 'fact and commercial common sense' in the delineation of a market. The absence of any precision in the Australian Act has meant that the courts have largely adopted economic tests rather than 'commercial common sense' in the determination of markets.

Without wishing to be accused of special pleading, I must point out that determining market boundaries according to 'commercial common sense' by the courts, rather than according to economic principles, has some major problems. Even though the application of the economic principles of demand- and supply-side substitution to the identification of a market can be the subject of disagreement between different 'expert economists', at least the principles are reasonably well agreed. The application of 'commercial common sense', either by the Commission, by outside experts, or by the courts, seems to involve few if any accepted disciplinary principles.

If the Australian authorities lean more towards applying narrower economic principles, while the NZ authorities take into account broader and less consistently defined 'commercial common sense' considerations, major differences could emerge between the two countries in the identification of markets, and therefore in the determination of competition within a market. This could present problems for mergers and takeovers and for further trans-Tasman economic integration. There may be a case, then, for looking more closely at the approach to market delineation and the determination of 'competition in a market' as part of the assessment of mergers and takeovers within and across the two countries.

The Dominance Test

The question of competition in a market is decided by the dominance test in both countries, with particular relevance to the merger and takeover provisions. 'Dominance' is defined in the New Zealand Commerce Act, while it has been left to interpretation by the courts in Australia. The elements of the dominance test in the Commerce Act (s. 3(8)) involve market share, technology, access to materials or capital, actual conduct among competitors and potential competitors, and the conduct of suppliers and buyers. The explicit recognition of factors other than market share in the Commerce Act is important. In particular, the role of conduct of participants in the market, including actual and potential countervailing power by sellers and buyers, is an important element. In the absence of explicit guidance in the Trade Practices Act, the TPC and the Australian courts have not always paid due recognition to market conduct, including actual and potential countervailing power, as distinct from structure.

In the Goodman Fielder/Wattie merger, recently reconsidered by the Commerce Commission, clearance has been granted subject to the disposal of certain assets in flour mills and bakers' yeast manufacture. The higher standard of 'dominance' compared to 'lessening of competition', as well as the explicit recognition of conduct and countervailing power in determining 'dominance', may potentially smooth the path for mergers/takeovers examined by the New Zealand Commerce Commission in future. A more stringent approach to the Australian merger/takeover provisions in s. 50, as suggested by some, may lead to a greater divergence between the two countries' approaches. The explicit recognition of a trans-Tasman market, rather than simply trans-Tasman import competition, appears to be important in order to maximise the opportunities for trans-Tasman economic integration within the CER framework.

Clearly, further trans-Tasman rationalisation in the production of goods and services and the improved international competitiveness of trans-Tasman enterprises would be well served by the adoption of the more explicit New Zealand approach to the question of dominance in both countries, as well as by the application of a single trans-Tasman spatial dimension to the determination of the 'market' within which competition (and, thereby, dominance) is assessed.

Public Benefit

'Public benefit' considerations apply in both countries. In Australia a net public benefit test applies to all authorisation applications, while in New

Zealand the consideration of public benefits is part of the necessary authorisation test, where clearance is denied a proposed merger/takeover.

It is clear that the consideration of public benefit has been confined to the 'public' within the individual countries, rather than involving both Australia and New Zealand. Thus, in Amcor/NZFP, the Commission found that benefits from the proposed merger must flow to the New Zealand public. Without making any judgment on the merits of this particular case, one must wonder whether the Commerce Commission's decision on authorisation (leaving aside the clearance question) would have been different if there had been an explicit consideration of benefits arising from trans-Tasman integration, improved resource utilisation and enhanced international competitiveness. In the context of CER, there is a case for a more explicit recognition of public benefits associated with trans-Tasman considerations in assessing mergers/takeovers on both sides of the Tasman.

A Case for Harmonisation?

There may be merit in more closely harmonising the approach to competition policy on a trans-Tasman basis in the following areas:

- replacing antidumping provisions with regulation under restrictive practices legislation;
- explicitly recognising a trans-Tasman spatial dimension to the 'market'; and
- explicitly recognising trans-Tasman issues in the 'public benefit' test.

Antidumping laws have been used by firms in Australia against imports from all sources, including New Zealand. As antidumping laws can be used in a frivolous manner, particularly to disrupt import supplies from particular sources, there is a case for relying on the predatory pricing provisions of each country's restrictive business practices provisions. Importantly, imports that are procompetitive as part of competition policy considerations may be prevented under the lower threshold antidumping laws. 'Unfair' trade laws may act at the margin as an impediment to free trans-Tasman trade. Subjecting imports to the appropriate restrictive business practice tests, including predatory pricing, rather than antidumping laws, would seem to be more appropriate for trans-Tasman trade.

As discussed above, while (at least actual) import competition is taken into account in both countries in considering questions of competition and dominance, there is no formal recognition of a trans-Tasman spatial dimension to the market. This is important in a number of industries where the effect of mergers and takeovers within one of the countries alone would be seen as very different if a trans-Tasman spatial dimension was considered. The issue is likely to become more important if there is a review of the Australian provisions regarding mergers and takeovers under s. 50. If there is a move to apply a lower threshold so that a less concentrated structure in a market is favoured, then the concept of a trans-Tasman market becomes particularly important. The experience of European mergers and rationalisation is relevant. In many industries, full exploitation of economies of scale and scope seems to require large enterprises. Within the small economies of Australia and New Zealand, the necessary integration and rationalisation must mean a small number of sellers. As the two economies become more closely integrated through trade in goods and services as well as investment, a single market (at least spatially) becomes especially appropriate for competition policy purposes.

Finally, and following from this last point, closer integration of the two economies requires consideration to be given to the trans-Tasman dimension in assessing public benefit outcomes. While recognising the difficulties in identifying and evaluating 'public benefits', it is clear that closer and increasing integration of the two economies needs to be taken into account. Improved resource utilisation, economies of scale, transport factors, supply reliability, and other benefits to the public from lower prices and the like, need to be viewed within the context and the realities of CER.

CER, Competition Law and Economics

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CER, Competition Law and Economics

Kerrin M. Vautier

The extent to which competition law will be discussed in the 1988 review of the Australia New Zealand Closer Economic Relations Trade Agreement (CER) remains to be seen. Business views, at least, suggest that it should feature as an important item on the agenda. These views are backgrounded in this paper, which goes on to track the rise — and fall — of the 'single market' as a concept relevant to Australasia's competition laws. In the context of policy objectives relating to CER and competition law, this paper raises some important issues of interpretation, particularly in respect of the statutory 'public benefit' test for mergers and takeovers. The purpose is to show the importance of these issues in determining whether or not efficient outcomes from intervention will be achieved — CER or no CER. This will lead to the overriding conclusion: the need to harmonise law and economics in the design and application of competition law. That is the harmonisation issue in the context of this paper, and one that is best addressed in reviews of our competition laws rather than in reviews of a bilateral trade agreement.

Progress under CER

The CER Agreement, and the progress within it, have been early milestones in New Zealand's drive for a less regulated, more efficient and more internationally competitive economy: the imperatives for which have been well documented. The process of implementing the planned steps in the Agreement is not an end in itself, but rather an important means whereby New Zealand (and Australian) businesses are being forced to address the consequences of greater exposure to competitive forces, consistent with mutual benefit for the two countries. If each country is thereby strengthened economically, CER can truly be a stepping-stone towards their stronger individual and joint presence in the context of international markets. The logic is strong for this perspective.

It is interesting, however, that recent research concluded that, noticeably, 'in almost all cases [of] joint production [this] is intended for Australasian markets. There have been very few cases of CER resulting in third countries being targeted as markets ...' (Bollard & Thompson, 1987:51).

The concept of a free trade area has been the central thrust (an estimated 86 per cent of trans-Tasman trade is already free of restrictions, with the prospect of 90 per cent within a year), but we are now moving very much into 'second generation' territory. Competition law (covering mergers or takeovers and restrictive trade practices), as part of the wider focus on commercial law and regulation in the CER context, has consistently been recognised as one of the second generation issues.

Background to Issues

The November 1987 Communiqué from the joint conference of the Australia New Zealand Business Councils made special mention of competition law as one of the issues 'which would shape the trading relationships between [Australia and New Zealand] in the 1990s and beyond'. Industry regulation was specifically mentioned as an impediment to the full development of CER that should be addressed as a matter of urgency in the 1988 Ministerial Review. In fact, generally, the Business Councils postulated that 'the aim should be to take governments out of the operative aspects of trans-Tasman trade, a cornerstone of the CER concept'.

The Councils went on to say that the next 'logical step' was the achievement of 'one market'. While their agenda of key issues was not exhaustive, the emphasis on the 'one market' concept in relation to mergers and takeovers was clear. It was specifically in this context that competition law was referred to, in the following terms: 'The widening of trade practices and competition law in both countries [should] reflect the one market concept rather than individual countries or regions in determinations of mergers and takeovers'. Interestingly, this aspect of government regulation appeared to be exempt from the Business Councils' desire 'to take governments out of the operative aspects of trans-Tasman trade'.

At this point it is probably worth reflecting on the background to this part of the Business Councils' Communiqué. What appears to be the origin of the perceived 'problem' and to what extent has a practical agenda for reform evolved?

In 1987, two proposed mergers of potential trans-Tasman significance were rejected by the Commerce Commission: Amcor/NZ Forest Products [Decision No. 208], and Goodman Fielder/Wattie [Decision No. 201A]. (A revised proposal for the latter merger, incorporating divestments, was authorised by the Commission [Decision No. 212A].) These rejections were a profound shock to the business community. It was during and after these cases that a corporate (or should I say big business) view took shape along the following lines: trans-Tasman enterprises were necessary to provide enough 'clout' to operate globally, by developing international markets for exports through ownership and the establishment of brand names, and through the achievement of scale economies; comparable size to competing organisations was a factor; there was conflict between the objective of international competitiveness and 'narrowly focused' domestic competition laws; it was intolerable that businesses on both sides of the Tasman be encouraged to work together when different competition laws applied in each country — some preference for Australia's merger or takeover system over New Zealand's was expressed; if governments wanted the benefits of CER, this objective must be facilitated through supporting legislation; because public benefit was too hard to prove, applicants for merger or takeover clearance were disadvantaged; adjustment of an economy should not be obstructed — regulatory delays, with their associated costs, including deferred rationalisation, were of particular concern.

Such views, expressed by business leaders on both sides of the Tasman, evidently had some impact at the political level. The two governments extended their CER agenda to cover business regulations, and the New Zealand Prime Minister spoke in this context about the spirit of CER and the need to expand our horizons (*The Australian Financial Review*, 23 November 1987). He hinted at 'policy action' within an accelerated CER timetable, the third step of which is a review 'to look into harmonising business regulation and practices in the two countries'. Business leaders have joined the call for harmonisation of tax and commercial laws, including company law, monopoly rules, industry assistance, and antidumping procedures. Mr Lange argued that the economic rationale for the present CER agenda is compelling, but was reluctant to declare himself on wider questions of New Zealand's sovereignty.

In 1987, New Zealand's Trade and Industry Minister, the Hon. David Caygill, said that the domicile of an acquiring party does not affect the approval procedures for mergers and takeovers under the NZ Commerce Act any more than it does under the Australian Trade Practices Act. He said that the provisions of the two Acts are already 'largely harmonised', and that the task of balancing such matters as developments under CER with other relevant issues was the responsibility of the Commerce Commission or the courts. But, again, there was hint of a policy response: 'to go beyond this [balancing] approach and to widen the definition of 'market' **for the purpose of assessing dominance**, to include both Australia and New Zealand, would be a significant extension of CER indeed. Perhaps such a step may emerge from the Treaty's [1988] Review' (*National Business Review*, 12 December 1987; emphasis added). Later, the Minister called for 'widening the jurisdiction of trade practice rules to provide a single code for business and investment'.

In contemplating the forthcoming review of the Commerce Act, the Minister indicated that he did not have any 'significant concerns' with the basic policy of the Act; nor did he see any need for a 'fundamental review' of the Act's provisions or its institutional arrangements. But significantly, in view of stated business concerns, Mr Caygill said that it would be appropriate to look at how the Act is being administered and the effects of the decisions made over the two years since its inception (*International Pespectives on the Application of Competition and Consumer Laws*, 1987).

This emphasis on evaluation ('the effects of the decisions') can also be looked at in the context of the Finance Minister's broader economic statement of 17 December 1987, which viewed economic success being achieved, *inter alia*, by 'ensuring the community can take advantage of opportunities for the development of internationally competitive activities', and by reducing cost structures.

What appears to be emerging is two-fold: first, a build-up in the momentum for harmonisation within Australasia's regulatory regime;[1] second, and related, a ready adoption of the notion of a single market, although generally this seems to fall short of contemplating a common external tariff. (A customs union is not an explicit policy objective, although the CER Agreement provides for selective application of a common external tariff as a means of promoting industry rationalisation, and in recognition of potential intermediate goods problems.) So, why is 'single market' being lauded as

[1]There is a useful distinction here between compatibility and uniformity, uniform laws not being an essential pre-requisite for the CER Agreement to work satisfactorily. Sir Frank Holmes stresses that respect for and tolerance of individual differences between the two countries is quite compatible with the spirit and development of the CER relationship. See Holmes et al., 1986:133.

such a useful vehicle for addressing perceived problems in the trans-Tasman regulation of competition and, particularly if not exclusively, regulation of mergers or takeovers?

Single Market

Under the Commerce Act, no person may acquire or strengthen a dominant position in a **market for goods or services within New Zealand.** Is this geographic boundary (which is clearly relevant to the question of national jurisdiction) a problem in the CER context? Does it unduly limit or distort the results of competition analysis in respect of mergers or takeovers? The answer lies entirely with the quality of that analysis. Let me explain.

Defining a market is not an end in itself. It is an important starting point for competition analysis. It is but one of the three central analytical constructs — market definition, market concentration, and market entry conditions — used for assessing the nature and extent of the constraints on acquiring or using undue market power (or dominance). The function of market definition (and the other tools of analysis) is to help organise the relevant information in each case; used together, these tools are the means for assessing the likely responsiveness of both demand and supply to a hypothetical non-transitory and non-trivial price increase.

What is crucial therefore in drawing the market boundary line — and, indeed, in employing any of the analytical tools — is to know, first, what information is in and what information is out. Does the defined market include, for example, only New Zealand production; or New Zealand productive capacity; or total New Zealand supply, including actual imports? Put another way, to what extent has the potential for supply (and demand) substitutability been accommodated in the market definition? If potential competition has been insufficiently accommodated, the focus then shifts to analysis of entry conditions.

A high share of a market within New Zealand, or even a single domestic supplier in a market, does not therefore of itself prejudice a merger proposal, provided, that is, that the relevance of each block of information for assessing market power is understood. In short, as long as the right questions are being asked, and all the relevant information is being assembled in one box or another, no one indicator of market circumstances should artificially influence the outcome of a proposal one way or another. So, if the dominance test (discussed below) is properly and consistently applied, the supply or potential supply into a New Zealand market, from Australia or elsewhere — including the possibility of *de novo* entry of investment into that market — would be taken into account.

If dominance is found in a domestic market, that is not the end of the matter, since there is provision in the law for a public benefit — other than competition — to justify a proposal. How this public benefit test is applied is much more critical in influencing merger or takeover decisions than would be the adoption of a single market framework (see the Public Benefit section below).

My conclusion at this point is that the notion of a single market, while conforming in a general sense with the spirit of CER, would appear to have little practical significance in the determination of trans-Tasman merger or takeover proposals.[1] Any suggestion that the finding of dominance would diminish in a single market is somewhat flawed, since — as indicated — the questions asked in competition analysis, and the information assembled, should conceptually be the same, irrespective of the particular market boundary defined.

If it were generally more difficult to allege dominance in a single market framework, this would be of little comfort to those consumers buying in what might be more realistically defined areas of actual or potential competition. In the absence of a common external tariff, how would the differential impact of tariffs on potential competition be assessed in a so-called single market? It is also interesting to reflect how public benefit might be addressed in a 'single market' framework, given the CER presumptions of mutual gain and a 'fair' distribution of the benefits from free trade between the two countries. Would a competition agency, in judging the potential flowback from a merger or takeover, be required to seek from applicants an assessment as to the likely distribution — and fairness — of gains between Australia and New Zealand?

Now, is the desired effect of promoting the single market concept to have built into competition law a preference for trans-Tasman mergers over mergers involving either Australia or New Zealand and a third country? If so, how would this fit with the present foreign investment rules, which, in essence, are non-discriminatory as to the source of foreign investment? The CER Agreement is not an investment agreement; but is the aim to seek formal change to Australia's and New Zealand's foreign investment rules so that

[1]However, it could well have some practical significance in respect of trans-Tasman trade practices. 'As well as ... formal joint ventures, there have been a number of informal agreements between Australia and New Zealand companies to organise production ... In some cases a prime reason for a business agreement rather than a merger between Tasman partner companies has been the desire to avoid the New Zealand Commerce Act' (Bollard & Thompson, 1987:50). It is interesting to note in this context that Canadian competition law legitimises specialisation agreements involving agreement to stop producing particular products or services.

they too discriminate in favour of Australasian-sourced direct investment (although foreign investment rules are typically concerned with ultimate ownership and control, rather than with the immediate source of investment)? The debate about foreign investment rules flourished in the early 1980s as particular businesses found the Foreign Investment Review Board, for example, impeding investments which they felt to be legitimised by CER (see *CER — The Business and Law Essentials*, 1983).

The corollary is: why should trans-Tasman mergers and rationalisation be treated as superior to rationalisation mergers **within** New Zealand or **within** Australia? If the 'single market' is embraced for competition law, it should not matter where a particular proposal occurs in that so-called market.

A further question flows from the elimination of protective trade barriers and the single market notion, namely, how is antidumping legislation to be treated? Is antidumping more likely to be aimed at protecting the interests of competitors, rather than protecting the competitive process that CER is designed to promote? Sir Frank Holmes argued that:

> the CER area is not yet sufficiently akin to a single market to enable antidumping action to be replaced by domestic competition law and fair trading law in respect of trans-Tasman transactions, as some have suggested. (*Closer Economic Relations with Australia Agenda for Progress*, 1986:128)

The same report did, however, acknowledge that dealing with any 'predatory pricing' matter under competition law was an important policy consideration (pp.52-3), and that both governments were reviewing their approaches.

The argument for using competition law as an alternative remedy is that the economic impact of predatory pricing would be the same, irrespective of the origin of such pricing decision. (It would not, however, eliminate the possibility of third-country antidumping action in either Australia or New Zealand, which I understand is provided for in the GATT Code.) How effective s. 36 of the Commerce Act or s. 46 of the Trade Practices Act, which deal with predatory pricing, might be as a remedy is a separate issue. In New Zealand's case, dominance has to be determined before the question of whether or not that dominance has been used for anticompetitive purpose.

In concluding this section, I pose the central question of how far we want to go along the trans-Tasman integration route. How jingoistic do we feel? A bilateral agreement by its very nature is discriminatory, as is pursuit of particular harmonisation targets such as standards and government purchasing. But the more we integrate, the more we will have to integrate — because each remaining issue will increase in relative importance as a factor seen to interfere in some way with trans-Tasman trade and factor mobility. Competition rules, foreign investment rules and antidumping rules need to be looked at together. (It should be borne in mind, however, that foreign investment and antidumping rules, with their legislatively provided ministerial powers, are typically more political than competition law. Hence, attempts to integrate these rules could confuse the issues.) To illustrate, what would be the logic in having competition law discriminating between sources of investment and yet retaining non-discriminatory foreign investment rules? But, more importantly, what is the economic rationale for having discriminatory foreign investment rules in the first place — given internationally mobile capital — since they say nothing about the relative efficiency of the favoured source of investment? Is Elders necessarily better for Petrocorp and the New Zealand public than British Gas? According to the government, apparently not.

Competition, Rationalisation, and Efficiency Objectives

Specialisation, rationalisation and 'orderly marketing' is the very language of CER, particularly intra-industry. Recent research has confirmed that a very rapid increase in intra-industry trans-Tasman trade has been occurring (Bollard & Thompson, 1987). Corporate growth and reorganisation will occur via internal expansion, mergers or takeovers, and joint ventures, and, generally, by a search for the most efficient forms of organising economic activity under conditions of change and uncertainty. (These forms might evolve for conventional scale-economy reasons or for reasons of minimising non-trivial transaction costs.) There is a strong expectation that trans-Tasman specialisation and rationalisation will and should continue to occur, since these are the very means whereby CER's restructuring and efficiency objectives will be achieved. This expectation is despite the strong implication that some competitors will be 'pushed aside' in the process — and left there.

Taking out a competitor, of itself, is not a concern of CER; neither is it a concern of competition law. But, to date, the policy-makers have given no indication that they regard trans-Tasman industry rationalisation as a generally superior objective to the promotion of competition. The clear legitimacy of both objectives puts a stress on the system when they come into conflict — as in competition law where there is provision for assessing the trade-off between competition loss and efficiency gain.

It may well be that the NZ Court of Appeal's recent judgment on divestment and other undertakings in merger cases gives added flexibility to the Commerce Commission in its determinations. In particular, it better enables the Commission to reconcile the international aspirations of applicants with the preservation of competition in domestic markets. However, in accepting divestment proposals for their easing of market power concerns, any potential loss of scale, technological or transactional economies associated with the original merger proposal should, presumably, also be taken into account.

New Zealand's law gives primacy to competition in its long title. That is consistent with having two competition tests in the Act, i.e. dominance and 'substantial lessening', as the sole basis for an initial screening of mergers or takeovers and trade practices, respectively. The long title, and the priority it suggests, also lead to the statutory requirement that a public benefit (other than competition) be greater than any competitive detriments before authorisation can be given. The question can properly be asked of policy-makers: 'is the admonition to make markets operate competitively too simplistic an approach in light of legitimate efficiency goals?' (Williamson, 1977:705).

It is then the administrative standard of proof required that will be most important in determining how any competition/efficiency trade-off is assessed. But, before turning to the public benefit test, it is important to see how the dominance or competition test for mergers or takeovers has been interpreted by the New Zealand Commission and upheld by a recent High Court judgment (see News/INL [Decision No. 164], Magnum/DB [Decision No. 182], and *Lion* v. *Commerce Commission & Ors* re Magnum/DB, Chief Justice High Court judgment November 1987).

Market Dominance

Correctly applied, the dominance test represents a high competition threshold. While the Commission is bound to take into account a number of factors, including market share, the Commission has interpreted the essence of the dominance concept as follows:

> ... dominance is **a measure of market power.** Being in a 'dominant position' is interpreted by the Commission, in essence, as having sufficient market power (economic strength) to enable the dominant party to **behave to an appreciable extent in a discretionary manner without suffering detrimental effects** in the relevant market(s). This interpretation stresses **independence of behaviour,** i.e. conduct that is pursued independently of the presence, actions or reactions of existing or potential competitors, purchasers or suppliers. The interpretation therefore suggests a **lack of restraint** on the behaviour of the dominant party — restraint that would be assumed to be associated with conditions

of effective competition ... (Magnum/DB [Decision No. 182], para 77; emphasis added)

Once the Commission is satisfied (as it is required to be) that dominance is or is likely to be acquired or strengthened, it is the **detriments** arising from the dominance that the Commission is bound to consider in authorisation proceedings. According to economic theory, there are strong grounds for presuming that the detriments from dominance (as defined) — namely a reduction in output and a higher price — will result in a direct loss of allocative efficiency and consumer welfare. In a more dynamic sense, there are fewer, if any, incentives for the dominant firm to innovate and to maintain or improve quality, service or design, for example. Assessing the extent of these inferred losses, or competitive detriments, is essential to the trade-off analysis.

Under New Zealand's mandatory pre-clearance system, a lower competition threshold would (inappropriately) capture many more transactions and subject these to a public benefit test even though, in the absence of undue market power, any detriments would be elusive.

Public Benefit

For those few mergers or takeovers that meet the dominance threshold, and that raise significant concerns in terms of loss of allocative efficiency, the public benefit threshold is also necessarily high. A valid topic for debate (raised in the context of CER and its objectives) is the standard of proof required of applicants. The following represents some sort of scale for illustrative purposes. First, at a level that is the least demanding of applicants, it has been suggested that proposals in 'the spirit of CER' should qualify as being in the public benefit. A second level might be that proposals with a rationalisation objective should qualify as publicly beneficial. A third and higher standard of proof might require specific quantitative data as to *ex ante* economies of scale, for example, in an attempt to verify claims that average costs of the merged firm would be less than those of the individual entities pre-merger. At an even higher standard might be the additional requirement that the claimed benefit(s) could not be achieved by means other than the proposed merger or takeover. And higher still might be an additional distributive preference, to the effect that benefits be distributed to particular groups of the public, e.g. the consumers of the products affected; benefits to these groups would then be accorded a higher weighting than benefits to other potential recipients. To assign weights to benefits in this way is tantamount to making an explicit distributive judgment.

Let us examine these last two requirements, given that the Commerce Act does not appear to make provision for either. First, it could be argued that authorisation procedures relate solely to the matter in hand and not to second-guessing whether or not the claimed benefits of a proposal may be achieved by alternative means. To deny the opportunity to realise, say, production efficiencies, by way of merger, on the grounds that these may eventually be realised by, say, internal expansion, may be permanently to deny that opportunity. If, however, alternative and less restrictive means were identified, and considered pertinent, the relevant question becomes: is any delay in the realisation of economies outweighed by the rivalry gains from prohibiting the merger?

Second, use of the word 'public' appears to carry no distributive connotation, except that the public be confined to the particular national jurisdiction. Also, there seems little merit, and certainly little economic substance, in the distinction between public and private benefit that tends to underpin legal treatment of distributive questions. In any case, it can be argued that resolution of distributive or equity issues should not be attempted under the umbrella of competition law, which is better suited to efficiency than income distribution aims based on subjective notions of fairness. As far as transfers between consumers and producers are concerned (see Williamson, 1977:711 for a discussion of this issue), these are not generally a concern of economics, and attempts to quantify and weight them in applying competition law are distracting. Furthermore, it is simply not possible to demonstrate how prospective benefits will be distributed over time. Therefore, any requirement to demonstrate that a public benefit be passed on to consumers, for example, suggests that applicants will likely fail the public benefit test, irrespective of the quantum of potential efficiency gains; this is because once dominance (as defined) is achieved, the incentives for **ensuring** particular flow-on effects, at least in the short term, no longer exist.

The Commission has interpreted the Commerce Act as meaning that detriments from dominance, as they affect consumers in the relevant NZ market(s), can be weighed against public benefit from a merger or takeover **proposal as a whole** (Goodman Fielder/Wattie [Decision No. 201A], para.259). Thus it has been accepted, at least implicitly, that the likely beneficiaries of a proposal can be different from those who are most likely to be directly and adversely affected by it. This interpretation recognises that productive efficiencies may be realised on all transactions, whereas monopoly power may be confined to one or a few markets.

In concluding this section, I suggest that the appropriate standard of proof would seem to lie somewhere between the extremes of unexplored objectives and assertions, and unequivocal 'evidence' that the alleged benefit of a proposal will be realised and then distributed in a particular way. The Chairman of the Commerce Commission, on a number of occasions, has expressed the view that the 'privilege' of dominance (as defined) in an NZ market is not justified simply by claims of public benefit, deriving from enhanced international competitiveness for example. Clearly there are difficulties in the prospective nature of the public benefit test and in evaluating efficiency arguments. Whatever the approach adopted, however, an important consideration must be that the standard of proof is the same for prospective dominance and competitive detriments as it is for prospective benefit. The potential cost of setting too high a standard of proof in respect of public benefit claims, say in the CER context, would be to impede economic adjustment and deny or delay real improvements in economic efficiency. At the other end of the spectrum, the public stands to be disadvantaged by firms that become dominant (at least temporarily) and whose alleged contribution to efficiency, and real growth, is not in fact realised — at least within a reasonable time frame.

The jury is still out on the public benefit issue; I hope it will continue to debate how legal and economic perspectives can be blended in the interpretation of this pivotal test in competition law.

Harmonisation of Competition Law and Economics

My overriding conclusion, after reflecting on CER and competition law, is that the most critical current issue in regulating for competition is the harmonisation of competition law and competition economics. This is a much wider and more significant issue in pursuing CER, and other policy objectives, than is the suggestion of a single market and preferential treatment for trans-Tasman mergers or takeovers.

But there is an important caveat here: institutional arrangements, and the legal system in particular, must have the capacity to absorb and reflect the dimensions of what is required to validate the harmonisation of a competition law and economics perspective.

What such harmonisation requires, first and foremost, is an explicit, internally consistent and coherent economic framework, based on sound economic principles, reflecting real-world benchmarks, that guides the questions to be asked in assessing market power and efficiency.

As an economist, competition regulator, producer, member of the public and consumer, I would argue that the most appropriate long-term objective for guiding the design and implementation of competition law is economic efficiency: itself a valued social goal. This objective contemplates both allocative and productive efficiency, which, together, determine the level of consumer welfare, i.e. the extent to which consumer demands generally will be satisfied, given resource limitations, including technology.

Competition law is well suited to the promotion of overall efficiency, and the demarcation between competition law and other policy instruments for pursuing other valued social goals should be clear. It is the risk from fudging the efficiency objective in competition law in order to accommodate ad hoc income distribution aims, for example, that needs to be avoided. Otherwise, particularly in view of the administrative discretion inherent in this law, there is a risk of blunting the effectiveness of a potentially well-targeted policy instrument.

Conveniently, an explicit efficiency objective would harmonise well with CER objectives. It would not require discriminatory (and possibly distortionary) concessions to those objectives. And, importantly, it would give greater certainty as to the approach to be adopted in competition and public benefit analyses.

Two further observations are necessary. First, in no way does this approach distract from the central role of competition in ensuring overall economic efficiency. Competition remains the most effective stimulus for achieving this objective. However, the difference between a competition and an efficiency mind-set needs to be understood, since competition is not an end in itself. This difference is well illustrated in analysing market entry conditions: an exercise for which a sound conceptual framework is an essential prerequisite. Some so-called entry barriers might in fact be quite consistent with efficient outcomes, and yet, given a competition mind-set, might tend to be treated pejoratively as deficiencies in market structure justifying intervention. With an efficiency objective, however, the concern is with those 'remediable impediments', the removal of which would be likely to lead to superior social outcomes, judged in efficiency/consumer welfare terms.

The second observation is that an efficiency objective for competition law, and the analytical framework that that implies, does not aim to pre-judge decision outcomes. Neither can it be predictive. The evidentiary burden remains. So too does the need for critically assessing the trade-off between competitive detriments and public benefit (in terms of efficiency gains), in accordance with the balance of probabilities.

It has always been a recognised danger of CER that it would discourage firms from pursuing more outward-looking strategies. The danger has been largely modified by our global trade liberalisation program that is running in tandem with removal of trans-Tasman trade barriers. But just as significant is the internationalisation of capital and labour markets (in addition to goods and services), assisted in large part by advancing technology. In short, all national economic boundaries are slowly dissolving ('Get ready for the Phoenix', *The Economist* 9 January 1988:11-12). This raises major long-term questions for national economic sovereignty and policy-making autonomy, irrespective of CER.

Nonetheless, in considering options for policy harmonisation within CER, we must be alert to the general risk of both countries opting for systems that do not necessarily represent best international practice. In terms of the comparative systems approach, which has come to the fore in public policy assessment, it is the search for the best operational system (consistent with what is realistically attainable) that should be the focus. Furthermore, while obviously we should be informed by the precedents of interpretation or approach in another country, there should be no pressure to adopt such precedents.

As far as competition law is concerned, there is a leadership opportunity in respect of the harmonisation of law and economics. This opportunity is consistent with — even demanded by — the economic imperatives confronting both New Zealand and Australia in a global setting.

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CER and Competition Law: A Lawyer's Perspective

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CER and Competition Law: A Lawyer's Perspective

James Farmer

I. INTRODUCTION

Prior to 1986, Australia and New Zealand had adopted quite different legal approaches to the promotion of competition policy. At least from 1974, in the form of the Trade Practices Act of that year, Australia had followed an overtly procompetition direction. It had also used the courts as the principal instrument by which the laws in this area were to be enforced, and, notably, had given private individuals and companies who were adversely affected by restrictive trade practices and anticompetitive and commercially deceptive conduct the right to seek injunctive orders, damages, and other relief directly in the courts.

By contrast, New Zealand legislation had lacked any clear and unequivocal stand in favour of competition as the major policy objective, but, under the 1975 Commerce Act, had sought to establish a balancing mechanism that defined public interest goals in terms not only of competition but also of industrial and commercial development and efficiency, reasonable behaviour, resource utilisation, technological development, employment opportunities, export trade considerations, and the general 'well-being of the people of New Zealand' (ss. 2A, 21, 80; see also Farmer, 1985). In addition, the Act conferred no private law remedies and enforcement took place through a cumbersome and largely ineffective administrative machinery.

The Australia New Zealand Closer Economic Relations Trade Agreement (the CER Agreement), which was executed on 28 March 1984 but was deemed to have come into force on 1 January 1983, has led to New Zealand taking a radically different direction in its legislative regulation of restrictive trade practices and other allied matters. In particular, by enactment of the Commerce Act 1986 and the Fair Trading Act 1986, the New Zealand parliament has abandoned both the previous public interest criteria and the enforcement machinery of the earlier legislation, and in their place has opted for Australian-type competition objectives and 'court-centred legislation' (Brunt, 1976:3).

The assimilation of the New Zealand legislation to the model provided by the Australian Trade Practices Act 1974 was provoked by the stated objectives of the CER Agreement, which include the following:

- to strengthen the broader relationship between Australia and New Zealand;
- to develop closer economic relations between the Member States through a mutually beneficial expansion of free trade between New Zealand and Australia;
- to eliminate barriers to trade between Australia and New Zealand in a gradual and progressive manner under an agreed timetable and with a minimum of disruption; and
- to develop trade between New Zealand and Australia under conditions of fair competition. (CER Agreement, Article 1)

To achieve these objectives, the Agreement further provided for:

- the progressive reduction and elimination within a period of five years of tariffs in both countries on all goods originating in their respective territories (Article 4(3));
- the progressive liberalization and elimination of quantitative import restrictions and tariff quotas on such goods (Article 5(3));
- the elimination of revenue duties that discriminate against the goods originating in and imported from the territory of a Member State by comparison to the duties or taxes charged on similar domestic goods (Article 7(2));
- the reduction and elimination of quantitative export restrictions on trade between both countries (Article 8(1));
- a 'working towards' the elimination of all export subsidies and

export incentives on goods traded in the Area covered by the Agreement (Article 9(1)); and
- an active 'working towards' the elimination of preferential treatment for domestic suppliers in government purchasing (Article 11(1)).

More specifically, in order to ensure the maintenance of free trade under comparable conditions of free trade, the Agreement placed obligations on the Member States to:

- examine the scope for taking action to harmonise requirements relating to such matters as standards, technical specifications and testing procedures, domestic labelling and restrictive trade practices; and
- where appropriate, encourage government bodies and other organisations and institutions to work towards the harmonisation of such requirements. (Article 12(1))

Such measures were included because it was thought that the existing differences in the legal requirements referred to were likely to 'impede or distort trade' in and between Australia and New Zealand (see Article 12(2)).

New Zealand has now responded to the directive of CER and the 1986 Commerce Act and Fair Trading Act embrace the same concepts and provisions for enforcement as are contained in the Australian Act. True, there are differences of detail: for example, there is no provision in the New Zealand Act expressly prohibiting exclusive dealing, although arguably it is covered indirectly by other sections. On the other hand, the New Zealand Act does not contain the Australian constitutional limitations, and there is therefore no doubt as to its application to individuals as well as to corporations. (As to possible solutions for dealing with the interjurisdictional problems created by the CER Agreement, see Kirby, 1984.)

It is a matter of debate, however, as to whether the new trade practices legislation in New Zealand was enacted because of CER or whether it derived from the economic policies of the 1984 Labour Government. Those policies were, during the first term of the government, implemented with breathtaking rapidity. The removal of foreign exchange controls and limits, the elimination of a wide range of subsidies and export incentives, the progressive dismantling of import licensing barriers and the lowering of tariffs, and the substantial withdrawal of price controls as an instrument of inflationary control are a far cry from the decades of price stabilisation measures, wage increase controls, and even at one time profit maximisation provisions pursued by previous administrations. In their place stands Competition, both domestic and foreign, as the jewel of the government's economic policy. Hence the importance of the new Commerce Act and in particular enforcement of its substantive provisions by private law remedies.

An essential element of the establishment of competition in New Zealand is the opening up of its markets to foreign traders and suppliers. New Zealand is too small an economy for competition to be guaranteed among domestic producers alone: indeed, there has been a well-observed tendency in many industries toward monopoly and oligopoly situations. Where import licensing barriers or high tariffs have existed (usually in the name of fostering local manufacturing) such situations have flourished. The removal of those barriers has therefore been seen as essential to the creation of a truly competitive environment. As Thomas (1983:104) has observed, 'protectionism is degenerative on our competitiveness; the apparent stability of protected industry is the economic equivalent of rigor mortis when growth and prosperity depend upon structural change'.

These are the sentiments that the Australian government professes also to espouse. Indeed, the Federal Minister for Industry, Technology and Commerce, Senator Button, in 1987 criticised the New Zealand Commerce Commission for refusing to authorise Amcor Limited to take over New Zealand Forest Products Limited when, so the Minister says, there have been plenty of New Zealand entrepreneurs who have moved successfully into Australia in the wake of the CER Agreement (*The Dominion*, 9 September 1987). The fact is, however, that the Australian Trade Practices Commission has also not been slow to enforce the Australian Act against New Zealand companies whose actions are perceived to infringe the provisions of that Act: in particular, the well-publicised intervention against the moves of Feltex Limited to take over Australian whitegoods manufacturer Email Limited (*Australian Financial Review*, 21 November 1986; *Sydney Morning Herald*, 7 November 1987; see also further below).

Both Commissions, it seems to me, probably acted correctly in terms of the provisions of the statutes they are charged to administer, and political appeals to CER are hardly helpful. This is not to say that there is not a case for expanding in both Acts the definition of 'market' beyond their present national and territorial limits (ss. 3(1) and 4 of the NZ Commerce Act 1986; s. 4E of the Australian Trade Practices Act 1974; and compare the arguments ventilated to the Commerce Commission in the Goodman Fielder/Wattie case [Decision No. 201/201A] and the Amcor/NZFP case [Decision No. 208]) — a matter to which I shall return but which, it should be noted, is ultimately a decision for the respective governments (including that of Senator Button) to take.

II. FREE TRADE AND FAIR COMPETITION

It should be noted that the goal of developing free trade between Australia and New Zealand propounded in the CER Trade Agreement is expressly linked to what is described as 'conditions of fair competition'. This accords with the view of the Organisation for Economic Cooperation and Development (OECD), stated as follows:

> trade policy measures that result in barriers to international trade can have important detrimental effects on domestic market structures by diminishing competition. For example, a trade policy that permits domestic firms to coordinate their exports in a cartel-like manner may weaken competition to the extent that export coordination also facilitates coordination of domestic sales. On the other hand, trade policy that permits a free flow of imports is likely to cause domestic markets to behave more competitively. Thus, trade policy can either significantly promote or substantially impede the economic goals of competition policy. With national economies being increasingly limited and interdependent, trade liberalisation policies maintain a climate conducive to the effective functioning of competition in national and international markets. (OECD, 1974:87, para. 235)

The reference to 'fair' competition in the CER Agreement should be emphasised. Laws regulating unfair trade or pricing practices seek to adjust 'competitive disequilibria brought about by unfair and injurious import pricing practices', but, as has also been remarked by the OECD (1974:112-3, para. 322), the enforcement of fair trading laws, such as antidumping legislation, can in certain circumstances restrict competition by raising entry barriers to foreign competitors. While competition laws and fair trading laws both seek to remove artificial market distortions, there are important differences in the nature of the interests protected and the manner in which the laws operate. In general, competition laws are not concerned to protect competitors but rather to maintain an environment in which traders or suppliers can compete with equal opportunity. On the other hand, laws that seek to prohibit dumping and to impose countervailing duties on importers who are perceived to be pricing their product 'unfairly' in relation to their costs or pricing policies in their country of origin are effectively (if not in strict theory) aimed more at protecting local suppliers. This has given rise to concerns by the

OECD that such fair trading laws may be used for anticompetitive purposes, that is to 'reduce competition in domestic markets, particularly where high levels of concentration already exist, through the foreclosure of foreign firms' (OECD, 1974:118, para. 344).

Australia, particularly, has been accused by New Zealand interests of abusing its antidumping laws under the fair trading banner so as to prevent New Zealand exporters from competing in Australian markets. At least in one reported case — *Tasman Timber Limited* v. *Minister for Industry and Commerce* 46 (1983) ALR 149 (cf. *Feltex Reidrubber Ltd* v. *Minister for Industry and Commerce* [1983] 46 ALR 171) — a Federal Court Judge agreed with them. In that case, an order for review was successfully sought by New Zealand exporters and Australian importers of New Zealand timber against the imposition of countervailing duties and cash securities. It was shown that, by taking into account extraneous financial considerations other than just the amounts of export subsidy received by the exporters, the Australian department had fixed a rate of duty that precluded them from selling timber competitively in Australia. The Judge sounded this warning:

> The ultimate power is to impose countervailing duties and they must not exceed the amount of the subsidy. That is fundamental to the notion of the power. It is entirely antithetic to the power that it be exercised in order to protect local industry by driving foreign goods out of the Australian market. The mere existence of a subsidy does not entitle the Australian government to impose countervailing duty under the Act. The Minister must be satisfied of material injury to an Australian industry by reason of the subsidy. Then the occasion for the exercise of the power arises, but the power is to neutralise or counteract the subsidy, not to penalise foreign traders. (46 ALR 149, 169)

Further criticisms were levelled by Professor F.H. Gruen of the Australian National University, who was commissioned by the Minister to review the legislation relating to antidumping and countervailing duties. In reporting in March 1986, Professor Gruen found that Australia makes greater use of antidumping action than other comparable countries and that this had the potential to frustrate the achievement of other government objectives in the areas of industry, trade, competition, and economic policy. He referred further to complaints by many of Australia's trading partners and to the fact that an antidumping regime that was 'extremely wide ranging and ... biased towards the local manufacturer' (Gruen, 1986) was likely to cause problems to Australian exporters.

The response to the Gruen Report of Senator Button, the Minister in charge of the department administering the antidumping provisions, was in traditional, unashamed, protectionist mould. If Australia 'was to rationalise protection', he said, 'it is essential that manufacturers here were not subject to injury from products imported at prices below those which they are sold in the country of origin' (Press Release 138/86, 30 October 1986). Despite this apparent adherence to an emphasis on protectionism, the Minister has nevertheless accepted the need for some changes, and an antidumping tribunal (within, rather than independent of, the department) is to be established by legislation and charged with the function of making recommendations to the Minister on the need for action in any particular case. Whether these changes are cosmetic only and will fail to disrupt entrenched attitudes within the Australian department remains to be seen. The establishment of review machinery within the department rather than independently of it does not give cause for optimism.

There has been hardly any enforcement of the comparable New Zealand sections — until very recently contained in ss. 186A-186E of the Customs Act 1966. The most notable occasion was the brief flurry caused by the imposition of duties on Fosters Lager imported into New Zealand, duties that were rapidly withdrawn after High Court proceedings were instituted. In June 1986, however, a decision was taken by the New Zealand government to accept the GATT antidumping code and to enact legislation that would conform with the requirements of that code. At the same time, a Working Party was established to review existing legislation and procedures and to recommend any changes that would improve the ability of the government to respond to complaints of dumping practices. The result of the Working Party's deliberations was the replacement of the above sections of the Customs Act by a new Part VA (ss. 186A-186P), enacted by the Customs Amendment (No.3) Act 1987, and a new Temporary Safeguards Authorities Act 1987. It is beyond the scope of this paper to review the detail of this legislation, but it must be said that it contains all the machinery and all the powers necessary to put up the shutters against foreign competition, if it is felt expedient to do so: an objective that was, however, denied by the Working Party.

It had in fact been argued by Treasury to the Working Party that dumping is generally to be regarded as being favourable to the country receiving the goods, that there was no general case for stopping other countries selling goods to New Zealand at prices below their production costs, and that any antidumping procedures adopted should 'only parallel the Commerce Act provisions for anticompetitive aspects of predatory pricing on the basis that the economic impacts of predatory pricing are the same irrespective of whether predatory pricing originates overseas or locally' (*Review of the New Zealand Antidumping and Countervailing Legislation*, Report 31 July 1986, paras. 3.1.6-3.1.8). That view was ultimately rejected by the Working Party, which said that 'it is generally accepted internationally that action against these practices is reasonable when injury is being caused to domestic production' (para. 3.1.9). While also rejecting protectionist arguments, the Working Party claimed that its recommendations would 'result in a system that provides an effective, fast and reasonably accessible response to injurious dumping without at the same time constituting an unjustifiable impediment to international trade, or unduly negating the benefits of international competition' (para. 3.1.11).

It seems to me that the more tolerant attitude of New Zealand to dumping is likely to lead to some tension between it and Australia, particularly as Article 15 of the CER Agreement authorises each country to levy antidumping duties in respect of goods imported from the other provided only that it has determined that dumping has occurred and that it has caused or threatens to cause material injury to an established industry, or material retardation of the establishment of an industry. It is true, however, that there is an obligation to consult with the other member state. Somewhat similar provisions are contained in Article 16 in relation to countervailing duties on imported goods that enjoy the benefit of a subsidy from the state of origin of those goods. If the objectives of the CER Agreement are to be properly fulfilled, these Articles may need to be either repealed or at least substantially modified so as to limit considerably the legitimate occasions when antidumping or countervailing duties can be imposed on goods from the other Member State.

One other relevant matter that has given rise to concern is the making of bounty payments to various industries by the federal government. Such payments are in the nature of subsidies. They have hitherto appeared to be outside the scope of laws relating to antidumping or countervailing duties. The 1988 Review of the CER Agreement conducted by the Australian and New Zealand Governments has now led to a broad agreement that from 1990 there should be no protective measures operating between the two countries. While at this time the detail and the scope of that agreement are yet to be seen in terms of new proposed legislation for each country, it would seem that henceforth neither antidumping provisions nor countervailing duties nor bounty payments will be able to be used as protection against imports between Australia and New Zealand. The existing laws in relation to third countries will remain unaffected by this agreement.

III. LOCAL AND AUSTRALASIAN MARKETS

There has been considerable discussion (some of it, such as Senator Button's criticisms of the Amcor decision, emotive and ill-informed) of the market limitations imposed by the Commerce Commission. A cursory perusal of the definition of 'market' contained in the Commerce Act (which the Commerce Commission is bound by law to observe), and the equivalent section of the Australian Act, will make it plain that the legal recognition of an Australasian market can be achieved only by legislative change. Section 3(1) defines a 'market' as meaning 'a market for goods or services **within New Zealand** ...' Similarly, s. 4E of the Australian Act defines a 'market' as meaning 'a market **in Australia** ...' This is not to say, however, that competition within a market is determined in isolation of and without reference to foreign traders. To the contrary, foreign traders may have a very important impact on the local market, at least so long as they have access to that market for their goods and services. Certainly, the degree of accessibility to a domestic market will determine the extent to which competition and its attendant phenomena — cost, price, quality and technological development and new product innovation — are present in the market. Conversely, protectionism through trade barriers is likely to have anticompetitive effects within the local markets and result in serious production and marketing inefficiencies, which in the long run are borne by the consumer and the taxpayer.

The role of imported goods in a local market is expressly recognised by both the Australian and the New Zealand Acts. In particular, s. 4(1) of the Australian Act defines 'competition' as including competition from imported goods or from services rendered by persons not resident or not carrying on business in Australia, and s. 3(3) of the New Zealand Act is in somewhat similar terms. It should be noted, however, that it is not just the presence of imported goods or services that creates or enhances competition in a domestic market. It is enough if, through the absence of import licensing and other prohibitory or quantitative barriers, there is a potential ability to bring in imports in the event that local suppliers are minded to sell at prices and trade on terms less favourable to the consumer than those at which importers can supply.

The importance of the potentiality of competition as an element of defining a competitive environment had been emphasised in the classic statement by the Australian Trade Practices Tribunal in Re Queensland Cooperative Milling Association Limited (1976) 8 ALR 481, 516, as to the elements of market structure. The most important of these, the Tribunal said, was the 'height of barriers to entry, that is the ease with which new firms may enter and secure a viable market'. It was that threat of entry, the Tribunal concluded, that 'operates as the ultimate regulator of competitive conduct'.

In this respect, so long as there are no artificial or excessive import licensing or tariff barriers to entry, the ability of foreign traders to import their goods or services into New Zealand (whether or not they in fact do so) provides the critical determinant of the extent of competition within the New Zealand market. The decision of the New Zealand High Court in *Fletcher Metals Limited* v. *Commerce Commission* (1986) 6 NZAR 33 provides a good illustration of the principle. In that case, the Commission had refused consent to two Fletcher Challenge subsidiaries acquiring a controlling interest in Pacific Steel Limited, which was a monopoly producer in New Zealand of steel wire rod and reinforcing rod and bar. The Fletcher Group held a strong downstream position in secondary phase manufacturing and in distribution, retail and user levels in the steel industry. The Commission took the view that the takeover would have adverse vertical integration effects and discounted the possibility of the establishment of competition through the relaxation of import restrictions as being too uncertain.

On appeal, however, the Court reaffirmed that it is 'the potentiality of new suppliers which achieves efficient competition', that it was 'not only actual competition which as it were "keeps a trader honest"', but that 'potential competition can be equally salutory in producing that same result' (p.43). The Court then set out the program that had been announced by the Minister of Trade and Industry for the progressive removal of import licensing and lowering of tariffs and concluded that 'the potential competition so created is sufficient to render anticompetitive behaviour on the part of Fletcher's interests unlikely' (p.43). A Fletcher-controlled Pacific Steel, with the lifting of import restrictions, the Court said, 'could not afford to alienate customers and cause them to turn to imports for their supplies, nor could it afford to suffer loss of demand and risk the inability to compete with imports on matters of price' (p.42, and see p.41). The same approach was taken by the Court in relation to a somewhat similar appeal by a rival bidder for control of Pacific Steel in *New Zealand Steel Limited* v. *Commerce Commission* (1986) 6 NZAR 97, in which it was said:

> it is not necessary there be 'firm indications' to influence prices on the New Zealand market. The likelihood of potential competition is sufficient so that if prices charged by the New Zealand companies become inflated then users of their products have the ability to import from overseas markets. (p.103)

Clearly, therefore, the accessibility of imported goods to a domestic market is a critical component in determining the extent to which competition (including potential competition) exists in that market.

IV. ANTICOMPETITIVE EFFECTS ON THE LOCAL MARKET OF OVERSEAS CONDUCT

With the growth of international trade has come an increasing awareness of the fact that anticompetitive conduct in foreign countries can have significant effects on local commerce. The outstanding example in recent times has been the OPEC cartel operated by the principal oil-producing countries, whose pricing and production policies have been the major determinant of oil prices, principally (but not exclusively) in the non-oil-producing countries that comprise the users of oil products (see the discussion below of the OPEC litigation). Areeda & Turner (1978:260) give numerous examples of the kinds of situations where in the United States local conditions of supply and price have been found to be affected by the conduct of foreign suppliers or of collusion (direct or indirect) between local and foreign suppliers:

> European aluminium producers might agree to curtail their production and their exports to the United States, perhaps in the hope that American producers would curtail their exports to Europe. Or American firms might agree to limit their exports or imports. Or American and foreign producers of a product might agree on the prices they will charge in some third country.

The extension of American antitrust laws to foreign trade to deal with these situations has, as Areeda and Turner comment, 'generated wide controversy', but US legislators and the courts have nevertheless established that 'conduct, whether at home or abroad, can be reached by [US] antitrust laws when it affects competition within the United States or export competition from the United States (1978:255; and see the Australian reaction, discussed below, to the decision in particular of *Timberlane Lumber Co.* v. *Bank of America* [1977] Trade Cas.61, 233).

Even in the United States, however, it has been acknowledged that the scope of liability in respect of anticompetitive conduct occurring abroad must be limited if all international economic conduct is not to be examined by the United States courts with a consequential intrusion on the sovereignty of other states. The solution has been to confine liability by operation of the doctrine of 'locus of effects' — that is, according to the effect within the jurisdiction of conduct wheresoever occurring. The landmark decision that laid down this approach was *United States* v. *Alcoa Aluminum Co.* (1945) 148 F.2d 416 (and see *Steele* v. *Bulova Watch Co.* [1952] 334 US 280). In 1945 a Canadian corporation, Alcoa Aluminum, which was owned by American interests and subject to personal jurisdiction in the United States, was held to have breached the Sherman Act by virtue of arrangements entered into with a European producer of aluminium under which the latter agreed that it would not sell aluminium in the United States in anticipation that Alcoa would thereby not sell its products in Europe.

The court in the Alcoa case imposed as a limitation on the locus of effects principle a requirement that the parties to the antitrust arrangement should have intended the effect complained of. Subsequently, however, the courts in the United States have developed a more sophisticated approach to the problem, which is intended to enable the court to balance a number of factors in determining whether or not to exert an extra-territorial jurisdiction over foreign anticompetitive conduct. In particular, as illustrated in the celebrated case of *Timberlane Lumber Co.* v. *Bank of America* (1976) 549 F.2d, 597, considerations of international comity and of foreign law and policy have been introduced into the equation. Nevertheless, the fact that conduct has anticompetitive effects in a foreign country has not been sufficient to give the United States courts jurisdiction in the absence of some 'cognisable injury to United States commerce' (*United States* v. *Westinghouse Electric Corporation* [1978] 471 F.Supp. 532, 542, aff'd 1981 Trade Cas. 64112; and see *AGS Electric* v. *BSR* (1977) 460 F.Supp. 707; *National Bank of Canada* v. *Interbank Card Association* 1980-81 [1981] Trade Cas. 63836; Areeda & Turner, 1982:103).

It can be argued that somewhat similar results are obtained in Australia and New Zealand (to differing degrees) by the limited extra-territorial effect given by the respective statutes. Thus, s. 4 of the New Zealand Act (and, with consequential changes, s. 3 of the Fair Trading Act 1986) simply reads:

> This Act extends to the engaging in conduct outside New Zealand by any person resident or carrying on business in New Zealand to the extent that such conduct affects a market in New Zealand.

Section 5 of the Australian Act is to similar effect save that, by legislative amendment in 1986, in any action in which damages or certain other relief (but not including injunctive relief) is sought, it is now necessary to obtain the consent of the Minister before replying on conduct of the kind described in ss. 5(1) and 5(2). By s. 5(3), the Minister is directed not to give consent where, in his or her opinion, either the law of the country in which the conduct occurred required or specifically authorised such conduct, or it is in the national interest the consent be given. Quite clearly, these requirements have been inserted because of considerations of state sovereignty and comity between nations.

V. CONTROL OF LOCAL CONDUCT HAVING ANTICOMPETITIVE EFFECTS OVERSEAS

It is suggested that the courts may well be able to restrain or regulate conduct occurring within their jurisdiction that has no local anticompetitive effects but that does damage a local trader in its export markets. Two examples will illustrate this point.

The first was the bid during 1986 by an Australian subsidiary of Feltex New Zealand Limited to take over the Australian whitegoods manufacturer, Email Limited United. This case raised many of the issues confronted by the US courts in considering the impact of foreign conduct on local markets. Feltex was 50 per cent owned by Equiticorp Holdings Limited, another New Zealand company, which in turn held 23.6 per cent of Fisher & Paykel NZ Limited. Fisher & Paykel dominated the NZ whitegoods market and both exported to Australia and imported to New Zealand from Hoover of Australia. In Australia, it sold goods to Email and to GEC, a competitor of Email.

Following the announcement of the Feltex bid, the Australian Trade Practices Commission wrote to Feltex asking it to withdraw and threatening action in the Federal Court in the event that that request was not met. Feltex complied, although indicating that it might yet try again. TPC Chairman Robert McComas explained his concern about the bid in the following way:

> If ... control of Email is acquired, and if, for example, Fisher & Paykel decides to buy from Email, rather than from Hoover, that has an impact upon Hoover's competitiveness in Australia because, we would say, Feltex would be in a stronger position than Email to dominate because, through the common link of Equiticorp shareholding, it could reasonably expect that these investments would be run sympathetically rather than in vigorous competition with one another. And if Email took business that Hoover is now enjoying, even though it is export business, it all adds to profitability through efficiency of production and so on.
>
> ... What we say is that Equiticorp can clearly exert influence over this market because it has de facto control. We say it can exert substantial

> influence that way because it has joint control. If it chooses to withhold its support, it frustrates Fisher & Paykel ... We're looking at what Equiticorp's potential power is. So once we establish that Equiticorp is in a position to exert a substantial degree of influence over that and this, then the way that this operates enables us to argue that there is an association linking Fisher & Paykel and Email ... (*The Australian Financial Review*, 21 November 1986, p.54)

The view of the TPC was that the Feltex bid for Email was governed by s. 50 of the Trade Practices Act (*AFR*, 21 November 1986; *Sydney Morning Herald*, 7 November 1986, p. 17.[1] Section 50 prohibits a corporation from acquiring, directly or indirectly, shares in the capital or any assets of a body corporate if, as a result, the corporation would be, or likely to be, in a position to dominate a market or to substantially strengthen its power to dominate a market.

The second example of abuse of local market power that damages a local manufacturer in his export market comes from Europe and arose in the Court of Justice of the European Communities in *Instituto Chemioterapico Italiano S.p.A and Commercial Solvents Corporation v. Commission of the European Communities* (1974) CMLR 309. In that case, the Court considered the effect of Article 86 of the Treaty of Rome, which prohibits an abuse of a dominant position within the Common Market or in a substantial part of it, in relation to the refusal of a monopoly producer of a certain product called ethambutol to supply Zoja, an Italian company. Zoja required the product to manufacture certain products of its own (antituberculosis drugs), 90 per cent of which it sold outside the Common Market and in particular to third-world countries. It was argued against Zoja that any abuse of dominant position by the Commercial Solvents Group in respect of its product ethambutol was not regulated by Article 86 because, according to its literal meaning, the article prohibited abuse only 'in so far as it may affect trade between member States'. This argument was rejected by the Court, which said:

> The Community authorities must ... consider all the consequences of the conduct complained of for the competitive structure in the Common Market without distinguishing between production intended for sale within the Market and that intended for export. When an undertaking in a dominant position within the Common Market abusively exploits its position in such a way that a competitor in the Common Market is likely

[1] I am grateful to senior officers of the TPC who kindly supplied me with this material.

> to be eliminated, it does not matter whether the conduct relates to the latter's exports or trade within the Common Market, once it has been established that this elimination will have repercussions on the competitive structure within the Common Market.

Thus, the fact that goods are not sold on the local market did not deprive the Court of jurisdiction insofar as there was found to be an anticompetitive effect on production activity and hence on the competitive structure (in a broad sense) within the jurisdiction.

VI. THE TENSION BETWEEN COMPETITIVE CONTROLS OF FOREIGN COMMERCE AND STATE SOVEREIGNTY

It will be seen from what is said above that many of the complaints that the New Zealand and Australian Acts lack the necessary extra-territorial operation to provide an effective Australasian competition regime overlook the degree of extra-territoriality that presently exists. No doubt, that process could be taken further by legislative amendment. However, the desire of economists to achieve such a result takes little or no account of political considerations operating on a much broader front than competition law and policy. In particular, it has to be recognised that the extra-territorial application of competition laws inevitably clashes with fundamental concepts of state sovereignty. At common law, the courts will not entertain a challenge to the acts of a foreign state done within its own territory (*Johnstone* v. *Pedlar* [1921] 2 AC 262, 290). Conversely, however, they will not allow the enforcement, directly or indirectly, of foreign revenue laws (*Government of India* v. *Taylor* [1955] AC 491), or penal laws (*Banco de Vizcaya* v. *Don Alfonso de Borbon y Austria* [1935] 1 KB 140), or foreign laws of expropriation that are discriminatory in character (*Oppenheimer* v. *Battermold (Inspector of Taxes)* [1975] 1 All ER 538; *Re Helbert Wagg and Co. Ltd.* [1956] Ch. 323).

The 'act of state' doctrine will preclude any action against a foreign government that acts within its own territory in an anticompetitive manner (*American Banana Co.* v. *United Fruit Co.* [1909] 213 US 347, 357-8), and may also provide a defence to an individual who either acts on instructions of a foreign government or induces it to act anticompetitively. Thus, it was held in *Interamerican Ref. Corp.* v. *Texaco Maracaibo* (1970) 307 F.Supp. 1291 that an antitrust action would not lie against a private party in Venezuela, who, on instructions from the Venezuelan government, refused to sell oil to the plaintiff. 'When a nation compels a trade practice', the court said, 'firms there have no choice but to obey. Acts of business become effectively acts of the sovereign' (p.1298; see also Areeda & Turner, 1978:273).

Some recent US decisions, however, indicate that not every action of a foreign government or foreign state-owned enterprise is protected by the act of state doctrine. Thus, in *Outboard Marine Corporation v. Pezetal* (1978) 461 F.Supp. 384, 397 (see also Areeda & Turner, 1982:106), it was held that a state-owned enterprise formed for the purpose of trade and doing business in the United States was not immune from a suit for predatory pricing. This accords with what is usually called the commercial activity exception to the doctrine of sovereign immunity (a doctrine closely allied to that of act of state, although in theory at least distinct from it). Thus, in the House of Lords in *Rahimtoola v. Nizam of Hyderabad* (1958) AC 379, 422, Lord Denning said that no ground existed for granting sovereign immunity where a dispute within the territorial jurisdiction concerned 'the commercial transactions of a foreign government (whether carried on by its own departments or agencies or by setting up separate legal entities)'.

It is tempting to conclude that, where the subject activity of a foreign government or governmental agency is commercial in nature, the courts will hold that they have jurisdiction over it, at least where it takes place within the territory in which the court is sitting. However, commercial activities may be so intertwined with sensitive political and sovereignty issues that the courts will decline jurisdiction.

A graphic recent instance of this is the US decision in *International Association of Machinists and Aerospace Workers v. OPEC* (1979) 477 F.Supp. 553 (aff'd Trade Cas. 64143; see also Areeda & Turner, 1982:106-8). In this case it was held that the Court lacked jurisdiction to hear a claim that the price-fixing activities of OPEC breached US antitrust laws. The Court of Appeals of the 9th Circuit said:

> The importance of the alleged price-fixing activity to the OPEC nations cannot be ignored. Consideration of their sovereignty cannot be separated from their near total dependence on oil ... decisions about oil are the essence of sovereignty to the OPEC nations. (1981 Trade Cas. 64143, at 76854)

There was no doubt, the Court said, that 'the United States has a grave interest in the petro-politics of the Middle East or that the foreign policy arms of the executive and legislative branches are intimately involved in this sensitive area' (Trade Cas. at 76856); hence, the courts 'should not enter at the will of litigants into a delicate area of foreign policy which the executive and legislative branches have chosen to approach with restraint' (Trade Cas. at 76857).

Quite apart from any common law principle of the kind just discussed, it is to be noted that both Australia and New Zealand (in common with the United Kingdom and some other countries) have enacted what is sometimes called 'blocking legislation' (see Tonking, CCH Trade Practices Reporter:9109-324). This has been designed to protect citizens of those countries from being subjected to the antitrust laws of other countries and in particular of the US.

In Australia, the current statutory provision is the Foreign Proceedings (Excess of Jurisdiction) Act 1984 (replacing the Foreign Proceedings [Prohibition of Certain Evidence] Act 1976 and the Foreign Antitrust Judgments [Restriction of Enforcement] Act 1979). The need for legislation of this kind arose out of proceedings for treble damages issued in the US by Westinghouse Electric Corporation against a number of American and foreign (including Australian) uranium producers and the subsequent issue of letters of request to the Supreme Court of New South Wales (for a comprehensive discussion of this case and the resulting legislation enacted in Australia, see Tonking, CCH Trade Practices Reporter:9283-324).

In considering the purpose and effect of the 1984 Act and its predecessors, one must remember that legislation providing for the reciprocal enforcement of judgments — for example, the Foreign Judgments (Reciprocal Enforcement) Act 1973 (NSW) and the Reciprocal Enforcement of Judgments Act 1934 (NZ) — and for the examination locally of witnesses whose evidence is required by a foreign court 'before which any civil or commercial matter is pending' — for example, the Foreign Tribunals Evidence Act 1856 (Imp.) (in force in the States of Australia) (see also *Ukley* v. *Ukley* [1977] VR 121) — is and has for a long time been an important part of the regular judicial machinery.

The Westinghouse litigation, however, raised issues and considerations that went beyond the normal processes of enforcement of foreign judgments. (In fact, the US was not a prescribed country whose judgments were entitled to be registered and enforced under reciprocal enforcement legislation. However, the common law option of an action on a foreign judgment remained.) In particular, the Australian government was of the view that enforcement against the Australian assets of the Australian uranium mining companies 'would inevitably have produced severe, if not irreparable, consequences for the mining industry in particular and the national economy generally' ('*Amicus Curiae* Memorandum' filed by the Australian Government in the appeal proceedings relating to the default judgments entered by

Judge Marshall in the District Court of Illinois Eastern Division of 17 September 1979, para. 18; cf. the OPEC case cited above). It was also concerned at the penal effect of the treble damages claim brought by Westinghouse (para. 20). These considerations met with a stern rebuff from the Court of Appeals, 7th Circuit, which said of the *amicus curiae* briefs presented by the Australian and other governments:

> shockingly to us, the governments of the defaulters have subserviently presented for them their case against the exercise of jurisdiction. (Trade Cas. 63, 183 [1980-1])

The proceedings were later settled but the issue of foreign judicial encroachment on the trading policies of Australia continued to rankle. The Attorney-General, Senator Durack, stated publicly that the judiciary had no expertise to decide 'questions as to the significance of a trading law to another country; as to the need for stabilisation of prices; as to the need to deal with an unforeseen emergency in the export market' (reproduced in Tonking, CCH Trade Practices Reporter:9323). Subsequently, on 29 July 1982, the US and Australian governments executed an agreement entitled 'Foreign Antitrust Judgments — Agreement relating to cooperation between Australian and US governments June 1982' (reproduced in full in CCH, *Australian Trade Practices Reporter*, at 20 741). By that Agreement, each government was directed to consult with the other (a) in the case of Australia, where it had adopted a policy that may have antitrust implications for the United States; and (b) in the case of the US, where one of its enforcement agencies had determined to undertake an antitrust investigation 'that may have implications for Australian laws, policies or national interests' (Article 1). The governments were further directed that during consultations they should 'seek earnestly to avoid a possible conflict between their respective laws, policies and national interests and for that purpose to give due regard to each other's sovereignty and to considerations of comity' (Article 5). There was, of course, no guarantee that such administrative measures, even though at an inter-governmental level, would prevent US plaintiffs from seeking to prosecute their claims in the courts and from enforcing judgments against the assets (whether in the US or abroad) of Australian corporations. Even although the Foreign Antitrusts Agreement imposed an obligation on the US government at the request of the Australian government to report to the court on the substance and outcome of consultations between them (Article 6), the hostile reaction of the court in the Westinghouse case to government intervention raised serious doubts as to the likely efficacy of the Agreement (see Tonking, CCH Trade Practices Reporter:9323; Report of the Parliamentary Joint Committee on Foreign Affairs and Defence, published November 1983).

The 1984 Australian Act introduced so-called 'clawback' provisions. That Act had continued provisions introduced in 1979 (Foreign Antitrust Judgments [Restriction of Enforcement] Act 1979, s. 3), which prohibited the enforcement of a foreign antitrust judgment where the Attorney-General had made an instrument to the effect either that the making of such an instrument was desirable for the protection of the national interest or that the assumption of jurisdiction or the manner of its exercise or of any power by the foreign court was contrary to international law or inconsistent with international comity or international practice (s. 9). Where such an instrument was in force, however, it also imposed on a plaintiff who had recovered in Australia or in any other country an amount pursuant to a foreign antitrust judgment from a defendant who was an Australian citizen or company, a liability to repay that sum together (in some cases) with reasonable costs and expenses (ss. 10 and 11; in the case only of 'prescribed proceedings' see s. 4(1)). Not all foreign antitrust judgments were subject to these provisions. In particular, only those where judgment had been given for multiple damages or in any other antitrust proceedings to which that part of the Act applied (s. 10(9)). These include, however, any foreign proceedings that relate to or affect trade or commerce with other countries or among the States, the trading operations of an Australian trading corporation, the business operations of an Australian financial corporation (s. 5), and inter-State banking or insurance. While New Zealand competition legislation contains no provision for multiple damages, judgments given by a New Zealand court under that legislation and to which the powers contained in the 1984 Act otherwise apply will fall within the purview of that Act. New Zealand, for its part, has not yet enacted clawback provisions.

New Zealand's 1984 Act also continued previous powers that enabled the Attorney-General to make orders prohibiting the taking of evidence in Australia if he or she is satisfied that the making of such an order is in the national interest or that the assumption or manner of exercise of jurisdiction by the foreign court is contrary to international law or inconsistent with international comity or practice (s. 6(3)(4) and s. 7), though the test by which the Attorney-General is to exercise this power is whether the jurisdiction or power 'infringes or is prejudicial to the sovereignty of New Zealand' or it is 'desirable for the purpose of protecting the trading, commercial, or economic interests of New Zealand' that an order be made.

Finally, reference should be made to Parts III and IV of the 1984 Australian Act, which again have no counterpart in New Zealand. These empower the Attorney-General, in the national interest, to prohibit an

Australian citizen or residence or corporation that is incorporated or carries on business in Australia from performing in Australia an obligation that is imposed on him or it by the laws or judgments of a foreign country that regulates or controls international trade or commerce (ss. 13 and 14).

VII. CONCLUSION

No doubt because of the spectre of treble damages that the Westinghouse litigation posed for Australian uranium exporters, at least as measured by legislative action, Australia has been much more acutely aware than New Zealand of the threat that private antitrust and competition suits pose to its sovereignty and its trading and export policies. The protective statutory machinery established by the 1984 Act provides in this respect a recognition that inter-government consultative mechanisms, valuable and useful as they are, do not in the last resort provide a defence against the marauding interests of private litigants who are prepared to pursue their legal rights without regard to the broader political considerations. While even the US courts have recognised that considerations of state sovereignty must be respected — most notably in the OPEC case — the trend has been to give generous effect to rights created by antitrust laws.

The increasing trade between Australia and New Zealand arising from the CER Agreement and the granting for the first time of private law remedies in New Zealand is likely to bring into sharp focus (though without the acerbity of multiple damages) the conflict between matters of national interest and state sovereignty on the one hand, and the considerations involved in providing an effective, rights-oriented system of competition law on the other.

In line with the recommendations made by the OECD Committee of Experts on Restrictive Business Practices that there should be notification, coordination and the supply of information between member states in respect of investigations and proceedings that involve important interests of another country (OECD, 1986), the New Zealand Department of Trade and Industry has recently entered into formal consultative arrangements with the Competition Policy Branch of the Australian Attorney-General's Department in place of the previous more informal arrangements. It has also reached agreement with the Commerce Commission that it should advise the Department of any investigations it may be carrying out into restrictive business practices in another country so that the New Zealand government is better able to fulfil its obligations under the OECD directive.[1]

From the lawyer's perspective, however, there are quite separate strands of legal principle pulling against each other. First, there is the traditional concern of the courts to uphold national integrity, a concern reflected in the doctrines of state sovereignty and of act of state. On the other hand, the inclination of judges (based on their experience and training as lawyers) is to uphold private rights. Concern for private rights has led to the courts refusing act of state protection to state instrumentalities engaged in commercial activities and to the development of the locus of effects doctrine. However, the dictates of state sovereignty and of constitutional unity ultimately provide a point beyond which the courts will not go.

Any discussion of an economic union between Australia and New Zealand or of Australasian markets or of trans-Tasman competition policy must therefore take account of the fact that at the end of the line exist two separate states and two separate judicial systems charged with administering the laws of their respective states. As Kirby (1984) has pointed out, suggestions of a trans-Tasman Commercial Court to adjudicate CER-generated litigation encounter major problems caused by the manner in which the exercise of judicial power is conferred by the Australian Constitution. The same difficulty would arise if a regional appellate court were to be established, perhaps when appeals to the Privy Council from the New Zealand courts are abolished. Kirby proposed complete political integration as the only feasible legal solution to these problems, a proposal that has not received any support from politicians on either side of the Tasman. One is therefore left with the inevitability of a legal system or systems whose overall objectives do not equate the aims of a unified CER competition policy.

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[1]I am grateful to Messrs J. Stevenson and R. Feil and Ms Kathy Smith of the New Zealand Department of Trade and Industry for advice and assistance given to me in relation to this part of the paper.

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Comments on Thomas G. Parry and Kerrin Vautier

Comments on Thomas G. Parry and Kerrin Vautier

P.W. Gallagher

I should begin by saying that although the title of my position refers to trade rules, the rules in question are those of the General Agreement on Tariffs and Trade (GATT) and not the trade practices rules. My professional interest in CER is in the possible negotiation of an agreement on services trade. The topic of these papers is therefore a little outside my area of responsibility. However, the prospects for liberalisation of services trade depend very strongly on questions of business regulation. I must add in the same context that my remarks must be accepted as personal opinion and not official policy.

I found the papers from Professor Parry and Ms Vautier provided a clear exposure of the issues that arise when we consider the contribution that harmonisation of some aspects of trade practices regulations across the Tasman could make to the expansion and efficiency of the trans-Tasman market. Professor Parry has given us an analysis of the potential benefits of making regulatory decisions about the conduct of firms and the structure of markets in an explicitly trans-Tasman context. Ms Vautier's paper I found particularly interesting for its focus on a much broader agenda: the harmoni-

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sation (or perhaps the synthesis) of competition policy and economic analysis of markets.

I wish to comment on an apparent conflict in the two papers on the definition of 'market' for the purposes of determining 'dominance'. I will then turn to a question the two papers consider more briefly: the possible use of competition policy in place of the established trade safeguard mechanisms of antidumping and countervailing duties. Looking at the history of CER, there is reason to expect that the potential for conflicting claims about the fairness of competitive behaviour and the objectivity of regulation is at least as great in this area as in the area of mergers and takeovers.

Harmonisation

There has not, as yet, been any announcement of a decision to attempt the harmonisation of trade practices legislation across the Tasman, although to judge from the statements of the two Prime Ministers after their meeting at Waitangi last November it looks likely. Certainly, business organisations in both Australia and New Zealand have promoted the idea and it has a strong economic and an administrative logic.

As to the economic logic, the elimination of market access barriers on a preferential basis is designed to expand, at least initially, the number of potential competitors in the market and eventually to improve the economic efficiency of production, distribution and so forth (perhaps by reducing the number of competing producers in the longer term). It would obviously be inconsistent with such goals to maintain different policies and legislation regulating the nature of competition on each side of the Tasman. In the terms used in Professor Parry's paper, if you want a single market structure then you cannot regulate the conduct of firms in different regions of that market differently.

The administrative logic for harmonisation is that, with the possible exception of the administration of merger provisions, the competition legislation on both sides of the Tasman is already very harmonious, as illustrated by the fact that the footnotes in the New Zealand Commerce Act of 1986 cite equivalent provisions in the Australian Trade Practices Act, and the New Zealand courts have drawn upon Australian decisions in developing their own body of law.

The merger provisions of the legislation in the two countries are, despite procedural differences to which our speakers have alluded, based on very similar principles. Although Professor Parry has chosen to highlight the differences, I suggest that it would be fair to conclude even from his paper that similarities rather than differences characterise the two laws.

Market Definition and Dominance

The two papers spend some time discussing the approach to the determination of 'dominance' in the market. Professor Parry reaches the conclusion that the 'explicit recognition of a trans-Tasman market, rather than simply trans-Tasman import competition' would be beneficial because it would allow the assessment of dominance to be made in a way that is more consistent with maximising 'the opportunities for trans-Tasman economic integration within the CER framework'.

Ms Vautier, on the other hand, believes that the explicit adoption of a 'single market' notion would have 'little practical significance' for the assessment of dominance since 'the questions [now] asked in competition analysis, and the information assembled, should conceptually be the same, irrespective of the market boundary defined'.

Well, does an explicit 'single market' notion make a difference or not? What Professor Parry seems to be arguing is that market characteristics other than import shares (and prices) are relevant. He wants authorities on both sides to take into account the competitive behaviour of market participants 'including actual and potential countervailing power'. From Ms Vautier's account I assume she would argue that these are already taken into account in the Commerce Commission's assessments of dominance. And, although there may be arguments as to cases, the Chairman of the Trade Practices Commission (TPC) has, in the absence of explicit provisions in the Australian Act, specified that among the 'most important criteria which the Commission will apply to its determination of dominance' will be 'the extent to which, post merger, the acquiring corporation will be inhibited in its conduct by actions of its competitors, by import substitution or by powerful buyers' ('Policies and Priorities' 1986 ATPR 32 544). If that is indeed the case on both sides of the Tasman, then I assume Professor Parry's concerns are met.

The greatest difference, it seems to me, in the operations of merger regulations on both sides of the Tasman lies not in the definition of the dominance and benefit tests embodied in the legislation but in the way the TPC and the Commerce Commission must assess 'public benefit'. On this subject I found Ms Vautier's exposition of the relevant considerations interesting for the range of criteria she suggested, and I am led to agree with her general conclusion that the high threshold of 'dominance' should require an equally high threshold of public benefit. Professor Parry suggests that there is a case for more explicit recognition of 'public benefits associated with trans-Tasman considerations' including improved resource utilisation and enhanced international competitiveness.

Both of these objectives are reflected in the statements we have seen from the two governments on the expected benefits of CER. The question that arises, however, is how, in the absence of some form of competition authority with trans-Tasman jurisdiction — and let me add I am not now advocating such an authority — the Commerce Commission or the TPC can assess public benefit except with reference to the New Zealand and Australian public respectively. I suggest that it would be inappropriate for either authority, as it is presently constituted, to make a determination based on the prospect of public benefit to another country. This is a jurisdictional question that, it seems to me, no amount of 'harmonisation' in the legislation will affect; it would require a fundamental change in the legislation.

Such changes eventually may be possible in the context of CER. But I suggest it will require an act of what Sir Humphrey Appleby calls 'courage' on the part of a government to ratify the emergence of a dominant firm in the trans-Tasman market on the basis of benefits that, as far as they were visible, could be distributed entirely in the other country. The distributive problem to which Ms Vautier refers is important and, as she notes, not a problem that competition law itself is good at handling. If the public benefits of a merger are unevenly distributed while the costs are general, then some remedy may have to be found outside competition law.

Antidumping Laws

I would like to touch briefly on the question of dumping, which both papers mention, noting that it would be preferable to be able to rely on competition laws rather than the continued use of antidumping laws in safeguarding firms from predatory import competition across the Tasman. From a competition policy perspective, such a proposal seems to have a lot going for it. The criticism frequently levelled at the antidumping provisions of the customs legislation — that they tend to inhibit import competition by allowing domestic industry to use the procedures (or the threat of recourse to the procedures) as contingent protection — is not, in my view, without merit.

The principal benefit from the use of the trade practices legislation is that the threshold for determining predatory pricing under competition law is generally higher than under the antidumping procedures. What may be considered unfair import competition under the customs legislation may be acceptable under trade practices legislation.

In accordance with the GATT Code on Dumping, Australia and New Zealand both use the concept of 'normal value' of a product in the commerce of its country of origin to determine whether a good has been dumped. Prices below normal value — adjusted in various ways for transport and quantities — are dumping prices. If the imports in question are determined to cause or threaten injury to a domestic industry or to the establishment of a domestic industry, then a specific remedy, in the form of a penalty import duty, applies.

Under trade practices legislation the price of a good in relation to, for example, its usual wholesale price, or even in relation to average or marginal costs of production, is not relevant to proof of predatory action. This is clear from the Explanatory Memorandum accompanying the revision of s. 46 of the Australian Act. It is also reasonably clear, I think, from the decision of the courts in, for example, *Victorian Egg Marketing Board v. Parkwood Eggs 20 (1978) ALR 129*, where Judge Bowen decided that it was not merely the bargain prices the Victorians had visited upon Canberra that made their actions predatory, but it was also the fact that they intended Canberra's good fortune to be very temporary while they scrambled Parkwood's local market.

This case also highlights another important difference between the unfair trade laws and competition laws. In the competition laws, evidence of some predatory purpose is required. Purpose is irrelevant in dumping actions; there need only be a causal link established between the imports and the 'injury' suffered by domestic industry.

Probably the greatest difference between the two forms of protection from predatory pricing, however, is the availability of private action for breaches of competition law. Antidumping and countervailing duty action can be taken only by administrative authorities on the petition of firms representing the domestic industry. This introduces a potentially far greater degree of government intervention in the market than seems likely in private action under competition laws.

However objective the administering authority attempts to be, the nature of this intervention is to directly affect a basic parameter of competition in the market — the price of the good on the domestic market — by setting a level of antidumping duty on the imported product. The government's role in competition law cases, it seems to me, is a much preferable form of regulation. It consists in setting the framework within which competition can take place, without 'making' the market as it can do using the unfair trade laws.

As a point of clarification, I am not advocating a private right of action for the fair trade laws as they stand. This would be inconsistent with the GATT codes, but more important, on the basis of present thresholds, evidentiary requirements and remedies could well lead to a flood of frivolous or speculative complaints.

Despite the apparent benefits of the use of competition law to guard against predatory pricing of goods in trans-Tasman trade, there are a number of difficulties to overcome before such an approach could be implemented:

Definition of market. This is essentially the same problem that Professor Parry and Ms Vautier have dealt with in the context of merger legislation. Both the customs antidumping legislation and the Trade Practices Act define the market, and, in the case of the customs legislation, the affected industry, in national terms. If the dumping legislation is to be set aside in favour of competition law, then the definition of 'market' will have to be changed.

Jurisdiction. If conduct that contravenes the competition laws takes place in both Australia and New Zealand, some arrangements will be needed to ensure that the courts in either country can enforce their findings in both countries. Similarly, investigating authorities would need special powers to make their investigations in the other jurisdiction.

Remedies. Enforcement of remedies (damages) in one country against a party from the other country would be ineffective if that party had no assets in the country where the judgment was issued. Reciprocal arrangements may be needed.

Discrimination. Not applying the lower threshold dumping legislation to each other while continuing to apply antidumping procedures to third parties may not be approved by other members of the GATT Dumping Code.

Finally, before getting too starry-eyed about the prospect of eliminating the use of the dumping provisions, let us remember that Australia has one of the highest incidences of dumping case initiation in the world. This could be because we are more often dumped upon than other countries, or because we are particularly vigilant when it comes to anticompetitive behaviour by importers. Or it could be because there are a large number of industries that find it in their interest to invoke antidumping sanctions early and often; industries that may consider it in their interest to spring to the support of the present use of antidumping legislation.

Panel Discussions
Sydney and Auckland

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Panel Discussion: Sydney

W.R. McComas: I'd like to comment on three practical problems arising from the impact of CER on the operation of the Commerce Act and the Trade Practices Act.

First, the intra-national takeover — the sort that occurs within one of the countries. If we're going to amend the Trade Practices Act to the effect that, in considering a merger between an Australian company and a New Zealand company, the Commission should regard the market as consisting of both countries, what are we then going to say about the market for purposes of internal takeovers? Are we to ignore the principle of s. 50 of the Act that says that in looking at a takeover the Commission should take into account substantial markets in Australia or in a State or in a Territory? Are we then going to take into account substantial markets in Australia in a State or a Territory or in New Zealand? If we are, then we're back at square one.

Second, in the context of the House of Representatives Committee that's going to review the Trade Practices Act, great care should be taken to ensure that any amendments should not destroy the present harmony between the Commerce Act and the Trade Practices Act. While there are subtle differences in drafting (and certainly there are major differences in procedure), there has been a complementary attempt in New Zealand to track Australian law in the interests of ensuring as far as possible that Australian businesspeople know that New Zealand law is not too different from Australian law, and vice versa. If we now start to apply special rules to Australia, immediately the harmonisation between the Commerce Act and the Trade Practices Act falls into the same category as the so-called uniform Companies Act before the Maroochydore agreement. It will be similar but not the same.

Third, the Trade Practices Commission takes consideration of New Zealand suppliers in examining takeovers involving both countries. The Commerce Commission takes a similar approach towards Australian suppliers. Take for example the TPC's consideration of the Feltex proposal to take over Email, which coincided with the Commerce Commission's consideration of the proposal of Equiticorp — the ultimate controlling entity of Feltex

— to increase its shareholding in Fisher & Paykel. Email and Fisher & Paykel were the pre-eminent suppliers of whitegoods in their respective countries — Email in Australia and Fisher & Paykel in New Zealand. In considering Feltex's bid for Email, the TPC took account of the control it would achieve, through its association with its ultimate parent, Equiticorp, of Fisher & Paykel, which was regarded as a viable alternative supplier to Australian consumers of whitegoods. We took the view that this association would have placed Feltex in a position of market dominance had it taken over Email. In its consideration of Equiticorp's application to take over Fisher & Paykel, the Commerce Commission took account of the fact that Feltex was aiming to take over Email. There was thus an interaction between the two pieces of legislation such that each took into account the opportunities that market influence in the other would have on a particular transaction.

Let us harmonise our laws as far as possible, legally and economically. But let us not throw out the significance of national laws in the process. Even in the European Community, national laws are still fiercely protected. The European Commission might take a particular view towards a proposed merger, but it doesn't follow that the individual member states will not mount their own investigations.

Thomas Parry: I wasn't confining my remarks in the CER context to Australia-New Zealand mergers. The point that's being missed is that the intent of CER is to move towards economic integration and the free movement of goods, services and financial capital. If and when that's achieved, it will put New Zealand in much the same position as the States of Australia. One would need to treat Australia and New Zealand as forming a single market with regard to all mergers and takeovers, quite apart from whether they involve Australia-New Zealand takeovers bilaterally or mergers and takeovers more generally.

Kerrin Vautier: I'm pleased by the degree of support, tacit or explicit, for efficiency as the appropriate objective of competition law. I have some reservations about a competition/consumer welfare paradigm, since I think the correct paradigm is competition/efficiency/consumer welfare. This recognises that competition is not an end in itself, but is there to serve efficiency and therefore consumer welfare. It also reveals that there may be a need for some trade-off analysis involving competitive detriments and loss of allocative efficiency as opposed to public benefit in the form of productive efficiency.

The focus of our concern is market power and, in particular, undue market power. That focus should help direct the questions that we should be asking under competition analysis. It should also identify the relevant information that has to be collected, whether it's about market definition, or entry conditions analysis, or whatever.

I would like to stress that market definition is clearly relevant to the analysis but is not an end in itself. What's important about these analytical constructs is to be aware of what information is in them and what isn't. For example, if you define market shares in terms of sales, you may get a very different result than if you define them in terms of capacity. We need to be aware that defining them in terms of capacity may give a better answer about the responsiveness of incumbents in the market to price increases.

Finally, there is some debate about where Australia and New Zealand should go on their merger and takeover systems. New Zealand has a mandatory pre-clearance system, but a lot of pressure is building up to review it because it captures so many mergers and takeovers — probably 96 per cent — that have no competition implications. That's obviously very wasteful. Perhaps we should go to a mandatory notification system with a number of trigger points.

Daniel Oliver: In the US we've made a great deal of progress. We emphasise markets and consumer welfare (though we don't make much of the distinction between allocative and productive efficiency). This represents a considerable improvement over where we were in antitrust 15 years ago; and I can't see that changing for years to come, despite the pressure from special interests.

I'm curious to know what is meant by 'the public interest' and what exactly that encompasses.

R.R. Officer: By 'the public interest' economists normally mean the social good, including producers, consumers and everyone else. Our concern is that some decisions have used the term to refer exclusively to consumers, which I think is wrong from an economic point of view.

Robert Baxt: When politicians talk about 'the public interest', they often have in mind different issues from those that are relevant to trade practices law. During the BHP takeover battle, some of them wanted the TPC to block the takeover; they were concerned about the lack of action on the part of the National Companies and Securities Commission; they were concerned with the interests of the workforce, the shareholders and others. It can be very confusing to lump all these issues together as the proper concern for trade practices law, which is basically about competition policy.

If the Australian Securities Commission is established, we may see a very different form of coalescence between company law and trade practices law. I am concerned that there may be confusion between them. It is important to ensure that the distinction between the two kinds of policy is preserved. CER is relevant in this context, since company law is one of the areas of harmonisation between Australia and New Zealand.

Another matter I want to comment on was raised by Warren Pengilley: the education of not only judges but the community generally in the philosophy of the trade practices law. Our Trade Practices Act has been in force only since 1974. In the US, it took the courts a number of years to begin to understand some of the economic issues relevant to the antitrust laws. There is a very real problem in asking our courts to evaluate some of the provisions of the Trade Practices Act. The task of educating the community in trade practices philosophy is still largely incomplete.

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John Fernyhough is currently Chairman of the Electricity Corporation of New Zealand Limited and Deputy Chairman of the New Zealand Forestry Corporation. He is also a director of several other well-known New Zealand companies. Until 1979 he was a practising lawyer and a partner in Russell, McVeagh McKenzie, Bartleet & Co in Auckland, and for six years until 1985 was Deputy Chairman of the New Zealand Securities Commission.

Panel Discussion: Auckland

Warren Hunt: I'd like to make some comments from the grass roots perspective of one who happened to be Managing Director of New Zealand Forest Products Ltd (NZFP) and simultaneously a director of Amcor (an Australian Company), UEB, and Wattie Industries Ltd.

In deference to John Collinge and Kerrin Vautier, I hasten to say that I have no quarrel with the Commerce Commission *per se*. But I am critical of the Commerce Act.

It's far too narrow and inflexible, and focuses obsessively on dominance in the market and public benefit situations. Take the proposed NZFP/Amcor merger, in the context of CER. We considered the two companies would be complementary to one another: NZFP with its vast softwood resources, and Amcor with its vast hardwood resources. We thought that a merger would embody comparative advantage, so fulfilling one of the aims of CER, and that economies of scale would create a substantial and competitive force in our natural markets in South-East Asia and the Pacific Rim. However, the Commerce Act's focus on domestic aspects of trade — market dominance and public benefit — led the Commission to reject the merger. In practice it denied both countries substantial benefits.

Again, the Commerce Act has constrained growth. Not long ago NZFP reviewed its operations in response to criticism that it had lost direction. We decided in the end not to diversify any further but to concentrate on doing what we did best. Accordingly, NZFP made a takeover bid for the UEB converting operations; this was an example of downstream vertical integration of the kind that's common in the forest products industry and universal in Australia and North America. But once again the Commission invoked market dominance and public benefit, and prohibited the takeover. The Commission's general approach also killed off Fletcher Challenge's proposed takeover bid for NZFP.

The Commission is in effect telling companies that they should not expand in their areas of comparative advantage. The result is to drive companies offshore: the classic examples are Fletcher Challenge in Canada and Carter Holt in Chile. Those companies' overseas ventures happen to have been successful. But it's hard to see how the New Zealand public benefits much from this outcome.

Barry Brill: I'd like to focus on three major concerns I have with the operation of the Commerce Act.

First, I don't think it's intended that the Commerce Commission should be an arm of the government's redistributive policies. Yet it has got itself involved in redistribution by 'counting heads' to assess public benefit.. In some of its decisions it has shown concern that the benefits that may outweigh the anticompetitive effects may never get beyond the shareholders of the firms concerned. In my view, if a merger creates wealth, it's inevitably going to be to the long-term benefit of the general public. It's not the function of the Commission to get involved in the question of the particular individuals to whom the wealth accrues: it should merely determine whether such benefits are created.

Second, once it's determined that there is a reduction of competition, it seems impossible to give tangible weight to the public benefit principle. In one proposed merger, it was established that the merger would increase market dominance by less than 1 per cent of the combined assets of the two firms. This was enough to persuade the Commission to prohibit the merger, regardless of the public benefit that might have flowed from it. In the end, public benefit contributed not a single dollar on the other side of the balance; my hunch is that it was worth a great deal more than that. Without any common denominator, the Commission is ill-equipped to weigh apples against oranges.

Third, productive efficiency seems to count for nothing. In such a small market as New Zealand, there are probably things we shouldn't really be doing, and areas where we should reduce capacity. The Commerce Act places no value on such changes under public benefit; and it rules them out under the market dominance criterion. In my view the Act should be amended to take account of cost savings that may be unique to very small domestic markets.

John Collinge: Perhaps I should clarify the role of the Commerce Commission. The Commission is a regulatory, not a policy-making, body. It had no input into the Commerce Act of 1986; it was not even invited to appear before the Select Committee. It therefore has no axe to grind with regard to the principles that govern the Act. I have never hidden my own particular view that the Act is defective in many respects.

On the proposed NZFP/Amcor merger, the Commission found that the potential benefits were weighty. But on the other side of the coin the merger would have led to market dominance; and although it's difficult to quantify the harm this would have done to the New Zealand public, it's worth noting that the price of kraft paper (the primary component of cardboard) tended to be as high as that of the American landed product, which has a duty component of 34 per cent. This seems to represent a significant loss arising from market dominance.

However, the crux of the matter is that the cases for and against the merger were both exceptionally good. The Commission came down against the merger because it decided that the onus of proof had not been discharged. As we saw it, the Act favours domestic competition, so that the onus is on the applicant to demonstrate decisively that the balance of advantage lies in a course of action that diminishes domestic competition.

John Fernyhough: The basic issue is efficiency and whether we use market mechanisms or intervention to control monopolistic and anticompetitive behaviour. My own view is that the market is a remarkably effective mechanism for that purpose. Many of the voluntary agreements made by unregulated businesses that seem to be anticompetitive are not necessarily anti-efficiency. An agreement was made between the pathologists in Auckland to stop setting up depots alongside one another to get more business, which seemed sensible at that time. But when the demand for their services had sufficiently increased, the agreement broke down. In my experience, such agreements survive only to the extent that they do increase efficiency: when they cease to, they soon collapse. So the market doesn't necessarily get it wrong when it leads to anticompetitive agreements, since it breaks those agreements down if they become harmful.

The market could also have solved the problem that John Collinge identified in connection with the proposed NZFP/Amcor merger. If the merger had gone ahead and created a monopoly in the kraft paper market, enormous pressure would soon have emerged to lower the duty on imported paper, thus making the market contestable. That seems to me a superior outcome to the one imposed by the Commerce Commission.

The breakdown of import licensing and of tariff barriers in New Zealand has made markets here so contestable that the case for a regulatory agency to preserve competition is much weaker than it was. If we do want to prohibit some anticompetitive practices, such as vertical price-fixing, all we need to do is identify them and legislate against them.

John Collinge: The case for regulation is not that the market doesn't solve problems. In the long run, monopolies like empires are vulnerable to inevitable changes in their environment. The argument is that there is a need to protect consumers in the short and medium terms.

I'd like to stress the point I made in my paper that the New Zealand legislation (like the Australian) does not equate public benefit with competition. Sometimes competition is wasteful. Sometimes competition may have to be sacrificed to the furtherance of CER objectives. This reflects a pragmatic approach to the interpretation of 'public benefit', which can perhaps be justified by New Zealand's special position as a small, exposed and vulnerable economy.

Regulatory agencies employ basically three types of procedures. Under the 'strike-down' procedure, as used in Australia, nothing happens until the agency initiates action with regard to a proposed merger. In New Zealand, firms have to apply for an 'advance clearance' and the Commission has to provide reasons for giving one. The US has a pre-notification system: firms proposing to merge must notify the agency 30 days in advance, and if the agency takes no action the merger can go ahead. There's something to be said for each procedure. But the New Zealand system does raise problems. In the first year of operation under the 1986 Act, the Commerce Commission had 330 mergers and takeovers to scrutinise, but at the most only ten of those had serious competition implications. So we processed 320 approvals for no competitive gain whatsoever. As for the Australian strike-down procedure, its main weakness is that it isn't very transparent, and the public cannot see the competition goals that the agency is trying to achieve. My own preference is, therefore, the American pre-notification system.

Daniel Oliver: That system certainly works very well in the US. Business finds it not too burdensome, and cases can be decided very quickly. Of the 2500 notifications submitted to us in 1987, there were only 26 in which the agency needed to ask for additional information; and only nine of those were blocked.

Since we believe that mergers are by and large efficient, we tend to let them through. However, there do need to be some regulations governing them. But if I were writing them from scratch, I wouldn't write the Robinson-Patman Act (but remember that American antitrust law is largely common law as opposed to statutory law). What is important is that we keep promoting free market principles and keep having conferences like this to promote them. The more we talk about free market principles, the harder it is for governments to make more regulations.

APPENDIX

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Antitrust Policy and Competitiveness

Thomas DiLorenzo

In a 1982 treatise, Yale Brozen argued that antitrust laws are 'themselves restraining output and the growth of productivity ... [and] are contributing to a deterioration of the competitive position of the United States in international markets'.

Antitrust policy has changed considerably since Brozen issued his warning. Antitrust scholars and policy-makers have increasingly embraced the evidence which supports Brozen's (and many others') view that industrial concentration is most often caused by efficiency, not monopoly. Policy now recognises that big business is not necessarily bad and that restrictions on size *per se* can be counterproductive.

But despite many improvements in antitrust policy — too many to categorise here — there is much work to be done. To a large degree, antitrust policy still stifles productivity while ignoring some glaring instances of monopolisation. Antitrust reform, moreover, can improve American manufacturing competitiveness.

Reforms That Can Improve Competitiveness

Most of the beneficial changes in antitrust policy in recent years have been the result of deregulation, but there are several areas where a wider application of antitrust may yield improvements in competition and productivity.

One possibility is to end the antitrust exemption for labour unions (Weidenbaum, 1979).

The Norris LaGuardia Act of 1932 exempted unions (with some exceptions) from antitrust prosecution. The problem is that this exemption creates a double standard in antitrust. Price-fixing conspiracies by businessmen are vigorously prosecuted by the Federal Trade Commission, the Antitrust Division of the US Justice Department, State Attorneys General, and the private antitrust bar. Industry-wide bargaining by labour unions also constitutes price fixing, but is ignored by antitrust law.

Perhaps more importantly, industry-wide, rather than company-wide, bargaining has been determined to be a hindrance to productivity. This is a subtle point, and requires some clarification.

Unlike other countries such as Japan, American unions bargain on an industry-wide basis. This enables them to fix the prices, i.e. wages, their members are paid, just as if there had been a conspiracy. Bringing such price-fixing conspiracies under the umbrella of antitrust would seem only fair.

In addition to fairness, another advantage is that such enforcement would likely have a positive impact on manufacturing productivity by giving unions incentives to eliminate such inefficient practices as featherbedding. Consider the incentives facing a union that is organised industry-wide versus another that is organised company-wide. In the former case the union may insist on a featherbedding contract that requires several people to perform a job that may require only one person. If international competition is not strong, featherbedding will not necessarily put any one firm at a competitive disadvantage, because with industry-wide bargaining all firms must comply with the contract.

By contrast, with company-wide bargaining any individual firm that was subjected to featherbedding would lose market share, be forced to cut back production, and lay off workers. Thus, it would be as counterproductive for the union as for the firm. Such inefficient practices would become rare in a more competitive union environment that lacks industry-wide bargaining.

Some unions have begun to realise that restrictive work rules, featherbedding, and supra-competitive wages have reduced American industry's competitiveness and have slowly begun to change their ways. For example, the contracts signed by the United Auto Workers (UAW) with Ford and GM in 1987 sharply reduced the number of job categories and allowed for greater flexibility and cooperation with management in an attempt to improve productivity.

But such positive changes were only begrudgingly accepted after decades of decline in the US auto industry and the loss of thousands of jobs.

Union executives are still not entirely pleased with the situation; many unions oppose such changes and still look to protectionism as an 'answer' to their problems. This is why altering the antitrust laws to apply to unions may be desirable. It would provide added incentives for unions to be more concerned with increased productivity as a means of generating job security.

Going a step further, revised antitrust law could encourage more productive labour relations by challenging the government-sponsored union monopoly fostered by so-called exclusive representation. Section 9(a) of the National Labour Relations Act of 1935 states that a union that is selected by a majority of employees in a firm's bargaining unit in a representation election shall be the exclusive bargaining agent for all workers in that bargaining unit. Employees who may wish to be represented by another union, by a non-union representative, or by themselves, are legally precluded from doing so.

Thus, unions are legal monopolies in the employee representation business. Like all monopolies, they can be expected to be less concerned about the welfare of their 'customers,' i.e. union members, than if there were competition in the market for employee representation services. This is one reason why for so many years unions bargained for higher wages while reducing productivity through featherbedding and other restrictive work rules.

Higher wages are certainly desirable; but when coupled with declining productivity they are a recipe for industrial decline. Many workers realised this and objected, but were ignored by their unions. The unions, as opposed to many of their members, benefited from these arrangements. Both higher wages and greater numbers of employees meant higher levels of union dues revenues — at least until the effects of international competition were felt. It is doubtful that unions would have clung to this strategy for as long as they did, had government policy allowed competition from other unions or from non-union employee agents.

Antitrust and State Antitakeover Laws

One of the strongest reasons that the 'bigness is bad' theory of industrial organisation is in disrepute is the understanding that corporate takeovers may increase efficiency by disciplining ineffective corporate management. Poorly-run businesses that are 'undervalued' by the stock market make attractive takeover targets. Thus, the market for corporate control provides incentives for efficiency. Those business managers who are ineffective run the risk of being replaced in the course of a takeover.

Because of this 'new learning', federal antitrust authorities have looked more kindly upon corporate takeovers in recent years. This has probably increased corporate efficiency, but not by as much as one would think. The reason for only cautious optimism is that, in response to changing federal policy toward takeovers, there has been a shift in antitrust activity to the States. More than 20 States have enacted antitakeover legislation that makes it more costly for takeovers to occur. This tends to give businesspeople in those States effective tenure, much like what a university professor enjoys. The effect in both instances is all too often that the businessman or the professor becomes less productive, and less competitive.

If the gains of federal antitrust reform are to be preserved, it may be well advised to use the federal antitrust laws to challenge State governments that have enacted antitakeover legislation that interferes with the market for corporate control.

Getting to the Root of the Antitrust Problem

The fact that antitrust litigants, dissatisfied with federal enforcement of antitrust laws, have turned to the States to voice their complaints underscores the tentative nature of the antitrust reform that has taken place in the past decade. Even though federal antitrust may have exhibited a more enlightened view in recent years, State governments have regressed.

Antitakeover laws are just one example of how State governments have largely ignored the lessons of antitrust history. States are also involved in other areas, such as predatory pricing and price discrimination cases, that have not been of much interest to federal policy-makers. And one must realise also that approximately 90 per cent of all antitrust cases are still litigated by the private antitrust bar, not federal or State governments. Thus, unless there are fundamental changes in antitrust laws, beneficial changes by one level of government may be undone elsewhere.

State goverments (and the private antitrust bar) may be constrained, however, in the amount of antitrust mischief they can make. They will be constrained by new legal precedents that have evolved which take a kinder view toward large-scale production and other business practices that were once suspect. But as we approach the 100th anniversary of the Sherman Antitrust Act of 1890, it is time the antitrust laws were reassessed.

One area in which antitrust reform is sorely needed is the Department of Justice's merger guidelines. The 1968 merger guidelines adopted the 'structuralist' view of industrial organisation that competition may be defined in terms of the number and size distribution of firms in an industry. Under the old guidelines, the magic number was the four-firm concentration ratio, or the share of sales accounted for by the four largest firms in the industry.

These guidelines were revised by the Reagan administration in 1982 to incorporate the reality that market concentration criteria do not necessarily have anything to do with monopoly power because they ignore such things as substitute goods, entry, potential entry, technological change, and foreign competition.

It may seem puzzling, in light of the 'new learning' in industrial organisation, that the Justice Department maintains such an outdated practice. Former Federal Trade Commission economist William Shughart offers an explanation:

> What explains the [Reagan] administration's apparent acceptance of the structural approach to antitrust policy, that is, who gains from narrow merger guidelines? The answer seems clear. Bureaucratic incentives run strongly in the direction of producing visible output, and tighter screens give the enforcement agencies more mergers to investigate. The more work there is for government, the more opportunities there are for the attorney staff to build the human capital that is rewarded when they subsequently take jobs in big antitrust law firms... The private antitrust bar gets to defend more clients, and economists working as consultants on both sides of the issue earn larger incomes. (Shughart, 1987:928)

Thus, according to Shughart, bringing antitrust policy up to date with economic thinking will require a victory of economic knowledge over special-interest politics, a difficult but not impossible task.

'Big Brotherism' and Pre-Merger Notification

Another relic of the structuralist view of antitrust is the so-called pre-merger notification process established by the Antitrust Improvements Act of 1976. This process requires firms above a certain size to announce in advance their intention to merge. The stated purpose of the Act is to give federal antitrust authorities enough time to study proposed mergers. There is evidence that the authorities, in fact, do study proposed mergers with a vengeance. To comply with the demands of the Act, firms proposing mergers have literally delivered paperwork to the Justice Department and FTC in truckload lots.

The paperwork burden of the pre-merger notification process is probably only a small part of the cost to society of this particular law. As explained by Shughart:

> Premerger notification ... requires firms to announce publicly that they have discovered a profit opportunity in the economy. In cases where the acquisition is postponed while the government seeks additional information from the prospective merger partners, other firms, which had been unaware of the existence of undervalued assets, are given time to step forward with takeover offers of their own ... [which] allows these other firms to free ride on the information revealed by the premerger announcement. This tends to reduce ... efficiency ... for two reasons. First, it lowers the value of information about ... profit opportunities to firms operating in the same industry. Second, it promotes conglomerate mergers because such mergers are less likely to be delayed. (Shughart, 1987:929-30)

Advocates of stricter antitrust regulation often complain about the 'waste' of resources whenever steel companies acquire oil companies or tobacco companies merge with soft drink manufacturers. But it is important to realise that it is the pre-merger guidelines that cause such actions. The firm that typically steps forward once a previously announced merger proposal is dropped due to antitrust considerations is one that has no overlapping markets. This is yet another reason why it is time to consider overhauling federal regulation of mergers.

New Attempts at Antitrust Activism

Regrettably, there appear to be efforts afoot to reverse this trend toward reform of antitrust policies. A number of antitrust scholars, in and out of government, are attempting to revive the discredited antitrust notions of predatory pricing and 'foreclosure'. The rubric of this attempted resurrection is 'raising rivals' costs' (*rrc*) (see Salop & Krattenmaker, 1986). The general idea is that a 'dominant' firm in an industry exercises some sort of strategy to increase the costs of its rivals. Such practices as exclusive dealing contracts, advertising campaigns, R&D spending, vertical mergers, and other forms of non-price competition raise rivals' costs in a predatory manner, charge the *rrc* theorists.

Another example of an *rrc* strategy is 'real foreclosure'. A firm can supposedly purchase such a large quantity of an input that the price of the input will rise for its competitors, thereby placing them at a competitive disadvantage.

Another possibility, according to *rrc* theorists, is that a manufacturer may act as a 'cartel ringmaster' (Salop & Krattenmaker, 1986:238). The idea here is that contracts between a 'predatory' firm and its input suppliers can require suppliers to deal with the predator's rivals only on disadvantageous terms. By getting several input suppliers to agree to charge monopolistically high prices to its rivals, the predatory firm acts as a 'cartel ringmaster' for these suppliers in return for a concession on the cartel price. The input suppliers, too numerous to cartelise on their own, are supposedly happy to comply with the scheme.

Another new predatory technique is what *rrc* theorists call the 'Frankenstein monster' technique. According to this theory a firm may enter into enough exclusive dealing contracts with enough input suppliers that the market structure of the input supply industry will become so concentrated that the remaining suppliers will be able to collude and charge monopolistic prices to the predator's rivals.

This is not the place for a detailed critique of this new theory of non-price prodation, but a few comments are appropriate. For one thing, the *rrc* models are long on theory and short on evidence. And the theory itself is very weak for a number of reasons.

First, the proponents of raising rivals' costs all but ignore potential counterstrategies by rival manufacturers. There is little explanation of why rivals would sit back and let a 'predator' prey on them in this way. For this to happen would require the odd assumption that the predatory firm is almost omniscient, whereas its rivals are nearly completely ignorant of what is going on around them.

Perhaps a larger problem with the *rrc* theory is that it largely ignores the 'new learning' in industrial organisation theory. The Frankenstein monster technique, for example, assumes that predatory behaviour can raise rivals' costs by altering the market structure in input markets. But research in industrial organisation over the past 20 years has shown market structure *per se* does not necessarily have any effect on how competitive an industry is.

Furthermore, *rrc* crucially relies on the **assumption** that entry will not take place. A typical example is the statement by Salop and Krattenmaker that 'assuming that there are entry barriers, the one remaining retailer can then monopolise trade with the manufacturer's rivals. That retailer is the Frankenstein monster' (1986:241). Of course, entry barriers are almost always overtaken if given enough time, especially when one considers the importance of international competition.

Another odd assumption of the theory is that 'where rivals' ability to substitute costlessly is limited, exclusionary rights [contracts] can injure consumers' (Salop & Krattenmaker, 1986:234). Of course, as long as resources are scarce, **nothing** can be substituted 'costlessly'. Scarcity is defined as an entry barrier in this theory, which virtually guarantees that markets will be modelled as monopolistic.

Legal Tests of Non-Price Predation

The proposed test to determine if conduct that raises rivals' costs is harmful involves a two-stage inquiry. The first question asked is, 'Did the firm's conduct "unavoidably and significantly" increase the costs of its competitors?' If the answer to this question is affirmative, the second question is, 'Did raising rivals' costs enable the excluding firm to exercise monopoly power, that is, to raise its price above the competitive level?' (Salop & Krattenmaker, 1986:214). If the answer to the second question is also affirmative, then the firm is guilty of raising rivals' costs and, thereby, guilty of reducing consumer welfare.

Application of the first stage of this test would find firms that contribute most to consumer welfare to most likely be guilty of anticompetitively raising rivals' costs. The more efficient a firm is, the more 'unavoidably and significantly' it raises the costs of its rivals, if its rivals choose to compete. Only firms that are no more efficient than their rivals, and that make no (or only weak) attempts to become more efficient, can 'pass' the first stage of this test.

Moreover, the test could conceivably create perverse incentives: firms wishing to avoid being scrutinised under the second stage of the test might reduce their level of efficiency or the attractiviness of their product. It has long been held that many businesses have responded to antitrust by trying to be competitive, but not too competitive, for fear of being sued by their rivals.

Another problem is that because competition induces firms to continually improve their market performance, far too many firms will find themselves being scrutinised under the second stage of the test as a result of failing the first stage. For the second stage to be operational, the courts must have some definition or method of calculating the competitive price, for it is this price that provides the benchmark for whether the exclusionary practice is anticompetitive. The problem is that the courts in the United States have a long history of refusing — justifiably — to pronounce which prices are and are not reasonable.

The Political Abuse of Antitrust

It is very likely that should the theory of raising rivals' costs be adopted by the antitrust authorities it would be used, as many other doctrines have been, as a rationale for uncompetitive firms to sue their more successful rivals. As stated by [former] FTC Chairman Daniel Oliver in a presentation before the FTC Commissioners (18 March 1988), 'it would be all too easy to use the theory of raising rivals' costs to challenge pro-competitive, pro-consumer arrangements'. Thus it is very likely that granting antitrust authorities greater powers to pursue non-price predation cases would harm rather than help American industrial competitiveness.

Despite the FTC Chairman's critical comment, much of the work done on the theory of raising rivals' costs has been done at the Federal Trade Commission. Indeed, there appear to be strong pressures at the FTC to employ the theory in a more activist antitrust policy.

Conclusions

Despite some promising changes, much antitrust policy remains misguided and detached from modern understanding of industrial organisation. Antitrust policies are still largely based on the structuralist view of markets. This approach may serve the interests of those who desire an 'objective' measure of monopolisation, but it has not served the public well.

Not only has antitrust been largely anticompetitive by restricting efficiency-enhancing mergers, it has also been misdirected. Specifically, there are numerous examples of blatant monopolisation, such as industry-wide labour agreements, which have been spared from enforcement. These exemptions have had a negative effect on manufacturing productivity and ultimately have harmed the very workers assumed to be helped.

Finally, an activist antitrust policy to combat so-called non-price predation by 'raising rivals' costs' would likely be a giant step backward. The chances are just too great that such a legal framework would be used by antitrust litigants to sue their competitors for **competitive** actions that always inevitably raise rivals' costs if rivals try to compete.

If American firms are to be internationally competitive, government can do its part by minimising its role in the marketplace. Certainly, what American manufacturing and American consumers do not need is a resurgence of antitrust activity.

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