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## **OECD Global Forum on Competition**

### **COMPETITION POLICY IN SMALL ECONOMIES**

-- AUSTRALIA --

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## AUSTRALIA

### SPECIAL ASPECTS OF COMPETITION POLICY IN SMALL ECONOMIES

#### 1. Overview

Australia's competition law is similar to that applied in most larger economies; however some additional competition policy features have been adopted in Australia's traded and non-traded sectors. In the traded sector, flexible merger laws and an authorisation process consider international factors, and some industries are subject to additional legislation. Australia has also instigated reforms under its National Competition Policy (NCP) which have particularly focussed on the non-traded sector. These reforms have shown significant benefits, which also flow through to the traded sector.

#### 2. Competition policy and small economies

Competition fuels economic growth, and benefits consumers through lower prices and a greater choice of goods and services. Market rivalry spurs firms to operate more efficiently, and to develop and adopt new practices and technologies to keep ahead of, or even just to keep up with, the pack. Without competition to check market power, prices are higher, productivity is lower, and the incentives to innovate are muted, producing a 'deadweight' loss, greater x-inefficiency and technological stagnation. Competition is the route economies take to maximise their welfare gains.

There are no discrete competition policy toolkits labelled 'large' or 'small' for different sized economies; the principles are the same regardless of size. There are, however, factors that impact differently on small economies, as they tend towards concentrated markets and the exercise of market power. The primary influences are openness, globalisation and technological change. In the traded sector, imports drive markets toward a competitive equilibrium and technological innovation generates new products and services. The non-traded sector has much less exposure to these pro-competitive forces, sometimes requiring intervention to achieve competitive outcomes. Industries in the non-traded sector, such as electricity and telecommunications, are essential inputs to the traded sector, so it too, benefits from competition policy reforms.

#### 3. Australia – A Small, Open Economy

While geographically large, Australia is a small economy with a GDP in 2001-02 of \$US404 billion<sup>1</sup>. One third of its 19 million people live outside the capital cities, and its infrastructure services many isolated population centres, covering vast distances.

Australia has become an increasingly open economy over recent decades, reflecting reductions in trade barriers and the general global trend toward greater economic integration. Its trade intensity (exports plus imports of goods and services as a proportion of GDP) has grown from 34 per cent of GDP in 1987-1988 to 43 per cent in 2001-02. It has low rates of assistance, in the form of tariffs, to industries in its traded sector, and the Productivity Commission has estimated the effective rate of tariff assistance to

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<sup>1</sup> Calculated at rate \$A1 = USD 0.58

manufacturing at 4.8 per cent in 2000-01<sup>2</sup>. The WTO considers that smaller countries are more open to trade<sup>3</sup>, however, for small economies that are geographically isolated, transport costs may function as a natural trade barrier for many goods.

#### 4. Traded Sector in an Open Economy

As globalisation has strengthened the economic linkages between countries, it has increased the level of competition in the domestic markets of those countries that are globally engaged. Lower tariff barriers have enabled new firms to enter these markets, while technology stimulates new products and industries. These factors have had a pro-competitive effect by constraining the exercise of market power by firms in concentrated markets, to the benefit of consumers and other businesses.

In an open economy, a merger policy may consider the level of import competition and international competitiveness of firms seeking to increase their market share. Australia's independent competition regulator, the Australian Competition and Consumer Commission (ACCC), recognises that international competitiveness reduces the need for intervention in a market. The ACCC has not objected to any merger where comparable and competitive imports have held a sustained market share of 10 percent or more for at least 3 years. The ACCC has also not objected to numerous mergers in circumstances where potential imports have been able to constrain the price and output decisions of the merged firm. In 1992, the predecessor organisation of the ACCC (the Trade Practices Commission) decided not to oppose a merger on the basis that proposed tariff reductions were likely to increase import competition in the relevant market, thereby benefiting consumers through lower prices<sup>4</sup>.

While competition constrains the exercise of market power, it also limits the opportunities for firms to expand. Larger firms are able to achieve economies of scale and increase their efficiency, expanding their export opportunities. Firms have argued that limiting their expansion may lead them to relocate their head offices in countries overseas, making the home market a 'branch office economy'. However, a survey on offshore investment by Australian firms conducted by the Productivity Commission concluded that "Australian mergers regulation did not rate as a major influence on respondents' decisions to produce or relocate offshore."<sup>5</sup> The benefits of merger activity in creating economies of scale versus their anti-competitive effects have been the subject of much public debate in Australia<sup>6</sup>.

Mergers that substantially lessen competition in a substantial Australian market are prohibited under Australia's *Trade Practices Act 1974* (the Act). However, Australia's mergers law regime is not an absolute impediment to mergers that result in a substantial lessening of competition if it can be demonstrated that they generate other public benefits which outweigh the anti-competitive detriment. Authorisation is the process of granting immunity, on public benefit grounds, for mergers and acquisitions which would or might otherwise result in a substantial lessening of competition.

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<sup>2</sup> Productivity Commission, 2001, *Trade and Assistance Review 2000-01*, Annual Report Series 2000-01, Ausinfo, Canberra, December, p16

<sup>3</sup> World Trade Organisation, 2002, *Trade and Economic Performance: The Role of Economic Size?*, p.12

<sup>4</sup> Broken Hill Proprietary Limited / New Zealand Steel

<sup>5</sup> Productivity Commission, *Offshore Investment by Australian Firms: Survey Evidence*, Commission Research Paper, AusInfo, Canberra, 2002

<sup>6</sup> Chapter 5 of the ACCC's submission to the Trade Practices Act review of June 2002 details aspects of this debate, and is available at <http://tpareview.treasury.gov.au/submissions.asp>

Where it is claimed that the merger will produce benefits, such as efficiency gains (which must be ‘strong and credible’<sup>7</sup>), which will outweigh the anti-competitive effects, one of the merging parties can apply to ACCC for authorisation. Alternatively, merging parties can provide undertakings to the ACCC, in the form of restructures or the divestiture of assets, to lessen or remove the substantial lessening of competition that would flow from the merger.

Australia’s authorisation process is particularly important in allowing factors specific to a small economy to be taken into account. In assessing the effects of a merger, the ACCC, under section 50(3) (a) of the Act, is bound to consider the actual and potential level of import competition. The Act states explicitly that the ACCC must take account of the international competitiveness of Australian industry in the authorisation process, and import substitution and an increase in the real value of exports are considered public benefits. There is no set of arrangements currently operating in any other jurisdiction elsewhere in the world directly comparable to the Australian merger authorisation process.

There are sectors which raise potential public interest arguments in the application of competition policy and law. In Australia, media and retail banking are two examples. Specific legislation has been introduced in these sectors, in addition to competition law, to help address these matters.

Concerns about the influence of media outlets and, therefore, the ability of the public to access diverse sources of information and opinion have led to the formulation of cross-media and foreign ownership regulation, under the *Broadcasting Services Act 1992* (BSA). Australia’s media industry has few players; two newspaper groups account for more than 90 per cent of Australia’s daily newspaper circulation<sup>8</sup>. The Government introduced legislation into Parliament in March 2002 to create a system of granting exemptions from cross-media rules which prevent mergers across the boundaries of radio, television and newspapers, to remove media specific foreign ownership restrictions in the BSA in relation to free-to-air television and subscription television and discontinue current newspaper-specific foreign ownership limits. The Government has deferred Parliament’s consideration of this legislation until 2003.

In the banking sector, the Government has in place a ‘four pillars’ policy whereby mergers between the four major banks are prohibited until it can be shown that there is increased competition, particularly in the provision of small business banking services.

## **5. Non-Traded Sector in an Open Economy**

While international factors influence the competitiveness of the traded sector, firms that are not exposed to imports supply vital inputs, and, for Australia, these have been the focus for reform. The ACCC, too, is increasingly shifting its focus towards mergers in non-traded sectors of Australia’s economy. This is because the competitiveness of the trade-exposed sector is dependent on the non-traded sector for many of its essential inputs. The application of mergers law in the non-traded sector enables the traded sector to have access to competitive input markets that will enable it to compete more effectively on both the domestic and international levels.

In Australia, the non-traded sector includes industries such as local phone networks, gas pipelines and electricity transmission grids, in which competition has been limited or non-existent. Australia,

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<sup>7</sup> Australian Competition and Consumer Commission, 2002, *Submission to the Trade Practices Act review*, June, p. 136

<sup>8</sup> Productivity Commission, 2000, *Broadcasting*, Report No 11, AusInfo, Canberra, p. 304

through its National Competition Policy (NCP) and competition law, has embarked on a program of reform, with the following key features:

- the review and, where necessary, reform of anti-competitive legislation;
- measures to address the potential for competitive advantage of government business enterprises;
- the structural reform of public monopolies;
- access to essential public and private infrastructure that would be uneconomic to duplicate to improve competition in upstream and downstream markets;
- independent oversight by State and Territory governments of the pricing policies of government business enterprises;
- the application of competition laws across all jurisdictions (this includes the scope for exceptions in some circumstances), administered by the ACCC;
- reform in the electricity, gas, water and road transport sectors.

Australia's status as a small federation of States and Territories has also called for the development of co-operative mechanisms between governments to implement necessary reforms. All governments have agreed to implement the reforms listed above, and their progress is assessed by an independent body, the National Competition Council.

Australia's competition policy also allows for the consideration of various non-economic factors, including impacts on regional communities, through a public interest test. While not exhaustive, the test prescribes several matters that must be taken into account when a policy calls for its benefits to be balanced against its costs.

The guiding principle for regulation in Australia is that legislation should not restrict competition unless it can be demonstrated that the benefits of the restriction to the community as a whole outweigh the costs, and the objectives of the legislation can only be achieved by restricting competition.

The application of the public benefit test ensures that competition is not pursued for its own sake and helps ensure that the interests of affected parties such as rural and regional communities are taken into account. Importantly, it can also help "sell" the benefits of competition reform.

Australia's competition reforms are yielding ongoing benefits for Australia. While the nature of the reforms means that their effects cannot be easily separated out and measured, the Productivity Commission has estimated that they have the potential to increase GDP by 2.5 per cent above what would occur in the absence of such reforms<sup>9</sup>. The Commission has also found that they would enhance Australia's export competitiveness, estimating export volumes 3.4 per cent higher than what could otherwise be achieved<sup>10</sup>.

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<sup>9</sup> Productivity Commission, 1999, *Impact of Competition Policy Reforms on Rural and Regional Australia*, Report No 8, AusInfo, Canberra, p.298

<sup>10</sup> Ibid, p.299

## **6. Enforcement issues faced by Authorities in Small Economies**

### **6.1 *Obtaining evidence***

The ACCC has not experienced any specific problems in obtaining evidence in competition matters that are the direct result of the relatively small size of the Australian economy.

The problem of obtaining evidence in international cartel and merger matters relates more to the dynamics of the transactions and companies involved, and how the anticompetitive conduct is uncovered, which in turn may be a function of the size of the economy and the strength of its competition law and sanctions. Most large international cartels have tended to be detected in the US and/or the EU, largely due to the effectiveness of their leniency programs. This in turn can create difficulties in obtaining evidence and information that has perhaps been granted confidentiality or the party has been granted immunity or leniency under the terms of the particular country's leniency policy.

### **6.2 *Remedies***

Australia has experienced situations in which it has blocked mergers that have been approved by larger jurisdictions. One relevant example is the BAT / Rothmans cigarette merger.

#### **6.2.1 *Rothmans/British American Tobacco***

In some countries the merger of these two cigarette companies did not generate competition concerns. In Australia the market was highly concentrated. Three companies had 99 percent of the Australian cigarette market. The market share of the merged companies would have been around 65 percent.

The ACCC contacted a number of overseas competition agencies. However the merged firm did not dominate the markets in many of the countries contacted.

There was agreement that the boundaries of the market were manufactured cigarettes. Pipe tobacco, cigars and loose tobacco for roll-your-own cigarettes were not seen as close substitutes. While the major firms in the cigarette market were international, with operations in many countries, the market was not considered to be international. In the Australian market, imports accounted for less than one percent of the market.

The ACCC took the view that, in Australia, the merger would lead to a substantial lessening of competition in the cigarette market. The merger parties were informed that the ACCC would oppose the merger.

While the merger went ahead in a number of countries, the merger parties entered into negotiations with the ACCC to undertake certain structural remedies. The merger parties agreed to divest certain cigarette brands and production and distribution facilities to an amount equal to seventeen per cent of the total market. The major British based international tobacco company, Imperial Tobacco, purchased the assets, and has subsequently increased its market share. The merger went ahead while competition in the domestic market was retained.

A related problem experienced by Australia relates to the strategies engaged in by the merging companies in getting their global transaction approved. It has been Australia's experience on several occasions that parties to a merger have had their international merger approved in several large economies before making the matter known to the ACCC. This has the effect of pressuring smaller economies to

approve a merger that might otherwise have anti-competitive effects. While the ACCC is prepared to take action in such cases, such as in the BAT / Rothmans matter, this problem requires other responses. The ACCC places considerable importance on its contacts and information exchanges with its counterpart organisations to obtain advance warning of such matters, where such information can be provided.

Jurisdictional issues also pose a problem, particularly for smaller economies which are likely to face resource constraints in pursuing such matters. Attacking offshore agreements, such as DVD global zoning agreements, is difficult for small economies who are not likely to be in a position to drive the details of the agreements. Further it is these small economies, with limited supply options, who are most likely to be adversely affected by such agreements.

### **6.3      *Sanctions***

Australia is not aware of any evidence that might suggest that sanctions in Australia for anti-competitive conduct deter entry into the Australian market. On the contrary, Australia considers that the existence of a strong competition regime, with effective sanctions, creates an incentive for new entrants to the market on the basis that they will be able to compete effectively with domestic incumbents.

Australia does recognise however, that this is likely to be a problem for even smaller economies.

### **6.4      *International Co-operation***

The ACCC actively cooperates and exchanges information with its international counterparts on a regular basis. This information flow is two way and occurs with competition authorities in both large and small economies.

In Australia's experience, information and assistance provided and requested from its counterpart agencies occurs in a timely and useful manner. As relationships between agencies continue to grow and strengthen, this trend is considered likely to continue.

However, as has been discussed in previous fora, the greatest impediment to international cooperation and enforcement assistance on competition matters are the restrictions and limitations that apply in most countries on the ability to exchange confidential information.