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Red tape the problem rather than monopoly

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If there is one thing we have learned it is that if a conclusion doesn't make much sense, it is wise to treat it with caution, no matter how carefully it has been derived.

The Treasury paper, released with the Intergenerational Report, which argues that there is less competition today in virtually every sector of Australia's economy than there was a decade ago, is a case in point.

At the heart of Treasury's analysis is an increase in profit margins, which it puts down to a weakening in competitive pressures – that is, to an increase in firms' market power. But it would be surprising if Treasury could find many consumers who believe they face less choice across the board. On the contrary, every study with which we are familiar suggests that consumers have access to a greater range of products, in most cases offered by more competing suppliers, than ever before. At the same time, consumers know (or, at least, can know) far more about their options, and firms about their customers, helping them navigate a fast-changing environment.

Indeed, it is that improved information that has made the spectacular increase in product variety possible. Nowadays, producers can target products at market niches so narrow that they would previously have been unviable; and they can "monetise" those niches more efficiently than ever, tapping latent pools of willingness to pay. Moreover, that happens not just

in digital markets but in the far broader range of industries that use information technology to track every aspect of consumer behaviour.

It would be astonishing if so vast a transformation did not yield gains to producers as well as consumers. Economists have long known that increases in product variety that meet unserved needs generally give rise to larger benefits in consumer welfare than do reductions in prices for existing products – put in economic terms, they unlock “gains from trade” that are shared between consumers and the producers who have seized the opportunities.

That process is hardly a symptom of the dead hand of monopoly. Yet it escapes the Treasury analysis, which seems to view competition as entirely centred on prices, overlooking quality, availability and variety.

However, it is unlikely that the technological transformation entirely explains the increases in profit margins Treasury’s data highlights. But nor are those increases, which are relatively widespread, likely to reflect the emergence of new monopolies.

After all, changes in competitive conditions are not like tides that sweep in and out across the entire shoreline; rather, left to their own devices, they typically vary greatly, as does their change over time, industry by industry, firm by firm.

It is therefore implausible that those changes could explain an increase in profit margins across the economy as a whole.

Rather, what one should be looking for are explanatory factors which are themselves economy-wide. In reality, one doesn’t need to look far, for the past decade has seen a tsunami of regulation – from climate change to directors’ liability – that has increased the risk involved in investing and pushed up required profit margins and rates of return. And by the way, those regulations also make it harder for new firms to enter and expand, giving some substance to Treasury’s story.

We are, in other words, in the midst of a battle between an innovation process that is yielding enormous consumer benefits and a regulatory explosion that threatens those benefits. Once

upon a time, Treasury would have been more alert to that clash and its dangers than anyone. Its analysis might have been technically less sophisticated than this paper is, but it would have focused on the real problems – and provided better guidance to policymakers.