Competition Policy and Economic Reform: The Way Forward

A presentation by Graeme Samuel

President, National Competition Council

to

Economic and Social Outlook Conference

Melbourne

4 – 5 April 2002

Global change and Australia

The other day I spent lunchtime trying to track down a rather obscure DVD. After rummaging through a couple of stores I finally asked a sales clerk if he could order it for me. Of course, he said, but it could take several weeks. I told him not to bother. Recounting this later to my teenage daughter, she asked why I hadn't ordered it myself on the internet. She logged on to a DVD retailer site, and within a couple of minutes, had located, ordered and paid for the disc. It arrived a few days later.

This is a small example but it illustrates a wider point. Australia's economy is undergoing rapid change driven by innovations in communications, financial and information-based technologies. Australian firms now compete against nations that are using technological advancements to drive down costs and enter markets that were previously sheltered by barriers of information and distance. With the integration of markets, world's best practice is the new benchmark for efficient supply.

These changes come in conjunction with wider forces of structural change, including demographic movements and a long term decline in commodity prices. In combination, these changes are also seeing a shift in consumption patterns and an erosion of traditional demarcations between products and markets (for example, the emergence of multi-utilities selling gas, electricity and telephony).

For Australia, wealth creation is no longer simply about boosting aggregate production. Increasingly, it is about finding better ways of doing things, and better ways of meeting consumer wants. Wealth creation now means things like:

- the supply of high value, sophisticated professional services in the areas of health, education and the law, including the export of those services;
- increasing the value of tourism services;
- producing higher quality food and drink, like high quality wine (rather than just more of the same product);
- providing services that make it easier for people to shop for what they want (rather than expecting consumers to buy what's for sale during traditional shopping hours);
- producing primary inputs like grains or iron ore that are designed to reduce manufacturing costs or improve product quality in downstream value-adding activities like meat or steel production; and
- providing innovative personal services to help improve the quality of life of consumers of these services.

Good economic management – the role of governments

As Australia deals with a global environment that is constantly evolving, on the domestic front it also faces change. Since the early 1990s, governments have implemented a wide-ranging program of microeconomic reforms, including the package of measures referred to as National Competition Policy. These reforms are directed to improving community welfare by encouraging businesses to use resources more efficiently and be more responsive to consumer choices, acting as a spur for better service provision and lower prices.

Such reforms contribute to one of the main responsibilities of government — to be good economic managers.

While governments of recent times have demonstrated sensible economic management, there is a parallel responsibility for dealing with the negative effects that are often associated with the implementation of government policies. While it may be difficult, and indeed counterproductive, to resist change, it is important to recognise that the Australian community can play an active role in deciding how it adapts to change. To this end, one of the most important roles for governments today is to manage the forces of change to achieve the best possible outcomes for society.

Benefits of good economic management

The nations to prosper in the 21st century will be those that adapt quickly to rapidly changing demand and supply conditions. And increasingly, it is irrelevant to talk about change in Australia as a distinct phenomenon from global change. With the increased mobility of capital, Australia's interest rates and exchange rate – major influences on the wellbeing of all Australians – are now shaped by global capital markets and international perceptions of our responsiveness to the challenges of global change.

To close ourselves off from the rest of the world – through trade barriers and the like – may be one response to this challenge, but it would be an extremely costly one. The isolationist route would mean taxing the inputs of our own industries, and numbing them from the disciplines of competition. This would insulate us from the very impetus needed to sustain growth and employment in the years ahead. The isolationist approach is the road to becoming an economic backwater; and history has shown that the costs fall heavily on those least able to meet them. Few countries would now even contemplate the idea.

Australia has reaped the benefits of implementing microeconomic reforms. We've already seen some of these benefits coming through in areas ranging from energy and transport charges to prices for milk, bread, and telecommunications.

The Productivity Commission estimates that, as a result of competition policy, Australia's gross domestic product is 2.5 per cent higher than it would otherwise have been, In other words, without microeconomic reforms such as competition policy, Australian households' annual incomes would on average have been around $7000 lower than they were at the end of the 1990's. An extra $7000 a year can mean big improvements in food, clothing and housing for most families, or help improve health and education standards. In the 1993/4 – 1998/9 period, Australia's productivity averaged growth of 1.7 per cent per annum compared with growth in the 0.5 to 0.9 per cent range over the previous 20 years.

There is little doubt that this period of strong and sustained economic growth has contributed to the nation's ability to weather domestic and global economic instabilities such as corporate collapses, a flat US economy, the September 11 tragedy and the prolonged Japanese downturn.

Importantly, it has also brought with it employment growth and improved living standards with increasing incomes enabling increased leisure, improved health, education and social welfare.

Reform in the community interest

But not every proposal for reform that improves business competitiveness is desirable. While promoting competition will generally improve economic efficiency and community welfare, this may not be the case in specific instances where the benefits of reform would be outweighed by associated costs, or where market failure might warrant regulation.

An important change management role for governments is therefore to determine whether reform brings a net community benefit. In doing this, governments must consider an array of community interest matters, including the environment, employment, social welfare, regional development and consumer interests as well as business competitiveness and economic efficiency.

A challenge for governments is to focus on outcomes that benefit the *community as a whole*, rather than providing special treatment for certain groups at the expense of consumers generally. At the same time, the impacts of reform on the individuals, regions and industries directly exposed to reform must be taken into account. It is also important that any trade-offs between the interests of different groups are made explicit so that governments can objectively consider the case for adjustment assistance to those who bear the costs of reform.

Addressing the fallout from change

Of course many reforms that proceed on the basis of net community benefit will nonetheless impose costs. The same can be said for the process of change more generally. Global change in combination with economic reform is contributing to an expanding – and more robust – economic cake, but the shape and flavour of the cake are undergoing continuous change. In the process, cake ingredients are being substituted and rearranged, and some are losing their relevance in the mix.

In the short-run, the benefits of change and reform are reaped by those able to capture them through skill, initiative, resources and adaptability. In the long run, the benefits accrue more widely through economic and employment growth, in turn generating resources needed to fund welfare, education, health and other social priorities. But amidst this, economic change is also downgrading the relative values of some skills and eroding job opportunities in some of the industries directly exposed to change.

In socio-economic terms what this means is that amidst aggregate production, income and employment growth, particular segments of the community are bearing some pretty severe fallout from change. For example, Victoria's Latrobe Valley has suffered significant job losses arising from the new arrangements in electricity. The reforms are contributing to a more productive and efficient Australia, but the socio-economic burden on the Latrobe Valley has been large.

In contrast, the old world of protected markets engendered illusory feelings of comfort and certainty. Now, instead, many people feel a loss of power over their lives, not knowing whether they will still have the same job, or whether their small business or farm will be viable in the future. The global market can deal harshly with those that do not make the cut. Some industries and geographical regions may lose their economic viability.

Fear of change is generally most evident in those with the least capacity to absorb the impact of change – that is to say those who lack the skills and tools to adapt to the business and social environment that flows from competitive international and domestic markets.

Such fear has been exacerbated by perceptions of indifference to, or ignorance of, the impacts of change by those who have been instrumental in bringing about the changes – in particular, governments and business.

As I have emphasised, while policy reforms have aggravated hardship in certain industries or communities, the underlying issues are much broader. For example, the viability of some rural communities has been threatened by a combination of a long-term decline in commodity prices, changing preferences among people to live near the coast, and advancements in farm technology. As agricultural markets become more integrated, producers with an eye for innovation, niche markets and cost-effective technology will do well; but the challenges for producers will certainly increase.

Whether adjustment costs flow from government policies or the wider process of change, a society split between haves and have-nots is simply not acceptable, no matter how much benefit is accruing in aggregate. Change management must therefore go beyond facilitating change to reap the economic rewards offered by the global market place. It must also ensure an equitable sharing of the spoils.

As Thomas Friedman points out in *The Lexus and the Olive Tree*, the biggest losers from change – people who have lost their traditional livelihood – can suffer swiftly and severely, and are often able to mobilise opposition to further change.

One of the key responsibilities of governments in the process of implementing reforms, is the identification of the possible winners and losers. However, the task of identifying those most likely to be negatively impacted is not nearly as difficult as identifying the beneficiaries of change and reform. The winners are the millions of consumers who gain access to lower prices and better services and the producers whose input costs are lowered through reform. Even as time passes, the difficulty in identifying beneficiaries prevails, for example, people who find employment in the industries that grow off the back of these changes.

Given that the benefits to individuals may be relatively small, or may be too remote from the original cause for a link to be obvious, it's not surprising that we haven't seen street rallies demanding change and reform.

But the silence of the majority can give opponents of change considerable leverage in mobilising public and political opinion against change. This only adds to misinformation and confusion in the community that globalisation is a new and corrosive phenomenon – rather than a new stage in a process that has been evolving for centuries. And factors like immigration, international trade and pro-reform policies become scapegoats for the fallout from change, when in fact they are helping Australia capture the benefits of global change.

What this means is that a society that relies purely on market forces to distribute the benefits of change will inevitably sow the seeds for polarisation and resentment. Ultimately, this feeds into social dislocation and political instability.

Some implications for government policy

The success and willingness of the community to embrace change may be determined by the method in which governments implement reforms — the risk of derailing the reform process is incentive enough to manage change effectively.

Indeed, if issues such as fairness are not adequately addressed, people may simply equate economic reform with job losses, breakdown in communities and so on. This in turn will increase resistance to economic reform.

However, the need to foster fairness does not mean that we should abandon economic reform. After all, most reforms that improve our economic prosperity will also improve fairness. And there are often smarter ways of achieving fairness than cutting back on economic reforms that have some adverse side-effects for fairness. We need soft hearts, certainly, but we also need hard heads.

And so we really need to think smarter about what range of policies will give us the most prosperity with the most fairness and, where they are at odds, the policies that will strike the best balance.

Helping people adjust to change must become an integral part of reform. It is imperative not just on moral and equity grounds, but to help communities feel more optimistic about their ability to adapt in a world where ongoing change is a part of life. Perhaps, most important of all, assistance ensures that people don't feel that they have been forgotten or discarded by the rest of the community.

As Nobel Laureate Amartya Sen points out, global change can generate the resources needed to alleviate poverty and marginalisation, but it takes commitment and vision to achieve this end result.

Critically, governments must not undermine the incentives to create and innovate, for these are the very generators of wealth. The best safety net of all is a strong economy able to provide jobs. And while traditional safety nets such as social security, public health and education are important, what is also needed, in the face of rapid change, are opportunities for people to adapt so that they can play an active role in the dynamics of change.

The challenge is: How to implement a reform such as competition policy, which provides demonstrable benefits, while managing the temporary adjustment costs that these types of changes usually produce?

The complexity of many National Competition Policy issues highlights the importance of open and consultative processes and independent and objective analysis in the consideration of public interest matters. These features are essential to maintain confidence that the interests of all in the community have been objectively examined, not just the interests of particular groups.

Explaining reforms (and the reasons for them) and assisting with adjustment to change when necessary, are integral steps in the successful implementation of any reform program.

In addition to the measures generally available to assist people to manage change, including social welfare payments such as unemployment benefits, labour market support instruments and redundancy arrangements, there are situations in which further assistance may be required to facilitate adjustment.

Structural adjustment assistance is certainly one consideration when facilitating change that may contribute to ensuring that those most affected by government reforms experience a fair and more effective transition.

The key considerations in determining whether adjustment assistance is warranted are the severity, speed and permanence of the effects of change, and whether significant hardship would be likely to result in the absence of assistance is complex because assistance is often required before the full effects of the change are evident. As previously mentioned, another key consideration is the identification of those less capable of absorbing the negative effects of change.

Assistance need not be monetary but can take other forms such as financial and career advice, re-training, re-skilling and access to other relevant services. It may mean things like access to venture capital for entrepreneurs keen to invest in a depressed region. It may mean replacement of lost services with alternatives such as enhanced communications infrastructure.

As the saying goes, give a man a fish and he eats for a day, teach him to fish and he eats for a lifetime.

Providing adequate support to assist with change should empower those most affected. Small business operators for example, faced with challenges of a deregulated and more competitive environment, may need the ability to act collectively in dealing with substantially more powerful suppliers or customers.

It is important that any assistance provided should be directed to managing and facilitating change – assisting those least able to absorb the impact of change while focussing on best value outcomes in the long term. Adjustment assistance should be distinguished from the payment of compensation for changes in government regulatory policy, particularly where people have invested largely or solely on the basis of regulatory restrictions. People undertake such investments knowing that government policies can and do change. Case by case judgement is required on the issue of compensation, taking into account precedent implications.

Technological progress and engagement in world markets offer very substantial benefits to Australians. Indeed, more than enough benefits to be shared by everyone. Well implemented, economic reform that has as its foundation a public interest objective provides the means to deliver improved living standards for the whole community. But governments must go beyond facilitating and implementing reform to also ensure that the benefits are shared equitably. No-one should be regarded as an expendable cost of achieving the benefits of reform.

The role of business

Adjustment assistance is, however, not just a matter for governments. Businesses, too, have a responsibility to the community, including sensible socially-responsible change management.

What is the role of business in dealing with these issues? Following the recent series of corporate collapses in Australia, the Prime Minister exhorted the need for Australian businesses to assume a greater level of corporate social responsibility.

Many business leaders took the position that business responsibility should remain focussed exclusively on returns to shareholders. Their community responsibility could be fulfilled by contributing towards a vibrant business sector whilst governments could look after equity and social policy.

Now there is some truth in this. There is an argument that, if shareholders wish to direct some of their returns to philanthropy, or in fulfilling a social responsibility, that is their right — that it is not the place of company directors to make those decisions on their behalf.

But business, as a full participant in the Australian community, has a social responsibility. What does this mean in practice? It is probably easier to identify things it doesn't mean. For example:

- It doesn't mean business advocating government policies regardless of their impact on the broader community or, exhorting a government in private to 'do the right thing' only to fail to support the reforms in public.

- It doesn't mean avoiding issues of public importance merely because taking a stand may mean some inconvenience or minor risks.

- And perhaps most importantly, it doesn't mean avoiding public accountability for actions that have pervasive impacts on the community – business has an obligation to explain changes – just as governments do.

Corporate social responsibility is a business imperative as well as an altruistic nicety. It is not so much about cheques as it is about attitudes, social involvement, and sensible, socially responsible change management.

For example, the community's concerns about bank closures, especially in small rural communities, are well known. While branch closures may make good commercial sense, what is surprising is the perception that the banks have not always thought ahead to manage the impacts of change on their customers.

While alternative types of service are now being offered – for example, greater use of mobile banking, agency banking and electronic access - these alternatives were often not in place, or not adequately made known to the community, when the branches were closed. The end result was that many communities were left with the perception – right or wrong – that the banks don't care about them, and that new services were only offered under pressure.

Increasingly, corporate profitability is about good employee relations and good relations with the community. Perhaps these links are emerging more slowly in Australia than in Europe, but they will only grow stronger. More and more people will shy away from buying products from – or even investing in – corporations perceived to be delinquent citizens.

A business philosophy that abdicates social responsibility also runs the risk that governments will intervene to address the community's needs through regulatory requirements.

This is not to say that business decisions should be guided entirely by social considerations. Indeed, the capacity of business to generate national wealth derives significantly from its ability to respond quickly and innovatively to market conditions. But for decisions likely to impinge on community sensitivities, it is important to take account of socio-economic impacts. This not only serves the interests of Australia. In the long run, it also makes good commercial sense.

Summing up the key themes

Let me sum up with three points.

The first is that we cannot avoid change. The world will no longer allow us to sit on our hands while the dollars grow on our sheep's backs, for instance. Many people would prefer a world without change or, at least, with less change. Some would even like to return to the so-called golden era of the 50s and 60s. However, there is a need to recognise the nature of our economic situation as a small trading nation in a changing world, dependent on trade to maintain our living standards. It is simply unrealistic to cut ourselves adrift from the rest of the world. In our circumstances, change *is* a reality, not an option. We can tackle it or let it tackle us. We therefore need to ease and facilitate change, and to address its social costs, wherever it occurs.

But it would be unfair and ultimately self-defeating to seek to halt it indefinitely, because sheltering one area of life from the realities of change simply shifts the costs to other people and ultimately makes us all poorer. We seek to avoid change only at a greater cost to our own future.

On this point, my desktop computer has a screen saver installed on it. Its scrolls relentlessly through the day with the message:

> ***"Grant me serenity to accept the things I can not change, courage to change the things I can, and wisdom to know the difference."***

We need the wisdom to know that we cannot stop the world changing, and the courage to act proactively to make the most of our changing circumstances and opportunities.

The second point is that there are few straightforward answers. When it comes to change, there will always be differences of opinion on what is the best way to deal with it, what is the best course of action to take.

This implies that before we endeavour to implement change, we must recognise that other sections of the community may not share our views. Indeed, in many instances they may not have considered the issues from our perspective or, indeed, from any other, and need first to be informed and ultimately convinced as to the need for change. These views need to be discussed in the community, to develop an understanding that there is a problem that needs to be fixed before an attempt is made to promote the merits of a solution.

The approach to any problem must recognise and reflect the interests of all elements of the community, individually and collectively, rather than the narrow interests of a reform proponent. Why should anyone support, or even acquiesce to, a reform measure that involves no apparent benefits and perhaps a few risks? Ideally everyone is a winner. Or, more realistically, there are substantially more winners than losers. And even the losers can be shown to have been treated fairly and equitably, and assisted with their loss where appropriate.

And this leads to the third and possibly most important point — the importance of governments, in their capacity as good economic managers, to address fairness as well as economic prosperity when considering government policy. As I have said, this does not mean that we should abandon economic reform. Nor does it imply a descent from robust wide-ranging reform into populist policy palliatives. But it does mean that we need to recognise and address the trade-offs that will sometimes emerge between fairness and prosperity objectives, and ensure that we choose the right policy mechanisms to pursue these community goals. And this applies in all areas of reform, whether it be tax, competition, labour market policies, the bush, or social areas.

Concluding thought

I think that we would be unanimous in endorsing the most commonly recognised aspect of the Australian ethos - the notion of the 'fair go". We are now well past the "greed is good" eighties.

I put it to you that we should be seeking to encourage those who lead us, in government, business and the general community to have the *understanding, courage* and *social sensibility:*

- Firstly to *understand* the economic imperatives that limit our choices.

- Secondly, within those choices, to have the *courage* to embrace a sustainable and robust program of economic reform directed to benefiting the community as a whole.

- And thirdly, to have the *social sensibility* to ensure that, while the reform program we choose delivers the economic efficiency we need, it will also deliver a fair and cohesive Australia.

Australia, like the rest of the world is undergoing much change. At the same time governments are trying to facilitate the best possible outcomes of change through economic reform.

The challenge, and the best way forward, is to respond to the concerns of those who are exposed to the effects of rapid change *without* jeopardising the path of growth and change which lay the foundations of wealth for the whole of society. This is a challenge that governments — and business — must rise to.

The reform process has, to date, encompassed legislative, structural, cultural and attitudinal changes. As we move into the next, and perhaps final, phase of reform, the emphasis will be on maintaining the cultural and attitudinal shift of the community. This will ensure the gains of the past six years are not eroded but continue to benefit all Australians.

References

Friedman, Thomas 2000, *The Lexus and the Olive Tree*, Harper Collins.

National Competition Council 1999, *National Competition Policy: Some Impacts on Society and the Economy*, Melbourne, January.

Parham, D., Barnes, P., Roberts, P. and Kennett, S. 2000, *Distribution of the Economic Gains of the 1990s*, Productivity Commission Staff research Paper, AusInfo, Canberra.

Productivity Commission 2001, *Structural Adjustment – Key Policy Issues*, Commission Research Paper, AusInfo, Canberra

Productivity Commission 1999, *Impact of Competition Policy Reforms on Rural and Regional Australia,* Inquiry Report, Canberra, September.

Sen, Amartya 2001, *All Players on a Global Stage*, Alfred Deakin lecture, May 15.