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Competition among companies is good, runaway regulation far less so

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Not long ago, Andrew Leigh, the opposition assistant Treasury spokesman and spokesman on competition, told us that “Australia’s markets are more concentrated than those in comparable countries” — and, brace yourself, “the problem is getting worse”.

Moreover, the “general trend” to greater concentration, and the monopoly profits it showers on big business, has “played a part in the steady rise in inequality”.

As I pointed out at the time, the data on which Leigh relied was highly questionable (“Evidence doesn’t justify more regulation,” *The Australian*, May 30, 2016). Now an important report by the Grattan Institute’s Jim Minifie demolishes Leigh’s claims brick by brick.

“Large firms,” the Grattan report finds, “are not unusually dominant” in Australia, nor have their revenues “grown faster than GDP”. Their profitability “has not risen much since 2000”. And while rates of return are relatively high in some pockets of the economy, concentration levels and barriers to entry play almost no role in determining them.

Moreover, comparing the report’s results to other studies, Australian investors expect high returns to be dissipated more quickly than has generally been the case for the advanced economies, driving profit rates down to normal levels.

As for crippling our economy, the report concludes that even entirely eliminating excess profits would increase the welfare of Australians by only tiny fractions of 1 per cent of GDP. In fact, the report’s estimates of the costs any lack of competition imposes on the Australian economy seem well below the amount we spend on enforcing and complying with the competition laws.

That doesn’t mean Rod Sims, who chairs the Australian Competition & Consumer Commission, should fear (or prepare to celebrate) losing his job. After all, without a vigilant regulator keeping them honest, the harm dominant firms impose might sky-rocket, though that seems unlikely in an age in which virtually every market risks being up-ended by internet-savvy customers.

But it does mean that the incessant demonisation of big business entirely misses the mark. In competitive economies, firms do not earn high returns by bleeding consumers dry or by throwing sand into each others’ gearbox; rather, they prosper by identifying, developing and supplying products that we value vastly more than they cost to produce.

That the US so regularly spawns hugely profitable firms such as Google, Walmart and Warren Buffett’s Berkshire Hathaway is therefore anything but a sign of weakness; on the contrary, it is the surest evidence of American capitalism’s enduring vitality. What Australia needs is many more firms that can and do reward investors handsomely thanks to their superior skill and acumen, not fewer.

Those points apply with as much force to banking, which has been 2017’s whipping boy of the year, as they do to the rest of the economy.

Here, too, myths abound. No, the Australian banking sector is not more concentrated than its counterparts in similar countries overseas; net interest margins, which reflect the difference between banks’ average lending and borrowing rates, are not especially high; and the spread between mortgage rates and the Reserve Bank’s cash rate is not unusually great. So, too, with the extent of competition: not only are rumours of its demise greatly exaggerated but the rapidly growing role of brokers in helping consumers optimise their finances is lowering switching costs and placing increased pressure on the major banks.

Indeed, if firms in the finance sector are willing to pay so much for the specialised skills they require, it is not because they are wallowing in monopoly rents but because a more complex and competitive environment makes those skills more valuable than they used to be.

Could banking be made even more competitive?

Perhaps. But be careful what you wish for. As Spain’s Xavier Vives, one of the world’s leading authorities on the subject, argues in his recent book *Competition and Stability in Banking*, there is a real trade-off between increasing the extent of rivalry and ensuring the banking system is robust and resilient.

“By increasing competitive pressure,” Vives warns, “we will reach a point where the benefits balance with (the risks of) increased fragility, and further increases will be socially harmful.”

Whether we are already at that point is controversial. What is certain, however, is that the greatest obstacle to competition in Australian banking lies in the quagmire of regulation that stifles incumbents and entrants alike. How that quagmire formed is no mystery: over the past five years alone there have been 29 separate reviews of banking by the various arms of government; so as to justify its existence, each and every one of them has recommended piling further regulations on.

It would be nice to think that the new royal commission will reverse the trend. Unfortunately, given the circumstances of its birth, it is far likelier that it will merely add to what is rapidly becoming a regulatory Sargasso Sea — an immense, turgidly revolving mass of regulatory debris, in which our financial institutions will moulder as they await the death blow that eventually causes them to sink.

No doubt that day will come. But a sensible debate on Grattan's findings may help put it off, not least by focusing attention on those parts of the economy that really do need an injection of competition: most obviously, public schools and hospitals, where poor performance endures because more efficient suppliers cannot displace their less efficient rivals.

Whether Leigh is open to that debate remains to be seen. And it also remains to be seen whether he will retract claims he made that are simply incorrect.

Quoting Keynes, Leigh likes to say that when the facts change, he changes his mind. Well, here's his chance to prove it.