Time to reform the Trade Practices Act

First published in The Australian, 4 January 2008

Reports that the Government is considering revising the Trade Practices Act so as to strengthen the "Birdsville amendments" (which seek to prohibit "predatory" pricing by large businesses) are deeply concerning.

To begin with, it is not apparent what problem these changes would be attempting to cure. There is simply no evidence that small firms are suffering from predatory or otherwise anti-competitive conduct by larger firms. Indeed, data from the ABS suggests that small and medium sized enterprise has flourished in recent years.

Thus, at June 2006 there were 108,000 more "employing" SMEs (that is, SMEs that employ staff) than in June 2004 and 183,000 more than in June 2003. At the same time, SME's contribution to the value of Australia's GDP is estimated to have increased by $23.8 billion in real terms over the period from 2004 to 2006. Additionally, the rate at which new SMEs are formed appears to be rising, especially for very small or "micro" businesses.

Moreover, even if there were compelling evidence of a problem, proposals to make discounting more difficult seem like the worst possible way of addressing it. In effect, discounting is a crucial form of price competition, and tends to be especially important in concentrated markets, where competition on "headline" prices is often muted. Additionally, discounting is generally the way cartels unravel, as colluders chisel from the cartel price so as to expand their own sales. Restrictions and prohibitions on discounting are therefore especially perverse, as they deprive consumers of the benefits of price competition in exactly those markets where added competitive pressures would be most valued.

International experience highlights the costs this can create. France, for example, has long had restrictions on discounting, especially in retail distribution. As the Attali Commission – set up by President Sarkozy to review these restrictions – has found, the main effect of the laws has been to increase costs to consumers, while doing nothing to promote efficient and sustainable small business. Similar results emerge from studies done in Italy, Germany and Austria, all of which have prompted calls for moves away from anti-discounting laws which far from promoting competition, undermine it.

This is not to suggest that all is well with the Trade Practices Act: that is certainly not the case. The reality is that the Act is a mess. The core problem with the Act is that it is a creature of the time when it was enacted, that is, the early 1970s. At that time, the Australian economy was highly protected, capital markets were stunted by regulation (making it difficult for new ventures to secure funding), and labour market regulations imposed a uniformity of wages and conditions that favoured larger, incumbent firms. The result was an economy in which competitive pressures were often weak and restrictive practices widespread. The Act tried to overcome this by sweeping prohibitions which in retrospect often proved poorly judged, as the conduct they proscribed was at least as likely to enhance competition and efficiency as to harm them.

Since then, further powers have been granted the ACCC, for instance in respect of mergers, with only minor changes being made to the prohibitions set out in the Act as originally enacted. Indeed, the only substantially de-regulatory change was made by the Keating Government, which – on the basis of advice from the Hilmer Committee – repealed the specific prohibition on price discrimination, despite concerted opposition from the small business lobby. However, most of the other, largely outdated, restrictions and prohibitions have been allowed to remain in place. The Birdsville Amendments then made matters worse, by adding a poorly drafted overlay to legislation that was already creaking at the edges.

The result is an Act which seems very poorly suited to a modern, competitive, economy. It is based on the presumption that anti-competitive conduct is far more prevalent than it is likely to be in an economy as open as Australia's and in which labour and capital markets are relatively flexible. At the same time, some of its prohibitions are glaringly inconsistent with current thinking in economics, as is their administration by the ACCC.

Nothing better illustrates this than the continuing prohibition on resale price maintenance (RPM). RPM, which covers practices whereby suppliers prevent their retailers from discounting their products, is prohibited under section 48 of the Act, regardless of whether it damages consumers or competition.

The reality is that RPM is more likely to enhance efficiency and promote competitive entry than to prevent it. For example, the difficulty a new entrant faces in markets for 'brand name' consumer products is usually that of securing the large distribution networks enjoyed by incumbents. Faced with that difficulty, an entrant can use RPM to provide incentives for retailers to vigorously promote its products. This is not to say that RPM is never harmful; but a presumption against RPM, as built into the Australian legislation, makes little sense indeed.

All of this has now been recognised by the United States Supreme Court which in June of last year overturned a 96 year old ban on RPM. The Court held that RPM should not be automatically prohibited, but rather should only be banned where it causes demonstrable harm to competition. The ruling took account of the economic literature which, it notes, exhibits "widespread agreement" that RPM agreements can promote competition.

There is a striking contrast here with the ACCC, which continues to enthusiastically advocate and enforce the Act's statutory prohibition of RPM, even in circumstances where there is no possible harm to consumers or competition.

Only last year, for example, the ACCC secured the 'highest ever penalty' for RPM of $3.4 million against four Jurlique companies and Jurlique's founder. It did so in circumstances in which the trial judge found that 'it is impossible to conclude' that the conduct of which the ACCC had complained had 'caused loss and damage to consumers'. Nonetheless, Justice Spender quite properly concluded that he was 'bound by the law', and decided the matter accordingly.

The RPM case merely highlights a more general problem. The Trade Practices Act is badly showing its age. It is overly complicated, and in some areas, sets too low a threshold for breach. At the same time, the way in which the ACCC administers the Act tends to aggravate matters, with too much discretion in the interpretation of key provisions, decisions which seem arbitrary or in any event are difficult to explain, and far too great a political element in the Act's administration.

In short, what the Act needs is a thorough-going modernization. The 2003 Dawson Review was a missed opportunity in this respect, with the changes subsequently made to the Act having more political appeal than economic merit.

If the Rudd Government really wants to de-regulate the Australian economy, it should therefore take the shearing clippers to the Act. It should strip it of outdated prohibitions which merely add cost and uncertainty to the competitive market-place, while making those few prohibitions which are warranted clearer and more effective. It should also simplify the Act's drafting and structure, and more narrowly limit the discretion vested in the ACCC, while increasing the ACCC's accountability. Doing anything else will merely make an existing mess even worse.