

## 2023 Annual Bannerman Competition Lecture

Transcript

PHILIP ARGY:

So my name is Philip Argy and I've got the honour of chairing the Business Law section of the Law Council of Australia and we are jointly hosting you tonight with the ACCC, and of course, thank you King & Wood Mallesons for providing this very nice venue and food.

I'll start off by acknowledging the Gadigal people of the Eora Nation, the original inhabitants of the land on which we gather this evening, and we'll pay our respects to their elders past, present, and emerging and, of course, also acknowledge the original inhabitants of the various lands and which those joining online are based. And we have a very large number, I'm told, nearly 180 people online, as well as the 80 or so gathered in the room tonight. So good audience, and I should note the first one we've had live for nearly four years so very nice to see people in the flesh, or, as I say, nice to see people from the neck down now. And of course I also extend their respects to any Aboriginal and Torres Strait Islander people in the room or online.

Now the first task I have is a very pleasant task, for those who don't know the Business Law section has scholarships and awards that we present every year and we have two of our award winners here tonight and I'm very pleased to present them with their certificates. The first one is the 2022 Gaire Blunt Scholarship, which is a scholarship which acknowledges learned articles that have been written in the previous 12 months, and if I can call on Mr Alan Zheng to come forward to collect his award. Is Alan here? No, all right. We'll put that one aside. I think Jessica knows where Alan might be. No, not here. Oh they were. They were there, they've disappeared. What about Mr Joshua Sinn, is Joshua here? They were both here together and now they're not both here together. All right, we might defer that until later so that we don't hold things up.

So we do have, of course, a wonderful guest speaker for you this afternoon in the form of Professor Ross Garnaut who has very timely walked in and sat in his seat, as I say that, but I'm not going to tell you about Ross, in fact, Gina Cass-Gottlieb is going to do that for us, and this is Gina's first Bannerman lecture, I believe, so it's wonderful, Gina, to have you here and follow in the footsteps of your predecessors in introducing our guest speakers. So without further ado I'll call on Gina to introduce Ross. Thanks everyone.

GINA CASS-GOTTLIEB:

Good evening everyone. I too wish to acknowledge the traditional custodians of this land on which we're all gathered together, the Gadigal People of the Eora Nation. I pay my respects to them and their cultures and to their Elders past present and emerging. I acknowledge their continuing connection to the land, sea, and community. I would also like to acknowledge and pay my respects to Aboriginal and Torres Strait Islander people who are joining us here in the room and also online.

On behalf of the ACCC and our co-hosts the Business Law Section of the Law Council of Australia I would like to warmly welcome you to the Ninth Bannerman Competition lecture. We at the ACCC thank the Law Council for their assistance in continuing to host and support this event, and King & Wood Mallesons for having us here tonight.

It is a great honour to have with us as well the members of the Bannerman family, Marilyn, Sarah and Sally. It is a delight to meet you and to share with you memories of and the wonderful contribution of your father and your grandfather. Thank you for joining us.

It is quite a delight to be able here to introduce our incredible guest speaker, Professor Ross Garnaut. This event remembers and pays tribute to Ron Bannerman's significant contribution to an enduring influence on competition law and consumer protection in Australia, by creating a forum for competition lawyers and economists to hear an insightful discussion of issues affecting competition regulation and the Australian economy, and I know we will definitely have that tonight. Many of the people who are joining us here were friends or colleagues of Ron or have been guided and significantly benefited by his legacy.

Ron Bannerman was the first and only Commissioner of Trade Practices from 1968 to October 1974. He was appointed Chairman of the Trade Practices Commission on its establishment in October 1974, and held the post until his retirement in December 1984. Ron was an exceptional public servant; he worked extensively to implement the foundations of modern competition law in Australia and established the Trade Practices Commission as an authoritative, effective agency. Throughout his term as Chairman of the Trade Practices Commission Ron continued to educate and persuade, carefully charting enforcement and regulatory paths which would advance the law. A strong promoter of competition and consumer law Ron engaged with all stakeholders, earning their profound respect not just for the breadth and depth of his knowledge, but for his resilience, diplomacy, humanity, sincerity, and constant courtesy. When I was speaking with Marilyn, Sally, and Sarah before, we each noted the penetrating gaze that he has in this photograph. In 1984 in the TPC's annual report soon before he concluded his term as chair, Ron described the complementary interaction of competition and consumer protection in terms that, I think, are as potent today as they were in 1984 when he said, “I have always seen consumer protection on the one hand and competition on the other as principles that should be mutually supporting and their administration equally so. If we are thinking about price, quality, and service, three fundamentals for consumers, then competition may often be the best way to secure them. If we are thinking more broadly about general standards of living, then the forces that can maintain or improve industry efficiency are vital. Competition is one such force. Consumers not only benefit from competition they activate it, and one of the purposes of Consumer Protection Law is to ensure that they are in a position to do so.”

The linkages of the comments in that quote and what Professor Garnaut is about to speak about are striking. In 2014 when the ACC celebrated 40 Years of our Act Professor Maureen Brunt described the early impact of the act as follows, “One of the striking things was, first of all, how novel The Act was but secondly how it made an immediate impact, absolutely immediate impact, so that after only 20 years the economy was transformed ; it's an extraordinary thing. So that rather than restrictive practices occurring and not even being noticed but just accepted as the normal Australian way of life, what began to be seen was that it was desirable to have a competitive economy. Much of the credit for that fundamental transformation is due to the work and dedication of Ron Bannerman as the first Chair of the Trade Practices Commission, absolute transformation.” Together with Maureen Brunt as a foundation economic member of the Trade Practices Tribunal from 1975 to 1998, it is indeed fitting that tonight a preeminent contributor to analysis and administration of policy directed to development, economic advancement, and transformation, Professor Ross Garnaut will deliver the annual Bannerman lecture. Professor Garnaut has held senior roles domestically and throughout Asia in diverse fields including as an academic Economist in government and private Industry. In Academia, Professor Garnaut has held senior roles in eminent Australian and international institutions. He's currently Professor Emeritus at the University of Melbourne in business and economics. He is a Fellow of the Australian Academy of Sciences and Distinguished Fellow of the Economic Society of Australia. In addition, Professor Garnaut is a Distinguished Life Member of the Australian Agricultural and Resource Economic Society, and also an Honorary Professor of the Chinese Academy of Social Sciences. You will be aware that Professor Garnaut has held a number of senior government positions including as Principal Economic Advisor to Prime Minister Bob Hawke and Australian Ambassador to China. He has led reviews into the wool industry federal state funding and was the Climate Change Advisor for the Australian government from 2007 to 2008. In that time he led the Garnaut Climate Change Review. Professor Garnaut is also author of numerous books, monographs, and articles on international economics, public finance, economic development, and sustainability. His recent work includes the book, “Reset: Restoring Australia after the Pandemic Recession,” which detailed how economic policy can be managed during periods of high deficits and debt, and restore productivity, growth, full employment, and create broad-based increases in living standards. You will be very aware of his notable publications including 2019’s, “Superpower: Australia's Low-Carbon Opportunity,” and 2022’s, “The Superpower Transformation: Making Australia's Zero-Carbon Future.” Together these books provide a critical and practical roadmap for establishing Australia as an economic superpower in the post-carbon world. Tonight Professor Garnaut’s speech will address the key changes in the 21st century that affect Australia's capacity to achieve equitable standards of living, the increase in the share of rent in total income, and the link to monopoly and oligopolistic strategic behaviour will be analysed, together with how competition policy alongside other policy instruments can contribute to more effective economic policy and enhanced economic outcomes. I'm delighted to ask Professor Garnaut to address us.

PROFESSOR ROSS GARNAUT:

Thank you, Gina, and it's a delight to meet members of Ron Bannerman’s family here this evening. When Gina contacted me about this lecture now quite a lot of months ago, I had my doubts about whether this this was too far from my familiar territory, but then I decided that, actually, it was my familiar territory [chuckle]. Also good to have the last Chairman of the ACCC, Rod here and it has been my pleasure to work with Rod on various things over the last half century.

The structure of the economy changes gradually. I’m just trying to put a stopwatch on because I know that I've got timetables to keep [laughter].

Structural change accelerates from time to time with big social, political, economic, and technological events. Over the years the changes accumulate to an extent that renders some old approaches to analysis unreliable and misleading. Most observers notice some unexpected outcomes, make small adjustments within familiar approaches to policy, and are surprised when we do not see the expected improvements. Bigger minds realize that something important has changed and develop new analytic frameworks. So it was with Adam Smith at the beginning of modern economic development. Marshall and the founders of neoclassical economics, rewriting the classical approaches that had led to the dismal conclusions of Malthus and Marx and the Keynesian Revolution from the 1930s. Sometimes innovative thinkers realise that structural relationships have changed, but don't see the whole of the new world and prescribe incomplete remedies which make some problems worse, while contributing to easing others. So it was with the influential Austro-Hungarian response to stagflation from the 1970s from von Mises, von Hayek and Friedman, with political economy roots in Emperor Franz Joseph's empire and his glittering capital. Big trends in economic development and thought about economic policy are sometimes global in their reach or shared across substantial parts of the world economy, but there are always national variations on the global themes. Unusual national institutions and structural characteristics require different framework for thinking about the economy and approaches to policy. Successful policy requires national differences to be reflected in ideas about policy, thus, there is an Australian National History of ideas about economic development interacting with the global narratives, and relating well or poorly to the Australian reality through different historical periods. Most of the value of economics is generated in the fresh thinking every now and then, both globally and nationally. The rest occupying the working lives of most economists is incremental adjustment to established interpretations of reality. The modern Australian economy was born rich with its abundant natural resources relative to population and modern economic institutions. It never faced the pressures on living standards from growth in the labour force that overwhelmed improvements in productivity through the first generations of the industrial revolution in Europe. Freedom from crude Malthusian constraints may have been a feature of the ancient Indigenous Australian economy as well, but that story is beyond my ambition this evening.

Democracy with a broad franchise emerged earlier in Australia and New Zealand than in the European and later American heartland of the Industrial Revolution. The Australian settlement of economic institution and policy in the early 20th century was a creative response to broad democracy and labour scarcity.

Two periods of far-reaching economic reform in the second and third thirds of the 20th century set the country up for long periods of economic expansion and prosperity. The first period of transformative change that sustainably lifted the economic welfare of Australians was post-war reconstruction commencing in the mid-1940s and continuing to the early 1970s. The second was the reform era that commenced with the election of the Hawke Labor government in early 1983, and continued to the beginning of the current century.

Both reform eras applied new knowledge to our policy choices. There have been big changes over the 21st century that greatly affect Australia's capacity to deliver rising standards of living to most people in a growing population. Most importantly there's been a large increase in the rent component of total income. This has diminished growth in productivity and output, while reducing the share of income accruing to the general run of citizens. More recently, in last couple of years, that has contributed to decline in the real incomes of most Australians. These developments and their large political implications have come later in Australia than in the US and the UK, but they are now important in Australia. The recent RBA review is built on the premise that our economy has performed reasonably well over the past three decades. On average over three decades, we have indeed done reasonably well, but that average hides close to the lowest growth in productivity and output per person and real per capita household income, amongst all developed countries. Over the past decade it hides that by averaging it with the developed world's top performance which we had in the 1990s.

In the past high terms of trade have been associated with pressures for higher real wages. Australian terms of trade over the past year have been higher than ever before, yet real wages in Australia have fallen more through last financial year and this, than in any other two-year period in our history. The official forecasts anticipate continuation of real wage reductions through next financial year. It is a striking fact that the profit share of income is decisively higher than ever and the wages share lower.

To understand these developments we must look afresh at the role of rent. After we have come to understand the changes in the structure of the economies that have produced these outcomes, restoration of economic dynamism and growth in ordinary Australian standards of living is going to require policy coordination across parts of the economy that we have been managing separately.

My special focus this evening is on policy related to management of economic rent. This is close relevance to competition law and policy but I will first look at a wider context.

Productive responses to large structural change require contributions from many institutions in different areas of policy and coordination across them. As John Maynard Keynes once said, “We need an orchestra with a range of instruments and a good conductor. At such times we can admire a virtuoso performance on a single instrument but it will not realise the potential of the time and place.” Competition policy is an important instrument and the ACCC an important player in the response to the increasing role of rents. They will have their greatest value as part of the orchestra with that good conductor. The past months discussion of economic policy making has been dominated by release of the review of The Reserve Bank. One problem with the discussion is that it has tended to examine monetary policy in isolation from other instruments. Excessive focus on one instrument and one player leaves out the many advantages of calling on a whole orchestra. Let me make the point with reference to two parts of the economy in which economic rents are important and in which standard approaches to monetary policy and response to inflation lead to perverse outcomes. These are rents for houses and energy supply. Housing costs are currently a source of much community stress. The ABS data say that rents have been increasing at high rates and contributing substantially to CPI inflation. Rents are increasing because record high immigration rates are lifting demand and investment in new residence is low. Higher rents feed into a higher CPI which is interpreted by the RBA as a signal to raise interest rates again. Higher interest rates reduce investment in housing and after a time raise rents, and so strengthen the single instrument case or even higher interest rates. How would a conductor who could call on any policy instrument go about reducing upward pressure on housing rents? She wouldn't think of raising interest rates first or second; she would think about easing immigration until such time as demand for rented housing was more closely aligned with supply, at what was thought to be a normal price over the longer term. She would look at easing any restrictions on the supply of land on which residence could be built. She would ask whether older Australian approaches to housing crises involving public Investment housing were warranted in current circumstances. She would ask questions about the anti-dumping measures and other import restrictions that were artificially raising costs of import competing building materials. She would examine taxation and other arrangements that have the effect of encouraging owners of housing assets to keep some off the market, and if she thought that higher interest rates were necessary for their effects the rest of the economy, she would think about macroprudential measures that reduce their impact on housing investment. Higher oil, gas, and electricity prices have been the largest contributors to a higher CPI over the past year. Electricity prices up at prices over 15 percent and gas over 26 percent. The RBA with interest rates as its only instrument thinks of raising them. How would a conductor who could call on any policy instrument go about reducing upward pressure on domestic gas and oil prices, gas, and electricity prices? She wouldn't think of raising interest rates first or second, and maybe not at all. She would be aware that for many householder users of power that charges for using poles and wires represent about half the power bill. Prices are regulated by arrangements that guarantee specific rates of return on past investment. The rates of return rise with higher interest rates. So higher interest rates feed directly into higher power prices, to the extent that higher interest rates reduce demand for power and the RBA sees rising interest rates reducing inflation, because they reduce demand. The reduced use of poles and wires requires a compensating increase in prices to compensate for lower volumes of sales. The conductor with access to all the orchestra's instruments would look at regulatory arrangements to set prices for the distribution and transmission of power, to make sure that they serve the public interest.

The rest of the cost of electricity to users is the supply of wholesale electricity and the profit margins for retailers. The increase in wholesale prices has been driven overwhelmingly by increased prices for coal and gas, themselves the result of the Russian invasion of the Ukraine. Higher interest rates reduce domestic coal and gas prices a bit because they raise the foreign exchange value of the Australian dollar, but this effect is small compared with reductions that could come from driving a wedge between domestic and international prices.

Placing caps on coal and gas prices as agreed by the National Cabinet is one way of doing that, alternatively, State governments onshore or the Commonwealth offshore could increase royalties or the Commonwealth could increase profits-based taxation to support compensatory payments to some or all users of power.

On retail margins there are a few dominant retailers in each state electricity market and much scope for oligopolistic pricing, so our conductor will be doing what she could to reduce or at least avoid increases in market concentration, and to make sure that retail margins were not markedly above those that could be justified in a competitive market.

For housing and electricity prices and their large contributions to the CPI, raising interest rates does more to raise than to lower prices. Good policy would bring in a range of instruments, with competition policy playing an important role alongside others.

The historic lift in the profit and fall in the wage share of income are challenging facts. The shifts are the more striking because they have come at a time when the real cost of capital available in competitive markets is the lowest it has ever been. The real cost of long-term debt has been close to zero over the past decade.. The low real interest rates suggest the world that Keynes described 92 years ago in his essay, “The economics of our grandchildren.” That essay was first given to his students at Cambridge University trying to cheer them up, to give them some hope that there was a future of a good life in the in the capitalist market economy, in a capitalist democracy like Britain. This at a time, 1931, when Democratic capitalism was engaged in a competitive struggle for hearts and minds with authoritarian political systems. The essay explained the accumulation of capital and technological Improvement would lead to such a surplus of savings beyond the profitable uses of investment, that the real interest rate on low-risk capital in competitive markets would fall to zero. “If we avoided unnecessary wars and economic depressions no one a century forward - - -” Keynes said, a century forward from when he was writing in 1931, “would have a high income simply because they earned capital.” We would see the “euthanasia of the of the rent rentier.” Ordinary citizens will be liberated for the challenge of using time for good purpose. There would still be opportunity for invention, innovation, and entrepreneurship, and therefore enhancement of the material human condition. People who earned high incomes would derive them only from using capital, labour, and technology in new ways and not from simply owning capital.

Real interest rates on sovereign and other low-risk debt in Australia and most of the developed countries have fallen steadily through the 21st century. Over the past decade average real returns on low-risk capital in competitive markets have been around zero. This is such a striking departure from historical returns to capital that most economists, business people, and officials either deny that it's true, or think it results from public policy that must change. They await the early return of what they see as normal real interest rates, variations around about five percent that prevailed through most of the four centuries after Elizabeth funded the fleet that dispersed the Spanish Armada. They don't understand the world in which they live. It's a different world than it's been for the last 400 years.

The reality of near zero real returns has been temporarily obscured by inflation following the supply disruptions and monetary expansion of the COVID years. The rise in nominal interest rates driven by the new inflation over these past 18 months is not a return to old real returns on low risk capital; nothing of the sort. Nominal policy rates remain well below the rate of inflation so real rates are still negative, and the longer bond rate set in competitive markets are more strongly negative than before the fiscal and monetary expansion in response to the pandemic recession. Real interest rates in competitive markets are near zero or negative because in the world as a whole and in Australia private citizens are tending to save higher proportions and to invest lower proportions of their incomes. The changes in savings and investment reflect changes in the structure of economies, including the rise in rent and associated increase in inequality and income distribution.

Why are savings high? The 21st century in the developed countries has seen a falling share of total income going to people on low incomes and without wealth who depend on wages to live. Those people spend most almost all of their income. An increasing share of income has gone to the wealthy who spend a much smaller part of their incomes. These effects are exacerbated by the increasing proportion of incomes held by the wealthy in international tax havens, accumulating without taxation or drawdowns for consumption. It's a big number when people have sought to estimate it, the proportion of global income being earned in in tax havens today. Developed countries that happen to have unusually high savings rates, first of all China, have increased their shares of global income. More of the world's income growth has been concentrated in developing countries where incomes have been growing rapidly and it takes time for consumption patterns to adjust upwards to higher incomes. In the developed world and China ageing populations want to provide for longer retirement, so they're the reasons why average savings rates are higher.

Among factors reducing investment the increasing share of services in the economy has reduced investment in buildings and equipment. Information technology has allowed more efficient use of capital. A higher proportion of investment is in intangible assets, like intellectual property, which does not require capital expenditure on fixed assets. A higher proportion of income takes the form of economic rent which is sustained with little new capital expenditure. Lower rates of productivity growth in the developed countries have reduced the rates of obsolescence of old plant and the need for investments in replacements. IT Network Services now represent a higher proportion of consumption, requiring tiny capital and also operating expenditure, in comparison with the value of sales. Returns to low-risk capital in competitive markets are close to zero in real terms and yet returns to business investment are higher than they have ever been in the developed world, and most impressively of all, in Australia. Attempts have been made to rationalise the facts. The Business Council of Australia and the Governor of The Reserve Bank have said that mining profits are more than half the total, and if you exclude them, there's been no increase in the profit share. The Council and Bank are speaking power to truth. Take mining out of the denominator as well as the numerator, and the profit share is still historically high. This is at a time when the cost of capital in competitive markets is close to zero and when low productivity growth demonstrates that high profits are not flowing exceptionally from innovation and entrepreneurship.

The increased profit share reflects the increased role of economic rent in the Australian economy. Economic rent is income above that which is necessary to attract the economically optimal amount of investment into an activity. It persists where competition and the supply of a particular good or service is imperfect, or, in some cases, non-existent. I'm not talking about the profits from innovation or entrepreneurship to use capital more productively in a competitive economic system. These are what 19th century Economist Alfred Marshall called quasi-rents, these are the temporarily high profits that follow changes in economic equilibria which take time for competition to erode. Economic rent arises whenever high profits in an economic activity fail to induce expansion of supply to reduce prices and profits to normal or competitive levels. The restriction on entry may arise because production requires a specific resource the supply of which cannot be augmented by investment. Land and mines that can produce valuable product at lower cost than others which are favourably located cannot be reproduced through more investment. The restriction may arise because there are overwhelming economies of scale that make it impossible for a newcomer to compete, as in a network or an economic activity where lowest cost scale of production is very large compared with the size of the market. They may arise because incumbents have established an oligopolistic position in the market to protect their market power with anti-competitive behaviour. The restrictions may exist because government law or regulation blocks new entrants.

Different sources of rent can interact with and reinforce each other. Economic rent is sometimes, but not always, associated with economic inefficiency. Regulatory barriers to competition that serve no public interest reduce economic efficiency, that's for sure. It is in the public interest to eliminate inefficient sources of rent by removing barriers to competitive entry or by actively promoting competition. However, some rent emerges from restrictions on competitive investment that increase economic efficiency. This is often the case with exclusive ownership of a specific piece of land or mineral resource, the allocation and enforcement of property rights. In the absence of this restriction on competition overinvestment in the use of the resource would reduce economic value. For example, a lot of labour and capital is wasted in a gold rush and as much or more gold might have been extracted with much less labour and capital if one firm had been allocated an exclusive right to mine the deposit. That's how we do it today; we did it differently in the 1850s, and populated Australia with Europeans.

A second category of efficient rent results from government protecting private use of intellectual property resulting from scientific or technological or intellectual or artistic creation, and there's efficiency in this because it provides an incentive to creativity and Innovation, but a balance has to be struck because that restriction reduces the value to the society as a whole of past innovation and creation. And so it's an area where the policy issue is to strike the right balance.

A third category of efficient rent is natural monopoly associated with ownership of a network or a physical asset with overwhelming economies of scale, or the two together. Examples of network monopolies are provided by the main information technology and social media platforms. Examples of the two together include electricity transmission, gas pipeline, and telecommunications hardware systems ,and in the zero carbon economy, the storage and transport of hydrogen. Duplication of investments in a natural monopoly would usually waste resources. The acceptance of monopoly allows the owner of the established assets to maintain high prices and profits at the expense of community welfare.

Some activities generating efficient rent can be subject to regulation of activity or price to increase total economic value. Whatever the source of rent and however rent may be constrained by regulation, rent can, in principle, be subject to additional taxation without sacrifice of economic value. The share of rent in national output and income has varied widely in the course of modern economic development. Such variations have had large effects on political systems. Generally, high proportions of economic rent in total incomes and the inequality of incomes with which it has been associated has blocked the establishment and undermined the maintenance of democratic political systems. Here the causation runs in two directions; economic systems in which incomes; wealth; and economic power are highly concentrated resist establishment of democracy, and democratic systems exert pressure for interventions to reduce extreme inequality.

In Australia a high end increase in proportion of incomes has emanated from rent heavy sectors, especially mining, but also urban real estate, information technology, financial services, media, and large-scale retailing. For confirmation of the Australian trends look at the role of mining, banking, and other rent heavy sectors in market capitalisation on the Australian Stock Exchange. Profits of mining with economic rent contributing a considerable proportion were larger than the profits in the whole of the rest of the economy in the final quarter of last year. Profits from mining were larger than the total from financial business and legal services - all the things that some of the people in this room are doing - plus hospitality, plus accommodation, plus construction, plus health, plus education, plus media, plus transport and all the rest, although mining accounts for less than two percent of employment.

In the text of my remarks I've got then got some details, some quantitative details about the increase in rent as a proportion of income globally and in Australia, but to stay on time I will leave people to read the full text for that.

It is time for these important developments to enter the mainstream of our discussion of the economy and economic policy. Robert Solow, long time Professor of Economics at the Massachusetts Institute of Technology received a Nobel Prize for work in the 1960s. This research developed what is now the standard way of measuring the contributions respectively of capital labour to economic value. In a letter to my longtime friend and colleague Professor Max Corden, written on the 17th of September 2017, Solow said that he was rethinking his contribution, and Max gave me permission to quote from the letter. “We conventionally allocate all of the value added to either compensation of labour or return to capital debt and equity,” and Professor Solow said we conventionally allocate value in that way and we do, but it's of course because of his work that we do. [Laughter] We conventionally allocate all of the value added to either compensation of labour or return to capital. That would be fine if there were perfect competition. In reality, there is a third component monopoly rent; it gets allocated to labour and capital in unknown proportions. What one would like is a three-way breakdown in market return to labour, market return to capital and rent.

When the Australian economy is playing by new rules it is time for thinking from first principles about the role of all of our instruments and how they can best be played. Competition policy is important to achieving all of Australia's economic objectives: full employment with moderate inflation, rising incomes and reasonably equitable distribution of income, but it cannot deliver any of them on its own.

Greater competition can sometimes be the most effective means of expanding economic activity in an industry, and so of economically increasing employment. It can sometimes be the most efficient way to reduce prices of a product and, therefore, to contribute to lower inflation. It will usually contribute to greater dynamism in an industry and, therefore, the productivity growth, and rising incomes in the whole economy is the source of greater equity in income distribution.

But greater competition is not always possible and where possible not always the lowest cost way of making progress. Sometimes it is better to recognise the monopoly or oligopoly is economically efficient, or that it's removal through application of competition policy would impose costs that exceed the benefits. The national interest then requires restructuring of taxation to increase its incidence on rent and reduce its incidence on competitive activity. The orchestra of economic policy needs an instrument that comes in when greater competition is both possible and the next best means to an important end. The ACCC is a regulatory and not policy agency, but it understands better than other parts of government what can work, what is best left alone, and how to make things work. It can assist the conductor in her choice of instruments and timing of calling them into play.

Let me conclude with a few suggestions on the priority roles of ACCC and Competition Policy. Mostly what I've got to say here reinforces approaches that have already been established, but there are a few lessons from our journey this evening through unusual features of our contemporary economic story.

First we should accept that there are important natural monopolies in which the presence of massive economies of scale prevents economically effective competition. This includes the transmission and distribution of power and gas and now the storage and transport of hydrogen. The lesson for the future is to avoid private ownership of new assets where these can be separated commercially from established private systems. We can at least apply the lessons of analysis and experience and keep storage and transport of hydrogen in public hands. Where the horse has bolted into private ownership as in electricity transmission and distribution in the three South-eastern mainland states, we should invest greater analytic effort into regulation of investment, access, and pricing. The setting of the rules is immensely complex and depends on information that is available more completely to the operating company than the regulator. One simple rule, easily applied but always contested in practice by operating companies, is to separate ownership and management from use of the utility.

Second, the whole range of network information services has some characteristics of natural monopolies but some opportunities for competition, at least at the margins of each company's business. Much of this is new territory for competition agencies everywhere. The ACCC has established itself as something of a leader in the space. Australia needs more sector-specific rules to promote competition and prevent the worst abuses of market power in the digital economy, along the lines that are currently in the process of being implemented in the European Union and soon the UK. In September last year the ACCC proposed new upfront rules for application to designated digital platforms in particular sectors; this has merit.

If Australia does not act we will fall behind other countries and promoting competition and protecting consumers in these areas. The application of sound rules in the Australian public interest will require Australian governments to stand up to great pressure from large foreign companies and influential governments.

Third is the well-established regulation of competition, avoiding additional concentration of ownership and management of industries in which genuine competition is possible, is more important than ever.

The challenge of introducing effective competition has increased by the asymmetry of information between consumers and producers, increased beyond recognition by the new information technology and artificial intelligence. It's a small change but I welcome the shift in focus currently being discussed in relation to the role of the ACCC from focus on the substantial lessening of competition to a significant lessening of competition. More fundamentally Australia needs to rethink its merger laws in the light of the discussion this evening. The changes recently recommended by Gina appear to be steps that a government seeking to increase welfare enhancing competition would want to implement.

Fourth, we should accept that there are large areas of the economy in which restrictions on entry are important for economic efficiency, and others in which increased competition is difficult to achieve, or carries risks of negative economic effects of other kinds. Resource rents are extraordinarily important in our economy. So are urban rents, network rents, and rents in natural monopolies. Here we need to recognize the limits of competition policy, to accept the continued presence of the rents associated with them, and build forms of taxation that raise substantial revenues from rents and relatively differ from competitive economic activity.

My fifth point is crucial to full employment, rising incomes, and equitable income distribution for a growing Australian population. This relates to the interaction between trade and competition policy. Free trade in goods and services is necessary to provide globally competitive access to input along the whole supply chains or export oriented industry. We can be confident that free trade will severely constrain the use of oligopolistic power in goods in which Australia is a substantial exporter. Constrain, but not remove. As we have learned in relation to gas pricing over the past few years where there is oligopoly within Australia, free trade is consistent with a wide range of prices for exportable products, between import parity and export parity. For much of our history import parity pricing was the norm for many exports that were also inputs into domestic manufacturing. For example, Australia was a major exporter of base metals for prices for these products were typically set as the price in London plus the cost of transport to Australia. The difference between export and import parity pricing is important to global and competitiveness of Australian manufacturing and processing activity, based on Australian energy and material inputs. And these of course are the industries that are highlighted in the two books on Australia is the Zero- Carbon Superpower. The ACCCs role should include ensuring the availability of exportable products within Australia at export parity pricing. This will be crucially important to building Australia as the Zero-Carbon Superpower of the future world economy.

Thank you.

PHILIP ARGY:

Thanks very much, Professor Garnaut, for your insightful remarks.

Now I'd like to invite Lisa Hewitt up to offer some reflections on what Professor Garnaut had to say, and also to moderate our Q&A Session. Thanks, Lisa.

LISA HUETT:

Thank you very much, Philip, and thank you Professor Garnaut for such a thought- provoking lecture.

For those of you who don't know me I'm Lisa Hewitt. I'm the Chair of the Committee, The Competition and Consumer Committee, and as Philip just explained, I'll moderate the Q & A session.

On behalf of the committee though I would like to extend a sincere thanks to Professor Garnaut for his time this evening. Thank you in particular for the fascinating overview of the transformative economic reform we've witnessed in Australia over the past century. There's much insight to be gained from stepping back and considering the economic conditions in which we now find ourselves in their broader historic context. As we now find ourselves in this era with COVID-19 supply chain disruptions and commodity price shifts flowing on from international geopolitical and trade developments.

There are a couple of points I'd like to reflect on in particular from your lecture. Firstly, you provided a very clear and concise explanation of economic rent and its impact on the Australian economy, highlighting how it arises when high profits fail to induce expansion of supply due to various factors, such as limited resources, economies of scale, anti-competitive behaviour, or government regulation. It was easy to digest, even for those like me who may not have had a strong economics background, and dare I say it struck a chord with me when you gave your visualisation of the orchestra and the role that the ACCC plays; it was a very compelling reference throughout the lecture. Your observations on economic dynamism are very topical, particularly given the Federal government's current focus on that topic. Our Assistant Minister for Competition, The Honourable Andrew Leigh MP, has expressed the view that more dynamism and more competition will make most people better off. The House of Representatives Standing Committee on Economics is also currently undertaking an inquiry into promoting economic dynamism, competition, and business formation following a reference from the Treasurer.

I also noted with interest Professor Garnaut’s acknowledgment that obviously we have a number of natural monopolies in Australia and there are circumstances where competition policy may not have a role, because the natural monopoly provides the most efficient distribution. He also recognised there are circumstances where the method of achieving the lowest cost is not always through the promotion or enhancement of competition. This is a timely observation in the context of the merger reform proposal announced by the ACCC Chair a few weeks ago. In that context it was interesting to see that the ACCC recognises that there may be certain mergers that substantially lessen competition, but still offer efficiencies that result in a net public benefit, and which would see that merger approved, despite increasing market concentration.

Another point of interest from the lecture is regarding the case for sector-specific regulation, a topic that has exercised the minds of many in the profession in recent years. While Professor Garnaut notes that it may promote competition in some situations others have cautioned against fragmentation of law reform and its potential to cause uncertainty for entities that may find themselves subject to multiple regulatory frameworks. This is an area our committee has commented on in a number of recent submissions including in relation to digital platforms and online booking platforms, to encourage consideration of whether there may be overarching merits in having economy-wide competition regulation.

I noted your comment in relation to one simple rule easily applied but always contested in practice by operating companies is to separate ownership and management from use of the utility. You mentioned that the horse may have bolted regarding electricity transformation and distribution in some states, but I thought I might just ask you, or kick off the questions, by asking whether there are sectors or Industries where you see this rule being employed in Australia? So are there sectors where you see the separation of ownership and management on the one hand from use?

Q&A

A:

PROFESSOR GARNAUT: Generally, we've accepted the principle, and the problem is resisting pressures to depart from it in practice, and one of the big ones is transmission and distribution of electricity where here the prime regulatory agency is a sector-specific agency, the Australian Energy Regulator, which is under the umbrella of the ACCC and complicated arrangement that either Gina or Rod could explain, but I won't try in front of them. But the rule is clear enough that the that if you are in a transmission or distribution company you should not be able to be a user of the power or supplier of the generator of the power. I think it's a very important rule but really being tested at the moment, when a major owner of one of the networks has put in a bid - and the ACCC will have to look at this [laughter] - put in a bid to own one of the major retailers, and at the same time, one of the major generators of power. And so that this actually is a very clear example of what I said was the pressure that always comes from the operators. I think it's tremendously important to hold by those rules because once you deviate from them it undermines the confidence of others in in the market. There's a lot of discretion in the transmission companies, the private transmission companies, on how they allocate costs. And if they are a big competitor at the retail end and the generator end and they can choose to allocate high costs to a connection of a competitor, they would have to be the Almighty himself to resist the opportunity to meet their obligations to their shareholders, and damage the competitor.

LISA HUETT:

Some of those issues are no doubt exercising the minds of the Commission at the moment. Straight out to the floor. If you wouldn't mind there is a roving mike, so just wait for one moment. If you wouldn't mind introducing yourself before your question.

Q:

My name is Yane Svetiev, I'm a professor of Market regulation at the Sydney Law School and, I guess, one of the instruments that I didn't hear you talk much about is that of industrial policy. Now industrial policy can have a kind of transformative effect in the economy, it can be a way of also controlling rents in a certain sense, and it is sometimes seen as kind of being in opposition with competition policy but there are views of kind of you know the two also working in a way together and being complementary. I was wondering, giving given the sectors that you've taken an interest in in recent times, I suppose I was wondering on your reflections on that in the context of, in particular, of the way in which it's kind of orchestrated with competition policy.

PROFESSOR GARNAUT:

A:

I've got a very clear idea of what competition policy is; I don't have a clear idea of what industry policy is. It means a lot of different things to different people. At its most general it's government intervening to provide support for some sectors and or some firms or sectors and not others. And seen in that way, there is conflict between competition policy and industry policy, but you can see industry policy in a different light. I've written a lot about these things over a lot of decades and I won't bore you tonight with a summary of all that, but generally the objective of industry policy however defined, as with monetary policy, fiscal policy, competition policy, it should be to improve our performance on those general objectives, full employment, growth in incomes, moderate inflation, reasonably equitable distribution of income, and seen in that light there's not much doubt in my mind after a lifetime working on these things, that the effect of interventions by government are mostly in the form of general measures available at least to all competitors in a particular field, applied, not at discretion of officials or ministers, but according to clear rules. And the most powerful are usually very general rules. In the written version of the of the paper which will be on your website, I refer to a proposal from a number of my colleagues and I to shift the basis of corporate income tax from conventional accounting profit to cash flow. I think that will have the effect, generally, of promoting innovation and promoting investment over other uses of funds. It will be good for industries that are ripe for growth and so it will be discriminatory in the sense it will favour the growth industries, would happen to favouring my view, than all of that investment this is going to be necessary to build the zero emissions economy. But it wouldn't be doing that by a very particular intervention, a particular thing, a particular firm, or a particular objective; it will be doing through general mechanisms. We've seen in the US recently the, what is grandly called the Inflation Reduction Act, probably the most inflationary bit of fiscal policy [laughter] in American history, but it's a mixture of broad brush and very specific things. And you know how that comes about, the negotiations that go on between the President and the Congress. But there there are massive general subsidies, for example, a general investment allowance to write off for a capital expenditure and renewable energy investment, very specific aid to consumers of electric cars, so long as the cars are made in America. If you think that a car from Japan or Germany is better you don't get the subsidy. So it's a mixture of some broad-based and very particular ones. I don't think that would be a good way for us to go, but I think we should be thinking a lot about broadly based interventions that improve the efficiency of the economy as a whole, and to the extent that they discriminate against activities, discriminate in favour of innovation and investment.

LISA HUETT:

Q:

You might have answered but I just have a quick question. What tax policy would best target revenue from rents without disincentivising competitive economic activities.

PROFESSOR GARNAUT:

A:

Well, that's the article I wrote with three colleagues, Reuben Finnighan, Craig Emerson and Stephen Anthony, published in the Australian Economic Review at the end of 2020. But that that is the shift from the conventional accounting base for the corporate income tax, counting profit to cash flow-based taxes. It would allow immediate write- off of capital expenditure. If that leads to negative cash flows, it would involve a cash payment equal to the tax rate. It would not allow any deductions for interest or for financing expenses, and we propose restrictions on deductions for imports of services that are not directly related to provision of a service. All those deductions that mean that Tesla sells a lot of cars and batteries but makes zero taxable income in Australia, and which is actually quite a challenge for Australian companies to pay tax in the normal way and don't use those opportunities.

LISA HUETT:

Thank you, Professor.

Q:

Thanks, Lisa. Philip Argy from the BLS. My question is about information technologies which you alluded. Players in the economy are utilizing information technology to increase the speed of the cycles, trade cycles. They can react to competitive moves by their competitors very quickly. I often give talks about what's called the illusion of collusion because computers can implement legitimate business rules at the speed of light and they might be legitimate business reactions. The airline ticket price is a good example where all of the computers monitor their competitors ticket pricing in advance and match or beat or do whatever the business decides, in a split second the minute they spot a move, which in the olden days used to be thought of as collusion. But my question is this: with all of this speed of reaction that we're seeing by market players we're seeing the opposite from regulators, and I'm interested in whether you have any concern about the fact that, take the Reserve Bank as an obvious example, we've had 11 interest rate rises and they're still working off such time lagged telemetry that they don't know yet what impact that's having on the economy. There seems to be a massive gap between the telemetry that business is using and the telemetry that The Reserve Bank and other Regulators are using. Do you have any thoughts about the impact of that?

PROFESSOR GARNAUT:

A:

The last one last one first. There is no computer that will tell the Reserve Bank what the effect of 11 interest rates will be. That effect will be decided by the decisions of 10 million Australian households and hundreds of thousands of Australian businesses, and that is inherently unpredictable. In fact, the biggest mistake the Reserve Banks made in recent years is to try too hard to predict the future with economic models. And the most the strongest criticism of The Reserve Bank in the last few years is about their statements about what the interest rates should be in 2024. Humans and their social behaviour are inherently unpredictable, and I suppose there is a degree of insight into human psychology that artificial intelligence may give the machines that replace humans that will change all of that, but we're nowhere near that at the moment.

Now on the question of the highly sophisticated machines that are used by business to interact with customers, I think this is a major problem for our society and for competition policy and regulation. Because it's increasing - there's always been a problem of asymmetry of knowledge between concentrated producers and the individual consumer - and an individual consumer that's much less knowledgeable than the firm selling services or goods to it, is subject to exploitation. And a lot of the new algorithms are all about obscuring the nature of the decision the consumer is going to make, taking advantage of knowing much more about the consumer than the consumer knows about the product or the company. I don't have an answer to that; I think it's one hell of a problem. I think it's one of the reason for the increasing share of rents in the economy. And there's a similar kind of problem in relation to the asymmetry between the regulator and the concentrations of economic power that are being regulated. The regulated invest very heavily into understanding the game's theory of the Regulator's reaction. We would have to resource our competition authorities as well as the major companies resource their interaction with the regulator. Probably there's no alternative to doing that; but we're a thousand miles from doing that now.

So I think the issues that you raise are very difficult issues, very big problems. They're part of the reason why at the time of record high terms of trade, we've had a record reduction in real wages. We’re - as I mentioned - we're further behind we're way behind the US and the UK though our democracy has not been corroded yet by the tensions associated with widening dispersion of income, but I think unless we deal with a lot of these problems the problems of Trump and Brexit lie ahead of us.

LISA HUETT:

George, I think.

Q:

George Siolis, from RBB Economics. I wasn't sure in terms of the timeline sort of when this increase in rents started to manifest itself here, the non-quasi-rent which are the enduring like a competition type rents, and if they were sort of at the beginning of this Century the last 25 years or so, is it because of a failure in the sort of [00:01:10:23] (? Hjalmar) settings which we all thought provided a boost to productivity, or is it a failure of competition enforcement which most of us in the room are to blame for, or is it something else?

PROFESSOR GARNAUT:

A:

I as I tried to point out in in the lecture it's the result of lots of things. For Australia, the increased profit share of income is mostly this century. It's gone much further in the past decade, it's gone much further in the last couple of years. It might, and if you take the official forecast, it's going to continue, and there are a number of factors there. Mining rents become much more important. That's driven by one big thing, the world's most populous country going through the most rapid economic growth that the world has ever seen over an extended period and that country happening to have poor endowments of a lot of resources in which we're rich. So mining has become very much more important and there’s a lot of rents in mining. But even putting that aside sector by sector the phenomenon of a rising profit share is there right across the board and, as I pointed out in the lecture, there's not what you’d expect if capital has become cheaper, and if there's less Innovation and less profits from entrepreneurship now than there used to be. But it's a whole lot of things. The growth of mining as a result of the China boom, which is which is continuing to influence things quite a lot, is the biggest single one. But I think the rise of information technology, I think structurally that's hugely important. Quite a high proportion of our income is spent on information technology in one form or another these days. The cost of that machine you've got in your pocket, the cost of actually manufacturing it is trivially low. Once Apple has done the work to create the system, the cost of producing another 100 million iPhones is very, very, very small, and that is the rents there are network rents, they’re of enormous importance globally. We get our share of that, that's quite an important part of the story. I think that the difficulty of regulating private monopolies, and we've got a lot more of them than we used to have, I think that is part of the story. One can be critical of the particular ways in which we've chosen to regulate transmission lines and tollways but one has to recognise it's inherently extremely difficult to do that in an efficient way. So it's a whole lot of things.

LISA HUETT: Gina.

Q:

Thanks, Lisa. The discussion before in Philip’s question and premise and Professor Garnaut's response, so significant asymmetry between data holding use computational advantage in the hands of small numbers of parties with market power, and then the delay and difficulty for Regulators to operate in too late, is the strong basis for the recommendation to have ex ante rules and the capacity to choose key services, for which there would be rules set in advance, flexibly, in relation to the small number of parties with market power and can involve both interoperability for greater competition, but also access to data. So as to seek to redress the effect of such asymmetries, I'm interested in that is a combination of a different not just competition policy but actually some quite specific economic policy thinking.

PROFESSOR GARNAUT:

A:

You’ve said enough, Gina, to tell me that while I recognise this was a hugely important problem I haven't got very far in thinking about the solution and you have. I think they are tremendously important things to think through and the answers were the general problem is the asymmetry of information, first between consumers and the sellers of goods and services, and then between the regulator of the sellers of goods and services, the asymmetry of information and the particular things you've referred to, I haven't thought all of those things through myself, but it sounds to me as if you're on the right track there.

LISA HUETT: Stella.

Q:

Oh, thank you very much Professor for your lecture. I, like Lisa, was very taken by your Orchestra analogy and your conductor; she sounds amazing, thank you. In terms of perhaps drawing a few threads together, one, Phillip’s comments around the cycle and the pace of change, two; your observations around turning points between Western democracy and authoritarian regimes and, three; the question of the conductor and whether it is in fact possible for us to ever find ourselves in a world - given the political pressures the political cycle the interests of stakeholders - to truly have a conductor that is capable on drawing on different instruments in order to achieve an outcome. My question for you is, how hopeful are you for the economies of our grandchildren in respect of some of the issues you've raised tonight?

PROFESSOR GARNAUT:

A:

Well, I haven't given up [laughter]. And the last 15, 17 years I've focused especially on one particular issue. I haven't stopped thinking about the rest but I'm actually much more hopeful than I was half a dozen years ago that we'll get there on dealing with climate change, and that's quite a big issue for our grandchildren. But on the similarly momentous question of competition between authoritarian and democratic political systems, let's not be complacent. Three points of references: I was at the Adelaide Writers Festival for The Superpower Transformation book, it's a wonderful writers festival, I always like being there, but Ben McIntyre talked about his book, Spies and Traitors, and I enjoyed that book so much. Him being there got me to read it that Jane, my wife, and I started reading others of his book including the story of Philby. Now Philby and Burgess and Macean and Blunt were students at Cambridge at a time when Cambridge was trying to say to students, don't give up the Democratic capitalism, there's a future. So that's a rather poignant juxtaposition of thoughts. And we had that massive competition between the West, at the time dominated by the US, and competition with the Soviet Union, systemic competition through the Cold War. I think there are two things that won the Cold War for the West.

Most important that it was delivering better lives for ordinary people, and over time that undermined the legitimacy of the Soviet regime. Eventually it was quite clear that the living standards of ordinary people in the Western democracies were doing better than the living standards of people in the Soviet Union.

The second thing was that in the end the productive capacity of the West was much greater than the Soviet Union, it was a more efficient economic system. That's tremendously reassuring that the Democratic West won that competitor struggle. But when I think of the history I am rendered a little bit nervous by thinking that that was competition between central planning socialism at its worst and Democratic capitalism at its best, and China's doing a much better job for ordinary people than the Soviet Union ever did, and these years are not democratic capitalism at its best. I think we have to lift our game, we have to recognise that the competition in the end will be very heavily determined by the quality of the lives of ordinary citizens of the democratic West. There's a few of us who would weight small points of intellectual freedom more highly than anything else, but that's just a few of us, and we will not determine the outcome of the new systemic competition.

So what's the hope of us getting back to democratic capitalism at its best? It's a little bit like the prediction of human behaviour in future. One thing I've learned from reading much more history than economics over the last 20 or 30 years is that changes in basic political systems are inherently - and motivations - hard to predict. Now we do have to change some big things in our society for us to be viable competitors. We've got to get money out of the influence it has in politics. A lot of the pessimism that you're reflecting in your question is the dominance of vested interests over policy and I wouldn't be very optimistic about that right now in the United States, because things have gone pretty badly there in the last few years. But in the last election in Australia there was seven Teal candidates, once it's that anyone other than a liberal party meant the member should have had no hope of ever winning and that was one of the key issues; integrity in government. And so the fact that they were able to get that response out of quite a large part of our electorate in Sydney, Melbourne, Adelaide, and Perth says to me there's something big to work on. So it's not certain, but there's a base there to work on.

LISA HUETT:

Are there any other questions? It’s a good place to call it to a close. Thank you very much for your provoking observations, Professor. We will watch with interest to see what the orchestra conductor does and how she calls upon the ACCC and what instrument they will play, so thank you very much. Thank you. [Applause]

PHILIP ARGY:

Thank you, Lisa. I’d like to now call on Marcus Bezzi to propose the vote of thanks and then I'll do a take two on our presentations.

MARCUS BEZZI:

Thanks very much, Philip.

From 1966 Ron Bannerman, in his initial role as Commissioner of Trade Practices, was not really a competition enforcer, instead, he used his position to raise awareness about the extent of Restrictive Trade Practices including pervasive market sharing and price agreements between competitors that existed everywhere in the Australian economy. In doing this he laid the foundation for the 1974 Trade Practices Act. He demonstrated the power of credible informed narrative to drive support for reform. As Gina said, he was a very skilled educator and persuader. Professor Garnaut, in a similar way your work, including your speech tonight, has shone a light on problems that we face as a nation. Like Ron Bannerman, you have offered us pragmatic ways to address them having regard to our national circumstances. As you noted, action in Australia will continue to be critical in managing the growth of oligopolistic and monopolistic markets in Australia, particularly given the changing digital environment. I should mention that the gas law reforms towards the end of last year clarified that the ACCC has a general power to serve notices on people and corporations overseas, and this, in a very small way we think, helps to address the asymmetry between Regulators, us in particular, and the economically powerful, particularly when they're based overseas in tax havens or wherever they might be.

I'm very pleased to see such a broad mix of regulators, policy makers, lawyers, economists, and other thought leaders with us tonight. Professor Garnaut your speech has given us all much to reflect on and be inspired by.

Thank you, once again, for your work preparing the speech and for taking time to speak to us tonight.

It's so pleasing to have everyone back in person, although I know there are a lot of people online as well, but it is great to be here in person, and to be in Sydney for the first time in some years. Thanks very much to Peta, wherever Peta is. There she is. Hi, Peta. Thank you thank you so much for hosting us here at KWM and thanks to your partners as well. We feel very welcome in these premises.

Thanks also to the Law Council for continuing to host the Bannerman Lecture Series with us.

Thank you to our guests, both in person and online. It's wonderful to have such a variety of attendees from across the globe at this event.

Thank you

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