



PARLIAMENT OF AUSTRALIA

Better Competition, Better Prices

**Report on the inquiry into promoting economic dynamism,
competition and business formation**

House of Representatives

Standing Committee on Economics

March 2024

CANBERRA

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Foreword

Competition and economic dynamism underpin everything we do in our daily life – whether it is shopping at the local supermarket; using our credit card to make a payment; using an app on our mobile phones to buy an airline ticket or obtain the latest news; and much more.

Some of the most important decisions we make in life, such as taking on a mortgage to buy a home, are (unknowingly) also heavily influenced by the level of competition and dynamism in the economy.

Competition and economic dynamism should be considered complementary parts of the economic ecosystem.

Competition puts downward pressure on prices as firms battle each other for our business. Competition also leads to better service – the more companies in any one sector, the harder businesses must work to retain customers and secure greater market share.

Economic dynamism includes such factors as the rate of new business formation, the efficient allocation of capital and labour, well-designed regulation and the development of new factors of production, including skills.

Competition improves economic dynamism because the entry and exit of firms and the growth of the most productive firms are key drivers in the efficient allocation of resources.

Economic dynamism drives competition by enabling the entry of new firms that can challenge incumbents. Over time, economic dynamism in conjunction with competition drive innovation and long-term productivity growth as individuals and firms strive to invent and commercialise new products and to create new markets.

Australia has one of the highest standards of living in the world. This was built on the back of decades of high productivity growth.

However, over the past 10 years, the rate of productivity growth has stalled. Moreover, since the completion of the Harper Review in 2015 and the Hilmer Review before that, the data shows declining competition and dynamism as measured by the high market share of leading firms, the margins that firms are charging in key sectors, and a declining rate of firm entry and exit in some sectors.

If we don't improve the level of competition and dynamism within our economy, today's consumers will get a raw deal, while future generations will be far poorer than they might have been. This is a key challenge for policy makers and this report puts forward practical steps that will help turn things around.

Australia needs to lift its game when it comes to both competition and economic dynamism. In the short-term, this will put downward pressure on prices, thereby improving the cost of living. It will also place a check on poor corporate behaviour towards consumers. If we don't tackle this challenge, future generations will be left poorer. The potential upside is massive: higher growth rates, higher incomes and better outcomes for consumers.

First, we need to get the economy-wide regulatory settings right. We need to continue to improve the design and scope of regulation. This includes reforming mergers law and restricting the use of inefficient and unfair restraints such as non-compete clauses.

Government now plays a major role in the economy, providing health care, education, social welfare, infrastructure, defence and more. Improving the effectiveness of government services is critical to long-run productivity growth. Where these are provided through markets or quasi markets administered by governments (such as labour market programs, the NDIS, skills development, and aged care), modern economy theory and its applications demonstrate that success requires a bespoke approach. Market design and market stewardship are key.

Government also spends tens of billions of dollars procuring services. The efficiency and effectiveness of this procurement needs to be improved, by including social enterprises and SMEs and through better designed auctions and panels.

This report also examines the performance of key sectors of the economy.

The financial services sector is one of the largest in terms of value add. The need for a regulatory grid was raised repeatedly in submissions and during our public hearings. The Committee welcomes the government's announcement that it will explore such a grid.

Other important issues include the need for a regulatory sandbox to facilitate and test sensible and timely first steps in areas of rapid product innovation where consumer harm is a risk, and well designed and proportionate licensing arrangements in areas such as the payments system.

As Paul Keating said, the banking system can be likened to the arteries of the economy. Some areas warrant regulatory tightening - such as variable interest rates charged to residential mortgage holders, particularly those who are not financially savvy; and the interest rates charged on deposits, particularly where complex bonus or introductory rates are offered.

This report sets out options for introducing behavioural prods to ensure more efficient and fair outcomes for consumers. It also suggests additional products for consumers such as tracker mortgages and ways for smaller institutional players to have access to more cost-effective funding.

The aviation sector is characterised by two large operators with a very high combined market share. To some degree this reflects capital requirements and network externalities. However, there is scope for more entrants, particularly on regional routes. Ensuring greater competition will require a combination of approaches, including potentially reallocating scarce landing slots and greater consumer protection.

The retail sector has also been the subject of considerable public debate. The Committee received evidence in relation to the high market share of the key players in the supermarket sector; profit margins; and the power imbalance in the relationship between the major supermarkets and farm-gate producers. Many agricultural suppliers are at risk of that power imbalance being used to negotiate outcomes that affect profitability and, therefore, the capacity and willingness to invest. Encouraging greater competition will involve changes to planning laws and approvals; strengthening merger laws; and improved oversight of negotiations between supermarkets and primary producers.

In other retail sectors, such as beer production, the evidence suggests that producers reap considerably higher margins than retailers do. The ACCC should continue to monitor this sector.

It is pleasing that a number of issues raised in submissions and our public hearings have already been actioned. This includes progress on the review of mergers law; the regulation and measurement of non-compete clauses; the regulation of landing slots at Sydney Airport; and the consideration of a regulatory grid for the financial services sector.

This report follows seminal reports by Hilmer and Harper over recent decades. It did not aim to replicate their breadth but, rather, to explore areas where opportunities for reform have arisen since they were published. We focused on areas of legal and regulatory reform that could be particularly impactful and sectors where the greatest technological or structural change is occurring.

Australia is at a crossroads. We are emerging from a decade of low productivity growth. The need for competition and economic dynamism is great. And as this report points out, there are many opportunities - at an economy-wide level and at a sectoral level - for meaningful reform that not only produces immediate benefits for consumers but that will also deliver higher standards of living for future generations.

Dr Daniel Mulino MP
Chair

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Abbreviations

ABA	Australian Banking Association
ACCC	Australian Competition and Consumer Commission
ADI	Authorised deposit-taking institution
AFCA	Australian Financial Complaints Authority
AFGC	Australian Food and Grocery Council
AI	Artificial intelligence
APRA	Australian Prudential Regulation Authority
ARNECC	Australian Registrars' National Electronic Conveyancing Council
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
ATO	Australian Taxation Office
AUSTRAC	Australian Transactions Reports and Analysis Centre
BCA	Business Council of Australia
BCCM	Business Council of Co-operatives and Mutuals
BITRE	Bureau of Infrastructure and Transport Research Economics
BLADE	Business Longitudinal Analysis Data Environment
CCP	Central counterparty

CFA	Consumers Federation of Australia
CFR	Council of Financial Regulators
CHESS	Clearing House Electronic Subregister System
CMD	Centre for Market Design
CME	Co-operatives and mutual enterprise
COAG	Council of Australian Governments
COBA	Customer Owned Banking Association
CR4	Four-firm market concentration ratio
CSF	Crowd-sourced funding
CUB	Carlton and United Breweries
DV360	Display & Video 360
EBIT	Earnings before interest and taxes
EBITDA	Earnings before interest, taxes, depreciation and amortisation
ELNOs	Electronic Lodgement Network Operators
ESVCLP	Early State Venture Capital Limited Partnerships
FGCC	Food and Grocery Code of Conduct
FTC	Federal Trade Commission
GDP	Gross domestic product
HHI	Herfindahl-Hirschman Index
IBA	Independent Brewers Association

ICA	Insurance Council of Australia
IPA	Institute of Public Affairs
LCC	Low-cost carrier
MAS	Monetary Authority of Singapore
NAB	National Australia Bank
NCC	National Competition Council
NDIS	National Disability Insurance Scheme
NFF	National Farmers' Federation
NIM	Net interest margin
NSW	New South Wales
OECD	Organisation for Economic Co-operation and Development
OPC	Operator proficiency checks
OS	Operating system
PC	Productivity Commission
PEXA	Property Exchange Australia
PRSS	Permanent Regional Service Series
RBA	Reserve Bank of Australia
RIS	Regulatory Impact Statement
RMBS	Residential mortgage-backed securities
RMG-128	Resource Management Guide – Regulator Performance

ROE	Return on equity
SME	Small to medium enterprises
VCCI	Victorian Chamber of Commerce and Industry
VCLP	Venture Capital Limited Partnerships
WASG	Worldwide Airport Slot Management Guidelines



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Terms of reference

The House of Representatives Standing Committee on Economics will inquire into promoting economic dynamism, competition and business formation, with particular reference to:

- a) The effect of a diverse and dynamic business environment on:
 - productivity, prices and better-paid jobs
 - our supply chain resilience to disruption
- b) The extent to which anti-competitive behaviour and changes in industry structures have contributed to rising market concentration in Australia
- c) The extent to which economic barriers—such as regulatory costs and barriers to finance, infrastructure, suppliers, customers and workers—contribute to rising market concentration and slowing business formation rates in Australia
- d) The extent to which businesses consolidating their market power has undermined productivity, stifled wages, made markets more fragile and led to higher mark-ups
- e) Drawing on international examples, how Australia could lower economic barriers to competition and business formation, further limit anti-competitive behaviour, and better manage changes in industry structure that would entrench, increase or extend market power, and
- f) Any other related matters.

List of recommendations

Recommendation 1

- 3.73 That the Australian Government seek to better understand trends in both labour productivity and multi-factor productivity.**

Enhancing the availability of firm-level and sector-level data is vital, especially considering that variations in firm productivity have a significant impact on factor allocation and overall sector-level and economy-wide productivity outcomes.

Recommendation 2

- 3.74 That key government agencies strengthen their capacity to analyse firm-level data.**

Some of this data may already be in the possession of government in collection agencies such as the Australian Taxation Office and the Australian Prudential Regulation Authority. A greater emphasis on using this data to inform policy-making would need to take account of privacy and other considerations.

Recommendation 3

- 3.75 That an appropriate government agency gather more detailed and higher-quality data related to profits, including Earnings before Interest, Taxes, Depreciation and Amortisation (EBITDA) rates and Return on Equity (ROE).**

Recommendation 4

- 3.76 That the Australian Bureau of Statistics assemble data on the market shares of the largest firms in key sectors and report this over time.**

Recommendation 5

- 3.77 That the Government's Business Longitudinal Analysis Data Environment (BLADE) dataset include price levels.**

That the Government consider expanding third party access to the BLADE dataset.

Recommendation 6

- 3.78** That the Australian Competition and Consumer Commission's capacity to analyse large microdata sets be enhanced.

Recommendation 7

- 3.79** That the Australian Competition and Consumer Commission be given oversight of market concentration powers.

Recommendation 8

- 4.29** That the Treasurer's Competition Policy Taskforce examine governance arrangements for the development and advancement of competition policy and institutions, including explicit consideration of whether this would best be achieved by the creation of a new institution responsible for developing competition policy or, instead, the allocation of this responsibility to an existing institution (with suitable resourcing).

Recommendation 9

- 4.30** That the Treasurer's Competition Policy Taskforce examine whether competitive neutrality principles require updating.

Recommendation 10

- 4.31** That the Treasurer's Competition Policy Taskforce examine the establishment of a single national regulator for co-operatives and mutuals.

Recommendation 11

- 4.65** That, above a suitable threshold, pre-merger notification to the Australian Competition and Consumer Commission should be required.

Recommendation 12

- 4.66** That the Treasurer's Competition Policy Taskforce examine whether, above an appropriate threshold, merger transactions should be suspended from completion without Australian Competition and Consumer Commission clearance.

Recommendation 13

- 4.67** That the Treasurer's Competition Policy Taskforce examine the suitability of the current merger test.

Recommendation 14

- 4.90** That the Treasurer's Competition Policy Taskforce review the prevalence and economic impact of non-compete clauses, including whether such clauses:
- are commonly used in inappropriate contexts; and
 - act as a constraint on people changing jobs and thereby dampen the level of dynamism within the overall labour market.

Recommendation 15

- 4.91** That the Treasurer's Competition Policy Taskforce should consider the appropriateness of constraints and bans on non-compete clauses and other restraint of trade clauses.

Recommendation 16

- 5.33** That the Commonwealth Government continue to advance its better regulation agenda, in conjunction with state and territory governments and other relevant stakeholders.

Recommendation 17

- 5.34** That the Government continue to strengthen the analysis of the impact of regulation and red tape to ensure that it is fit for purpose.

Recommendation 18

- 5.35** That the Government consider strengthening the guidelines in relation to the development of Regulatory Impact Statements (RISs) so that they more explicitly include consideration of the impact of new measures on competition and economic dynamism.

Recommendation 19

- 5.36** That the Government strengthen RMG-128 (regulator performance) so that:
- Ministers are asked to review any Ministerial Statements of Expectations they have issued to regulators to ensure they sufficiently deal with issues relating to competition and economic dynamism.

- That best practice collaboration and engagement with stakeholders should include, where appropriate, seeking advice as to whether regulatory settings optimally manage issues relating to competition and economic dynamism.
- That agencies periodically review and report on the efficacy of regulatory sandboxes.

Recommendation 20

5.37 That the Government consider the extension of the regulatory sandbox currently used by the Australian Securities and Investments Commission.

Recommendation 21

5.89 That the Government examine the potential scope for the use of market design in areas where:

- Traditional market mechanisms face challenges (e.g. price is not the best or only appropriate allocation mechanism).
- This could include situations in which there are:
 - Material supplier or consumer heterogeneity issues that limit the effectiveness of the price mechanism.
 - Co-ordination issues between suppliers and/or consumers.
 - Thin markets.

Recommendation 22

5.90 That the Government explore ways to develop and implement matching markets (or reform existing markets) where thin markets are a problem. This could include:

- Creating platforms or trading mechanisms that encourage participation from a diverse range of stakeholders where such platforms or mechanisms may not arise through other means (eg due to market failure). Where platforms or mechanisms have arisen without government prompting, to consider whether regulation is appropriate.
- Exploring the possibility of setting up physical or virtual marketplaces tailored to the needs of specific regions or communities.
- Incentivising access for all eligible individuals, irrespective of their location or background.
- Using media to contact potential participants and inform them about market opportunities.

Recommendation 23

- 5.91** That the Government (along with market design experts), develop, undertake and evaluate a series of pilot projects to test the potential for market design to provide benefits in different areas of social service delivery. This could include:
- The delivery of complex services, particularly in outer-urban or regional and rural areas.
 - The delivery of services that require considerable co-ordination between clients.

Recommendation 24

- 5.146** In relation to the electronic market for homogenous goods, that the Government explore (and fund) pilots for the procurement of selected goods and services where there is potential for material gains in cost savings, quality or both.

Recommendation 25

- 5.147** In relation to the procurement of goods or professional services, that the Government review the use of panels and whether there are ways to capture the efficiencies of infrequent firm vetting/contractual arrangements—versus arrangements that increase the scope for a wider range of firms to offer their services.

Recommendation 26

- 5.148** That the Government explore ways it could adjust procurement processes to allow for greater participation by Small to Medium Enterprises (SMEs) and social enterprises. This could include adjusting the way panels are used to be less exclusionary to SMEs and social enterprises.

Recommendation 27

- 5.149** That the Government explore ways packages of goods and services can be unbundled to allow for SMEs and social enterprises to effectively compete to provide the goods or services. In doing so, the Government should consider:
- How to optimally manage transaction costs, allowing for the possibility that unbundling increases competitive tension in some areas of service provision.
 - The potential for SMEs or social enterprises to undertake parts of the work required for an overall project.

Recommendation 28

5.150 That the Government develop a social enterprise accreditation scheme to facilitate its procurement of goods and services from social enterprises, drawing from the models already in operation in Victoria and Queensland.

Recommendation 29

5.171 That the Government continue to develop and advance its digital strategy, particularly in areas where it can enhance client outcomes.

Recommendation 30

5.172 That the Government develop a dashboard that outlines in an accessible way key performance indicators. This could be started with pilots by Services Australia and the Australian Securities and Investments Commission.

Recommendation 31

5.173 That the Government actively develops greater opportunities to appropriately share or use government funded data and research, in ways that create public benefit, but also preserve privacy.

Recommendation 32

6.28 That the Government develop a fit for purpose 'regulatory grid' to provide greater visibility and coordination of regulatory interventions across the financial services sector.

Recommendation 33

6.106 That the Treasury Competition Policy Taskforce examine mechanisms to increase consumer engagement with mortgages and deposit products. Initially, this could take the form of pilots of one or more of the following:

- examine mechanisms to increase consumer engagement with mortgages and deposit products. Initially, this could take the form of pilots of one or more of the following:
 - A requirement that banks should notify the base interest rate at the end of the introductory period where a retail deposit product is offered.
 - A requirement that banks should clearly notify retail deposit holders of changes to their interest rates, changes to the eligibility requirements for a bonus interest rate and, where practicable, alert customers when they are approaching a threshold for eligibility for a bonus interest rate (e.g. a minimum balance level).

- That APRA provide an independent benchmark (or series of benchmarks) for variable rates for new/switching customers over the preceding 12 months. That this benchmark be published for use by mortgage brokers and financial advisers to improve their capacity to contact new clients to improve churn rates.

Recommendation 34

- 6.107 That the Government examine the merits of adopting a government-backed Residential Mortgage-Backed Securities (RMBS) scheme, taking into account the characteristics, and evaluation, of the Canadian RMBS model.

Recommendation 35

- 6.108 That the Australian Prudential Regulation Authority examine the suitability of macro prudential regulation of medium and smaller banks and, in particular, their capital holding requirements.

Recommendation 36

- 6.109 That the Government explore cooperating with the banking sector in the development and evaluation of a pilot in relation to tracker mortgages.

Recommendation 37

- 6.126 That the Government explore mechanisms to make the spread and fees on foreign exchange transfers more transparent for customers.

Recommendation 38

- 6.166 That the Government explore the suitability of more flexible licensing arrangements for participants in the payments system, as part of the next review of the Government's Strategic Plan for the Payments System (scheduled to commence by mid-2024).

Recommendation 39

- 7.50 That the Government examine the barriers to financing at the different stages of the innovation process to identify barriers and opportunities to increase investment.

Recommendation 40

- 8.102 That the Government explore which longer term competition policy settings can provide appropriate oversight of the airlines.

Recommendation 41

8.103 That the Government consider, as part of the Aviation White Paper, strengthening consumer compensation arrangements and consider adopting measures to enhance consumer protection in aviation services, similar to other jurisdictions.

Recommendation 42

8.104 That the Government examine the suitability of current ‘use it or lose it’ arrangements for airport slots.

Recommendation 43

8.105 That the Government progress reforms to Sydney air traffic demand management.

Recommendation 44

10.44 That the Government examine removing barriers to entry of providers of settlement and clearing services for equities, to boost competition in the sector.



1. Introduction

Background

- 1.1 Following a reference from the Treasurer, the Hon Dr Jim Chalmers MP, on 31 January 2023, the House of Representatives Standing Committee on Economics commenced an inquiry into promoting economic dynamism, competition and business formation.

Scope

- 1.2 The Committee acknowledges the foundation of competition policy in Australia was laid by two previous significant inquiries, the 1993 Hilmer report and the 2015 Harper review. Indeed, the Committee commenced its work on this inquiry with background briefings from the esteemed authors of these inquiries—Professor Frederick Hilmer AO and Professor Ian Harper AO.
- 1.3 However, the Committee did not seek to cover old ground. Rather, its focus was on understanding why competition and business dynamism in Australia appears to have stalled in recent years—reflected in productivity rates at generational lows—and to consider new solutions. In particular, the Committee sought to consider how new technologies could be leveraged to boost competition and dynamism, while remaining conscious of the regulatory challenges posed by these same technologies.
- 1.4 Economic dynamism and competition are relevant to the lives of all Australians and businesses. These issues affect the prices they pay at the supermarket, their options for travel on Australia’s aviation network, the quality of the government services they receive, or can enable a small business to bid for a government contract from a level playing field.
- 1.5 Accordingly, the Committee consulted as widely as possible, hearing from witnesses across industries and social enterprises, communities, academia (including from overseas), thinktanks, consumer groups, regulators and government departments. And, beyond Canberra, inquiry hearings were held across the eastern seaboard to gain a broader perspective—including in Toowoomba, Sydney, and Melbourne.
- 1.6 The Committee sought to first put down a conceptual framework for the inquiry, grounded in data and research. Its initial public hearings, commencing on 16 March 2023, were with academics, thinktanks and regulators to understand the history, contemporary context and strategic challenges that policymakers face in relation to competition and business dynamism.

- 1.7 Prominent cross-cutting issues quickly emerged that the Committee was then able to investigate in more detail. These included data gaps, the need for overarching renewal of national competition architecture, the requirement for merger law reform, labour mobility, and the disproportionate impact on young firms and young people of low rates of competition and dynamism.
- 1.8 From there, the Committee took a sectoral approach to understand how such issues manifest across the economy, including in the public sector and the care economy. Hearings were held with representatives from the finance sector (including regional and community-owned banks), social enterprises, Big Tech, Tech start-ups, media enterprises, airlines and airports, supermarkets, brewers, the mining sector, e-conveyancing, and from state governments.
- 1.9 Finally, the Committee returned to the regulators and thinktanks to test the viability of the ideas and proposed solutions that it had heard. Its 15 September 2023 hearings with the Australian Competition and Consumer Commission (ACCC), the Productivity Commission, the National Competition Council, and with Treasury's Competition Review Taskforce was the culmination of an intense program of 18 days of hearings over the preceding six months.
- 1.10 Additionally, the Committee acknowledges that many of the issues and reform ideas suggested in this inquiry are also being considered through initiatives such as the Government's Competition Review, the review into the Food and Grocery Code of Conduct, the Aviation White Paper, and the continuous program of inquiries that the ACCC conducts into various competition issues (including its current inquiry into prices and competition in the supermarket sector). As this inquiry report shows, competition and business dynamism is of central importance to productivity and, by extension, the future prosperity and wellbeing of Australians. Accordingly, the Committee lends its support both to these bodies of work and to a continuing future focus by government on competition policy reform.
- 1.11 The Committee is sincerely grateful to all those who provided evidence to the inquiry, whether at a hearing or through a submission. It was a window into how Australians think about these issues and their views were invaluable in informing the inquiry's findings and recommendations.
- 1.12 A list of organisations and individuals who appeared as witnesses can be found at Appendix A¹.
- 1.13 A list of submissions can be found at Appendix B.

¹ Answers to Questions on Notice taken by witnesses can be accessed as Additional Documents on the inquiry webpage - https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Economicdynamism



2. Economic dynamism, competition, and productivity

The opportunity for higher living standards

- 2.1 To set the context for this inquiry, it is important to highlight the Committee's concerns about the persistent decline in Australia's productivity performance over the past two generations, and the troubling implications for the living standards of everyday Australians. Accordingly, the Committee considers boosting national productivity growth to be a key economic policy goal.
- 2.2 It is in this light that the Committee has sought ideas to bolster Australia's economic dynamism and to improve competition settings, which the Committee views as key components of the solution to restoring productivity to higher levels.

Productivity and why it matters

What is productivity?

- 2.3 Productivity measures how efficiently firms, organisations, industry, and the economy as a whole convert inputs—such as labour, capital and raw materials—into output. Productivity is commonly defined as a ratio between the output volume and the volume of inputs. New products or improved products are also captured by productivity measures. Productivity does not reflect the value we put on what is produced; it only measures how efficiently we use resources.
- 2.4 There are different measures of productivity and the choice between them depends either on the purpose of the productivity measurement and/or data availability. One of the most widely used measures of productivity is Gross Domestic Product (GDP) per hour worked. This measure captures the use of labour inputs better than just output per employee.
- 2.5 To take account of the role of capital inputs, an appropriate measure is the flow of productive services that can be drawn from the cumulative stock of past investments (such as machinery and equipment).
- 2.6 After computing the contributions of labour and capital to output, the so-called multi-factor productivity (MFP) can be derived. It measures the residual growth that cannot be explained by the rate of change in the services of labour, capital and intermediate

investments, and is often interpreted as the contribution to economic growth made by factors such as technical and organisational innovation.¹

- 2.7 Productivity growth is affected by a number of factors, including innovation and technological improvements, economies of scale and scope, workforce skills, management practices, competitive pressures and the stage of the business cycle.
- 2.8 While, at the macroeconomic level, productivity is important to economic growth, it also makes a real difference to individual lives. According to the Productivity Commission, productivity has been the key driver of long-term improvements in living standards. The average Australian worker produces about as much in one hour today as it took a full day's work to produce at Federation in 1901.
- 2.9 Additionally, the Productivity Commission told the Committee that higher productivity tends to result in higher wages and reduced working hours.²
- 2.10 Productivity also contributes to positive social outcomes, for example in the care economy. As a key driver of revenue, productivity improves the nation's capacity to finance social investments and, in the words of the e61 Institute, to respond to the society-shaping megatrends of the future, such as 'decarbonisation, digitisation or globalisation'.³
- 2.11 Treasury advised that its policy work was informed by a 'broad view of productivity, defined to include both market and non-market goods and services, which many Australians increasingly depend upon'.⁴
- 2.12 Additionally, productivity can assist in managing inflation—the Reserve Bank of Australia has told the Committee in a separate inquiry that weak productivity growth combined with higher aggregate demand adds to upward pressure on prices.⁵

International examples of the transformative power of productivity

- 2.13 Ample historical precedents demonstrate the transformative power of productivity in shaping national destinies through the efficient allocation of resources and innovation. The post-war economic resurgence of Japan is one. More recently, the remarkable economic transformation of China over the past thirty years has seen half its population escape poverty.
- 2.14 Perhaps the most striking example of the effect of productivity growth is the Korean Peninsula. Emerging from their intense conflict of the early 1950s, both North and

¹ The Organisation for Economic Co-Operation and Development (OECD), *Defining and Measuring Productivity*, www.oecd.org/sdd/productivity-stats/40526851.pdf, viewed 29 February 2024.

² Mr Michael Brennan, Chair, Productivity Commission, *Committee Hansard*, 16 March 2023, p. 10.

³ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 7.

⁴ Mr Jason McDonald, Division Head, Competition Taskforce, Treasury, *Committee Hansard*, 15 September 2023, p. 19.

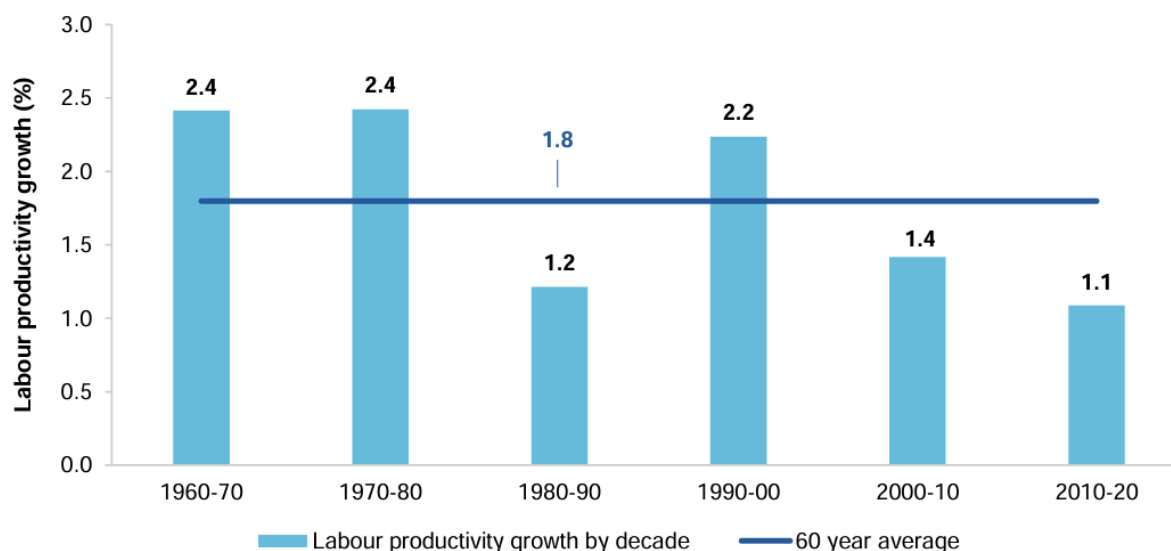
⁵ Mr Philip Lowe, Governor, Reserve Bank of Australia, Review of the Reserve Bank of Australia Annual Report 2022, *Committee Hansard*, 11 August 2023, p. 3.

South Korea had per capita GDP levels amongst the lowest in the world. Over the following decades, South Korea experienced continuous high productivity growth to the extent that today, its citizens enjoy GDP per capita levels comparable to most OECD countries.⁶ By contrast, North Korea’s economic growth stagnated and today its people remain among the world’s most impoverished.⁷

Australia’s declining productivity performance

2.15 Disturbingly, productivity growth rates in Australia currently sit at 60-year lows – at 1.1 per cent over the 2010–2020 decade compared to the 60 year average of 1.8 per cent (since 1960)—as highlighted by the Productivity Commission in Figure 2.1.⁸ This is also particularly concerning in light of Australia’s rising dependency ratio which, as Australia’s population ages, will increasingly see relatively fewer workers support greater numbers of retirees.⁹

Figure 2.1 Average labour productivity by 10- and 60- year periods



Source: Productivity Commission, ‘5-Year Productivity Inquiry: Volume 1 - Advancing Prosperity’, 17 March 2023, p. 2.

⁶ In 2024, South Korea’s GDP per capita (purchasing power parity) stood at US\$59,350, compared with advanced economies at \$68,280. See International Monetary Fund, *GDP per capita, current prices*, <https://www.imf.org/external/datamapper/PPPPC@WEO/ADVEC/KOR>, viewed 29 February 2024.

⁷ Reliable economic data for North Korea does not exist, however the CIA World Factbook estimated North Korea’s real GDP per capita at \$1,700 in 2015, ranking it 214 of all countries at that time. See: Central Intelligence Agency, *World Factbook – North Korea*, www.cia.gov/the-world-factbook/countries/korea-north/#economy, viewed 5 September 2023.

⁸ Productivity Commission, ‘5-Year Productivity Inquiry: Volume 1 – Advancing Prosperity’, 17 March 2023, p. 2.

⁹ The dependency ratio is a measure of the number of dependents aged zero to 14 and over the age of 65, compared with the total population aged 15 to 64. This demographic indicator gives insight into the number of people of non-working age, compared with the number of those of working age.

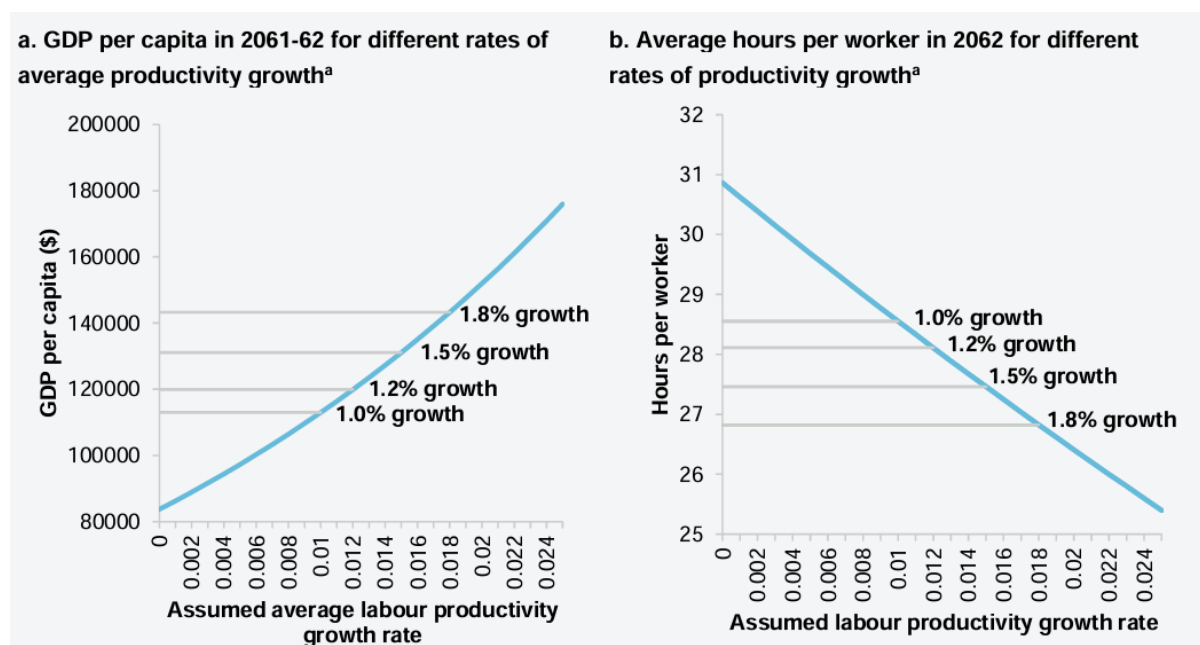
- 2.16 Australia's productivity slowdown has been broad-based—with other advanced economies experiencing lower 10- and 20-year productivity growth compared to their 30-year average.¹⁰
- 2.17 The ramifications of this productivity slowdown are far-reaching.
- 2.18 First, the impact on national income to date has already been stark. According to the Productivity Commission, if Australia had sustained its 60-year average in productivity growth, national income per capita in 2020 would have been bolstered by an additional \$4,600 (a 6 per cent increase).¹¹
- 2.19 Looking ahead, the forecasts paint a bleak picture. If the economy persists on its current trajectory, Australians face a future where incomes would fall by close to 40 per cent, relative to what they would otherwise have been.¹² Put another way, lifting productivity growth rates over the next 40 years from current historic lows back to the long-term average of 1.8 per cent would see Australians in 2060 better off by approximately \$23,000 per capita each year, and working significantly reduced hours, according to Productivity Commission estimates (see Figure 2.2).

¹⁰ Treasury, *Intergenerational Report 2023*, 24 August 2023, p. 84.

¹¹ Productivity Commission, '5-Year Productivity Inquiry: Volume 2 – Keys to growth', 17 March 2023, p. 30.

¹² Productivity Commission, '5-Year Productivity Inquiry: Volume 1 – Advancing Prosperity', 17 March 2023, p. 1.

Figure 2.2 The projected impact of slower productivity growth on income and leisure



a. Estimates of GDP in 2021-22 taken from national accounts, estimates of hours worked taken from Labour Account while estimates of employment taken from Labour Force Survey.

Source: Commission estimates using ABS (*Australian System of National Accounts*, 2021-22 financial year, Cat. no. 5204.0, table 1; *Labour Account Australia*, June 2022, Cat. no. 6150.0.55.003, Industry summary table; *Labour Force, Australia*, October 2022, Cat. no. 6202.0, table 1).

¹ These projections are based on assumptions for forecasting incomes, productivity and working hours in 2062.

- The roles of capital deepening and multifactor productivity in driving labour productivity growth have not been separately delineated. Relatedly, this model only considers gross measures (such as GDP and labour productivity), and so the role of depreciation in decreasing incomes will not be considered.
- The employment to population ratio is the same as its present value. This is similar to the forecasts in the Intergenerational Report, which have participation rates falling from 66.3% to 63.6% between 2021 and 2061 (Commonwealth of Australia 2021, p. 35)).
- While the number of employees is fixed exogenously, working hours per worker decrease proportionally with labour productivity about the rate at which they have since 1950. Historically, for every 10% increase in labour productivity, average hours per worker fall about 2% (estimated using Feenstra, Inklaar and Timmer (2015)). This assumption was used to forecast average working hours given.
- The role of international borrowing and investing as well as the terms of trade have been ignored.

Source: Productivity Commission, '5-Year Productivity Inquiry: Volume 2 - Keys to Growth', 17 March 2023, p. 29.

Productivity benefits of collaborative workplaces and good jobs

2.20 Recent workplace relations reforms have sought to create better higher-wage jobs and more collaborative workplaces. This is based on theoretical and empirical

research indicating that more collaborative workplaces yield benefits within workplaces and productivity gains across the economy.¹³

- 2.21 The OECD argues that co-ordination in wage bargaining and employee voice, such as through unions, is a key ingredient for good labour market performance including higher employment, inclusive labour markets and lower inequality. More collaborative workplaces can also contribute to ‘lower turnover and longer tenure [which] can reduce hiring and training costs and increase productivity’.
- 2.22 We know that treating workers fairly isn’t mutually exclusive with a strong economy, and good business performance. Countries with higher proportions of workers covered by agreements with higher wages are also high productivity countries.
- 2.23 Professor Alex Bryson at the University College of London found that employee voice helps improve worker engagement, helping companies to innovate and adopt more productive practices.¹⁴
- 2.24 Workers who are more satisfied are less likely to leave their jobs, which reduces employer costs on recruitment and re-training. This is important since firms find more innovative ideas from their own workers than from any other source.¹⁵
- 2.25 Some organisations claimed during the inquiry that recent workplace relations reforms would be bad for overall productivity. However, it is not clear that underpaying workers or requiring workers to be always contactable outside work hours would enhance productivity. In fact, in some contexts, the ‘flexibility’ that some employers demand can undermine productivity. Less worker protections and rights can lead to employers intensifying work hours, paying workers less and stifling employee innovation. Unhappy, burnt-out workers increase staff turnover and costs to business in recruitment and retraining. Dissatisfied workers exhibit lower morale and effort, which lowers productivity.
- 2.26 The Centre for Future Work found that 71 per cent of workers surveyed worked outside their scheduled work hours often due to overwork or pressure from managers. This led to increased tiredness, stress or anxiety for around one-third of workers, disrupted personal lives for more than one-quarter, and lowered job motivation and satisfaction for around one-fifth. The Select Committee on Work and Care heard evidence in relation to the negative consequences of working outside scheduled hours for productivity, turnover, and mental and physical health.¹⁶
- 2.27 In an environment where businesses are focusing less on undercutting each other on wages and conditions to save costs, the emphasis will be more on working smarter,

¹³ OECD, ‘Negotiating Our Way Up: Collective Bargaining in a Changing World of Work’, 18 November 2019, p. 70.

¹⁴ A Bryson, A Charwood and J Forth, ‘Worker voice, managerial response and labour productivity: an empirical investigation’, *Industrial Relations Journal*, 37/5 (September 2006), pages 438-455.

¹⁵ Treasury, *Working Future: The Australian Government’s White Paper on Jobs and Opportunities*, 25 September 2023, p. 89.

¹⁶ The Centre for Future Work, ‘Call Me Maybe (Not): Working Overtime and a Right to Disconnect in Australia’, November 2022, p. 4.

investing in new skills and new technologies. That can end up being a key driver of productivity.

Productivity is also driven more by non-workplace relations factors—many that businesses control

- 2.28 Research shows that direct links between workplace relations policies and productivity growth is weak. However, if anything, productivity is lower in more individualised systems, rather than more worker-protective systems.¹⁷
- 2.29 Since the mid-2000s, productivity growth has slowed in Australia and other advanced economies. This is due to several factors, including reduced dynamism and competition among business (e.g. as manifested by higher rates of market concentration and less firm entry/exit), slower investment in and uptake of technological innovation, and shifts to a services industry economic base with a higher proportional labour input.¹⁸
- 2.30 Productivity is also driven more by factors controlled by businesses, such as investment in new machines and technologies, research and development, staff skills, and management capabilities. Tellingly, in the two years to mid-2021, 60 per cent of Australian businesses did not introduce a new process and almost 80 per cent did not introduce any significant new good or service.¹⁹

Competition and economic dynamism

- 2.31 Competition and economic dynamism are interrelated concepts and are both pivotal drivers of productivity. Competition and economic dynamism can encourage positive economic outcomes such as a higher rate of productivity growth—leading to higher wages and standards of living, new products and services and sustainability of government—as well as better consumer outcomes such as lower prices and better levels of service.

What is competition?

- 2.32 Competition refers to a process of rivalry in a market where businesses seek to attract consumers for their own objectives, such as an increase in profit or to gain

¹⁷ D Peetz, 'Hollow Shells: The Alleged Link Between Individual Contracting and Productivity Growth', *Journal of Australian Political Economy*, 56 (January 2005).

¹⁸ Treasury, *Working Future: The Australian Government's White Paper on Jobs and Opportunities*, 25 September 2023, p. 75.

¹⁹ Australian Bureau of Statistics, *Innovation in Australian Business, 2021-21 financial year*, www.abs.gov.au/statistics/industry/technology-and-innovation/innovation-australian-business/2020-21, viewed 13 March 2024.

market share. This rivalry may occur in the form of price, service, efficiency, quality, or a combination of factors that consumers may value.²⁰

- 2.33 In economics, competition refers to the number of firms in an industry and how they interact in seeking market share. In competitive environments, companies strive to differentiate themselves from rivals by offering superior products and services.
- 2.34 In the view of the Productivity Commission, while competition is not an end in itself, it provides consumers with choice, incentivises innovation, and assists society to derive the greatest value from its scarce resources.²¹
- 2.35 Building on this, Treasury told the Committee that competition rewarded merit over special interests by supporting ‘new and innovative business practices over incumbents’ and by forcing ‘businesses to pass productivity gains forward to consumers as lower prices, or back as higher payments to attract the best workers or suppliers’.²²
- 2.36 The Australian Competition and Consumer Commission (ACCC) told the Committee that in the absence of sufficient competition, ‘we get the problem of reduction of output, raising of prices, lower product quality and, at times, just lower choice’ as well as ‘a diminishing of convenience and a transfer [away] of wealth from consumers and smaller suppliers’.²³
- 2.37 A key factor when assessing competition are the barriers to entry of a particular market or sector. Barriers can include high start-up costs, regulatory hurdles, or any other obstacles which prevent companies from easily entering a market. Barriers to entry protect incumbent firms from ‘contestability’—the threat of entry by new firms.
- 2.38 Three key metrics are often used to assess the level of competition in an industry:
- Market share of the largest firms (concentration),
 - Price mark-ups (the gap between price and marginal cost); and
 - Firm entry/exit.

What is economic dynamism?

- 2.39 There is no universally agreed definition of economic dynamism. It usually refers to the levels of competition, innovation, and creativity in an economy. A dynamic economy can quickly adapt to changes in demand and supply by reallocating

²⁰ Australian Competition and Consumer Commission, *Competition and anti-competitive behaviour*, www.accc.gov.au/business/competition-and-exemptions/competition-and-anti-competitive-behaviour, viewed 23 February 2024.

²¹ Productivity Commission, ‘Submission to the Competition Policy Review’, June 2014, p. 2, www.pc.gov.au/research/supporting/competition-policy-review.

²² Mr Jason McDonald, Division Head, Competition Taskforce, Treasury, *Committee Hansard*, 15 September 2023, p. 19.

²³ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 17 March 2023, p. 3.

resources such as labour and capital. The regulatory environment also plays a crucial role; excessive bureaucracy hinders dynamism while productivity-boosting regulations foster dynamism. A dynamic economy creates more jobs and helps power wage rises for workers.

- 2.40 For the purposes of this report, the Committee will use a broad definition of dynamism as explained by the Productivity Commission:

Economic dynamism is concerned with the efficient adaptation to new demand and supply trends and re-organisation of resources (labour and capital) across the economy, supported by the creation of new knowledge and its rapid diffusion. The concept of dynamism recognises that new technologies are not seamlessly adopted throughout an economy, but will often require people to move and learn, investments in physical and intangible capital, new managerial models, and the death and emergence of businesses and business models. It gives prominence to the actions and capabilities of all firms and employees — not just the few technological leaders in an economy.²⁴

Innovation

- 2.41 An important aspect of economic dynamism is the way the economy allows for or encourages innovation and a culture of risk taking. Innovation is often a vital mechanism through which new market entrants or disruptors can respond to incumbents' exercise of market power. This, in turn, compels incumbents to improve the quality or pricing of their products and services.
- 2.42 In the telecommunications sector, for example, when new operators introduced more affordable mobile plans with larger data allowances, established operators had to re-evaluate their pricing strategies and resource allocation to ensure their competitiveness. They invested in infrastructure to enhance network coverage and speed, streamlined operations to cut costs, and were more innovative in their service offerings.
- 2.43 The creation of online platforms compelled traditional retailers to adapt to changing consumer preferences. This involved investing in their own online platforms, integrating technology into online experiences, and leveraging data analytics to gain a deeper understanding of consumer needs.
- 2.44 In the financial services sector, many Australians and Australian businesses are bypassing the traditional payments and value storage systems offered by banks and major financial institutions. They are turning instead to digital payment products offered by emerging fintech companies, such as apps to enable international payment transfers or real-time account-to-account payments. These alternative payment products are a striking example of the efficiency and convenience for consumers that innovation can bring.

²⁴ Productivity Commission, *Submission 1*, p. 4.

2.45 According to the Australian Banking Association:

- More than 15.3 million cards were registered to mobile wallets in 2022, up from just over two million in 2018—a 760 per cent increase.
- 98.9 per cent of banking interactions take place via apps or online.²⁵

Regulation

2.46 Another consideration is regulation, which can either enhance or reduce economic dynamism, depending on how it is applied. Proactive regulation that improves transparency in a market, for example, can reduce the asymmetric information advantage of incumbents relative to challenger firms or consumers seeking to switch to an alternative (asymmetric information occurs when one party to a transaction has more, or superior, information compared to another). On the other hand, regulation is potentially restrictive in four ways: by limiting the number or types of businesses in a market, by limiting the ability of businesses to compete, by reducing the incentive of businesses to compete, or by limiting the choices and information available to consumers.²⁶

2.47 The Productivity Commission signalled the importance of the regulation of intellectual property in preserving innovation. Though patents arguably stifle competition, there is 'an essential aspect to having at least a limited capacity to earn profits on your innovation. If all innovations end up having their benefits taken away immediately by any rivals, the incentives for innovation decline'.²⁷

2.48 The financial technology industry outlined the regulatory challenges in its sector.

2.49 On the one hand, regulators need to ensure appropriate protections regarding the security of customer data and its disclosure, and prudential measures around capital adequacy and liquidity to protect customer funds.

2.50 On the other hand, it is critical that regulatory frameworks do not stifle innovation, and that they remain flexible enough to keep pace with the rapid evolution of technology and with overseas models. Block, the fintech company, for example, advocated for 'outcomes-focused' regulation:

So it's having regulation that's not focused on the process but is actually focused on the outcome that we want to achieve and having flexibility about how we get to that outcome so that you can have innovation around products. Otherwise, if we're regulating processes and creating compliance checklists, products start to look very similar and you don't get competition around product innovation.²⁸

²⁵ Australian Banking Association, 'Mobile wallet transactions skyrocket to \$93 billion, as 98.9% of bank interactions take place digitally', *Media Release*, 7 June 2023.

²⁶ Department of the Prime Minister and Cabinet, Office of Best Practice Regulation, 'Competition and Regulation Guidance Note', March 2020, p. 3, <https://oia.pmc.gov.au/sites/default/files/2021-09/competition-regulation.pdf>.

²⁷ Mr Ralph Lattimore, Chief Economist, Productivity Commission, *Committee Hansard*, 16 March 2023, p. 2.

²⁸ Mr Michael Saadat, International Head of Policy, Block, *Committee Hansard*, 3 May 2023, p. 12.

Links between competition, dynamism, and productivity growth

- 2.51 As noted earlier, there are clear links between competition and economic dynamism. The linkages can work both ways. More competition can boost dynamism as firms innovate to outdo each other.
- 2.52 It is widely accepted by economists that economic dynamism can boost competitive tension and productivity growth—although sector-specific factors also play a significant role. The Productivity Commission highlighted the ‘dynamic benefit’ of competition, that the disruption caused by a new entrant to a market or by a new business model ‘ideally’ favours firms that are ‘...better at satisfying consumer wants’,²⁹ a view echoed by the ACCC.³⁰
- 2.53 An increase in the level of competition often leads to the emergence of new products and services, a phenomenon driven by the desire of firms to differentiate themselves from competitors and attract consumers.
- 2.54 Through the process of ‘creative destruction’, new firms enter the market and introduce innovative products and ideas in an attempt to contest profits and capture market share.³¹
- 2.55 The openness of an economy (to international trade, to international investment and capital, to foreign labour etc) has implications for competition and dynamism in many sectors. Treasury pointed out that the ‘threat of import’, for example, can be a significant factor in incentivising competitive behaviour, even in a highly concentrated industry.³²
- 2.56 More intense competition between companies generally leads to higher quality products and services. To facilitate a competitive environment, it is essential that consumers can easily switch to using other products and services. This could be through mechanisms such as comparison websites, reducing complexity by standardising definitions and harmonising information across sectors (e.g. adopting uniform definitions across insurance policies, ensuring consistent nutritional information on food packaging, or implementing universally recognised energy efficiency ratings) and proactive regulation by requiring, for example, financial institutions to inform customers about the potential benefits of switching (discussed further in Chapter 6).

²⁹ Mr Michael Brennan, Chair, Productivity Commission, *Committee Hansard*, 16 March 2023, p. 2.

³⁰ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 17 March 2023, p. 3.

³¹ RJ Caballero and M Hammour, ‘On the timing and efficiency of creative destruction’, *The Quarterly Journal of Economics*, 111/2 (August 1996), pages 805–852.

³² Mr Jason McDonald, Division Head, Competition Taskforce, Treasury, *Committee Hansard*, 15 September 2023, pages 22–23.

- 2.57 Competition also serves as a crucial disciplining mechanism with several positive outcomes for dynamism. It discourages rent-seeking behaviours,³³ with companies instead encouraged to adopt strategies that enhance productivity to gain a competitive advantage. And competition spurs enhancements at the management level, with executives incentivised to eliminate inefficiencies in the production chain to ensure resources are utilised to their best potential.
- 2.58 Ultimately, boosting competition and economic dynamism are key strategies for boosting long-term productivity growth.
- 2.59 This was demonstrated by evidence from the e61 Institute regarding ‘allocative efficiency’, a situation where higher levels of competition and economic dynamism result in greater market entry by innovative firms, increased levels of employment growth in high productivity firms, and higher rates of exit in low productivity firms:
- ...new firms bring new ideas, intensify competition and encourage incumbents to invest and adopt new technologies. More generally, this promotes a competitive environment that fosters the reallocation of scarce resources to most productive uses.³⁴

The impact of artificial intelligence

- 2.60 Witnesses across the board viewed artificial intelligence (AI) as providing both significant opportunities for, and threats to, economic dynamism and competition. Witnesses also voiced concerns about whether Australia was properly positioned to take advantage of the technology. Either way, AI cannot be ignored, so the challenge for Australian firms is to harness it in a safe way, enabled by effective regulation.
- 2.61 Representing the technology sector, the Tech Council of Australia told the Committee that it’s ‘never been more important to...remove barriers to tech adoption given the important role that it plays in driving productivity, dynamism and competition’. The Council emphasised the vital role of ‘start-ups and scale-ups’ in ‘generating new sources of competition and innovation, including in new tech verticals such as AI, quantum and robotics’.³⁵
- 2.62 The Tech Council and the Australian Government have a shared goal of employing 1.2 million tech workers by 2030, which will require an additional 653,000 individuals to join the workforce in the next seven years—an additional 186,000 tech workers above business-as-usual projections.³⁶

³³ ‘Rent seeking’ is an economic concept describing when an entity seeks to gain wealth without any reciprocal contribution of productivity, for example when a company lobbies government for grants, subsidies, or tariff protection.

³⁴ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 1.

³⁵ Mr Thomas McMahon, Deputy Chief Executive Officer, Tech Council of Australia, *Committee Hansard*, 3 May 2023, p. 1.

³⁶ Tech Council of Australia, *Submission 32*, p. 8.

- 2.63 Banks are cognisant of the potential productivity dividend from using AI.
- 2.64 National Australia Bank (NAB) commented that data interrogation provided new behavioural insights into customers and improved predictive capability in assessing creditworthiness.³⁷
- 2.65 Both Heritage Bank and Bendigo & Adelaide Bank told the Committee that AI could reduce operating costs.³⁸
- 2.66 Westpac highlighted the opportunities for small businesses to leverage AI to grow, provided they could master the technology.³⁹
- 2.67 However, firms were cautious about the risks of using AI and the governance structures required to oversee AI.
- 2.68 NAB noted the critical importance of protecting customer data. It also stressed the work it was doing to ensure the technology could be used while preserving key principles such as transparency and accountability.

It's really important that, when we build models and run models, we understand how those models work and how they arrive at decisions. So we have separate teams that actually review and challenge—or, what we call, validate—our models...

What models will help us do is give us some really strong insight, and that insight will continue to evolve with the better use of data and more access to data. But, fundamentally, we have to be responsible in the way we use that information and the way we use it in reaching our decisions. We can't abrogate all the decisions to models on their own, and we don't.⁴⁰

AI net effect on competition

- 2.69 There remains no clear view about the fixed costs of managing and harnessing AI, its effects on market entry, and whether AI will result in a net positive or negative for competition. Several witnesses were particularly concerned over Australia's capacity to be internationally competitive in the AI field.
- 2.70 The Productivity Commission highlighted that Australia ranked poorly on data analytics and AI—'fourth from the bottom of OECD countries'. The Commission noted that Australia was very good at producing data, less so at using it. It had heard from industry that the key reasons for this poor performance were low internet

³⁷ Mr Shaun Dooley, Group Chief Risk Officer, National Australia Bank, *Committee Hansard*, 12 July 2023, p. 64.

³⁸ Mr Peter Lock, Chief Executive Officer, Heritage and People's Choice Ltd, *Committee Hansard*, 30 June 2023, p. 5; Ms Marnie Baker, Chief Executive Officer and Managing Director, Bendigo and Adelaide Bank, *Committee Hansard*, 4 July 2023, p. 26.

³⁹ Mr Chris de Bruin, Chief Executive, Consumer and Business Banking, Westpac Group, *Committee Hansard*, 13 July 2023, p. 50.

⁴⁰ Mr Shaun Dooley, Group Chief Risk Officer, National Australia Bank, *Committee Hansard*, 12 July 2023, p. 64.

speeds, skills deficiencies, and an associated lack of diffusion of knowledge and take-up of AI across the small business sector.⁴¹

- 2.71 Echoing this concern, the Grattan Institute added that a significant impediment to AI adoption in Australia was ‘barriers around the quality and management of Australian firms’ and that improving the nation’s skilled migration settings could assist in tackling this.⁴²
- 2.72 Google said that regarding accessing AI and the ability to use its products, there were low barriers to entry for firms in the Australian technology sector.
- ...we would say that, if you're looking at different industries in Australia and globally, the tech sector is one where all of the hallmarks and elements of a fiercely competitive sector are there...We see the emergence of AI and, each day, a number of different players emerging into that market. As I've said, there are low barriers to entry. There are low costs, relatively, for consumers and businesses to use our products.⁴³
- 2.73 By contrast, Westpac said that the digital economy ‘tends to drive us towards a winner-takes-all type of position’ and that it was challenging for small businesses to ‘keep up in areas where technological scale is really important’.⁴⁴
- 2.74 As AI becomes integrated into the production of goods and services it will become an important source of competitive advantage.
- 2.75 As a factor of production, AI may exhibit some characteristics that reduce competition. Compared to other factors of production, such as human, physical and financial capital, AI may be less transferrable across firm boundaries. Traditionally, competition is fostered in industries when workers leave to start competing companies, or when new firms emerge in different geographies, or when investors seek to mimic a successful innovator.
- 2.76 But AI is less transferrable across firms. It can’t be poached, like a good worker. It isn’t fungible like investment dollars. It isn’t necessarily limited by geographic boundaries. And AI, unlike other factors of production, is able to innovate on itself.
- 2.77 AI may be less amenable to competition than traditional factors of production. As AI becomes a more important ingredient in production processes across the economy, it could entrench the power of incumbent firms.
- 2.78 On the effects of AI on scale and the requirements for entering—or remaining in—the market, Bendigo & Adelaide Bank told the Committee that organisations need to

⁴¹ Mr Ralph Lattimore, Chief Economist, Productivity Commission, *Committee Hansard*, 16 March 2023, p. 13.

⁴² Mr Brendan Coates, Economic Policy Program Director, Grattan Institute, *Committee Hansard*, 2 May 2023, p. 8.

⁴³ Mr Justin Mining, Competition Policy Lead, Asia-Pacific, Google, *Committee Hansard*, 29 August 2023, p. 2.

⁴⁴ Mr Chris de Bruin, Chief Executive, Consumer and Business Banking, Westpac Group, *Committee Hansard*, 13 July 2023, p. 50.

recruit people with the requisite skills to implement and manage the ‘risk side’ of AI ‘because it can be a bigger cost in itself’.⁴⁵

- 2.79 Shift Financial, a digital credit and payments platform provider, told the Committee that to be competitive it needed to be at the ‘cutting edge’ of AI, but that recruiting skilled labour was ‘relatively difficult’ and often needed to be sourced from overseas.⁴⁶

Regulating AI

- 2.80 Witnesses held mixed views about a suitable regulatory approach to the swift development of AI and Australian industry’s preparedness for it.

- 2.81 Microsoft told the Committee that government needed to partner with industry in developing regulation, and that the future regulatory path was likely to require a mix of experimentation and self-regulation. For these reasons it supported a ‘regulatory sandbox’ approach.⁴⁷

So there is risk in regulating what we know today because it will be out of date, if not tomorrow, then by next week. There is a way to look at it around adopting principles, self-regulation, co-regulation and steps along the path until we find out where that spot is...The biggest risk is that, if government feels that it has to come up with the solution on its own, that will probably not be workable. I think the sandbox idea makes sense, and we'd be supportive of that.⁴⁸

- 2.82 Former Productivity Commission Chair Mr Peter Harris cautioned the Committee to treat with scepticism arguments for AI regulation put forward by those with an interest in raising barriers to market entry.

And I note that there's great capacity to exaggerate the impacts here. We hear that AI is going to be massively disruptive and therefore needs to be regulated. I note that most of the people who are calling for regulation are the incumbents who've managed to solve the problem, and you could argue that of course regulation then becomes a barrier to somebody else being able to replicate their service and compete with them. So, I'd always be a little more sceptical about claims that everything is massively disruptive.⁴⁹

- 2.83 On related ethical matters—such as managing the risk of AI tools reinforcing existing human biases and thus leading to unfair outcomes in, for example, insurance

⁴⁵ Ms Marnie Baker, Chief Executive Officer and Managing Director, Bendigo and Adelaide Bank, *Committee Hansard*, 4 July 2023, p. 26.

⁴⁶ Mr James Spence, Head of Product Strategy, Shift Financial, *Committee Hansard*, 3 May 2023, p. 10.

⁴⁷ A regulatory sandbox is a framework where participants can test innovative concepts in the market under relaxed regulatory requirements at a smaller scale, on a time-limited basis and with appropriate safeguards in place. In Australia, ASIC administers an enhanced regulatory sandbox that allows individuals and businesses to test financial services or credit activities without first obtaining an Australian financial services licence or an Australian credit licence.

⁴⁸ Ms Belinda Dennett, Corporate Affairs Director, Microsoft, *Committee Hansard*, 3 May 2023, p. 23.

⁴⁹ Mr Peter Harris, Private capacity, *Committee Hansard*, 25 July 2023, p. 28.

underwriting—the Australian Prudential Regulatory Authority (APRA) advised that the financial industry was alert to such questions ‘...but it’s obviously going to be a rapidly evolving space’.⁵⁰

- 2.84 In January 2024, the Government announced that it would take action to ensure AI is safe and responsible. In its interim response to the Safe and Responsible AI in Australia consultation, the Government said it was considering mandatory guardrails for AI development and deployment in high-risk settings, whether through changes to existing laws or the creation of new AI-specific laws.⁵¹

The impact of inflation

- 2.85 There was no clear evidence about the effect on competition of the higher inflationary environment that Australia has endured in recent times. However, several witnesses expressed the view that in certain circumstances a concentrated market would intensify the effects of (rather than be the primary cause of) inflation.

- 2.86 Professors Flavio Menezes and John Quiggin pointed the Committee to their research, which shows that ‘to the extent that market power amplifies the inflationary impact of market power it doesn’t cause inflation but amplifies the price increase following a market shock’.⁵²

Our analysis shows that with standard models of competition; oligopolies, such as Cournot models; or competition in supply schedules, this is quite a robust result—that demand inflation will be amplified by market concentration.⁵³

- 2.87 The ACCC told the Committee that given recent inflation had been caused by ‘a mix of real and nominal shocks’, it was difficult to assess its relationship with competition.

If shocks were purely nominal, then you might be able to say that firms with market power could find it easier to raise prices by more than costs, because of the camouflage provided by the high rate of general price increases, but if shocks are mainly real shocks, like supply chain disruptions or labour shortages in particular industries, then even firms that behave competitively or operate in competitive markets might raise their prices and markups to ration demand, at least until those shocks are resolved. So at a general level it might be hard to make a judgement on this question except in hindsight.⁵⁴

- 2.88 Former ACCC chair Professor Rod Sims said that in a market with a small number of firms, each was watching the other and that ‘when there’s an opportunity to increase

⁵⁰ Dr Sean Carmody, Executive Director, Insurance Division, Australian Prudential Regulatory Authority, *Committee Hansard*, 2 June 2023, p. 8.

⁵¹ The Hon Ed Husic, Minister for Industry and Science, ‘Action to help ensure AI is safe and responsible’, *Media Release*, 17 January 2024.

⁵² Professor Flavio Menezes, Private capacity, *Committee Hansard*, 18 May 2023, p. 17.

⁵³ Professor Flavio Menezes, Private capacity, *Committee Hansard*, 18 May 2023, p. 17.

⁵⁴ Mr Rajat Sood, Acting Chief Economist, Australian Competition and Consumer Commission, *Committee Hansard*, 17 March 2023, p. 9.

prices in a way that is explainable, I think they are more likely to do that'. He caveated this by adding that he did not possess any quantifying data.⁵⁵

- 2.89 In his February 2024 inquiry into price gouging and unfair pricing practices, another former ACCC Chair, Professor Allan Fels, noted the following:

Prices in Australia are often too high reflecting the many markets where there is less than fully effective competition.

Not only are many consumers overcharged continuously but 'profit push' pricing has added significantly to inflation in recent times.

...

This report concludes that business pricing has added significantly to inflation in recent times.

'Profit push' or 'sellers inflation' has occurred against a background of high corporate concentration and is reflected in the surge of corporate profits and the rise in the profit share of Gross Domestic Product. There is much support for the view that prices have added much to inflation. This is to be found in research from OECD, IMF, BIS, European Commission, European Central Bank, US Federal Reserve Bank, Bank of England and many think tanks globally and locally and many detailed research studies. Claims that the rise in profit share in Australia as explained by mining do not hold up. The profits share excluding mining has risen and energy and other prices associated with mining have been a very significant contributor to Australian inflation.⁵⁶

- 2.90 The Productivity Commission, by contrast, firmly rejected the notion of 'greedflation'—that firms with market power were using inflation to mask unfair price mark-ups over costs to increase profits. For such firms, an inflationary environment did not provide new opportunities for 'sustained exploitation of market power', as they can already use that power at any time.

...the greedflation thesis seems to have been quickly overtaken by the facts. Australia's annual inflation rate appears to have peaked at 7.8 per cent and has now declined to six per cent. Company profits declined by 13.1 per cent in the June 2023 quarter and fell by 11.8 per cent over the year to June. Some might ask, 'If there is greedflation, why were firms apparently greedy up until recently but have now suddenly stopped being greedy?'⁵⁷

⁵⁵ Professor Rod Sims, Private capacity, *Committee Hansard*, 2 May 2023, p. 20.

⁵⁶ Professor Allan Fels AO., 'Inquiry into Price Gouging and Unfair Pricing Practices – Final Report', February 2024, p. 5, <https://pricegouginginquiry.actu.org.au/>.

⁵⁷ Dr Alex Robson, Deputy Chair, Productivity Commission, *Committee Hansard*, 15 September 2023, p. 55.

3. Key empirical findings

Empirical findings in relation to the level of competition

- 3.1 The Committee acknowledges the complexity of measuring competition, as each industry is influenced by unique dynamics and operates under distinct conditions. This chapter contains key empirical concepts and data, which are foundational to understanding the rest of the report.
- 3.2 Recognising the diversity in methods used by economists to evaluate the level of competition, the Committee has heard that ‘...it is important to actually look at the existing different metrics in unison’.¹ Some experts advocate for a multifaceted ‘triangulation’ approach, using various metrics to gain a clearer, more reliable, and comprehensive understanding of market competition.

Box 3.1 Measures to evaluate market competition

- **Market concentration (Market share of the largest firms).**
 - **Four-firm concentration ratio (CR4):** Market share of the top four firms.
 - **Herfindahl-Hirschman Index (HHI):** calculated by squaring the market share of each firm operating in a particular market or industry and then summing the resulting numbers, with higher values indicating greater market concentration.
- **Markup:** Refers to the gap between price and marginal cost. Higher markups indicate greater market power, as firms with significant market power can set higher prices above marginal costs.
- **Firms entry/exit and barriers to entry:** Entry measures the ratio of new firms to the total firms at the start of the year. Exit measures the proportion of firms ceasing operations against the total firms at the beginning of the year. Barriers to entry, like control of key resources, dominance of established firms, or regulatory challenges, hinder new competitors' market entry.

¹ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 2.

Market concentration

Concentration and market power

3.3 The Committee acknowledges that a large market concentration does not always directly imply reduced competitive outcomes. In some ‘winner takes all’ markets, the most productive company naturally dominates. If a firm offers a superior product at a lower price and captures the market, this can be seen as an efficient outcome, particularly if the threat of firm entry places a constraint on firm pricing.²

3.4 The Productivity Commission (PC) argued that across the economy, and also within some sectors, a rise in market concentration could partially be attributed to efficient, large-scale providers entering regional markets—potentially improving local competition. It told the Committee that:

... larger firms that tend to be strong innovators, ... may be more productive than some smaller firms... a policy that promotes more competitors... isn’t necessarily going to drive good competitive outcomes in all cases, and it may not drive innovation and productivity.³

...

It’s not hard to identify sectors where you can see a headline increase in market concentration, but a kind of eye test suggests there is pretty vigorous competition going on.... There is very high churn and high levels of both entry and exit—that’s partly just the nature of that industry, with lower fixed-cost businesses—and then others where it’ll tend to be dominated by incumbents over a longer period of time... It might be that there is plenty of competition and plenty of innovation by incumbents.⁴

3.5 In response, the Australian Competition and Consumer Commission (ACCC) considered that market concentration raises concerns when it is associated with anti-competitive actions, such as competitive actions, where market leaders deliberately limit consumer choices, for example, or block suppliers from engaging with other competitors.⁵ It told the Committee that:

...while the specific roles that concentration plays in driving market behaviour and performance in a given circumstance is an empirical question... concentration is one of the key features of market structure, and high levels of concentration tend to give rise to market power concerns’.⁶

² D Autor et al, ‘The fall of the labor share and the rise of superstar firms’, *The Quarterly Journal of Economics*, 135/2 (2020), pages 645–709.

³ Mr Michael Brennan, Chair, Productivity Commission, *Committee Hansard*, 16 March 2023, p. 2.

⁴ Mr Michael Brennan, Chair, Productivity Commission, *Committee Hansard*, 16 March 2023, p. 3.

⁵ Australian Competition and Consumer Commission (ACCC), *Fines and penalties*, www.accc.gov.au/business/compliance-and-enforcement/fines-and-penalties, viewed 16 February 2024.

⁶ Mr Rajat Sood, Acting Chief Economist, ACCC, *Committee Hansard*, 17 March 2023, p. 5

- 3.6 The Committee also heard evidence from the e61 Institute, that in concentrated industries there is evidence of both higher rates of cost pass-throughs to prices and higher rates of consumer law contraventions (compared to in less concentrated industries).⁷

Variation across industries

- 3.7 The Productivity Commission told the Committee that market concentration varies widely across industries. It said that highly concentrated sectors often involve natural monopolies, such as utilities in telecommunications, energy, water services, and airports. In such circumstances, ‘...the presence of a single dominant business is almost inevitable, making regulation the proxy for competition’ [...] ‘...and competition must be achieved through means other than entry’.⁸
- 3.8 In Australia, industries such as airlines, banks, retail, and insurance are also highly concentrated, with the top two to five companies dominating the market, often due to significant entry barriers such as capital requirements and regulatory hurdles.
- 3.9 Additionally, the Productivity Commission has found that the banking, supermarkets, mobile telecommunications, internet service provider, fuel wholesale and retail, and general insurance sectors all have top four firm market shares of 70 per cent or more.⁹

What the data reveals

- 3.10 Data from the e61 Institute has revealed a significant increase in market concentration in Australian industries, as measured by the market share in a sector of the top four firms (the ‘CR4’). Firms’ concentration has nearly doubled, rising from 1.7 per cent in 2010 to almost 3 per cent in 2020.¹⁰ Utilities and the retail sector are the sectors contributing the most to this increase.
- 3.11 The Productivity Commission explained that some measures using HHIs show that overall business concentration in Australia has increased between 2002 and 2016. Australia’s average HHI has consistently risen due to significant concentration increases in various industries, including warehousing and storage services, non-depository financing, life insurance, gas supply, water freight transport, and several manufacturing sectors.¹¹

⁷ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 28 August 2023, p. 15.

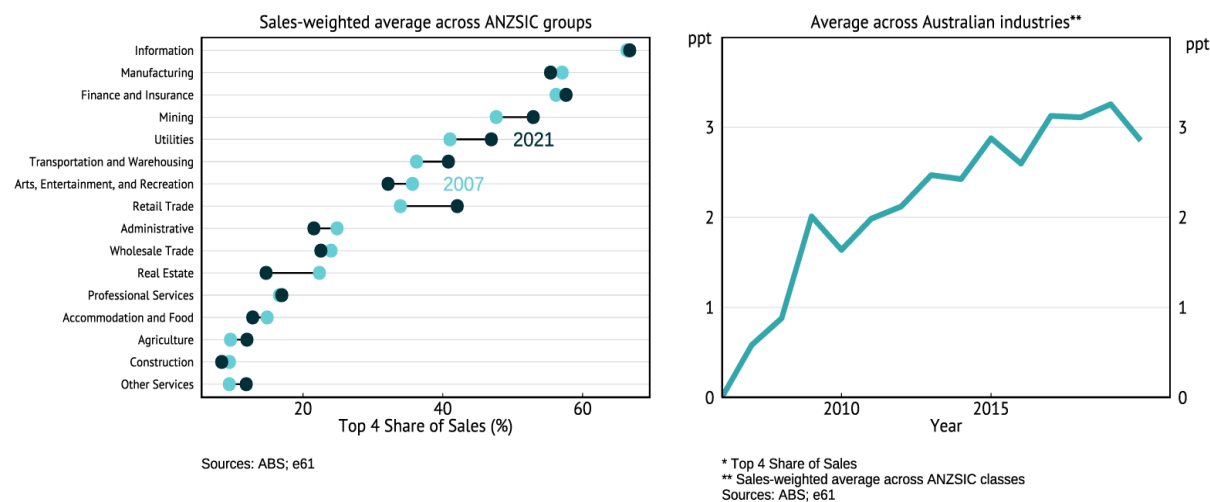
⁸ Mr Ralph Lattimore, Chief Economist, Productivity Commission, *Committee Hansard*, 16 March 2023, p. 2.

⁹ Productivity Commission, ‘5-year Productivity Inquiry: A competitive, dynamic and sustainable future’, 17 March 2023, p. 3, www.pc.gov.au/inquiries/completed/productivity/report.

¹⁰ N Adams et al., ‘Better harnessing Australia’s talent: five facts for the Summit’, *e61 Institute*, 28 August 2022, e61.in/five-facts-for-the-summit/, p. 11.

¹¹ Productivity Commission, *Submission 1*, p. 18.

Figure 3.1 Changes in concentration



Source: e61 Institute, 'The State of Competition in Australia', 30 August 2023, p. 5.

Mark-ups

3.12 The e61 Institute presented data showing an increase in price-to-cost margins.¹² The Committee also notes data compiled by the Hon Dr Andrew Leigh, Assistant Minister for Employment and for Competition, Charities and Treasury, which shows that firms in the top 10 per cent of markup distribution—holding the most significant market shares—have also been the firms with a larger increase in markup trends.¹³ Separately, research by the economist Jonathan Hambur suggests that since the mid-2000s, firms' mark ups have risen by 5 per cent.¹⁴

3.13 Regarding the existing relationship between mark-ups and market competition, the Committee heard that there are differences between economic sectors and that, in some situations, an intricate part of the mark-up is the necessity for all businesses to cover their fixed costs.

3.14 The e61 Institute said that:

...If you're a capital intensive firm or you've got a large investment in intellectual property, that's not going to be in your marginal cost, so you must recover it in other ways...If there is any trend towards high fixed costs, you will see a trend of upward margins as a necessary feature of commercial viability.¹⁵

¹² Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 16 March 2023, p. 1.

¹³ A Leigh, 'A More Dynamic Economy', *The Australian Economic Review*, 55/4 (2022), pages 431–440.

¹⁴ J Hambur, 'Product Market Competition and its Implications for the Australian Economy', *Economic Record*, 99/324 (2023), pages 32–57.

¹⁵ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 16 March 2023, p. 2.

3.15 The Committee is aware that companies deeply involved in digital activities experienced a notable 12 per cent increase in their mark-ups. Yet, even sectors less dependent on technology observed a growth pattern in markups.¹⁶

3.16 For example, the e61 Institute advised that Australia, in comparison to other economies:

...is unique in that we've seen a much more broad-based rise in mark-ups across the distribution. So it's not just a story of superstar effects not just a story of reallocation of factors to high mark-up firms.¹⁷

3.17 Additionally, the Productivity Commission told the Committee that:

... aggregate markups don't tell you what you might want to know across different sectors...there is a need to dig down below the aggregate level to be able to draw out causal links.¹⁸

Markups and inflation

3.18 The Committee acknowledges arguments proposing that firms with market power may seize the opportunity to introduce additional price hikes, taking advantage of overall inflation to make these increases less conspicuous.

3.19 In this vein, the Productivity Commission argued that in a high-inflation environment, price disparities across various sectors are more pronounced, leading to misleading price signals compared to a stable price environment. This could result in varying markups appearing across different sectors.¹⁹ Additionally, in the Commission's view, markups do not inherently indicate temporal changes or universal industry impacts, unlike inflation, which signifies a sustained average price increase over time. Notably, the Commission observed, aggregate markup increases seem to have commenced before the current inflationary period.²⁰

3.20 Contrarily, the ACCC stated that:

... it is crucial to analyse the type of inflation we're experiencing, [...] ...it seems recent inflation has been due to a mix of real and nominal shocks, complicating the assessment of competition or market competitiveness effects. In a purely nominal shock scenario, firms with market power might find it easier to raise prices beyond costs due to the obscurity created by general price increases. However, real shocks, like supply chain disruptions or labour shortages, could lead even competitive firms to increase prices and markups temporarily to manage demand until the shocks are resolved.²¹

¹⁶ A Leigh, 'A More Dynamic Economy', *The Australian Economic Review*, 55/4 (2022), pages 431–440.

¹⁷ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 16 March 2023, p. 4.

¹⁸ Mr Alexander Robson, Deputy Chair, Productivity Commission. *Committee Hansard*, 16 March 2023, p. 6.

¹⁹ Mr Michael Brennan, Chair, Productivity Commission, *Committee Hansard*, 16 March 2023, p. 9.

²⁰ Mr Alexander Robson, Deputy Chair, Productivity Commission, *Committee Hansard*, 16 March 2023, p. 9.

²¹ Mr Rajat Sood, Acting Chief Economist, ACCC, *Committee Hansard*, 17 March 2023, p. 9

Rate of firm entry and exit

- 3.21 The Committee emphasises the importance of considering dynamic factors like firm entry and exit, which allow for a more comprehensive understanding of the market's competitive landscape.
- 3.22 The Committee is aware that a disruptive firm entry, characterised by high innovation, can be a notable source of competitive tension in various sectors, particularly in financial services. Innovations such as 'buy now, pay later' services and platforms like Uber exemplify this trend, bringing significant market changes and competitive pressures.
- 3.23 At an aggregate level, the Committee heard from the e61 Institute that the entry rate of firms in Australia '...declined from around 15 per cent in the early to mid-2000s to around 12 per cent just before the pandemic, but there has been a slight uptick since then'. Concurrently, the exit rate also decreased. It started at 10 per cent in 2005 and fell to 8 per cent by 2020, leading to an increase in the average age of firms.²²
- 3.24 Complementing this analysis, the Productivity Commission stated that 'the entry rate grew modestly between 2013-14 and 2019-20, before experiencing a significant increase during the COVID-19 pandemic'. It also noted that because entries remained above exits, the stock of competing businesses grew overall.²³
- 3.25 Further, the Productivity Commission explained that 'competition can be strong even with lower entry and exit rates if there is contestability [where the barriers to entry and exit are relatively low] or a small number of firms are competing vigorously for market share'.²⁴

Incumbent entrenchment

- 3.26 The Committee also heard that there is significant data which indicates the same companies remain entrenched as market leaders in Australia, and that this phenomenon has been consistently observed across various sectors of the economy. The e61 Institute told the Committee that:
- ... not only has the market share of the largest firms increased, but the leadership positions are also consistently held by the same firms.²⁵
- 3.27 Further, e61 Institute research reveals that in 2006, a firm in the top four of its market had a 61 per cent chance of retaining its position. By 2018, this likelihood had increased to 66 per cent.²⁶

²² Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 2.

²³ Productivity Commission, *Submission 1*, p. 5.

²⁴ Productivity Commission, *Submission 1*, p. 6.

²⁵ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 2.

²⁶ N Adams et al., 'Better harnessing Australia's talent: five facts for the Summit', *e61 Institute*, 28 August 2022, p. 11.

- 3.28 Separately, analysis by the Hon Dr Andrew Leigh, Assistant Minister for Employment and for Competition, Charities and Treasury, has highlighted the relative stagnation of the Australian economy as measured through the low rates of historical change in the make-up of Australia's largest firms.

In the mid-1980s, the largest US firms were IBM, Mobil, Exxon, Ford and General Motors. Today, they are Apple, Microsoft, Alphabet, Amazon and Tesla. In Australia, there's been barely any change. In the mid-1980s, the largest Australian firms were Westpac, Commonwealth Bank, NAB, BHP and ANZ. Today they are Westpac, Commonwealth Bank, NAB, BHP and CSL.

It gets worse if we go back to 1917. None of America's top ten companies then are still in the top ten today. But of Australia's top ten companies at the end of World War I, five still make the list today. Although some have changed their names, Westpac, ANZ, NAB, BHP and Wesfarmers have enjoyed more than a century at the top of the Australian sharemarket.²⁷

- 3.29 In relation to firms' survival, the Productivity Commission submitted that during periods when exit rates have fallen, both new and established businesses have shown higher survival rates after two and three years. These survival rates could enhance productivity, as firms that endure start to expand and contribute to competitive dynamics, thereby boosting overall productivity.²⁸

- 3.30 The Productivity Commission expanded on these caveats:

...measures of market concentration such as the four firm concentration index or the Herfindahl-Hirschman Index should be interpreted with a great deal of care, particularly when measured at an aggregate level.

Indeed, the proposition that market concentration measures by themselves must be negatively associated with productivity growth and economic wellbeing has been debated by economists for at least 50 years. As a matter of economic theory, it is straightforward to derive examples where a higher HHI, which indicates great market concentration, is associated with higher rather than lower economic wellbeing. In practice, as our submission discusses, the link between concentration and wellbeing greatly depends on the economic context. In any case, at the industry level, our analysis of concentration dynamics shows that most Australian industries are not concentrated and very few became concentrated between 2006 and 2021. Moreover, the distribution of concentration measures across industries has been relatively stable over that period, so the claim that the Australian economy as a whole is becoming more concentrated does not seem to hold up. Most industries in Australia are not highly concentrated and this has not changed much.

²⁷ A Leigh, *Fair Game: Lessons from sport for a fairer society and a strong economy*, Monash University Publishing, 2022, pages 18-19.

²⁸ Productivity Commission, *Submission 1*, p. 8

Related to this...there is some evidence that mark-ups have been increasing in Australia. However, the evidence is plagued by measurement issues, and, from a policy perspective, interpreting aggregate evidence on mark-ups isn't straightforward. For example, you could have a situation where costs and price are falling together, so that consumers are better off, but prices are falling at a slower rate, so that mark-ups rise. In that case, what would be the appropriate policy response?²⁹

Committee comment

- 3.31 The Committee recognises that while it is challenging to draw definitive conclusions from any single measure of competition levels, the combined evidence it received suggests a decline or stagnation in competition across all key metrics.
- 3.32 Despite arguments that high market concentration can be a result of efficient, dominant firms leading markets, or that it might not necessarily impede competition and innovation, the data shows a significant rise in market concentration—with the top firms increasing their market share and maintaining their leadership positions over time. Additionally, increases in price mark-ups and changes in the rate of firm entry and exit point towards growing market entrenchment and potentially reduced competitive pressures. This situation could adversely influence the overall market dynamics in Australia, impacting innovation and productivity growth.

Empirical findings in relation to economic dynamism

- 3.33 The Committee acknowledges that the root causes of the productivity slowdown are multifaceted and have been intensified by a waning competitive environment, with a significant decline in economic dynamism being a primary factor.³⁰
- 3.34 The Committee is aware that the declining dynamism of the economy manifests in various ways, from inefficient resource allocation and reduced motivation for firms to innovate and invest, to a more gradual adoption of cutting-edge technologies and a decline in the emergence of new market players.³¹

Allocation of factors of production: capital and labour

- 3.35 The Committee is aware that the decline in dynamism in both product and labour markets is interlinked. New firms entering the market naturally offer alternative job

²⁹ Mr Alex Robson, Deputy Chair Productivity Commission, *Committee Hansard*, 15 September 2023, p. 55.

³⁰ A Leigh, 'A More Dynamic Economy', *The Australian Economic Review*, 55/4 (2022), pages 431–440.

³¹ International Monetary Fund, 'World Economic Outlook, October 2019: Global Manufacturing Downturn, Rising Trade Barriers', October 2019, pages 55–76, www.imf.org/en/Publications/WEO/Issues/2019/10/01/world-economic-outlook-october-2019, viewed 28 February 2024.

options for workers, facilitating job transitions. Data shows that approximately half of the observed decline in job transitions can be attributed to fewer workers moving from established firms to new entrants in the market. The propensity of the average Australian worker to change jobs has been decreasing, dropping from 11.3 per cent in the mid-2000s to a more modest 8.5 per cent in 2022.³²

- 3.36 This trend is further supported by the fact that the percentage of Australian workers taking on new jobs has decreased by an average of 16 per cent since the early 2000s.³³
- 3.37 The e61 Institute has also argued that the role of input reallocation in boosting aggregate productivity has been diminishing, suggesting a lessened transfer of resources from less productive to more productive firms. This trend is further highlighted by the shrinking disparity in employment growth between high and low productivity firms, which contracted by over 2 per cent from 2003 to 2016. Since 2012, there has been a marked slowdown in the rate of labour reallocation from low to high productivity firms.³⁴
- 3.38 Additionally, the e61 Institute has found from the mid-2000s onward, firms with lower productivity levels have had a higher likelihood of survival, while the movement of labour towards more productive firms has decelerated. Such phenomena explain approximately a quarter of the observed productivity slowdown.³⁵
- 3.39 The e61 Institute's research has also shown that the propensity for high-productivity firms to expand and low-productivity firms to contract has declined over time, and that the extent to which scarce labour is reallocated from less productive to more productive firms has therefore stagnated. Some estimates suggest that such a decline in productivity-enhancing labour reallocation is a key feature of Australia's productivity slowdown in the past decades.³⁶

Specialised factors of production, skilled labour

- 3.40 The Committee is aware that skilled migration can help Australia fill gaps in professional expertise across various fields. The Grattan Institute advised that 'skilled migrants with work experience abroad are the most likely to diffuse knowledge and international best practice into Australia'.³⁷
- 3.41 The e61 Institute has argued in separate research that economic prosperity relies on efficiently utilising and optimally allocating existing workforce talent. Policies should

³² A Leigh, 'A More Dynamic Economy', *The Australian Economic Review*, 55/4 (2022), pages 431–440.

³³ A Leigh, 'A More Dynamic Economy', *The Australian Economic Review*, 55/4 (2022), pages 431–440.

³⁴ D Andrews and D Hansell, 'Productivity-Enhancing Labour Reallocation in Australia', *Economic Record*, 97 (2021), pages 157–69.

³⁵ D Andrews and D Hansell, 'Productivity-Enhancing Labour Reallocation in Australia', *Economic Record*, 97 (2021), pages 157–69.

³⁶ D Andrews and D Hansell, 'Productivity-Enhancing Labour Reallocation in Australia', *Economic Record*, 97 (2021), pages 157–69.

³⁷ Mr Brendan Coates, Economic Policy Program Director, Grattan Institute, *Committee Hansard*, 2 May 2023, p. 8.

therefore focus on reducing market frictions to enable productive firms to grow, thereby creating quality jobs. While enhancing educational standards and adjusting migration policies are long-term goals, in the Institute's view immediate gains can be realised by ensuring the right skills match with the right jobs and firms.³⁸

- 3.42 The Grattan Institute also told the Committee that diversity in management is crucial, stressing that efforts to promote more women into senior executive positions and encouraging broader female participation in the workforce would undoubtedly enhance workforce participation and productivity.³⁹

Young firms and workers

- 3.43 The Committee heard from the e61 Institute that: '...young firms disproportionately drive aggregate economic growth, whether it's job creation, productivity or innovation.' It added that '...young firms are more productive, and on average, they create about 13 jobs each per year. That accounts for about 40 per cent of aggregate net job creation in the Australian economy. So any friction we create that affects the ability of young productive firms to upscale can potentially entail large macroeconomic costs.'⁴⁰
- 3.44 The e61 Institute has also argued that the dip in business dynamism has notably impacted the employment prospects of young people, who are typically drawn to newer or emerging firms that resonate with their skills and ambitions. Young workers have used job transitions to locate roles that better match their developing skill sets. However, the Institute has found, with the decline in the number of new firms entering the market, opportunities for such mobility have been diminishing, making it increasingly difficult for young Australians to establish themselves in the professional arena.⁴¹
- 3.45 Young firms are discussed in more depth in Chapter 4: Economy-wide measures to boost competition and economic dynamism.

Level and translation of innovation

- 3.46 The Productivity Commission highlighted to the Committee the essential role of business investment in Australia's economic growth, emphasising its positive impact on labour productivity, wages, incomes, and innovation. Investment not only boosts the capacity to produce goods and services but also serves as a critical channel for knowledge transfer. The investment to GDP ratio, particularly outside of mining and ownership of dwellings and ownership transfers, has been declining, and has

³⁸ N Adams et al., 'Better harnessing Australia's talent: five facts for the Summit', *e61 Institute*, 28 August 2022, p. 20.

³⁹ Mr Brendan Coates, Economic Policy Program Director, Grattan Institute *Committee Hansard*, 2 May 2023, p. 8.

⁴⁰ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 2.

⁴¹ N Adams et al., 'Better harnessing Australia's talent: five facts for the Summit', *e61 Institute*, 28 August 2022, p. 13.

reached its lowest level since 1960. Since the global financial crisis, all business investment as a share of GDP in Australia has declined. Further, the Commission's findings from its 5-year Productivity Inquiry reveal a concerning slowdown in investment in knowledge-intensive capital, which is crucial to fostering innovation and skill development.⁴²

- 3.47 The Productivity Commission submitted that this sluggish investment in 'capital with brains' over the past decade is particularly troubling, as it directly affects the economy's ability to innovate and grow. The shift pointed to a broader challenge facing Australia's economic dynamism and future prosperity.⁴³

Empirical findings in relation to productivity and economic outcomes

- 3.48 The Productivity Commission highlighted studies conducted by Treasury and the Reserve Bank of Australia (RBA) which have found a relationship between the competitive pressures in the economy and the slowdown in productivity growth.⁴⁴

Global productivity frontier

- 3.49 Moreover, the economic literature suggests Australian firms are lagging behind global industry leaders, and that the rate at which these firms are closing the gap with leading global practices has slowed compared to previous years. It has shown that the pace at which laggard firms approach the global productivity frontier is slower in industries that have either experienced fewer pro-competitive reforms or have seen increasing markups.⁴⁵ Also, younger firms tend to align with the global frontier faster than established ones, as they have the advantage of adopting new technologies without prior constraints.

- 3.50 In this light, the e61 Institute told the Committee that:

...there is a divergence in the global productivity slowdown. Market-leading frontier firms in each sector actually experienced rapid productivity growth. That was symptomatic of their better managerial quality and their ability to use digital technologies productively. The issue was that all other firms fell increasingly behind...

...this divergence between Australian firms and the global frontier was more pronounced in services. I think that says something about the importance of competition in this regard'.⁴⁶

⁴² Productivity Commission, *Submission 1*, p. 24.

⁴³ Productivity Commission, *Submission 1*, p. 24

⁴⁴ Mr Michael Brennan, Chair, Productivity Commission, *Committee Hansard*, 16 March 2023, p. 6.

⁴⁵ D Andrews, C Criscuolo and PN Gal, 'The best versus the rest: divergence across firms during the global productivity slowdown', *OECD Productivity Working Papers*, 5 (November 2016), pages 1–76.

⁴⁶ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, pages 5–6.

- 3.51 Further, the e61 Institute pointed to Treasury research suggesting that the declines in business dynamism and competitive pressures appear to account for half to three-quarters of the slowdown in the rates at which Australian firms reach the global productivity frontier.⁴⁷

Income distribution and wages

- 3.52 The economic literature suggests that a decrease in market competition has led to a growing disconnect between productivity and wages. More market power is associated with greater 'excess economic' profits accruing to shareholders, or a higher 'profit share'. This implies that a lower share of income will be paid to production factors like labour and also points to workers' bargaining power being reduced.^{48,49}
- 3.53 The e61 Institute has pointed to evidence showing a decade of little to no real earnings growth over the past ten years.⁵⁰ One of the contributing factors to this stagnation is the reduced movement of labour to high productivity firms. Given that these firms generally provide higher salaries, their diminished presence in the market translates to fewer opportunities for well-paying jobs.
- 3.54 As noted above, there is evidence suggesting the decline in job mobility towards higher-paying roles has led to a reduction in worker bargaining power. Fluid labour markets typically provide workers with alternative options, strengthening their negotiation position with current employers. However, as labour market fluidity diminishes, workers inherently find their bargaining power reduced.
- 3.55 For example, the e61 Institute has posited that in the past 15 years, the estimated pass-through from productivity to wages has dropped by nearly 25 per cent. In the mid-2000s, a 1 per cent surge in turnover per worker correlated with a 0.19 per cent rise in average wages. By 2020, this relationship had diminished, with the same 1 per cent increase in turnover leading to just a 0.14 per cent wage increase.⁵¹ Further, the Institute has found that the industries with the most profound declines in new firm creation, such as real estate and retail, have experienced the lowest pass-through rates.⁵²
- 3.56 The e61 Institute stressed to the Committee the disproportionate impact on younger Australians of low wages growth. It added that skills mismatches disproportionately affect young workers, who typically depend on job transitions to find a suitable match.

⁴⁷ D Andrews, J Hambur, D Hansell and A Wheeler, 'Reaching for the stars: Australian firms and the global productivity frontier', 7 February 2022, p.1, treasury.gov.au/publication/p2022-243535.

⁴⁸ S Barkai, 'Declining Labor and Capital Shares', *The Journal of Finance*, 75/5 (2020), pages 2421–2463.

⁴⁹ J De Loecker, J Eeckhout, and G Unger, 'The Rise of Market Power and the Macroeconomic Implications', *Quarterly Journal of Economics*, 135/2 (2020), pages 561–644.

⁵⁰ N Adams et al., 'Better harnessing Australia's talent: five facts for the Summit', e61 Institute, 28 August 2022, p. 18.

⁵¹ N Adams et al., 'Better harnessing Australia's talent: five facts for the Summit', e61 Institute, 28 August 2022, p. 14.

⁵² N Adams et al., 'Better harnessing Australia's talent: five facts for the Summit', e61 Institute, 28 August 2022, p. 15.

Additionally, younger workers are more likely to work for newer firms, and a decrease in such firms reduces opportunities for them.⁵³

- 3.57 There is evidence suggesting that low wages may be linked to the low rates at which workers are changing jobs. The e61 Institute's research indicates that lower rates of job switching have led to a decrease in average wages.⁵⁴
- 3.58 A decline in job switching also leads to a scarcity of attractive alternative employment opportunities, and means workers face more risks when transitioning between jobs. Treasury research has indicated that for every one per cent drop in the job switching rate, there is an associated decline of approximately half a percentage point in wage growth.⁵⁵

Data collection and analysis

Caveats to the interpretation of the data

- 3.59 Witnesses consistently stressed the need for caution in interpreting the data on competition.
- 3.60 First, strong conclusions should not be drawn on the basis of a single metric. A rise in market concentration, for example, may not indicate less competition per se, if there is also an increase in market churn (where efficient enterprises, with their superior operational strategies, supplant inefficient firms that struggle to maintain their market position), a point made by the e61 Institute.⁵⁶
- 3.61 It is important therefore to stress test any empirical findings, where possible, to see if a trend extends across multiple metrics. In the words of the e61 Institute:
- ...it's important to actually look at all these different metrics in unison, not just market concentration. It's how it connects to the entrenchment of incumbents and how that's correlated, for instance, with entry rates and so forth and how that's connected to basically job mobility rates.⁵⁷
- 3.62 Second, economy-wide conclusions should not be drawn from limited datasets and without broader context.

⁵³ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 6.

⁵⁴ N Adams et al., 'Better harnessing Australia's talent: five facts for the Summit', e61 Institute, 28 August 2022, pages 12–13.

⁵⁵ M Quinn, 'Keeping pace with technological change: the role of capabilities and dynamism', Speech, 20 June 2019, treasury.gov.au/speech/s2019-390085, viewed 28 February 2024.

⁵⁶ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 2.

⁵⁷ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 2.

- 3.63 Treasury noted that much competition research on Australian conditions had been based on the Australian Bureau of Statistics' Business Longitudinal Analysis Data Environment (BLADE) mechanism, which analyses firm-level data. However, BLADE lacked price data and even though enhancements to BLADE are being explored, its precision is 'limited'.⁵⁸ Building on this, the Productivity Commission said that price level data generally did not exist at the firm level so the alternative that tends to be used, an 'average aggregate price level', was 'pretty rough and ready'.⁵⁹
- 3.64 In a similar vein, European Central Bank President Christine Lagarde recently observed that 'we don't have as much or as good data on profit as we do on wages...if I had the choice, I would improve our data on profits on an aggregate basis as well as on a more granular basis'.⁶⁰
- 3.65 Further, Treasury pointed to the importance of carefully distinguishing between industries when considering the policy significance of firm entry rates. Concentration and the entrenchment of a few large firms in an industry with high fixed costs, such as the resources sector, is considered normal. Indeed, when it comes to innovation, Australia's top mining firms are at the leading edge of the global frontier.⁶¹ But in retail, for example, where small business would be expected to play a major role, market dominance by a few major players may indicate a problem for competition and dynamism.⁶²
- 3.66 Overall, the Productivity Commission cautioned, the concept of dynamism '...is hard to measure well...' and that phenomena such as firm entry and exit, concentration, and price-markups are '...proxies for dynamism, which have varying insights into the underlying processes'.⁶³ It is important, therefore, to '...distinguish between dynamism as a *process* at continuous work in the economy and *indicators* of it...' as '...movements in the imperfect proxies may reflect factors unrelated to real dynamism in an economy'.⁶⁴
- 3.67 The Productivity Commission also pointed out that economic dynamism depended on many other factors beyond competition—including levels of entrepreneurship, business regulation, labour market mobility and flexibility, the degree of technology diffusion across firms, and levels of investment.⁶⁵

⁵⁸ Dr Owen Freestone, Assistant Secretary, Competition Review, Treasury, *Committee Hansard*, 15 September 2023, p. 29.

⁵⁹ Dr Stephen King, Commissioner, Productivity Commission, *Committee Hansard*, 15 September 2023, p. 58.

⁶⁰ C Lagarde, 'Hearing of the Committee on Economic and Monetary Affairs of the European Parliament', Speech, 5 June 2023, www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230605~0aadd43ce7.en.html.

⁶¹ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 6.

⁶² Dr Owen Freestone, Assistant Secretary, Competition Review, Treasury, *Committee Hansard*, 15 September 2023, p. 23.

⁶³ Productivity Commission, *Submission 1*, p. 4.

⁶⁴ Productivity Commission, *Submission 1*, p. 4.

⁶⁵ Dr Stephen King, Commissioner, Productivity Commission, *Committee Hansard*, 15 September 2023, p. 60.

Committee comment

- 3.68 The Committee recognises that a meticulous examination of data related to market competition in Australia is needed to comprehend the decline in national productivity growth. Such a comprehensive analysis will unveil insights into the complexities, challenges, and ramifications associated with the low productivity of recent years.
- 3.69 Despite the data limitations outlined above, the Committee recognises that data collection and analysis has undergone significant transformation in the past decade. Thanks to the availability of more detailed and high-quality data at the firm level, we now possess the ability to discover insights into competition and market dynamics that were once hidden due to the constraints of sector-level or economy-wide data.
- 3.70 Consequently, the Committee emphasises the critical role of data collection, particularly firm-specific data, in shaping effective policies. The rapid evolution in both the availability and quality of data underlines the pressing necessity for policymakers and government agencies to harness this wealth of information to devise more impactful policy. By actively engaging with these data-driven opportunities, the Committee is confident that the Government can foster a marketplace that is both more competitive and dynamic.
- 3.71 The Committee believes that such an approach is especially pertinent given the current gaps in our understanding of productivity trends, competition, and economic vitality. Enhancing the availability of both firm-level and sector-level data becomes imperative, as variations in firm productivity, along with the underlying factors, which may include aspects of competition and economic dynamism, have significant implications for allocative efficiency and overall sector and economy-wide outcomes.
- 3.72 On this point of gaps in our understanding, the Committee has reviewed evidence highlighting the strategic use of microdata in refining competition policy. As stated by the Hon Dr Andrew Leigh, Assistant Minister for Employment and for Competition, Charities and Treasury in his January 2024 speech, 'Game Changer: Harnessing Microdata for a Fairer Competition Landscape',

Economic dynamism will always be a difficult concept to neatly bundle up and measure as there are so many variables, but microdata can provide new insights. ... Microdata includes survey data from the Australian Bureau of Statistics as well as de-identified administrative data sourced from government agencies such as the Australian Taxation Office and IP Australia...A few key projects (from the Competition Taskforce's research program) include a newly developed tool that tracks merger activity and an investigation of the impact of competition in the aviation sector in recent decades.⁶⁶

⁶⁶ The Hon Dr Andrew Leigh MP, Assistant Minister for Employment and Assistant Minister for Competition, Charities and Treasury, 'Game changer: harnessing microdata for a fairer competition landscape', Speech, 30 January 2024, ministers.dewr.gov.au/leigh/game-changer-harnessing-microdata-fairer-competition-landscape, viewed 28 February 2024.

Box 3.2 Key findings

Trends in competition and economic dynamism

- On some key metrics—including market share of the largest firms, price mark-ups, and firm entry/exit—*the level of competition and dynamism across the economy* has declined over recent years, based on the predominance of evidence put to the Committee. However, the Committee also acknowledges data limitations in these fields.
- On some key metrics—including market share of the largest firms, price mark-ups, and firm entry/exit—*the level of competition and dynamism within some sectors of the economy* has declined over recent years, based on the predominance of evidence put to the Committee. However, the Committee also acknowledges data limitations in these fields.
- It is important to assess not just the level of competition and economic dynamism in the economy—but also the impact of these indicators on key economic and social outcomes, including standards of living, productivity growth, real wages growth, and the cost of living.

The link between competition, economic dynamism and productivity growth

- The reduction in competition in some sectors of the economy may have consequences for the medium and long-run performance of the economy and, in particular, for economy-wide productivity growth rates.
- The long-run relationship between productivity growth and living standards implies that there is also a relationship between levels of competition and living standards in the long-run.
- Improving the level of competition—either across the economy or at the sectoral level—will improve the medium and long-term performance of the economy and outcomes for consumers.
- Improving the level of economic dynamism—including through measures that support research and the commercialisation of new products and services, better regulation and investment in skills—will support higher levels of long-term productivity growth and innovation.
- The level of economic dynamism will also impact the productivity growth rate, in particular through levels of innovation, the expansion of productive firms, and the commercialisation of new ideas.

Recommendation 1

3.73 That the Australian Government seek to better understand trends in both labour productivity and multi-factor productivity.

Enhancing the availability of firm-level and sector-level data is vital, especially considering that variations in firm productivity have a significant impact on

factor allocation and overall sector-level and economy-wide productivity outcomes.

Recommendation 2

3.74 That key government agencies strengthen their capacity to analyse firm-level data.

Some of this data may already be in the possession of government in collection agencies such as the Australian Taxation Office and the Australian Prudential Regulation Authority. A greater emphasis on using this data to inform policy-making would need to take account of privacy and other considerations.

Recommendation 3

3.75 That an appropriate government agency gather more detailed and higher-quality data related to profits, including Earnings before Interest, Taxes, Depreciation and Amortisation (EBITDA) rates and Return on Equity (ROE).

Recommendation 4

3.76 That the Australian Bureau of Statistics assemble data on the market shares of the largest firms in key sectors and report this over time.

Recommendation 5

3.77 That the Government's Business Longitudinal Analysis Data Environment (BLADE) dataset include price levels.

That the Government consider expanding third party access to the BLADE dataset.

Recommendation 6

3.78 That the Australian Competition and Consumer Commission's capacity to analyse large microdata sets be enhanced.

Recommendation 7

3.79 That the Australian Competition and Consumer Commission be given oversight of market concentration powers.



4. Economy-wide measures to boost competition and economic dynamism

National Competition Policy in need of renewal

- 4.1 The Committee heard that national competition policy—covering federal, state and territory jurisdictions—was no longer fit-for-purpose in several areas and needs to be revitalised.

The legacy of the Hilmer Review

- 4.2 The Hilmer Review of 1993 provided the foundation of Australia’s modern national competition policy framework.¹
- 4.3 Its recommendations paved the way for the establishment of the Australian Competition and Consumer Commission (ACCC) and the National Competition Council (NCC).
- 4.4 Reforms to the Trade Practices Act ended anomalies experienced by commercial entities arising from the division of constitutional authority between federal and state governments and provided a new regulatory regime to block natural monopolies from abusing their market power.
- 4.5 The resulting intergovernmental Competition Principles Agreement, agreed at the 1995 meeting of the Council of Australian Governments, included two key elements:
- That regulation and legislation be reviewed for their impact on competition—in other words, does the public benefit exceed the cost?
 - That state-owned entities, before engaging in commercial activity, be subject to ‘competitive neutrality’ requirements to address any market distortions that could potentially affect private businesses.
- 4.6 The Productivity Commission described competitive neutrality as follows:
- ...the proposition that state owned enterprises and private businesses should compete on a level playing field. Competitive neutrality policy is also concerned

¹ Professor F G Hilmer, M Rayner and G Taperell, ‘National Competition Policy Review’, 25 August 1993, <http://ncc.ncc.gov.au/pages/overview>, viewed 2 October 2023

with government businesses that may compete with each other. It has long been recognised that favourable conditions for government enterprises, in relation to their private sector counterparts, can distort all kinds of economic decisions, particularly around innovation, investment and hiring, ultimately leading to suboptimal outcomes for consumers and workers. Artificial cost advantages can also lead to resources like capital and labour flowing to government businesses simply because of their government ownership rather than them being the most efficient users of those resources. Where resource allocation distortions occur, the nation's productivity suffers.²

- 4.7 A 2005 Productivity Commission review found that the post-Hilmer National Competition Policy improvements delivered an increase to GDP of at least 2.5 per cent. This did not include the 'dynamic' benefits of more competitive markets resulting from the reforms, 'such as the stronger incentives for service providers to continue to improve their productivity and quality and to innovate in order to achieve competitive advantage'.³

Harper Review

- 4.8 A subsequent competition policy review, between 2013–2015, was led by Professor Ian Harper. The review made sweeping recommendations for the reform of competition law and changes to competition policy and competition policy institutions. Recommendations included strengthening the misuse of market power prohibition, a simplification of the prohibitions against cartel conduct, a repeal of price signalling provisions, and the creation of an independent access and pricing regulator.
- 4.9 Additionally, the Harper Review provided a series of recommendations prioritising competition reform in the delivery of human services and infrastructure, and for reviews across jurisdictions of anti-competitive regulations, competitive neutrality, and government procurement guidelines. It also proposed a review of Australia's intellectual property regime.⁴
- 4.10 Several changes to Australian competition law ensued. These included provisions regarding misuse of market power, mergers, cartels and joint ventures, 'concerted practices', infrastructure access, and third party forcing and resale price maintenance.⁵

² Dr Alex Robson, Deputy Chair Productivity Commission, *Committee Hansard*, 15 September 2023, p. 57.

³ Productivity Commission, 'Review of National Competition Policy Reforms', 28 February 2005, p. xvii, www.pc.gov.au/inquiries/completed/national-competition-policy/report, viewed 2 October 2023.

⁴ Professor I Harper, P Anderson, S McCluskey and M O'Bryan QC, 'Competition Policy Review', March 2015, p. 8, treasury.gov.au/publication/p2015-cpr-final-report, viewed 2 October 2023.

⁵ The Hon Scott Morrison MP, Treasurer, 'Strengthened competition law – Harper reforms passed', *Media Release*, 18 October 2017.

National competition policy needs a refresh

- 4.11 Despite Hilmer’s positive impact, the consensus of witnesses was that the momentum for competition policy reform in Australia had long since stalled, especially because many key recommendations of the Harper Review had not been implemented—notwithstanding the legislative changes referenced above.
- 4.12 The NCC told the Committee that the intended successor to the post-Hilmer 1995 Competition Principles Agreement, the post-Harper 2016 Intergovernmental Agreement on Competition and Productivity, had not been agreed to by all the states.⁶ This meant there were no national competition principles currently in operation and that adherence to competitive neutrality and reviews of potentially anti-competitive provisions in legislation had ‘waned somewhat’.⁷
- 4.13 Evidence of the competition policy drift, the NCC continued, included the fact that the NCC had not been directed since to review the competitive neutrality policies of the Commonwealth, states and territories, despite the need for ‘focused attention’ in this area.⁸
- 4.14 The NCC added that it firmly supported the 2015 Harper Review’s recommendations that a public interest approach be reinstated to assess the impact on competition of legislation and regulation. This was because:
- ...there’s no doubt that anti-competitive elements that shouldn’t be there have crept into legislation in most or all jurisdictions. In particular, there hasn’t been a cost-benefit or public interest test (different from a RIS) about whether there’s a net benefit to having those regulations.⁹
- 4.15 Similarly, the Productivity Commission told the Committee that the time had come for reforms to national competitive neutrality policy, particularly as Australia had recently signed up to the OECD’s recommendation in this area.¹⁰ The limitations of the current regime, the Commission continued, were extensive:
- ...the policy lacks a credible enforcement regime; there’s a lack of guidance on what a public interest test should embody and what it should look like; there are poor processes to ensure compliance with the policy by startup government businesses; there’s little guidance or principles on what constitutes ‘government’

⁶ Mr Martin Wallace, Councillor, National Competition Council, *Committee Hansard*, 15 September 2023, p. 16.

⁷ Mr Martin Wallace, Councillor, National Competition Council, *Committee Hansard*, 15 September 2023, p. 11.

⁸ Mr Martin Wallace, Councillor, National Competition Council, *Committee Hansard*, 15 September 2023, p. 16.

⁹ Mr Martin Wallace, Councillor, National Competition Council, *Committee Hansard*, 15 September 2023, p. 17.

¹⁰ In May 2021, the OECD adopted a recommendation that governments ‘ensure competitive neutrality to the maximum extent practicable and unless overriding Public Policy Objectives require otherwise’. See R Smith, D Healey, X Bai, ‘Competitive Neutrality: OECD Recommendations and the Australian Experience’, *Journal of Competition Law and Economics*, 19/2 (June 2023), pages 250–276.

in 'significant government business activities'; there's little guidance on which policy or complaints process should apply for business activities with multiple government owners; there's no mention of the full range of possible material competitive advantages, other than those relating to tax, debt and regulatory neutrality and any commercial rate of return, and there's poor guidance on methodologies for estimating the value of some advantages; there's an absence of guidance on whether any identified cost advantages should be addressed by the imposition of an adjustment payment or by directly addressing the source of the advantage; and, finally, there's a need to reformulate the commerciality test of competitive neutrality policy.¹¹

- 4.16 In addition, the Productivity Commission advised, implementation of the competitive neutrality principles was poor. Investigations (conducted by the Australian Government Competitive Neutrality Complaints Office within the Productivity Commission) depended on 'goodwill more than anything'. No time frames for responses from the relevant parties meant that the process extended excessively or was not completed. On the enforcement side, there was little incentive for jurisdictions to act on investigation recommendations because national competition policy payments from the Commonwealth to the states and territories (based on satisfactory progress against reform objectives) lapsed almost twenty years ago. To the Commission's knowledge, there had only been one competitive neutrality complaint resulting in a competition case.¹²

A national regulator for co-operatives

- 4.17 The inquiry also heard from the Business Council of Co-operatives and Mutuals (BCCM) about its role in helping build a strong, resilient and inclusive economy. The purpose of co-ops and mutuals is to deliver benefits back to members, rather than profit maximisation to investors.
- 4.18 In 2022 some 1,832 active co-operative and mutual enterprises operated in Australia. These firms had a combined 31.7 million memberships, generated \$203 billion in revenue, managed over \$1.28 trillion in assets, and directly employed at least 76,000 people.
- 4.19 The BCCM raised concern over demutualisation in recent decades, which had significantly reduced diversity. It submitted that the stated rationale is the need for additional capital to develop the business, noting that 'However, the actual experience of demutualisation is that most businesses soon ceased to trade as independent entities as they were merged into larger consolidated groups.'¹³ Further, the BCCM claimed that 'legislation governing co-operatives and mutual enterprises (CMEs) actually incentivises demutualisation by permitting legacy assets to be distributed.'¹⁴

¹¹ Mr Alex Robson, Deputy Chair, Productivity Commission, *Committee Hansard*, 15 September 2023, p. 57.

¹² Dr Stephen King, Commissioner, Productivity Commission, *Committee Hansard*, 15 September 2023, p. 65.

¹³ Business Council of Co-operatives and Mutuals, *Submission 4*, p. 10.

¹⁴ Business Council of Co-operatives and Mutuals, *Submission 4*, p. 11.

- 4.20 In some countries, legislation prohibits the distribution of such capital. Instead, it must be used for the purpose intended by the original founders or otherwise transferred to a different CME to fulfil this objective. In those jurisdictions where legacy assets are not available for distribution, demutualisation is less common and as a consequence, large CMEs maintain their member ownership, reflecting significant mass in a range of markets.
- 4.21 The BCCM stated that in Australia, there are no legislative restrictions on the distribution of assets and as a result, waves of demutualisation have occurred, starting in the late 1980s and 1990s.
- 4.22 The BCCM called for voluntary legislation, such as is being implemented in the United Kingdom, to ensure legacy assets are preserved for the purpose they were intended and not the subject of asset raids.

A job for the Competition Review

- 4.23 Witnesses agreed that the current Competition Review, announced by the Treasurer, the Hon Dr Jim Chalmers MP, in August 2023,¹⁵ was the best means for developing a new round of national competition policy reforms.
- 4.24 The Competition Review recently released a consultation paper and is inviting public submissions. The consultation paper covers emerging concerns related to Australia's merger rules and processes, and presents a variety of options for change. This is intended to be the first in a number of stages.¹⁶
- 4.25 The NCC said it was 'very confident' the Review would consider the competition issues outlined above and that it would need to 'pick those reforms that are going to deliver the best outcome for the investment made in them'.¹⁷ The NCC also emphasised the importance of a shared agreement and commitment between jurisdictions about the priority areas for reform, aligning incentives across states and territories, and then 'independent monitoring of reform delivery'.¹⁸
- 4.26 Similarly, on the issue of competitive neutrality, the Productivity Commission identified the Review as the appropriate vehicle for reconsidering policy.¹⁹
- 4.27 Treasury, in response, told the Committee it looked forward to working with states and territories on competition reforms, that it had a 'specific mandate' to do so, and

¹⁵ On 23 August 2023, the Treasurer announced an Australian competition review. A Treasury taskforce is coordinating the review, which will run for 2 years and focus on the government's priorities for modernising the Australian economy. Treasury, *Competition Review*, treasury.gov.au/review/competition-review-2023, viewed 31 December 2023.

¹⁶ Treasury, *Merger Reform*, treasury.gov.au/consultation/c2023-463361, viewed 11 February 2024.

¹⁷ Mr Martin Wallace, Councillor, National Competition Council, *Committee Hansard*, 15 September 2023, p. 12.

¹⁸ Mr Martin Wallace, Councillor, National Competition Council, *Committee Hansard*, 15 September 2023, p. 11.

¹⁹ Dr Alex Robson, Deputy Chair Productivity Commission, *Committee Hansard*, 15 September 2023, p. 58.

that such work would be progressed through the Council on Federal Financial Relations.²⁰ Treasury added that competition policy reform aligned with the priorities of like-minded countries, notably the United States, the United Kingdom and Canada.²¹

4.28 The Committee notes that boosting national competition policy could take a number of forms:

- A reinvigorated National Competition Council;
- A more explicit coupling of competition policy and enforcement in the ACCC's regulatory arrangements; or
- A competition role in another body, such as the Productivity Commission.

Recommendation 8

4.29 That the Treasurer's Competition Policy Taskforce examine governance arrangements for the development and advancement of competition policy and institutions, including explicit consideration of whether this would best be achieved by the creation of a new institution responsible for developing competition policy or, instead, the allocation of this responsibility to an existing institution (with suitable resourcing).

Recommendation 9

4.30 That the Treasurer's Competition Policy Taskforce examine whether competitive neutrality principles require updating.

Recommendation 10

4.31 That the Treasurer's Competition Policy Taskforce examine the establishment of a single national regulator for co-operatives and mutuals.

- **Now that co-operatives national law has been consistently adopted across all states and territories, a single regulator would ensure national consistency and access to full information about co-operatives and mutuals.**
- **Such a process should be managed under a principle of no disadvantage—adopting best practice from different jurisdictions and ensuring all types of co-operatives and mutuals are treated equally and fairly.**
- **Consideration of such a measure should include an assessment of its impact on the broader banking sector.**

²⁰ Mr Marcus Bezzi, Chief Adviser, Competition Taskforce Division, Treasury, *Committee Hansard*, 15 September 2023, pages 21, 25.

²¹ Mr Jason McDonald, Division Head, Competition Taskforce Division, Treasury, *Committee Hansard*, 15 September 2023, p. 21.

Merger laws

- 4.32 The inquiry received substantial evidence that Australia's pre-merger notification arrangements were not conducive to a competitive environment. Witnesses also saw the current merger test as falling well short of international best practice.

Australia's merger regime

- 4.33 Though most mergers are not anti-competitive and can be beneficial, an effective merger regulatory regime could prevent transactions that were likely to be anti-competitive. A strong merger regime was therefore essential to maintaining 'competitive, dynamic and resilient markets'.²²

Inherent weaknesses

- 4.34 Australia's mergers review regulatory framework is a voluntary system. There is no legal requirement to notify the relevant regulator, the ACCC, of a proposed merger.
- 4.35 Such an approach, the ACCC argued to the Committee, was no longer fit for purpose and was 'out of step with international best practice'. It could result in late, incomplete, or non-notification to the ACCC of a potentially anti-competitive merger. In certain circumstances, the ACCC may be able to take action in the Federal Court to prevent or unwind a merger. However, the ACCC—rather than the merger parties—bore the burden of evidentiary proof. The ACCC summarised the future risk to competition of the current mergers review regime as follows:

The future is inherently uncertain and is particularly so where markets are dynamic and there are complex commercial environments, as is increasingly the case. This is particularly difficult in circumstances involving the acquisition of a potential or nascent competitor, where the potential for competitive harm can be profound but where there is also considerable uncertainty about the future of competition. Since a court must be convinced of the future state of the market, this uncertainty can be the driving factor behind difficulties proving a breach of section 50 rather than an absence of risk to competition. Where there are risks that a merger will result in significantly less competition, it is the public interest rather than the merger parties, that ends up bearing the risk in our current merger regime.²³

- 4.36 The Committee heard from former ACCC chair Professor Rod Sims that Australia had 'the weakest merger regime of any country we compare ourselves to'. Professor Sims summarised the differences thus:

All those other countries have a regime where you have to notify the regulator. You have to get some form of approval before you can proceed. The regulator

²² ACCC, *Submission 34*, p. 1.

²³ ACCC, *Submission 34*, p. 2.

gets to form a view and gets to call in a lot of information. Our law doesn't do any of that. It simply says, 'Don't have a merger or acquisition that is likely to substantially lessen competition.' Essentially that's it. There is an informal regime, where people knock on the ACCC's door and say, 'Look, if we go ahead, are you likely after the event to come after us, because we would like to know upfront?' There's no requirement on them to do that.²⁴

- 4.37 The Committee also heard that shortcomings in the management of merger reviews could be having a material impact on the level of competition in some sectors of the economy. Professor Sims observed that under the current arrangements, the ACCC had not been able to prevent mergers in 'energy, telecommunications, railways, and a whole range of sectors' and that this had damaged the economy.²⁵
- 4.38 In August 2023, for example, the ACCC blocked ANZ Bank's \$4.9 billion takeover of Suncorp's banking arm, on the grounds that the acquisition would 'further entrench an oligopoly market structure that is dominated by the four major banks.' However, the decision was appealed, and in February 2024, the Australian Competition Tribunal overturned the ACCC's ruling.²⁶

Tracking mergers

- 4.39 Treasury's Competition Taskforce has just developed Australia's first whole of economy approach to tracking mergers and acquisitions.²⁷ This includes the first mergers database for Australia using administrative data, which gives a more complete picture of mergers and acquisitions.
- 4.40 Under the voluntary notification system, the ACCC has considered about 330 mergers each year on average over the past decade. Initial results from the mergers database tracking labour flows suggests there are many more mergers than this each year—somewhere between 1,000 and 1,500. For every merger that is notified to the ACCC, there are two to four more mergers and acquisitions that take place.
- 4.41 The database shows that most target firms are medium-sized businesses, while acquisitions are disproportionately made by very large firms (which account for less than 1 per cent of the universe of firms). It also shows that merger activity by very large firms increased over the 2010s.
- 4.42 The database also shows merger target firms are more likely to have a trademark or patent compared to an average firm. Merger target firms are more than twice as likely to have a patent (0.4 per cent relative to 0.15 per cent of firms overall) and almost twice as likely to have a trademark (4.5 per cent relative to 2.4 per cent of all firms).

²⁴ Professor Rod Sims, Private capacity, *Committee Hansard*, 2 May 2023, p. 18.

²⁵ Professor Rod Sims, Private capacity, *Committee Hansard*, 2 May 2023, p. 17.

²⁶ ACCC, 'Australian Competition Tribunal authorises ANZ's proposed acquisition of Suncorp Bank', *Media Release*, 20 February 2024.

²⁷ Competition Review Taskforce, 'Tracking mergers in Australia using worker flows', treasury.gov.au/review/competition-review-2023/mergers, viewed 11 February 2024.

This highlights the purchase of intellectual property as a possible motivating factor behind mergers.

- 4.43 Additionally, the database demonstrates that merger activity is more frequent in the manufacturing, retail, professional services, and health and social services sectors.

ACCC proposed reforms

Changes to the merger review process

- 4.44 The ACCC's inquiry submission has proposed changes to improve both the merger review process and the merger law.²⁸
- 4.45 The current process places the onus on the ACCC to show why a potentially anti-competitive merger should not proceed.
- 4.46 The ACCC has suggested instead a mandatory suspensory formal clearance regime—in essence requiring merger parties proposing a transaction above a prescribed notification threshold to demonstrate that the merger would not 'significantly reduce competition'. This model would include transparent information requirements and review timeframes, a notification waiver option for proposals that meet the threshold but with a low risk of a substantial lessening of competition and provide the ACCC with greater discretion to consider cases below the threshold but that still raise competition concerns. The process reforms would also have a judicial review mechanism and a second stage public benefit test for a disallowed merger—enabling the merger to still proceed 'where the competition effects are outweighed by real, verifiable, and substantial public benefits'.²⁹
- 4.47 The ACCC summarised the benefits of its proposed clearance system as follows:
- An appropriately designed formal clearance system would provide greater transparency, accountability and ensure the ACCC has sufficient time to consider the competition effects of proposed mergers, while providing more timing certainty for the merger parties. It could also transition from the existing taxpayer funded regime towards a user pays approach, and provide greater consistency in the assessment of domestic and foreign acquirers (which are subject to a mandatory and suspensory regime under the Foreign Acquisitions and Takeovers Act 1975 (Cth)). In addition, the notification waiver process explained above would allow for a quick and simple process for the many mergers that do not give rise to competition concerns.

Changes to the merger law

- 4.48 The ACCC submission also advocates for changes to the relevant governing legislation for mergers, section 50 of the *Competition and Consumer Act 2010* (the

²⁸ ACCC, *Submission 34*, p. 2.

²⁹ ACCC, *Submission 34*, pages 2–3.

‘Act’) to ‘better focus the merger assessment on the structural conditions for competition in markets most at risk of the exercise of market power, and on identifying the competition lost when the acquirer has substantial market power’.³⁰

- 4.49 As it stands, the ACCC advised, section 50 is inadequate in addressing creeping acquisitions by a dominant firm of smaller or potential competitors. This is due to its focus on whether the incremental change from a single acquisition results in a substantial lessening of competition rather than on whether the acquisition increases or enhances a firm’s position of market power—which is a particular concern regarding digital platforms.³¹
- 4.50 The ACCC submission has proposed that section 50 be changed to expressly state that a substantial lessening of competition includes ‘entrenching, materially increasing or materially extending a position of substantial market power’, aligning it with a similar provision in the European Commission’s merger test.³²
- 4.51 It also proposes several wording changes to the guiding factors in section 50(3) of the Act, which governs the issues to be taken into account when assessing ‘substantial lessening of competition’. This is to bring greater clarity and scope to the mergers review regime, particularly in considering the effects on competition of dominant firms potentially controlling data and technology.³³

Support for the ACCC proposals

- 4.52 The Committee heard broad support for the ACCC’s proposed changes to the merger review regime.
- 4.53 Another former ACCC chair, Professor Allan Fels, was in general agreement with the ACCC’s proposed changes to the merger review process and law, viewing it as an area of critical reform to tackle declining competition in Australia. The limitations of the current regime, Fels believed, had seen the ACCC lose ‘a lot of merger cases lately not due to their poor litigation skills’. This contrasted with the US, which still ‘reject some mergers’, and the European Union, where there’s ‘far more merger rejection’.³⁴
- 4.54 Professor Fels agreed that a compulsory pre-merger notification should be legislated, aligning Australia with ‘North America, Europe and most of the rest of the world’. Pre-merger notification would also mean that when international mergers involving Australian entities were approved overseas, the effects on the Australian market structure can be assessed.³⁵ Additionally, Fels supported the ACCC being empowered to make legally binding determinations on whether a proposed merger breaches the Act on the grounds of a reduction in competition. This should have an

³⁰ ACCC, *Submission 34*, p. 3.

³¹ ACCC, *Submission 34*, p. 3.

³² ACCC, *Submission 34*, p. 3.

³³ ACCC, *Submission 34*, pages 3–4.

³⁴ Professor Allan Fels AO, Private capacity, *Committee Hansard*, 18 May 2023, pages 1, 5.

³⁵ Professor Allan Fels AO, Private capacity, *Committee Hansard*, 18 May 2023, p. 3.

associated ‘merits based’ appeal process through the Australian Competition Tribunal that would ‘in essence review the principles that governed the ACCC decision and the adequacy of the evidence’.³⁶

- 4.55 Professor Fels agreed that the wording of the Act should be ‘tweaked’ by adding some words to enable the ACCC to focus on ‘whether or not the merger creates, or adds to, a substantial degree of market power’.³⁷
- 4.56 Separately, Professor Sims had proposed merger regime reforms in 2021 while chair of the ACCC. He also firmly supported the ACCC’s proposed reforms suggested in its submission, noting that the ACCC had consulted widely with him and others on the subject. Professor Sims told the Committee it was now time to bring the ACCC proposals to parliament as draft legislation.³⁸
- 4.57 The e61 Institute deferred to the ACCC as best placed to advocate for changes to the merger review regime. The e61 Institute’s concern with the current system was that its voluntary nature could miss important mergers and acquisitions. In particular, the e61 Institute warned of the phenomenon of ‘midnight’ mergers, whereby large firms acquired smaller firms one by one without scrutiny. Each acquisition looks insignificant in isolation but taken cumulatively, the practice can dramatically affect concentration in a market. For these reasons, in the e61 Institute’s view, questions about thresholds and how ‘substantial lessening of competition’ was defined and measured in the future were key.³⁹ The Committee notes that the proposed ACCC reforms seek to address these questions.
- 4.58 Professors Flavio Menezes and John Quiggin held similar views to the ACCC. Professor Menezes told the Committee that the decline of competition highlighted the inadequacy of Australia’s ‘more passive approach to assessing mergers’. Like others, Professors Menezes and Quiggin supported a mandatory notification regime, and empowering the ACCC to ‘independently initiate market studies and investigations along with considering the adoption of a per se rule that prohibits dominant firms from acquiring businesses in markets already lacking sufficient competition’.⁴⁰ An additional justification for a mandatory regime, Professor Menezes continued, was to give the ACCC sufficient time to analyse the effect of a proposed merger on a market—an important consideration given the complexity of the issues at hand.⁴¹
- 4.59 Professor Deborah Healey and Dr Rhonda Smith agreed that merger provisions required ‘urgent review and improvement, as they are difficult to enforce even in a non-digital environment but are particularly so in a digital environment’. They voiced similar concerns to others over the ‘substantial lessening of competition’ test and saw

³⁶ Professor Allan Fels AO, *Submission 31*, p. 2.

³⁷ Professor Allan Fels AO, *Submission 31*, pages 2–3.

³⁸ Professor Allan Fels AO, Private capacity, *Committee Hansard*, 2 May 2023, p. 17.

³⁹ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 3.

⁴⁰ Professor Flavio Menezes, Private capacity, and Professor John Quiggin, Private capacity, *Committee Hansard*, 18 May 2023, p. 15.

⁴¹ Professor Flavio Menezes, Private capacity, *Committee Hansard*, 18 May 2023, p. 16.

as vital some form of public benefit analysis in the process. They told the Committee that:

The problem with mergers is that the current 'substantial lessening of competition' test administered by the courts is not working well. We agree with the ACCC that a system of compulsory notification over predetermined thresholds, with an administrative decision by the ACCC, would be better than the current situation. These could be appealed to the Australian Competition Tribunal, which has [fewer] issues around dealing with economic evidence because it's not bound by the Evidence Act.

... the commission has refined its suggestions, and we agree with some of those. There is still now a proposal to allow the weighing of a merger's anticompetitive detriment and public benefit, which the first tranche of suggestions had taken away. We think that's really important, because we will now, going forward, often be looking at issues like sustainability and supply chain issues, which may substantially lessen competition in a merger but do have overriding public benefits. So we think some form of public benefit analysis is essential.⁴²

- 4.60 Professor Healey and Dr Smith also highlighted that while the mergers test was necessarily a forward-looking process, it was complicated by the dynamic environment of a modern economy undergoing digital transformation. It meant that rather than base assessments on historical patterns, regulators may be better served in taking a risk assessment approach to the test. For this reason, the Australian Competition Tribunal would be preferable to the courts when it comes to the review aspect of a new mergers assessment regime—it was better-placed to take a strategic approach, grounded in economics, to understanding a planned merger's effect on a market rather than the 'very legalistic approach to competition law cases compared to other jurisdictions' taken by the Australian courts.⁴³ Dr Smith told the Committee that:

What we have normally done in the past is that we've recognised that things may change in the future but we've used the past as a guide to where we're heading. When you're looking at very dynamic environments it becomes much more difficult to predict what the situation is going to be, and we've developed this approach of saying what will happen with the merger and what will happen without the merger. It may well be that we're doing ourselves a disservice by approaching it that way and that really we should simply be asking: 'What is the likely effect of the merger? How is it going to change the environment?' But at the end of the day it becomes something of a risk analysis. We can make forecasts about what the future might look like, but we need to attach certain probabilities or risks to those forecasts. That may not be something that is easily managed in a court. It's much more easily managed where the rules of evidence are still

⁴² Professor Deborah Healey, Faculty of Law and Justice, University of New South Wales, and Dr Rhonda Smith, Private Capacity, *Committee Hansard*, 18 May 2023, p. 31.

⁴³ Professor Deborah Healey, Faculty of Law and Justice, University of New South Wales, and Dr Rhonda Smith, Private capacity, *Committee Hansard*, 18 May 2023, p. 33.

thought about but not applied in the strict sense that the court applies them. That's the big difference between the court and the tribunal.⁴⁴

The Productivity Commission's alternate view

- 4.61 The Productivity Commission was the only witness firmly opposed to the ACCC-proposed reforms to the merger review regime.
- 4.62 In its most recent 5-year productivity inquiry, released in March 2023, the Productivity Commission stated that 'it is unclear whether the need for legislative reform would remain if the regulator [the ACCC] were to augment its approach to litigation'. The Commission cited Federal Court findings that the ACCC's use of economic theory and modelling was 'unconvincing' on merger cases, given the commercial realities facing businesses. The Commission added that mergers could enhance productivity by better allocating resources 'so long as the market remains competitive'. The Commission also stated that the proposed reforms placed 'a great deal of power with the regulator, necessitating some other avenue of accountability'.⁴⁵ It told the Committee that:

on merger policy, we conclude that, overall, there doesn't appear to be a strong case for the implementation of a new formal authorisation regime of the kind proposed by the former chair of the ACCC. Instead, we think that there may be more value in the ACCC further considering its internal merger review processes and government considering how best to avoid perverse incentives across merger clearance procedures.⁴⁶

Merger policy: the path forward

- 4.63 Treasury advised that the current merger regime would be an 'immediate focus' of the current Competition Review.⁴⁷ The review would examine whether the current arrangements remain fit for purpose, particularly in the digital age, and would consider all options, from maintaining the status quo through to adopting the ACCC's proposed reforms. Treasury told the Committee that:

Mergers can be an important means for improving productivity by capturing synergies, achieving economies of scale or embedding superior management practices in the merged business. However, today we have a better appreciation of potential costs to consumers and the broader economy of mergers that reduce competition, both here and internationally. This reflects better data and more detailed ex post reviews by the ACCC.

⁴⁴ Dr Rhonda Smith, Private capacity, *Committee Hansard*, 18 May 2023, pages 32–33.

⁴⁵ Productivity Commission, '5-year Productivity Inquiry: A competitive, dynamic and sustainable future', 17 March 2023, p. 15, www.pc.gov.au/inquiries/completed/productivity/report/productivity-volume3-future.pdf, viewed 2 October 2023.

⁴⁶ Dr Alex Robson, Deputy Chair, Productivity Commission, *Committee Hansard*, 15 September 2023, p. 57.

⁴⁷ Mr Jason McDonald, Division Head, Competition Taskforce Division, Treasury, *Committee Hansard*, 15 September 2023, p. 21.

At the same time, digital data technologies are changing the way that businesses interact with the marketplace, which can make consumers more vulnerable for a given level of market power. Mergers policy has always been risk based, so it's appropriate to reconsider a policy as risks and the opportunities for managing them can change over time. We will be looking at all options, ranging from maintaining the status quo to the various reforms proposed by the ACCC. We'll also be consulting publicly with stakeholders and commissioning data analysis to help both the government and the community decide how best to go forward.⁴⁸

- 4.64 This would indicate that pre-merger notification be required at a stage of interaction such that it would not unduly impact on discussions between firms that may lead to productive mergers.

Recommendation 11

- 4.65 That, above a suitable threshold, pre-merger notification to the Australian Competition and Consumer Commission should be required.**

Recommendation 12

- 4.66 That the Treasurer's Competition Policy Taskforce examine whether, above an appropriate threshold, merger transactions should be suspended from completion without Australian Competition and Consumer Commission clearance.**

Recommendation 13

- 4.67 That the Treasurer's Competition Policy Taskforce examine the suitability of the current merger test.**

Labour mobility

- 4.68 As discussed in Chapter 3: Key empirical findings, labour mobility refers to the propensity of the average worker to change jobs and is an important factor in economic dynamism. The percentage of workers taking on new jobs each year is declining, raising important questions about barriers to labour mobility, which include non-compete clauses, non-poach agreements, and differences in occupational licensing.
- 4.69 The Committee heard that declining labour mobility had been shown to be a relevant factor in Australia's productivity slowdown and reduced wage growth. The e61 Institute observed that:

⁴⁸ Mr Jason McDonald, Division Head, Competition Taskforce Division, Treasury, *Committee Hansard*, 15 September 2023, p. 20.

...the leading Australian studies about productivity slowdown show that about one-quarter of the productivity slowdown is accounted for by the decline in labour allocation from less productive to more productive firms. That's very much connected to the decline in job mobility we've seen in the economy.... Anything that basically slows down that productivity enhancing reallocation is going to be bad for wages. We also know that productivity growth is driven by what happens within firms. We know, for instance, in a more competitive environment where basically more start-up firms are entering and so forth, that places indirect pressure on incumbents to innovate and adopt new technologies. When we have less created destruction and we have less mobility in the economy there is going to be less pressure on incumbent firms to do those good things that lift their productivity.⁴⁹

- 4.70 The Committee also heard from Treasury that US research indicated that new-entry firms were the biggest losers from constraints on labour mobility, such as non-compete clauses. This is because such firms rely on picking up workers with the latest skillsets. Constraints on labour movement thus 'make it more difficult for them [new entry firms] to compete' with incumbent firms.⁵⁰
- 4.71 The importance of declining labour mobility meant the inquiry was focused on what changes could make it easier for workers to switch jobs. In particular, the inquiry received evidence that removing or limiting the use of non-compete clauses would help remove an increasing barrier to labour mobility.
- 4.72 The Committee notes that the current Competition Review includes consideration of non-compete and related clauses that restrict workers from shifting to better-paying jobs.⁵¹
- 4.73 It is important to view labour mobility in a broader policy context. While boosting job switching may increase productivity, it is important to supplement this with appropriate supports such as targeted social insurance and access to mid-career training opportunities.

Non-compete clauses

- 4.74 A non-compete clause is a clause in a contract where an employee agrees not to work for an employer in a similar industry or area for a period of time after their employment with the first employer finishes.⁵² These clauses can prevent an

⁴⁹ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 28 August 2023, p. 10.

⁵⁰ Dr Owen Freestone, Assistant Secretary, Competition Review, Treasury, *Committee Hansard*, 15 September 2023, p. 27.

⁵¹ The Hon Dr Jim Chalmers MP, Treasurer, 'A more dynamic and competitive economy', *Media release*, 23 August 2023.

⁵² Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 28 August 2023, p. 8.

employee moving to a rival firm but can also prevent an employee from starting up a competing firm.⁵³

Prevalence in the Australian context

- 4.75 The e61 Institute, in collaboration with the Susan McKinnon Foundation, surveyed 3,000 Australian workers who had changed jobs over the 12 months to May 2023.⁵⁴ The survey, conducted online, indicates that at least one in five Australian workers is subject to a non-compete clause, while one-half of the workforce is subject to a post-employment restraint.⁵⁵ The prevalence of non-compete clauses differs depending on occupations. Managers have the highest level of exposure at 39 per cent, while clerical workers and labourers have the lowest at 14 per cent.⁵⁶
- 4.76 The e61 Institute also obtained qualitative evidence from legal practitioners, which revealed that non-compete clauses now apply to outward-facing customer roles—childcare workers, yoga instructors and in-vitro fertilisation specialists for example—and have become more prevalent over time. Indeed, non-compete clauses are now a default option in many employment contract templates.⁵⁷
- 4.77 In response to a question about its confidence levels in the online survey results, the e61 Institute told the Committee that the United States' experience indicated that online polls were a reliable gauge. The Institute said that it expected the true prevalence of non-compete clauses in Australia to be even higher than suggested by the survey results, explaining it thus:

I think the US experience is very instructive here. In 2014, Evan Starr and fellow coauthors conducted a similar exercise in the context of an online poll of 11,000 US workers. We've taken the same questions from that original measurement. They found that 18 per cent of US workers were subject to non-competes. Three years later, the Bureau of Labor Statistics in the US conducted a more efficient survey in the context of their more robust sampling methods. They found exactly the same result in terms of prevalence. These online polls can provide a reliable gauge. Secondly, these online polls have been asking workers about their experience of non-competes. There is a question about awareness here. One of the things we do in our poll is only ask those workers who've changed jobs within

⁵³ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 28 August 2023, p. 8.

⁵⁴ D Andrews and B Jarvis, *The Ghosts of Employers Past: How Prevalent are Non-Compete Clauses in Australia?*, e61 Institute, June 2023, e61.in/the-ghosts-of-employers-past-how-prevalent-are-non-compete-clauses-in-australia/, viewed 2 October 2023.

⁵⁵ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 28 August 2023, p. 9.

⁵⁶ D Andrews and B Jarvis, *The Ghosts of Employers Past: How Prevalent are Non-Compete Clauses in Australia?*, e61 Institute, June 2023, e61.in/the-ghosts-of-employers-past-how-prevalent-are-non-compete-clauses-in-australia/, viewed 2 October 2023.

⁵⁷ D Andrews and B Jarvis, *The Ghosts of Employers Past: How Prevalent are Non-Compete Clauses in Australia?*, e61 Institute, June 2023, e61.in/the-ghosts-of-employers-past-how-prevalent-are-non-compete-clauses-in-australia/, viewed 2 October 2023.

the last year about their exposure to non-competes. If anything, that's going to understate prevalence, because if a non-compete actually prevents you from moving then we're not going to pick that up. The second thing to note is that international experience suggests that those surveys that basically approach firms instead of workers tend to yield higher estimates of prevalence. If anything, our estimate of 22 per cent is probably a low amount and we suspect it could plausibly be higher than that.⁵⁸

- 4.78 The e61 Institute told the Committee that 'this rise in non-competes has the potential to explain some portion of that part of the productivity slowdown led by a decline in job mobility'.⁵⁹
- 4.79 Similarly, Treasury told the Committee that 'internationally there is growing evidence that non-compete clauses are hampering job mobility, innovation and wages growth'.⁶⁰

The 'chilling effect' of non-compete clauses

- 4.80 Non-compete clauses are by default not enforceable unless the employer can demonstrate the clause goes no further than is reasonably necessary to protect the employer's legitimate business interest.⁶¹ However, the Committee has heard that non-compete clauses do not need to be enforceable or end up in court to exert a 'chilling effect' on labour mobility.⁶²
- 4.81 The Committee heard that evidence from the United States indicates 40 per cent of workers report turning down a job offer from a competitor because of a non-compete clause, even though they reside in a state where non-compete clauses are unenforceable.⁶³
- 4.82 Related to this, inequality in bargaining power between workers and employers and uncertainty were highlighted as reasons for the 'chilling effect' caused by non-compete clauses.⁶⁴ The e61 Institute stated that:

There is very much an inequality there and a lot of legal uncertainty around these. What we know is that when there's uncertainty it tends to bind more legally those with less bargaining power. If you're earning \$60,000 or \$70,000 a year

⁵⁸ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 28 August 2023, p. 10.

⁵⁹ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 28 August 2023, p. 10.

⁶⁰ Mr Jason McDonald, Division Head, Competition Taskforce Division, Treasury, *Committee Hansard*, videoconference, 15 September 2023, p. 20.

⁶¹ Productivity Commission, *Submission 1*, p. 36.

⁶² Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 28 August 2023, p. 8.

⁶³ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 28 August 2023, pages 9–10.

⁶⁴ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 28 August 2023, p. 10.

and a HR department in a large firm tells you can't change jobs when you try to because of a non-compete, you're not going to have the resources to challenge that in court. I think those big differences in bargaining power we see in our economy really underline this chilling effect. It means that even if a non-compete doesn't go to court it could significantly change the behaviour of workers.⁶⁵

Overseas governments are taking action

- 4.83 The Committee heard that overseas governments are now taking action to limit the use and impact of non-compete clauses.⁶⁶
- 4.84 In the US, the Federal Trade Commission (FTC) is proposing a law banning non-compete clauses in most employment agreements. The FTC has cited the harmful effects on workers and competition, and says the ban could increase wages by nearly US\$300 billion per year and expand career opportunities for about 10 per cent of the population.
- 4.85 The UK has announced it will legislate statutory limits of three months for non-compete clauses.
- 4.86 In New Zealand, a bill before parliament would prohibit the use of restraints of trading and employment agreements for employees who earn less than three times the minimum wage.⁶⁷

Shifting the burden of non-compete clauses

- 4.87 Overall, witnesses viewed non-compete clauses as often being applied in a manner for which they were not intended, or as influencing workers to behave in a way counter to their own interests. Accordingly, witnesses saw non-compete clauses as representing a significant barrier to labour mobility, with all agreeing that policy reform is important.
- 4.88 The Productivity Commission highlighted the need to minimise the use of such clauses to improve economic dynamism.

One additional example of labour market reform not covered in the Productivity Inquiry is in minimising the use of non-compete clauses in contracts. Currently, in Australia non-compete clauses are by default not enforceable (unless the employer can demonstrate that they go no further than reasonably necessary to protect the employer's legitimate business interests) but workers may not know this, or may not be willing to bear the cost of legal action to avoid being bound by

⁶⁵ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 28 August 2023, p. 10.

⁶⁶ Mr Jason McDonald, Division Head, Competition Taskforce Division, Treasury, *Committee Hansard*, 15 September 2023, p. 19.

⁶⁷ Mr Jason McDonald, Division Head, Competition Taskforce Division, Treasury, *Committee Hansard*, 15 September 2023, p. 19.

a non-compete clause. It may be more effective for the default to be non-compete clauses do not exist, unless the firm can prove a clause is integral to protecting their interests.⁶⁸

4.89 The e61 Institute told the Committee that the evidence showed that the onus should shift on to the proponents of non-compete clauses to demonstrate why they are needed.

Honestly, we need to shift the burden here and to have it such that proponents of non-competes should actually justify why they exist. Based on all the evidence we see, there's a very strong economic evidence base that suggests they're problematic. I think that the burden should be on the proponents to demonstrate why they are important and why they're in the national interest. I just don't see that based on the body of evidence we have currently internationally and increasingly domestically.⁶⁹

Recommendation 14

4.90 That the Treasurer's Competition Policy Taskforce review the prevalence and economic impact of non-compete clauses, including whether such clauses:

- are commonly used in inappropriate contexts; and
- act as a constraint on people changing jobs and thereby dampen the level of dynamism within the overall labour market.

Recommendation 15

4.91 That the Treasurer's Competition Policy Taskforce should consider the appropriateness of constraints and bans on non-compete clauses and other restraint of trade clauses.

Young firms

The disproportionate impact of declining dynamism on young firms

4.92 An indicator of falling economic dynamism is a relative lack of entry by new firms bringing fresh ideas, greater competition and the incentive for incumbents to 'invest and adopt new technologies'.⁷⁰ This in turn contributes to reduced productivity and investment.

⁶⁸ Productivity Commission, *Submission 1*, p. 36.

⁶⁹ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 28 August 2023, p. 14.

⁷⁰ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 1.

4.93 The Committee heard from a variety of witnesses that the decline in economic dynamism in Australia reflects the tough business environment facing start-ups and new firms.

Witness views

4.94 The e61 Institute pointed to its research which shows that growing firms tend to be younger and account for about '40 per cent of aggregate net job creation in the Australian economy'. Accordingly, any impediments to the ability of young firms to upscale potentially creates 'large macroeconomic costs'.⁷¹

4.95 Additionally, the e61 Institute continued, lower levels of dynamism excessively affect the wages of younger workers. This is for two reasons:

- First, young workers 'rely disproportionately on job-to-job transitions to establish a good match'. So, given the decline in fluidity and mobility in labour markets—a current indicator of declining dynamism in Australia—this would 'hurt younger Australians more'.⁷²
- Second, 'young workers are more likely to work for younger firms. When there are fewer young firms in the economy, by definition that creates fewer opportunities for young Australians'.⁷³

4.96 In a similar vein, the Organisation for Economic Co-operation and Development (OECD) told the Committee that young firms were 'the engine of growth in most OECD countries', contributing in particular through innovation and job creation.⁷⁴

How to improve conditions for new-entry businesses

Tech sector

4.97 Given the plethora of young small firms in the tech sector, the Tech Council of Australia was well placed to propose several ways to facilitate a better environment for the growth of new firms.

4.98 First, the Tech Council submitted, regulatory frameworks should be improved in the financial sector to reduce barriers to entry and enhance consumer outcomes. Key areas for reform are 'modernised privacy laws...positioning Australia as a world leader in cyber security...informed, targeted and proportionate regulation of emerging technologies...economy-wide competition and consumer protection laws underpinned by effective enforcement...targeted and risk-based security regulation

⁷¹ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 7.

⁷² Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 3.

⁷³ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 3.

⁷⁴ Mr Francesco Manaresi, Economist, Organisation for Economic Co-operation and Development, *Committee Hansard*, 29 August 2023, p. 49.

[of the financial technology sector]...payments system reform' and an industrial relations system enabling fit-for-purpose flexible employment.⁷⁵

- 4.99 Second, investment in start-up technology firms seeking to scale up could be improved through:
- Creating a more friendly environment for foreign venture capital investment in Australia (see Chapter 6: Finance).⁷⁶
 - A tax environment that 'rewards investments in innovation and technology' and reduces the complexity of the Research and Development Tax Incentive for software to level the playing field for smaller companies.⁷⁷
- 4.100 Additionally, the Tech Council told the Committee, the tech jobs pipeline could be strengthened through raising awareness of pathways into tech jobs and careers. This could be achieved through reforming training to ensure it is relevant and responsive to current needs (for example, through defined skills standards and pathways, the establishment of a digital apprenticeship model, and improved integration of industry certifications), and through increased diversity in the tech sector (particularly greater representation of women).⁷⁸
- 4.101 Zepto, a fintech payments company, observed that making government procurement processes more transparent and accessible for smaller players would make a 'massive difference' in enabling new firms to compete with larger businesses and to 'take that step up to the next level and become a larger and more successful business'.⁷⁹ Procurement is discussed in more detail in Chapter 5: Government.

Harnessing talent

- 4.102 The Grattan Institute advised that reforms to the skilled migration program could support the growth of a more dynamic entrepreneurial culture, conducive to the growth of young businesses. However, the Grattan Institute continued, any new visa categories should be introduced only in a graduated way and be subjected to careful evaluation.

If we are going to go down this path of creating innovation visas, for example, the program should start incredibly small and we should evaluate it really carefully. The opportunity cost here is all the other skilled migrants that we don't otherwise bring in with those limited number of visas on offer. We know from Treasury's work that, for example, a skilled employer sponsored visa holder, a primary visa holder—the primary applicant—brings a fiscal dividend alone, ignoring any productivity benefit, of about \$400,000 to \$500,000 discounted over their lifetime

⁷⁵ Tech Council of Australia, *Submission 32*, pages 12–13.

⁷⁶ Mr Thomas McMahon, Deputy Chief Executive Officer, Tech Council of Australia, *Committee Hansard*, 3 May 2023, p. 2.

⁷⁷ Tech Council of Australia, *Submission 32*, p. 7.

⁷⁸ Tech Council of Australia, *Submission 32*, pages 8–11.

⁷⁹ Mr Gabe Perrottet, Senior Legal Counsel, Public Policy and Regulation, Zepto Payments, *Committee Hansard*, 3 May 2023, p. 9.

to Commonwealth and state governments. That is a lot to give up in order to take a punt on someone. You want to start small and evaluate. The same way a VC would evaluate a portfolio of options, we should be doing that with our migration program with respect to innovation and entrepreneurship.⁸⁰

...

That means making the system as non-bureaucratic as possible and getting rid of that red tape. As the chair mentioned earlier, some people favour a wave threshold idea for skilled migration. That's us. That is opposed to having occupation lists and the like. That would be number one. That would, frankly, make the most difference, I think. If you are an Atlassian or a small-scale Atlassian and you're trying to get someone who has had seven years of experience in a particular role to run a team and launch a new product—not many of those people exist in Australia—literally the only place you're going to get that is from abroad. You want to make that as simple as possible.⁸¹

4.103 Similarly, the Tech Council of Australia highlighted the importance of reforming migration settings to enable firms to more easily introduce the 'high-skilled global talent they need to be more productive and successful'. The Council's feedback from its members showed that importing such workers has the additional benefit of rapidly imparting advanced technical knowledge and skills transfer into the workforce.⁸²

4.104 The importance of young firms for driving both competition and economic dynamism is reflected in a number of recommendations throughout this report. For example, it is reflected in sector specific recommendations in relation to banks, fintech, aviation and retail. In all cases, removing barriers to entry will improve sector-wide dynamism by facilitating firm entry and create new employment opportunities, particularly for young people.

⁸⁰ Mr Brendan Coates, Economic Policy Director, Grattan Institute, *Committee Hansard*, 2 May 2023, p. 13

⁸¹ Mr Brendan Coates, Economic Policy Director, Grattan Institute, *Committee Hansard*, 2 May 2023, p. 13.

⁸² Mr Thomas McMahon, Deputy Chief Executive Officer, Tech Council of Australia, *Committee Hansard*, 3 May 2023, pages 2, 5.



5. Government

- 5.1 Government plays a key role in the economy. Through regulation and its direct role in the consumption and production of goods and services, it impacts on both economic dynamism and competition across the economy as a whole. This section will cover four aspects of the role that government plays in the economy.
- 5.2 First is government's role as a regulator. Governments regulate many aspects of society for a wide range of reasons. While regulation is often justified, it is important that it be fit for purpose. Regulation can be critically important for both economic dynamism and competition where it: facilitates the flow of information to consumers; ensures fair trading; prevents collusion; and corrects for market failures.
- 5.3 Second, the Committee recognises the role that government plays in the direct provision of services. Sometimes, government provides these services directly, such as public education or building approval services. It can sometimes be the sole provider of services, although in some instances (such as education) it competes against other providers. In some instances, government arranges for the provision of services through markets or quasi-markets, including labour market programs, childcare, aged care, disability services and training. Governments may participate in these markets as one of many providers, or it may simply fund and regulate the market/quasi-market. The Committee notes that, in instances where services are provided through markets and quasi-markets, policies relating to market design and in particular the development of matching markets are increasingly recognised for their potential to stimulate competition, achieve better outcomes, and ensure resources are utilised more efficiently.
- 5.4 Third, governments at all three levels procure many billions of dollars of goods and services each year. The Commonwealth Government alone procures an estimated \$70-75 billion each year on goods and services ranging from the simple and homogenous through to the highly complex.¹ Improved procurement strategies would involve more competitive processes and have the potential to save governments very significant amounts of money.

¹ In 2022-23 there were 83,625 Commonwealth contracts published on AusTender with a combined value of \$74.8 billion. However, it is important to note that *the contract values* on AusTender represent the total maximum value of each contract over its life, including where contracts span multiple years. AusTender data **does not** reflect annual expenditure. In July 2022, the Finance Minister, Senator the Hon Katy Gallagher, said that the Commonwealth spends approximately \$70 billion a year on contracts. See Department of Finance, *Statistics on Australian Government Procurement Contracts*, www.finance.gov.au/government/procurement/statistics-australian-government-procurement-contracts, viewed 12 February 2024; Senator the Hon Katy Gallagher, Minister for Finance, and the Hon Julie Collins MP, Minister for Small Business, 'A Better Deal for Australian Businesses Under Commonwealth Contracts', *Media Release*, 1 July 2022.

- 5.5 Finally, there are ways that government can be more transparent in how it interacts with citizens. This can improve economic dynamism and help to achieve better outcomes for the public.
- 5.6 These proactive strategies can complement traditional regulation to ensure more transparent and competitive markets, which ultimately leads to a more effective and equitable distribution of resources.

Regulation

- 5.7 Regulation exists because governments identify a problem that requires an intervention to minimise, mitigate or eliminate some kind of harm. It can be defined as ‘any rule endorsed by government where there is an expectation of compliance’.²
- 5.8 The Office of Impact Analysis (OIA), previously called the Office of Best Practice Regulation, works to ensure government policy and decisions are supported by the best possible evidence and analysis. The OIA works with departments and agencies to produce detailed, evidence-based assessments of complex policy issues.
- 5.9 ‘Red tape’ generally refers to regulations, prohibitions or other requirements perceived to impose an unreasonable burden on people, businesses, or community organisations.³ Red tape often involves complex or time-consuming administrative processes and compliance requirements for those subject to the regulations. Efforts to reduce red tape aim to simplify and streamline regulatory processes without compromising intended regulatory objectives.
- 5.10 An important focus of the Committee was how to achieve the right balance between regulation and ensuring appropriate safeguards. In its discussions with stakeholders, the Committee inquired into the extent that economic barriers, such as regulatory costs or ‘red tape’, had contributed to market concentration, slowing business formation, and stalled productivity.
- 5.11 It is important that regulation is designed to promote and not hinder productivity. The Productivity Commission, in its 5 Year Productivity Review, viewed sector specific regulation as a lever for a more dynamic economy—enabling competition, efficiency and contestability in markets.⁴

² Office of Impact Analysis ‘Former Australian Government Guide to Regulatory Impact Analysis, Second Edition’, 2020, p. 10, oia.pmc.gov.au/sites/default/files/2021-06/australian-government-guide-to-regulatory-impact-analysis.pdf, viewed 17 February 2024.

³ Office of Impact Analysis, ‘Australian Government Guide to Policy Impact Analysis’, 17 February 2023, p. 57, oia.pmc.gov.au/resources/guidance-impact-analysis/australian-government-guide-policy-impact-analysis.

⁴ Productivity Commission, ‘Advancing Prosperity: 5-year Productivity Inquiry report: Volume 3’, 17 March 2023, p. xi, www.pc.gov.au/inquiries/completed/productivity/report.

Witness views

Current levels of regulation considered a problem

- 5.12 The Committee heard evidence that red tape was a continuing concern. Sectors that raised the impact of red tape in their submissions included pharmacies, personal hygiene, agriculture, minerals, disability support services, and co-operatives and mutuals.⁵ The Committee also looked at the effect of regulation in other industries, including finance, aviation and the technology sector. The evidence is discussed in more detail throughout this report.
- 5.13 The Business Council of Australia (BCA), in its submission, stated that heavy regulation affected whether Australia was viewed as an ‘easier place to do business, not harder’.⁶ In the BCA’s view, current levels of regulation are high and hinder the ability for businesses to create productive new enterprises, innovate and hire. Excessive regulation can also raise barriers of entry or contestability for new firms and global competitors.⁷
- 5.14 This view was shared by the Victorian Chamber of Commerce and Industry (VCCI), which stated that fulfilling regulatory requirements was a ‘major impediment’ to businesses of all sizes, but particularly small businesses, which have limited time and resources.⁸
- 5.15 Similarly, the Institute of Public Affairs (IPA) was concerned with increasing levels of red tape and its impact on the economy. Referencing the findings of its forthcoming research, the IPA emphasised that red tape—as measured by the number of regulatory restrictions in force—was at its ‘highest level in recorded history’.⁹
- 5.16 In the IPA’s view, red tape cost the economy ‘about \$176 billion per annum’. The IPA saw this as disproportionately affecting small businesses, which do not have the resources to manage the regulatory burden. Red tape was a ‘huge preventer of business formation in Australia’.¹⁰
- 5.17 The Productivity Commission took a different view on the regulatory burden, describing it as ‘really hard’ to measure, and that the amount of regulation was not necessarily the best indicator of economic impact.¹¹ It explained that:

You can write a very short regulation in one line that could have very deleterious impacts on productivity, depending on what it says. It is an important indicator in

⁵ For examples, see: Accord Australasia Limited (*Submission 16*), Business Council of Co-operatives and Mutuals (*Submission 4*), Private Healthcare Australia (*Submission 10*), Marriot Support Services (*Submission 58*), GrainGrowers Limited (*Submission 14*), NSW Farmers (*Submission 15*).

⁶ Business Council of Australia, *Submission 3*, p. 14.

⁷ Business Council of Australia, *Submission 3*, p. 14.

⁸ Victorian Chamber of Commerce and Industry, *Submission 40*, p. 4.

⁹ Institute of Public Affairs, *Submission 7*, p. 2.

¹⁰ Mr Saxon Davidson, Research Fellow, Institute of Public Affairs, *Committee Hansard*, 2 May 2023, p. 26.

¹¹ Mr Michael Brennan, Chair, Productivity Commission, *Committee Hansard*, 16 March 2023, p. 11.

terms of the red tape and compliance burden and so on, but the causal link between that and productivity growth over long periods of time may not be that direct. It's fair to say, in every commission report that I've read and been involved with, that we always advocate quite strongly for regulations that are justified on a benefit cost basis and that also have relatively low compliance costs. In terms of the flow of regulation, I think we're always cognisant of and advocating for the things which have that net benefit test at the end of it, whatever it might be.¹²

Proposed reforms

- 5.18 The Committee inquired into which areas presented the best opportunities for reducing red tape.
- 5.19 The IPA identified duplication between state and federal legislation as one area for improvement.¹³ Further, the IPA proposed that a serious red tape reduction program would 'reinvigorate Australia's most critical industries' and make them more attractive to investors—ultimately promoting economic dynamism, competition and business formation in the broader economy.¹⁴
- 5.20 Similarly, the VCCI recommended that there be a review and redesign of the regulatory environment to reduce the cost to consumers and the burden of compliance on businesses, while also acknowledging 'that regulation serves an important purpose'.¹⁵
- 5.21 The Productivity Commission said that reviewing regulations to determine whether they were still needed and/or remained fit for purpose was an area for improvement but a 'huge exercise'.¹⁶

Existing initiatives to improve regulation and reduce red tape

Increasing economic dynamism through regulatory approval reform

- 5.22 Australia's competitiveness to attract global capital for major developments in Australia such as for nascent Green Energy projects relies on the ability of all levels of government to work collaboratively, to set clear direction to industry, establishing harmonised (if not uniform) standards and regulations and developing the workforce skills and capacity. Critical to economic dynamism, business certainty and to de-risk project ventures is streamlined, fast, approval processes.
- 5.23 Whilst historically State Agreements were used to underpin large-scale developments, through improvements with case management and regulatory

¹² Mr Alexander Robson, Deputy Chair, Productivity Commission, *Committee Hansard*, 16 March 2023, p. 11.

¹³ Mr Daniel Wild, Deputy Executive Director, Institute of Public Affairs, *Committee Hansard*, 2 May 2023, p. 27.

¹⁴ Institute of Public Affairs, *Submission 7*, p. 5.

¹⁵ Victorian Chamber of Commerce and Industry, *Submission 40*, p. 5.

¹⁶ Mr Alexander Robson, Deputy Chair, Productivity Commission, *Committee Hansard*, 15 September 2023, p. 62.

approval sprints, there is evidence of major projects approved for construction of between 18 months and 3-4 years.¹⁷ However, to meet aggressive government targets such as for greenfield industrial renewable developments by 2030, accelerated approval models are needed. Given the global competition for the same capital, examining case studies internationally for regulatory approval reform best practice, in order to facilitate the dynamics needed for market investment and competition in Australia, is needed.

- 5.24 As an international example, in Germany, in the wake of the Ukraine crisis, Chancellor Olaf Scholz announced the rapid construction of LNG terminal within 10 months and to connect it to Germany's gas supply network.¹⁸ What would ordinarily take 10 years for regulatory approvals and construction, has been made possible by granting provisional approval for the plant even before the permit has been issued. Provisional approval is granted where:
- 1 a decision in favor of the applicant can be expected,
 - 2 there is a public interest or a justified interest of the applicant in the early start; and
 - 3 the applicant undertakes to compensate for all damage caused by the granting of the facility up to the time of the decision and - if the facility is later not approved after all - to restore it to its previous condition.¹⁹
- 5.25 Domestically, a number of existing initiatives and programs aim to improve the quality of government regulation and reduce red tape.
- 5.26 First is the overarching requirement that a Regulatory Impact Statement (RIS) be prepared for all new regulatory interventions. The Department of Finance has issued detailed guidelines around preparing a RIS.
- 5.27 In summary, the RIS guidelines propose that policy makers: clearly demonstrate why something is a public policy problem and the options (including non-regulatory) for addressing it, determine which option delivers the greatest net benefit, consult in a 'genuine and timely' way with affected stakeholders, publish the information upon which decisions are based, and periodically review regulation to test its continuing relevance.²⁰

¹⁷ Joint Committee on Trade and Investment Growth, Australia's trade and investment opportunities in a global green economy, *Committee Hansard*, 17 March 2023.

¹⁸ How can Germany achieve its plan to build LNG terminals quickly? Hillemann, D 2022 <https://www.fieldfisher.com/en/insights/how-can-germany-build-lng-terminals-quickly>; Germany will reduce the authorization procedures for new LNG terminals Energynomics 2022 <https://www.energynomics.ro/en/germany-will-reduce-the-authorization-procedures-for-new-lng-terminals/>

¹⁹ These provisions can be found in the Act on the Prevention of Harmful Effects on the Environment Caused by Air Pollution, Noise, Vibration and Similar Phenomena (Federal Immission Control Act - BImSchG)

²⁰ Office of Impact Analysis 'Former Australian Government Guide to Regulatory Impact Analysis, Second Edition', 2020, p. 9, oia.pmc.gov.au/sites/default/files/2021-06/australian-government-guide-to-regulatory-impact-analysis.pdf, viewed 17 February 2024.

- 5.28 The RIS guidelines include seven questions that policy makers must answer. These questions are critical because they help policy makers focus on the potential impact of major decisions: in other words, to what extent is the community affected. The seven questions are:
- 4 What is the policy problem?
 - 5 Why is government action needed?
 - 6 What policy options are to be considered?
 - 7 What is the likely net benefit for each option?
 - 8 Who was consulted and how was their feedback incorporated?
 - 9 What is the best option from those considered and how will it be implemented?
 - 10 How will the chosen option be evaluated?²¹
- 5.29 The Department of Finance also issues guidance (Resource Management Guide—Regulator Performance (RMG 128)) to assist Commonwealth entities that perform regulatory functions, including standalone regulators and those located within policy departments.²² The RMG-128 regime promotes high standards of performance and consistent regulatory approaches for Commonwealth regulators. The guidance defines regulatory functions; provides information on performance expectations; sets out the three principles of best practice that regulators are required to report against (continuous improvement and building trust; risk based, and data driven; and collaboration and engagement); and provides information on issuing Ministerial Statements of Expectations, Regulator Statements of Intent and their role in the performance framework.²³
- 5.30 In addition to the overarching frameworks outlined above, the Regulatory Reform Division of the Department of Finance has been tasked with undertaking a series of projects to reduce the regulatory burden. Some will be conducted in the Commonwealth sphere; some in conjunction with State and Territory jurisdictions.

Committee comment

- 5.31 The Committee accepts that tackling high levels of red tape remains a work in progress for all levels of government. The Committee supports the streamlining and simplification of regulatory processes where appropriate, to ensure that regulation remains fit for purpose and relevant to the contemporary economic landscape.

²¹ Office of Impact Analysis, *Regulatory Impact Analysis Guide for Ministers' Meetings and National Standard Setting Bodies*, 18 January 2024, oia.pmc.gov.au/resources/guidance-impact-analysis/regulatory-impact-analysis-guide-ministers-meetings-and-national, viewed 17 February 2024.

²² Department of Finance, *Regulator Performance (RMG 128)*, www.finance.gov.au/government/managing-commonwealth-resources/regulator-performance-rmg-128, viewed 24 February 2024.

²³ Office of Impact Analysis, *Regulatory Impact Analysis Guide for Ministers' Meetings and National Standard Setting Bodies*, 18 January 2024.

- 5.32 The Committee acknowledges and supports the vital work of the Office of Impact Analysis and the Government's renewed deregulation agenda. The Office of Impact Analysis' program should continue to assist the development of policy to ensure it offers the greatest net benefit for Australia, while cognisant of economic and competition impacts.

Box 5.1 Key finding

Regulatory Flexibility

The Committee found there can be a regulatory tension when new trends emerge in an economy between regulating in a timely way (e.g. to protect consumers as new products and services emerge) and waiting to regulate so as to calibrate regulation in a way that it doesn't impede productivity enhancing innovation.

Recommendation 16

- 5.33 That the Commonwealth Government continue to advance its better regulation agenda, in conjunction with state and territory governments and other relevant stakeholders.

Recommendation 17

- 5.34 That the Government continue to strengthen the analysis of the impact of regulation and red tape to ensure that it is fit for purpose.

Recommendation 18

- 5.35 That the Government consider strengthening the guidelines in relation to the development of Regulatory Impact Statements (RISs) so that they more explicitly include consideration of the impact of new measures on competition and economic dynamism.

Recommendation 19

- 5.36 That the Government strengthen RMG-128 (regulator performance) so that:
- Ministers are asked to review any Ministerial Statements of Expectations they have issued to regulators to ensure they sufficiently deal with issues relating to competition and economic dynamism.
 - That best practice collaboration and engagement with stakeholders should include, where appropriate, seeking advice as to whether regulatory settings optimally manage issues relating to competition and economic dynamism.
 - That agencies periodically review and report on the efficacy of regulatory sandboxes.

Recommendation 20

5.37 That the Government consider the extension of the regulatory sandbox currently used by the Australian Securities and Investments Commission.

Market design

The role of traditional markets and the price mechanism

- 5.38 In many areas of service delivery, government over recent decades has set up markets or quasi-markets. The key rationales for this have been to ensure:
- Convenience and client choice
 - Competitive tension between providers
 - The incentivisation of innovation.
- 5.39 In setting up such markets, governments should be aware of the limits of different allocative mechanisms, particularly when dealing with complex services and vulnerable individuals, families and communities.
- 5.40 In broad terms, the basic function of the market is to determine the distribution of resources—‘who gets what’. This allocation is predominantly influenced by the interplay of supply and demand, with prices acting as the principal mechanism to balance the two.
- 5.41 The Committee recognises the efficacy of markets, particularly in the trading of goods that can be grouped together where each item in a batch is indistinguishable from the others. The Committee also believes that in a fully competitive market (which contains the broad characteristics outlined in Box 5.2 below), the price mechanism is an effective and efficient way of matching buyers with suppliers.

Box 5.2 Characteristics of a competitive market

Generally speaking, the main characteristics of a competitive market are:

- 1 Large numbers of buyers and sellers: There are so many buyers and sellers that none can influence price.
- 2 Homogeneous products: All firms produce highly similar, substitutable products.
- 3 Perfect information: All buyers and sellers have complete and immediate access to information regarding prices, product quality, and other product characteristics.

- 4 Free entry and exit: There are no barriers to market entry or exit; new firms can enter when it is profitable and exit when losses occur.
- 5 Perfect mobility of factors of production: Resources can be easily moved from one use to another without restriction.
- 6 Absence of externalities: There are no external costs or benefits affecting third parties not involved in the transaction.

- 5.42 In truly competitive markets, prices effectively convey all necessary information for economic agents to make informed decisions. When prices surpass the 'market clearing price', demand falls, resulting in excess supply. This drives prices down toward equilibrium. On the other hand, when prices fall below the 'market clearing price', demand increases and some suppliers may cut back on production or exit the market altogether, which pushes prices back up toward equilibrium.
- 5.43 Recognising the self-regulating nature of prices, the Committee endorses the view that in competitive markets, any form of price regulation can potentially compromise efficiency.
- 5.44 Artificially manipulating prices can cause significant market distortions. Setting prices too low leads to shortages, leading to rationing or long waits, as demand exceeds supply. Conversely, setting prices too high results in excess supply, wasting resources. Both scenarios disrupt market equilibrium, negatively impacting both consumers and producers.

Departing from traditional markets

- 5.45 In traditional markets, the primary aim is to create private value, meaning each participant seeks personal gain. Transactions are driven by competition, with multiple buyers and sellers searching for the best deals. This competitive environment determines how goods and services are allocated and priced, based on the dynamics of supply and demand.
- 5.46 The Committee recognises that in moving away from such conventional settings, the complexities of marketplaces become more pronounced and there may be instances of market failure.²⁴
- 5.47 The Committee acknowledges the existence of complex quasi-markets designed specifically for the delivery of social services, such as health, education and community services.
- 5.48 For the provision of such services, the goal of transactions is to generate public value as defined by legislation and policy statements. These address specific social needs and ensure that essential services are delivered to those who need them most. The

²⁴ A Roth, 'Marketplaces, Markets, and Market Design', *American Economic Review*, 108/7 (2018), pages 1609–1658.

Committee heard from Treasury that in those services, ‘...the concept of consumer sovereignty has even more importance than it may in more traditional markets’,²⁵ and should be designed to offer clients more autonomy and agency. Additionally, as the Harper review found, equity of access, universal service provision and minimum quality standards are also important.²⁶

- 5.49 The Committee is aware that to ensure the best use of taxpayer money it is essential to strike a balance between efficiency and overarching social goals. Therefore, it concludes that a different economic architecture is often needed to ensure market participants are incentivised to prioritise public value over private gain.
- 5.50 Price can play an allocative role in a number of these quasi-markets. Sometimes the prices charged in these markets are regulated. This can take a number of forms—e.g. a schedule of prices, price caps and other arrangements.
- 5.51 However, in less traditional markets, the price mechanism can have limited functionality in some contexts. The desirability of using alternative allocation mechanisms from prices is worth exploring when:

Goods or services are multi-dimensional and consumers have highly diverse preferences

- 5.52 Market mechanisms enable buyers to find products that match their needs. In commodity markets, standardised descriptions and measurement protocols allow for transactions based on descriptions without the need for pre-purchase inspection. Such products are classified as search goods.
- 5.53 However, the Committee heard from the University of Melbourne’s Centre for Market Design (CMD) that, when it comes to the provision of human services, consumer choice is complicated by the inherent diversity of people and the complexity of attributes—such as the nature and severity of the individual’s condition, geographical location, timing of service requirement, and cultural, social, linguistic, and gender considerations. Because all services need to be tailored to meet the needs of each individual, the market for delivering human services is distinctly different from, and more complex than, standard commodities.²⁷
- 5.54 Treasury highlighted the inherent complexities in the delivery of human services, attributing these challenges to this intrinsic diversity. It told the Committee that:

...In care markets, the good itself is so heterogeneous it's very hard to do comparisons across providers. Ideally, you almost want a service which is specifically tailored to the needs of the recipient for whatever circumstance

²⁵ Mr Jason McDonald, Division Head, Competition Taskforce Division, Treasury, *Committee Hansard*, 15 September 2023, p. 30.

²⁶ Professor Ian Harper, Mr Peter Anderson, Ms Su McCluskey, Mr Michael O’Byrne QC, ‘Competition Policy Review – Final Report, Part 2: Findings and Recommendations’, 31 March 2015, p. 35, treasury.gov.au/publication/p2015-cpr-final-report.

²⁷ Mr Gary Stoneham, Director, Policy Projects, Centre for Market Design, University of Melbourne, *Committee Hansard*, 18 May 2023, p. 25.

they're in to make sure that their wellbeing and their life chances are as large as possible.²⁸

- 5.55 Further, Treasury advised, 'the heterogeneity in the service provision raises real issues about how to compare among providers and make sure the best provider is allocated to the client'.²⁹ Each client might have a unique perspective on how to rank suppliers based on various factors, including their rapport with the supplier or specific needs and requirements.
- 5.56 Where highly individual-specific goods and services are involved, the market may not ensure the best outcomes. The Committee is of the view that there needs to be put in place processes to elicit preferences and specific needs to enable buyers with unique requirements to find appropriate sellers (the search process), facilitate the exchange of information, and group potential trading partners into niche markets to enable negotiations.

Heterogeneous matching preferences between suppliers and consumers.

- 5.57 The Committee recognises that commodity transactions depend on matching easily described items where it is not crucial to involve specific parties. However, this approach is ineffective for the delivery of many social services, where the challenge lies in finding the 'best' matches between recipients and suppliers. This is a more complex process. It is not a simple matter of matching items with similar descriptions. Rather, it involves carefully considering the unique needs and capabilities of each party.

Coordination issues that are difficult to resolve in bilateral transactions.

- 5.58 Numerous products are bought and sold as separate items. Many others offer increased value when produced or consumed in conjunction with other items, necessitating coordination among participants or the integration of various product components.
- 5.59 The Committee is aware that with complex, multi-dimensional goods and services, coordination can be an issue. Multiple consumers may need to be matched with each supplier and/or multiple suppliers matched with each consumer to satisfy mutual needs.
- 5.60 The Committee posits that market mechanisms struggle in scenarios where transactions are not purely price-based but involve a mutual selection process that prioritises compatibility and preferences. This is particularly the case in 'matching markets' with varied participants and coordination challenges. In those situations, the focus is on maintaining 'stable allocations' because the suggested pairings may not

²⁸ Mr Jason McDonald, Division Head, Competition Taskforce Division, *Committee Hansard*, 15 September 2023, p. 31.

²⁹ Mr Jason McDonald, Division Head, Competition Taskforce Division, *Committee Hansard*, 15 September 2023, p. 31.

be optimal.³⁰ It suggests that potential swaps among suppliers and beneficiaries could improve overall welfare in these complex markets, as illustrated in Box 5.3 below.

Box 5.3 Unstable allocation within the context of the National Disability Insurance Scheme (NDIS)

Key definitions

Unstable allocation: An unstable allocation in a matching market occurs when there is a pair of participants who would prefer to be matched with each other over their current matches.

Stable allocations: In a stable allocation, no two participants would prefer to be matched with each other over the current allocation.

Properties of stable allocations: Stable allocations maximise the overall satisfaction of participants and avoid situations where some participants could be better off at the expense of others.

Example

Consider two service providers, Provider A and Provider B, and two participants, Participant 1 and Participant 2.

Preferences:

- Participant 1 prefers Provider A because of its reputation, even though Provider B offers a similar service in relation to the type of services Participant 1 requires.
- Participant 2 prefers Provider A because it offers specialised physical therapy.
- Provider A can offer more effective support to Participant 2 due to specific expertise in what the participant needs.
- Provider B is indifferent regarding the two participants.

Initial Allocation:

- Provider A is assigned to Participant 1.
- Provider B is assigned to Participant 2.

This allocation provides potential instability. Participant 2, assigned to Provider B, would prefer the services of Provider A. Simultaneously, Provider A would better serve Participant 2 due to their specialised expertise. This mutual preference indicates the potential benefit in altering the allocation.

³⁰ Economic Sciences Prize Committee of the Royal Swedish Academy of Sciences, 'Stable Allocations and the Practice of Market Design', 15 October 2012, www.nobelprize.org/uploads/2018/06/advanced-economicsciences2012.pdf, viewed 27 February 2024.

Thin Markets

- 5.61 The Committee is aware that market allocations may not be optimal when participants on both sides of the market struggle to connect, or there are too few providers, for example. This results in a thin market, which can compromise efficiency and potentially hinder the overall functioning of the market. This problem is especially acute in regional areas.
- 5.62 The Committee recognises the factors that can lead to a thin market:
- Heterogenities on both sides:
 - In the context of social services and the challenges presented by the NDIS, the Centre for Market Design stated the following:
Think about a patient in northern Sunshine with a disability who needs services on Wednesday afternoon and every other week on Monday morning. It's very hard, in a decentralised market, for him to find a nurse that's going to look after him. [...] If you don't have the matching algorithm or matching platform in place that allows these agents to find each other, you're just not going to have competition. There is never going to be a commodity market for nurses in north Sunshine on Friday afternoon or Wednesday afternoon from 3 to 5 pm.³¹
 - Asynchronous arrival problem: where buyers and sellers do not engage in transactions simultaneously, this results in timing complexity.
 - In financial markets, for example, electronic trading platforms, which facilitate transactions in milliseconds, can lead to a scarcity of buyers or sellers at any given moment. The rapid pace of trading means that at times, the necessary items for transaction might not be available, making trading risky.³²
- 5.63 The Committee is aware that thin markets appear to be a defining feature of markets in the care and support services, where the asynchronous arrival problem is combined with heterogeneity and matching complexities.
- 5.64 The CMD emphasised that human service markets thin rapidly due to specific demand-side needs and diverse preferences, significantly narrowing the pool of suitable providers. This results in a wide variation of offerings, skills, location of services, times services are offered, and cultural attributes.³³
- 5.65 Given this evidence, the Committee concludes that failing to tackle the thin market problem can lead to several inefficient outcomes. Where price drives the market, limited compatible providers curb the competition required to ensure the efficient pricing that is essential for proper allocation. This diminishes the bargaining power of service recipients and enables suppliers to charge above-market rates. Conversely,

³¹ Professor Simon Loertscher, Director, Centre for Market Design, University of Melbourne, *Committee Hansard*, 18 May 2023, p. 24.

³² G Haeringer, *Market Design: Actions and Matching*, The MIT Press, 2018.

³³ Mr Gary Stoneham, Director, Policy Projects, Centre for Market Design, University of Melbourne, *Committee Hansard*, 18 May 2023, p. 23.

in markets that prioritise compatibility between providers and recipients, the fewer options result in lower quality matches and poor outcomes.

Designing the rules of the market

- 5.66 The CMD told the Committee that market design is a significant facet of economics, exploring how the architects of policy, or the so-called designers, can establish the rules of the game in prevailing markets or formulate new ones where they are non-existent, to realise commendable policy objectives. Like competition policy, market design is aimed at making markets more competitive and reducing the market power of the various economic actors, as this exertion of market power is usually harmful to society.³⁴
- 5.67 The fundamental challenge in designing these markets is to identify the specific rules and processes needed to motivate self-interested buyers (recipients of government support) and sellers (self-interested service providers) to obtain and supply care and support services in a way that implements defined public policy objectives at minimum cost.³⁵
- 5.68 Given the challenges posed by departing from traditional markets and based on the evidence presented to it, the Committee believes that market design holds significant potential to tackle a range of market failures. The Committee's view is that policymakers and regulators can craft market rules to ensure order and fairness in economic transactions, thereby rectifying inefficiencies and imbalances in various sectors.

Fit-for-purpose solutions

- 5.69 The Committee recognises that specific market failures demand tailored solutions over generic ones, underscoring the need for detailed analysis of each problem's economic structure and policy goals. The Committee further stresses that the failure to resolve these challenges may lead to more complex issues.
- 5.70 For example, the Committee heard evidence about a case of trying to promote price transparency at petrol stations in Western Australia which led to unintended consequences. The CMD explained that the state government's FuelWatch website aimed to provide consumers with price transparency at all the petrol stations and at all times of the day, enabling them to compare and make informed choices. However, this design inadvertently facilitated price coordination among petrol retailers.

³⁴ Professor Simon Loertscher, Director, Centre for Market Design, University of Melbourne, *Committee Hansard*, 18 May 2023, p. 22.

³⁵ Mr Gary Stoneham, Director, Policy Projects, Centre for Market Design, University of Melbourne, *Committee Hansard*, p. 23.

Consequently, market competition diminished, and petrol retailers were able to double their profit margins.³⁶³⁷

Box 5.4 Redesigning school transportation for disadvantaged students in Melbourne, Australia

This example, based on inquiry evidence from US economist Professor Charles Plott, refers to a 2018 pilot program in Melbourne aimed at improving the commute for students with a disability, and underscores the significance of meticulous design and the strategic use of competitive forces.

Background: In Melbourne, 79 children with autism attend a specialised school. These students face lengthy commutes of up to four hours each day on buses, frequently resulting in late arrivals. This problem is primarily attributed to the outdated procurement process for these transportation services. This process encompasses the pre-qualification of public transport providers, who determine the bus routes. It also includes the submission of sealed bids by these providers for each one of the routes, followed by the negotiation of contracts.

The New Approach:

- **Route Redesign:** Instead of sticking to traditional routes, dictated by the preferences of bus providers, there was a redefinition of specific pick-up and drop-off locations. The focus was on locations that were easily accessible, ensuring children did not have to travel far to board.
- **Optimal Route Planning:** Using tools like Google Maps and past experiences, optimal routes were crafted to limit student travel to an hour each way.
- **Innovative Auction System:** A simultaneous auction was held, whereby all routes were auctioned at once with prices decreasing in set percentages.
- **Limited Information for Bidders:** In the auction, bidders had limited information about competitors, bid amounts, or leading bids, which helped prevent collusion and maintain genuine competition.

Outcome: A much more efficient way of transporting students. Average travel time was cut by 60 per cent and costs were reduced by 3 per cent.

Foundational market design principles

5.71 While the Committee recognises that it is essential to tailor detailed analyses to each unique situation, economists have identified recurring market issues. These can often be resolved using foundational market design principles, which offer a framework to

³⁶ Professor David Byrne, Director, Capability Building, Centre for Market Design, University of Melbourne, *Committee Hansard*, 18 May 2023, p. 22

³⁷ D Byrne and N de Roos, 'Learning to Coordinate: A Study in Retail Gasoline', *American Economic Review*, 109/2 (2019), pages 591–619.

tackle a broad spectrum of market inefficiencies and challenges before delving into specific solutions.

i) Market Thickness

- 5.72 Market thickness, as defined by a robust presence of both buyers and sellers, is essential for a well-functioning marketplace. A thick market offers a wide array of potential transactions, but participants need to be able to compare various offers effectively. This requires information to be presented in a clear and accessible way, to allow for easy comparison.
- 5.73 The CMD told the Committee that ‘...thickness or competitiveness of a market is not exclusively a function of the number of agents who are active in the market, like the number of suppliers, but also a function of how these agents interact with each other on one side of the market or across the two sides of the market, and, in particular, of the aforementioned rules of the game’.³⁸
- 5.74 Additionally, the CMD explained, ‘Even where there are lots of participants, markets can still thin out and become uncompetitive because of rules and regulations about who can trade with whom’.³⁹ To demonstrate this point, the CMD cited a 2017 example from New South Wales (see Box 5.5 below).

...one example we have worked on with the New South Wales Government, where they created the capacity for developers to offset degradation in the ecosystem by contracting landholders to replace the vegetation that was destroyed in the development project. There are lots of developers and lots of landholders, but by the time you impose all of the rules and regulations about who can trade with whom and you consider the huge number of species that have to be considered in offsetting—by the time all of those things are put in place—markets thin out and become uncompetitive.⁴⁰

- 5.75 Further, the CMD continued, a well-structured market design can foster market thickness by ensuring the presence of ample actors from both sides.⁴¹ It told the Committee that:

In the case of New South Wales, what we did was to create a search algorithm. Basically, a computer ran through all of the buyers and sellers, and had all the rules embedded in the code, and that allowed us to identify who could trade with whom.

...

³⁸ Professor Simon Loertscher, Director, Centre for Market Design, University of Melbourne, *Committee Hansard*, 18 May 2023, p. 22.

³⁹ Mr Gary Stoneham, Director, Policy Projects, Centre for Market Design, University of Melbourne, *Committee Hansard*, 18 May 2023, p. 23.

⁴⁰ Mr Gary Stoneham, Director, Policy Projects, Centre for Market Design, University of Melbourne, *Committee Hansard*, 18 May 2023, p. 23.

⁴¹ In commodity markets, congestion is effectively eliminated through pricing. A price conveys all the necessary information that sellers and buyers need to make informed decisions.

The second intervention was to create a bargaining space, a central clearing house, where all of the buyers and sellers that could transact, according to the regulations, gathered in a central location. So you can thicken the market in that way and allow competition to do its thing.

...

The sorts of gains that you might get out of that in terms of value in the economy—we refer to that as economic efficiency—we've tested in the laboratory, and it sort of scales from 18 per cent, where you just allow people to go find their own counterparty and bargain, to 90-plus per cent if you do the sorts of things I've just described. There is a lot of improvement in value created by designing a market in that case.⁴²

Box 5.5 A case study on biodiversity offsets in New South Wales

This example refers to the New South Wales Biodiversity Offset Scheme, which commenced in its current form in August 2017.

Background: With ever more urbanisation and development projects, there is a growing need to offset their environmental impact, particularly the degradation of ecosystems. Biodiversity offsets have emerged as a solution where developers can compensate for the environmental harm they cause by funding conservation activities elsewhere.

Challenge: Despite there being numerous developers and landholders, the market for biodiversity offsets can become thin and uncompetitive due to stringent rules and regulations. These dictate who can trade with whom and take into account the potential harm to a vast number of species that needs to be considered for offsetting. As a result, identifying potential trading partners becomes a complex task.

Market Design Solution:

Search Algorithm — A computerised search algorithm was developed to navigate through all the buyers (developers) and sellers (landholders). All the trading rules were embedded in the algorithm's code, enabling it to identify potential trading matches based on compatibility and regulatory compliance.

Thickening the market — With the use of the search algorithm, the market was effectively 'thickened'. Potential trading partners could be identified more efficiently, making the market more competitive.

Benefits: With a more efficient and competitive market, developers could find suitable offset opportunities more quickly, and landholders could get fair compensation for their conservation efforts. This not only ensures environmental conservation but also promotes economic activity in the offset market.

⁴² Mr Gary Stoneham, Director, Policy Projects, Centre for Market Design, University of Melbourne, *Committee Hansard*, 18 May 2023, p. 23.

5.76 The Committee has heard how modern technology offers transformative solutions for creating thick markets. Treasury explained that by using technology, the decision-making processes for both clients and providers can be significantly enhanced.⁴³ Providers can gain insights into optimal locations for service delivery and discern the types of services that are in high demand. Concurrently, clients benefit from real-time information on available choices and their respective advantages. This is particularly crucial as it directs clients towards choices that align best with their needs, based on the services on offer.⁴⁴

ii) Avoiding congested markets

5.77 The Committee notes that preventing congestion, caused by insufficient time or resources to assess all transactions, is crucial once market thickness is achieved. With an abundance of sellers and buyers, sifting through every option becomes a daunting task. The Committee is aware of research by US economist Professor Alvin Roth which suggests that congestion can trigger a phenomenon called unravelling, where transactions begin even before the official opening of the marketplace. Such premature dealings can cause participants to miss out on the benefits of a more robust, thick market.⁴⁵

iii) Is it safe to participate?

5.78 The economic literature shows that a well-structured market design must not only be safe but also sufficiently straightforward to encourage participation within the market. Otherwise, alternative transaction methods would be sought. Ensuring the system is both secure and accessible to all participants is key.⁴⁶ In the words of Treasury, it is critical 'that the providers and the consumers have trust and faith that what is happening in terms of allocation is best for them'.⁴⁷ This will stop participants from engaging in costly and risky behaviour.

Box 5.6 Key principles of market design

While specific strategies must be tailored to tackle distinct market failures, the following foundational principles should always be taken into account:

- 1 Create Market Thickness: Ensure an ample number of participants on both the buying and selling sides, fostering a rich environment for potential transactions within the market.

⁴³ Mr Jason McDonald, Division Head, Competition Taskforce Division, Treasury *Committee Hansard*, 15 September 2023, p. 31.

⁴⁴ Mr Jason McDonald, Division Head, Competition Taskforce Division, Treasury *Committee Hansard*, 15 September 2023, p. 31.

⁴⁵ A Roth, 'Marketplaces, Markets and Market Design', *American Economic Review*, 108/7 (2018), pages 1609–1658.

⁴⁶ G Haeringer, *Market Design: Actions and Matching*, The MIT Press, 2018.

⁴⁷ Mr Jason McDonald, Division Head, Competition Taskforce Division, Treasury, *Committee Hansard*, 15 September 2023, p. 30

- 2 Avoid Congestion: Transactions should be facilitated in a manner that prevents system overloads, particularly during high-demand periods.
- 3 Safe and simple participation: The market should be structured in a manner that instils confidence in participants. It should be easy to navigate, encouraging participation by minimising barriers to entry.

Endurance of market design

- 5.79 The Committee heard from Treasury that for market design to be effective and enduring, it is essential to acknowledge the multifaceted nature of human objectives and the limitations of rational judgment. Treasury stated that it is important to incorporate market design with behavioural insights ‘because things that you might think are fantastic and will work well, from a theoretical perspective, may not work because you have humans involved in these markets’.⁴⁸ Additionally, human behaviour can deviate from that anticipated by behavioural norms.⁴⁹
- 5.80 Therefore, Treasury continued, ‘thoughtful, deep market design and careful experimentation are important’⁵⁰ in crafting rules that remain resilient against a spectrum of misbehaviour.⁵¹
- 5.81 The Committee is aware that while certain forms of misbehaviour can be anticipated, others remain unpredictable. Therefore, thoroughly evaluating a new design is inherently an engineering task, one that needs to be rigorous to withstand laboratory stress testing when the market design is novel.⁵² In the words of the Productivity Commission, ‘...We need a lot more experimentation to properly try things, gather the data, evaluate the outcomes and work out what works, and then we can roll out what works’.⁵³

Implementing market design

- 5.82 The Committee acknowledges that the implementation of market design in government and other sectors marks a pivotal shift towards systems that are both more efficient and equitable. It understands that a ‘one size fits all’ approach fails to

⁴⁸ Mr Marcus Bezzi, Chief Adviser, Competition Taskforce Division, Treasury, *Committee Hansard*, 15 September 2023, p. 30.

⁴⁹ A Tversky and D Kahneman, ‘The belief in the law of small numbers’, *Psychological Bulletin*, 76 (1971), pages 105–110.

⁵⁰ Mr Marcus Bezzi, Chief Adviser, Competition Taskforce Division, Treasury, *Committee Hansard*, 15 September 2023, p. 30.

⁵¹ G Bolton, ‘Not up to Standard: Stress Testing Market Designs for Misbehavior’ in N Vulkan, A Roth and Z Neeman, eds, *The Handbook of Market Design*, Oxford University Press, 2013, pages 51–61.

⁵² Considering the challenges associated with predicting human (mis)behaviour, it may be prudent to test a new market design in phases. This could begin with a lab setting, which is less costly and poses minimal risk, followed by small-scale field tests that are more expensive and carry somewhat higher risk. Finally, the design could advance to broad implementation, which is the most costly stage and poses significant risks (see G Bolton, ‘Not up to Standard: Stress Testing Market Designs for Misbehavior’ in N Vulkan, A Roth and Z Neeman, eds, *The Handbook of Market Design*, Oxford University Press, 2013, pages 51–61).

⁵³ Dr Stephen King, Commissioner, Productivity Commission, *Committee Hansard*, 15 September 2023, p. 69.

tackle the unique challenges and market failures inherent in different contexts. The application of market design, demonstrated in scenarios as diverse as organ transplants (Roth et al. 2005)⁵⁴ to public housing allocations (Sharam et al. 2018)⁵⁵ has shown it can provide robust solutions. The aforementioned examples were successful by creating, analysing, and restructuring markets to optimise performance.

- 5.83 The Committee recognises the transformative impact of matching markets in revolutionising the allocation of human services, where the specific pairing of parties is critical. In matching markets, where allocation is based on type and preferences rather than ability to pay, a range of human services are offered efficiently. These include organ transplants but also offers for places at schools and universities, medical internships, and public housing allocations. Each of these applications relies on a detailed understanding of participants' needs and preferences, highlighting the depth and flexibility of market design in addressing a wide array of societal needs.

The role of a market maker

- 5.84 Successful implementation also requires a market maker. As an architect and facilitator, the market maker smooths market operations, thus ensuring optimal matches and maximising overall efficiency and fairness.
- 5.85 The Committee is aware that the economic architecture sets the stage for interactions between buyers and sellers, often necessitating market maker interventions for optimal function. For example, in commodity markets, centralised clearing houses such as the Chicago Board of Trade manage issues such as asynchronous arrivals, while simultaneously standardising metrics and establishing intermediaries for a streamlined process. Another example is provided by firms such as Amazon and eBay, whose electronic trading platforms and reputation systems facilitate transactions.
- 5.86 The Committee is aware that while all markets benefit from some common interventions such as regulatory oversight, others require specific solutions, particularly in matching markets where central pools of participants, acceptance protocols, and coordinated scheduling are crucial. These interventions, which are often too complex or critical to be left to the mechanism alone, necessitate a market maker to ensure diverse and efficient trading environments. Such interventions may include:
- Engagement Processes and Protocols: Pre-qualification procedures and participant training ensure smooth operations and an understanding of the market's workings.

⁵⁴ A Roth, T Sönmez and U Ünver, 'A Kidney Exchange Clearinghouse in New England', *American Economic Review*, 95/2 (2005), pages 376–380.

⁵⁵ A Sharam et al, 'Matching markets in housing and housing assistance', *Australian Housing and Urban Research Institute Limited*, AHURI Final Report No. 307 (2018), www.ahuri.edu.au/research/final-reports/307.

- **Standardised Contracts:** Clear definitions of the goods or services being traded and the incentives for all parties involved.
- **Thickening Markets:** The use of interventions to gather and organise participants, manage their interactions, and implement effective transaction rules and protocols.
- **Monitoring and Verification:** The establishment and enforcement of standardised contracts with designed incentives and protocols, along with mechanisms to monitor and verify outcomes.
- **Strategic Behaviour Management:** The integrity of the mechanism is protected by embedding specific rules and processes to prevent unwanted behaviour.

Committee comment

- 5.87 The Committee concludes from the evidence presented to it that the application of market design principles in government operations offers a promising avenue for enhancing operational efficiency and fairness. By recognising the unique attributes of government commodities, such as the need for widespread geographical coverage, market design can be tailored to accommodate these specificities, thereby ensuring that markets are not only competitive but also responsive to the diverse needs of the population.
- 5.88 Moreover, the strategic implementation of well-structured rules can significantly reduce market power while promoting competition, which leads to more equitable outcomes for all participants. Embracing market design in government procurement policy and operations is not just beneficial but essential to modernise and optimise service delivery, ensuring that government agencies can meet their obligations effectively and efficiently.

Box 5.7 Key finding

Market Design

- That market design mechanisms (including designed auctions and matching markets) have already been used to materially improve outcomes in a range of areas including:
 - Skills matching (e.g. the placement of legal and medical graduates in the US)
 - Environmental outcomes; and
 - Situations involving thin markets, such as the delivery of services in regional and rural markets.

Recommendation 21

- 5.89 **That the Government examine the potential scope for the use of market design in areas where:**

- Traditional market mechanisms face challenges (e.g. price is not the best or only appropriate allocation mechanism).
- This could include situations in which there are:
 - Material supplier or consumer heterogeneity issues that limit the effectiveness of the price mechanism.
 - Co-ordination issues between suppliers and/or consumers.
 - Thin markets.

Recommendation 22

5.90 That the Government explore ways to develop and implement matching markets (or reform existing markets) where thin markets are a problem. This could include:

- Creating platforms or trading mechanisms that encourage participation from a diverse range of stakeholders where such platforms or mechanisms may not arise through other means (eg due to market failure). Where platforms or mechanisms have arisen without government prompting, to consider whether regulation is appropriate.
- Exploring the possibility of setting up physical or virtual marketplaces tailored to the needs of specific regions or communities.
- Incentivising access for all eligible individuals, irrespective of their location or background.
- Using media to contact potential participants and inform them about market opportunities.

Recommendation 23

5.91 That the Government (along with market design experts), develop, undertake and evaluate a series of pilot projects to test the potential for market design to provide benefits in different areas of social service delivery. This could include:

- The delivery of complex services, particularly in outer-urban or regional and rural areas.
- The delivery of services that require considerable co-ordination between clients.

Government procurement

5.92 The Committee is aware of the role of government procurement policy as a practical tool in shaping competition. Through procurement, the Federal Government consumes tens of billions of dollars' worth of goods and services. Ensuring that

companies compete on price and quality does not just enhance value for money for the taxpayer—it can also enhance competition in the markets through which government procures, thus serving as an alternative or complement to traditional regulatory mechanisms.

- 5.93 The Committee shares the view of the University of Melbourne’s Centre for Market Design (CMD) and the National Competition Council (NCC) that some areas of procurement could benefit from a more nuanced approach. Where a one size fits all approach is adopted, it may fail to consider the unique aspects of each procurement scenario and ignore what is the ‘best procurement practice to actually get the best outcome’.⁵⁶
- 5.94 The Committee acknowledges that market design offers an opportunity to resolve a specific problem by allowing for the creation of procurement mechanisms that are better suited to the particular goods being acquired. CMD research has shown that procurement design opens up the prospect of harnessing competition and provides incentives that more effectively achieve cost savings for government. Accordingly, it is now possible to design fit-for-purpose mechanisms that improve procurement outcomes for government.⁵⁷

Electronic markets for homogenous goods

- 5.95 The Committee recognises the significant influence that tender design can have on the procurement process for homogenous goods, and how this may affect value for money. The Committee is also aware that the procurement methods employed by many governments for these goods do not always align with best practice.
- 5.96 The use of closed tenders, or restricted tenders, means only a select group of suppliers is invited to bid.
- 5.97 While closed tenders may have advantages where specialised expertise is required, or there are security or confidentiality concerns, the Committee heard evidence that in the supply of homogeneous goods, a closed tender can stifle competition. This is due to the limitation of participation, which may lead to a decrease in innovation and diversity of offerings, less favourable pricing and quality due to a lack of competitive pressure, and can even induce ‘collusive’ behaviour among the participants.⁵⁸
- 5.98 Closed tenders can often involve a select group of bidders who are familiar with each other, which creates an environment that is conducive to collusive behaviour. As Professor Plott noted, a closed tender can cause an ‘extremely thin market...with the possibility of collusion’.⁵⁹

⁵⁶ Mr Martin Wallace, Councillor, National Competition Council, *Committee Hansard*, 15 September 2023, p. 15.

⁵⁷ The University of Melbourne, Centre for Market Design, ‘Procurement Case Studies: Victoria’, pages 5–7.

⁵⁸ Professor Simon Loertscher, Director, Centre for Market Design, University of Melbourne, *Committee Hansard*, 18 May 2023, p. 23.

⁵⁹ Dr Charles Plott, Private capacity, *Committee Hansard*, 18 May 2023, p. 11.

5.99 Where there is a small number of participants, they can coordinate on bids and make agreements to divvy up contracts, which reduces competition. Companies may also collude by choosing a tender winner, on the understanding that each company will eventually get their turn in future tenders.

5.100 The ACCC commented that:

...in some areas...cartel behaviour is happening through procurement processes. This is either because of the way panels are structured, so parties know who the only competitors are to supply the services or because there are elements about the necessary probity that government procurement goes through that provide greater observability to possible parties contracting with government...⁶⁰

5.101 Where bidders have incomplete information about the true value of the item or contract being bid on, closed tenders may give rise to the winner's curse problem. This occurs when the winning bidder realises they have overpaid for a contract.

5.102 The Committee also heard that small tweaks in the procurement design can lead to a significant increase in competitive tension.

5.103 For example, using electronic marketplaces and their digital platforms to streamline the procurement process can mitigate the constraints of closed tenders. This transformation introduces several key advantages, which may include:

- A broadening of competition and a lowering of the barriers to entry by providing an accessible platform for a diverse range of suppliers, including small to medium enterprises (SMEs). In this vein, the Victorian Chamber of Commerce and Industry (VCCI) told the Committee that in going digital:

...a business doesn't have to duplicate the system or the application process and information that's required for each department each time. That duplication issue is definitely a big issue and a big impediment to our members when they are applying for procurement processes.⁶¹

- Greater firm entry, which may result in more competitive pricing and better value, and enhanced innovation due to suppliers being motivated to differentiate their offerings from competitors.
- Improved market efficiency and the potential for dynamic pricing through faster and more responsive buyer-supplier matchmaking.
- More flexibility and adaptability to evolving technologies and market conditions as well as the ability to automate tasks to reduce administrative burdens and enhance overall efficiency. In relation to this, the CMD told the Committee that:

The solution to it is to migrate to electronic auctions or systems, build them once, store them as a library and reuse them for the same problem if the problem

⁶⁰ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 17 March 2023, p. 12.

⁶¹ Ms Sonja Rose, Principal Policy Adviser, Policy and Advocacy, Victorian Chamber of Commerce and Industry, *Committee Hansard*, 4 July 2023, p. 32.

remains the same. This whole process of design, store, reuse would mean you get better value out of the design process.⁶²

- **Reduced red tape:** CMD research has shown that electronic auctions or markets can be easily reused or adapted at a low cost for repeated or similar procurement activities and have been shown to substantially shorten the procurement life cycle.⁶³

5.104 Additionally, the Committee heard evidence that governments worldwide have achieved significant savings by using dynamic electronic markets. The CMD submitted that such tendering processes have achieved savings between 15 and 50 per cent. It told the Committee that:

Brazil, for example, went to Comprasnet, which is the use of auctions rather than negotiation to procure paper and, basically, commodities. [...] In the UK a lot of procurement occurs in the local government area, and a lot of those have started using slightly more designed procurement processes.⁶⁴

5.105 Separately, Professor Plott advised that setting up an e-market in the tender process for petrol purchases by the State Government had delivered substantial savings for the State Government in the tendering process.⁶⁵

Box 5.8 Fuel procurement for the Victorian Government vehicle fleet

Context: The Victorian Government buys about 50 million litres of fuel annually, at a cost of about \$100 million.

The Government ran a tender for the right to provide the fuel for fleet vehicles.

Old procurement strategy:

The Government ran a two-stage sealed bid tender:

- 1 First stage: fuel providers offered provisional discounts; and a subset of bidders was shortlisted.
- 2 Second stage: the shortlisted bidders negotiated with the Government around their final bids.

Three providers were selected based on the discount offered and to ensure wide geographical coverage.

The amount of the discount varied among the three contracted providers.

However, this strategy had a number of drawbacks:

⁶² Mr Gary Stoneham, Director, Policy Projects, Centre for Market Design, University of Melbourne, *Committee Hansard*, 18 May 2023, p. 26.

⁶³ The University of Melbourne, Centre for Market Design, 'Procurement Case Studies: Victoria', p. 8.

⁶⁴ Mr Gary Stoneham, Director, Policy Projects, Centre for Market Design, University of Melbourne, *Committee Hansard*, 18 May 2023, p. 26.

⁶⁵ Dr Charles Plott, Private capacity, *Committee Hansard*, 18 May 2023, p. 13.

- There was no incentive for drivers to use the fuel provider that offered the highest discount; and
- There was an incentive for fuel providers to offer smaller discounts because even if they came second or third in the bidding process, their fuel card would still be used by drivers.

In other words, there was a lack of competitive tension because three fuel providers would effectively be winners.

An alternative model set up by the Centre for Market Design:

- A pre-qualification step ensured that the fuel suppliers could guarantee wide geographical coverage across the state.
- The rules were changed: on offer was a Primary Fuel Card for all government fleet vehicles and two Secondary Fuel Cards specifically for regional and emergency services. This move introduced competitive tension.
- The type of auction held was a “multiple clock ascending price auction”. While a very technical term, the key is that this process determines the prices of all three cards simultaneously. This rules out the potential for any collusion among bidders.
- There was no negotiation phase.
- Participants could bid to be the provider of any of three fuel cards, but could only win one of the three cards.

The process increased competition to be the provider of the primary card and curbed strategic bidding because there was no perverse incentive to finish second or third.

Outcome: A 100 per cent increase in the fuel discount offered by the provider of the primary fuel card.

5.106 The Committee acknowledges that when government entities institute efficient procurement policies, competitive pricing and efficient processes lead to savings.

5.107 This allows government to use that money in other critical areas, ensuring that taxpayers receive better value. The abovementioned fuel procurement process in Victoria resulted in a 100 per cent improvement in the discount of fuel purchases compared with previous procurement outcomes, according to the CMD.⁶⁶

Procurement of professional services

5.108 The Committee recognises that, in contrast to homogenous goods, professional services exhibit a greater diversity of characteristics. Such services are currently procured through the use of government panels.

⁶⁶ The University of Melbourne, Centre for Market Design, ‘Procurement Case Studies: Victoria’, p. 16.

- 5.109 The Committee understands that vetting through panels introduces several efficiencies:
- The presence of experts on panels ensures a thorough examination of the issues in the decision-making process, which should mean better outcomes.
 - They minimise the need to re-evaluate each company or provider for each procurement, thus reducing transaction costs.

5.110 However, the Committee is also concerned that the use of panels can exclude potential service providers who might otherwise introduce competitive tension.

5.111 SMEs and social enterprises, for example, may be excluded because participating in the panel procedures can be expensive and complex. The bureaucratic complexity of panel processes often favours instead larger, well-established companies that have the resources to navigate these challenges. Expanding on this point, the VCCI told the Committee that:

If we're encouraging small businesses, in particular, or anyone that hasn't engaged with government procurement at the state or Commonwealth level, there's a capability gap there... There's a language of procurement. It's a whole different world. You can be really good at your work as an employer or as a business delivering a good or service, but you might not be good at writing a tender.⁶⁷

5.112 The Committee is also aware that if vetting is done separately by each department, SMEs face a challenge as they have to apply for panels across various departments, thereby incurring substantial costs and risks. This can limit the participation of some SMEs, thus affecting the diversity and competitiveness of the market.

5.113 Additionally, the Committee heard that existing procurement processes benefit incumbents. The e61 Institute told the Committee that:

...older incumbents have been increasingly likely to receive government contracts over time. There is an issue there about the extent to which our institutions and government can encourage a level playing field.⁶⁸

5.114 Ultimately, there is a trade-off between the efficiencies of vetting and the potential inefficiencies of a reduction in competitive tension.

5.115 The ACCC stated that the way panels are structured has the potential to lead to collusive behaviour.

Parties know who the only competitors are to supply the services, or because there are elements about the necessary probity and process that government procurement goes through that provide greater observability to possible parties

⁶⁷ Ms Sonja Rose, Principal Policy Adviser, Policy and Advocacy, Victorian Chamber of Commerce and Industry, *Committee Hansard*, 4 July 2023, p. 32.

⁶⁸ Mr Dan Andrews, Research Director and Head of Policy Engagement, e61 Institute, *Committee Hansard*, 2 May 2023, p. 4.

contracting with government so that it's more discoverable for them to operate in a collusive fashion.⁶⁹

5.116 The frequency with which these panels are updated or refreshed with new providers is critical to competition in procurement. Infrequent updates can result in the interim exclusion of numerous entities. The VCCI told the Committee that:

...what's decided at executive government, once it materialises and comes down through the departments and the service delivery arm, doesn't necessarily reflect what the intent was. As a consequence of that, a lot of businesses find themselves quite frustrated.⁷⁰

5.117 The Committee also shares the view put forward by Zepto Payments, that making panel entry requirements clearer and more transparent may be an effective way to reduce barriers to entry.

The requirements to get on to a panel could be made more transparent so people can meet them...maybe there's a way to structure a panel process whereby smaller competitors can come in and give a presentation for one hour, for example, which would be a much easier way for us to do it, and showcase our product...in order to fight for that work.⁷¹

Small business and social procurement

5.118 The Australian Bureau of Statistics defines a small business as an actively trading business with 0 to 19 employees and a medium-sized business as an actively trading business with 20 to 199 employees. Employment size ranges are based on headcount rather than a measure of full-time equivalent people.⁷²

5.119 Small businesses include SMEs and other types of organisations such as not-for-profits and social benefit suppliers, which are organisations and businesses whose mission is centred on a social purpose. Social benefit suppliers include social enterprises that generate employment and deliver other social outcomes.⁷³

5.120 The Committee heard that the current design of procurement policy, which often involves bundling goods and services or entails significant transaction costs, risks excluding many SMEs and firms that provide unique or unconventional services. This

⁶⁹ Ms Gina, Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 17 March 2023, p. 12.

⁷⁰ Mr Dylan Broomfield, General Manager, Policy and Advocacy, Victorian Chamber of Commerce and Industry, *Committee Hansard*, 4 July 2023, p. 32.

⁷¹ Mr Gabe Perrottet, Senior Legal Counsel, Public Policy and Regulation, Zepto Payments, *Committee Hansard*, 3 May 2023, pages 9–10..

⁷² Australian Bureau of Statistics, *Small Business in Australia*, www.abs.gov.au/ausstats/abs@.nsf/DOSSbyTopic/297DB51F08B97920CA256BD000281897?OpenDocument, viewed 24 February 2024.

⁷³ Victorian Government, *Improving access to government business for SMEs – goods and services procurement guide*, www.buyingfor.vic.gov.au/improving-access-government-business-small-and-medium-enterprises-goods-and-services-procurement, viewed 24 February 2024.

is because larger, more established firms are typically better equipped to handle such procurement structures. Aggregating services into large contracts often limits the number of firms that can realistically bid, thus reducing competition.

- 5.121 The Committee is aware that the Victorian and Queensland Governments advocate for segmenting parts of the overall procurement package.⁷⁴ This approach is designed to enhance competition and enable a greater diversity of providers, while still ensuring value for money.
- 5.122 Unbundling large tasks allows a wider array of firms to participate in different aspects of a project. While this may increase transaction costs, by having to run multiple procurement processes, it could enrich the competitive landscape by involving more firms. Moreover, breaking up tasks could potentially lower the barriers to social enterprises, enabling them to compete on more of a level-playing field with for-profit entities. The Victorian Department of Government Services told the Committee that unbundling:
- ...allows the social enterprises to win work that they otherwise would not have the capacity to do. Then, once they win that particular work, it provides an opportunity to build their capabilities to be able to tender for even bigger projects as well.⁷⁵

Challenges and opportunities for social procurement

- 5.123 Social enterprises are a growing segment in the Australian economy. Social enterprises exist to create a fairer, more sustainable world. They must do three things:
- Have a defined primary social, cultural or environmental purpose;
 - Derive a substantial portion of their income from trade; and
 - The public/community benefit must outweigh the private benefit.
- 5.124 There are more than 12,000 social enterprises in Australia. They contribute \$21.3 billion to the economy each year and account for 1 per cent of GDP. They employ more than 200,000 people; 1 in 60 jobs or 1.6 per cent of the workforce. This is about the same number of people as employed in arts and recreation services or the mining industry.
- 5.125 The Committee recognises that social enterprises are unique in the economy, blending diversity, dynamism, and a commitment to social good. Differing from traditional businesses, they prioritise social goals, focusing on community and

⁷⁴ Ms Sharon Bailey, Deputy Director-General, Queensland Government Procurement, Department of Energy and Public Works, *Committee Hansard*, 30 June 2023, pages 38–39. Dr Vasko Nastevski, Director, Procurement Assurance, Department of Government Services, Victoria *Committee Hansard*, 26 July 2023, p. 20.

⁷⁵ Dr Vasko Nastevski, Director, Procurement Assurance, Department of Government Services, Victoria *Committee Hansard*, 26 July 2023, p. 20.

environmental wellbeing. This approach redefines 'value for money' to include wider social and environmental benefits.

5.126 The Committee shares the view of witnesses in the social enterprise sector that the current procurement processes often place social enterprises at a disadvantage compared to the offerings from larger, more established firms. Social Enterprise Australia stated that:

The greatest barrier for social enterprises in a procurement sense is when price, not value, determines who is awarded the contract. It is very hard for social enterprises, including large ones, to tender on the basis of price when they fundamentally care about the quality and the public outcomes that their service is creating. The risk at the moment is that if it is just on price it's a race to the bottom. It's not about the specific challenges that the government and the enterprise are both trying to tackle.⁷⁶

5.127 The Victorian Department of Government Services stated that:

The value for money concept doesn't necessarily always come down to the price. There are obviously other things that we place value on such as social outcomes...[and a set of] qualities that can flow back to the community...we'll value the social outcome and the environmental outcomes that flow to the broader community.⁷⁷

5.128 Further, the Social Enterprise Council of NSW & ACT advised that:

There is also a mindset difference...[The way] social enterprises think and work, which is relational, shared value, 'How do we all win out of this? How can this project deliver the maximum value to this community?'⁷⁸

5.129 The Committee also shares the view of witnesses in the social enterprise sector that by adopting a social procurement framework that supports social enterprises, government can use its spending power to generate both social and economic outcomes, thereby creating a more inclusive and beneficial economy. The Committee heard that:

Government is already spending money, buying things, so why not spend the same amount of money but buy from organisations that are having a positive impact on people and the planet?⁷⁹

...

⁷⁶ Ms Jess Moore, Chief Executive Officer, Social Enterprise Australia, *Committee Hansard*, 5 July 2023, pages 16–17.

⁷⁷ Dr Vasko Nastevski, Director, Procurement Assurance, Department of Government Services, Victoria, *Committee Hansard*, 26 July 2023, p. 20.

⁷⁸ Ms Kylie Flament, Chief Executive Officer, Social Enterprise Council of NSW & ACT, *Committee Hansard*, 5 July 2023, p. 7.

⁷⁹ Ms Kylie Flament, Chief Executive Officer, Social Enterprise Council of NSW & ACT, *Committee Hansard*, 5 July 2023, p. 4.

Social procurement is a ready-made solution to embed social value into the economy by directing the market to compete on best value, rather than lowest cost...Social enterprise sector can partner with government to create a more dynamic economy that puts public benefit ahead of private benefit.⁸⁰

5.130 The Committee is also aware that focusing on social procurement not only yields social benefits but also offers tangible financial advantages to government. By incorporating a broader range of service providers, government enhances its service provision ecosystem.

5.131 For example, the Committee heard evidence that the social enterprise sector includes thousands of firms that employ tens of thousands of people.

5.132 The social procurement frameworks implemented by the State Governments in Queensland and Victoria have ensured the successful employment of thousands of vulnerable individuals and have also accomplished various environmental and social objectives. Social Traders told the Committee that:

...by 2030 social enterprise procurement will deliver 44,000 jobs for Australia's most marginalised jobseekers and in doing that it will generate savings to society of over \$4 billion.⁸¹

5.133 Regarding the financial viability of social enterprises, the Committee recognises that although they may achieve success and cash flow in a competitive commercial environment, such earnings can be cyclical and uncertain.

5.134 The Committee heard that social procurement provides social enterprises with a steady and reliable cash flow, which is essential for stability and expansion. This reliable source of income, often from government contracts, allows social enterprises to plan and grow with confidence. Social Enterprise Australia told the Committee that:

Government...is a secure and reliable buyer. If a social enterprise secures a contract and is able to grow through that contract, that increases its ability to then service other businesses as well. Government contracts can also enable growth in the sector that meets the capacity to deliver services but also public outcomes more broadly.⁸²

5.135 In a similar vein, the Social Enterprise Network Tasmania stated that:

To have those longer-term opportunities is significant for building the sustainability of social enterprises, rather than knowing that you only have a six-month contract and wondering where you get the next lot of business.⁸³

⁸⁰ Ms Tara Anderson, Chief Executive Officer, Social Traders, *Committee Hansard*, 5 July 2023, p. 13.

⁸¹ Ms Tara Anderson, Chief Executive Officer, Social Traders, *Committee Hansard*, 5 July 2023, p. 13.

⁸² Ms Jess Moore, Chief Executive Officer, Social Enterprise Australia, *Committee Hansard*, 5 July 2023, p. 18.

⁸³ Mr Paul Quilliam, Managing Director, Social Enterprise Network Tasmania, *Committee Hansard*, 5 July 2023, p. 5.

5.136 The Committee shares the view of the VCCI that the financial stability of social enterprises may be complemented by capacity building. The VCCI advised that:

One of the greatest impediments to competition is businesses not feeling more encouraged to go and participate. You can look at all the other elements and all the other drivers, but it's making them feel that they have an ability to do it that isn't too cumbersome which is probably more important than anything else...You get someone from a department who helps you go through and navigate the parts you missed out on.⁸⁴

5.137 The Committee also heard that the use of advisors may be crucial in identifying potential partnerships and in guiding companies on how to initiate and conduct procurement processes, as well as how to connect with relevant social enterprises. The Victorian Department of Government Services advised that:

We work right through the procurement process. We support the evaluation often as well in those processes, and then we also are undertaking some activity with projects that are during delivery. We'll go in and have a look at what's been committed in contracts when it comes to social procurement and then how the contractors or suppliers are performing against those commitments during the life of the project.⁸⁵

5.138 The Committee believes that certification is crucial for social services because it ensures quality and facilitates social procurement.

5.139 For example, organisations such as the Social Enterprise Council of New South Wales and the ACT, the Victorian Government, and Social Traders emphasised that when accreditation is rigorous and well structured, it not only validates the credibility of social services but also aids in quantifying their impact. This, in turn, can lead to more informed decision-making and resource allocation by government bodies and other stakeholders, fostering a more accountable and impactful social services sector. The Committee heard that:

...there has been a lack of shared impact measures. At the moment, anyone can pick the social impact measures or environmental impact measures that they want and say, 'Look. We protected three frog species and that was the environmental impact of this project.' We need some shared impact measures so that we're talking the same language, measuring in the same way and reporting in the same way.⁸⁶

...

⁸⁴ Mr Dylan Broomfield, General Manager, Policy and Advocacy, Victorian Chamber of Commerce and Industry, *Committee Hansard*, 4 July 2023, p. 34.

⁸⁵ Ms Sam Edmonds, Manager, Social Procurement Assurance, Department of Government Services, Victoria, *Committee Hansard*, 26 July 2023, p. 19.

⁸⁶ Ms Kylie Flament, Chief Executive Officer, Social Enterprise Council of NSW & ACT, *Committee Hansard*, 5 July 2023, p. 11.

...the Victorian government is investing...to develop a measurement tool for social enterprises to be able to evaluate and make assessments in terms of their long-term outcomes. [...] we embed social procurement assurance advisors within individual projects across the whole of Victorian government to ensure that the Social Procurement Framework, and as an indirect consequence of that social enterprises, are given visibility and are connected to those projects and are certainly engaged where it's fit for purpose.⁸⁷

...

...Social Traders certification is the only way to identify a genuine social enterprise from a business that may be attempting to social wash.⁸⁸

5.140 Social Traders told the Committee that the use of aggregated contracts or 'supporting coalitions and alliances of social enterprises'⁸⁹ can significantly streamline the procurement process, offering a strategic advantage to both the public sector and smaller suppliers, including SMEs and social enterprises.⁹⁰

5.141 The Committee also heard that consolidating requirements into larger, '...aggregated contracts, where there might be a lead contractor and a number of suppliers'⁹¹ can level the playing field for social enterprise SMEs, which might otherwise find it challenging to independently bid for larger contracts. This provides these SMEs with access to opportunities that might otherwise be out of reach due to their size or resources. Aggregation may allow for:

- A diverse range of suppliers to participate, which not only introduces a variety of business models and innovative solutions but also encourages competition that can drive down costs through economies of scale. For example, the Victorian Department of Government Services told the Committee that:

...accessing diverse talent, employees, through social enterprises or through direct employment is so critical because there are skill shortages across a lot of the sectors that government procures from. Filling some of those skills gaps using social enterprises or other sources of talent that face barriers to employment is a huge benefit of social procurement...⁹²

- Gaining the experience and exposure necessary for SMEs to enhance their capabilities and market presence through:

⁸⁷ Dr Vasko Nastevski, Director, Procurement Assurance, Department of Government Services, Victoria, *Committee Hansard*, 26 July 2023, p. 18.

⁸⁸ Ms Tara Anderson, Chief Executive Officer, Social Traders, *Committee Hansard*, 5 July 2023, p. 13.

⁸⁹ Ms Tara Anderson, Chief Executive Officer, Social Traders, *Committee Hansard*, 5 July 2023, p.16.

⁹⁰ Aggregated contracts refer to a procurement strategy where a government consolidates its requirements and procures goods or services in a collective manner. Instead of issuing multiple separate contracts, the government aggregates or bundles the contracts, appointing a lead contractor who further collaborates with multiple suppliers, including SMEs and social enterprises.

⁹¹ Ms Jess Moore, Chief Executive Officer, Social Enterprise Australia, *Committee Hansard*, 5 July 2023, p. 21

⁹² Ms Sam Edmonds, Manager, Social Procurement Assurance, Department of Government Services, Victoria, *Committee Hansard*, 26 July 2023, p. 21.

- Sharing of knowledge and best practices, due to the opportunity to work alongside larger contractors, which can enhance their competitiveness in future tenders.
- Increased flexibility due to having multiple suppliers contributes to a more adaptable and responsive procurement system, capable of meeting specific needs and adjusting to market changes.

5.142 Where procurement processes establish high barriers to entry, they can exclude firms from participating, reducing competitive tension and overall economic dynamism. This can take a number of forms. Where the barriers to entry are high transaction costs (eg filling in complex forms or lengthy tender processes), this can exclude smaller firms, even though that they may be able to perform the tasks to a high standard. Where the barriers to entry take the form of inflexible panel processes (eg infrequent refreshing of panel members), young firms may find themselves excluded from bidding for work for long periods of time, particularly if they come into existence shortly after a panel is established. Where barriers to entry take the form of work packaging (eg aggregating many tasks together), the government agency might save on transaction costs by procuring multiple tasks simultaneously – but might do so at the expense of competitive tension by excluding small and medium firms who might be able to perform sub-tasks to a high standard.

5.143 Finally, the Committee notes that Social Enterprise Australia proposes to create a social procurement policy that sets clear goals for purchasing from social enterprises; improves the availability of diverse funding options to help social enterprises start, expand, and flourish; and compensates social enterprises for their contributions to public or community benefits.

Committee comment

5.144 The Committee recognises that adopting social procurement strategies for main contractors or subcontractors could solve the issue of scale that frequently impedes small enterprises, including cooperatives and mutuals, from competing effectively. This approach could help lower the barriers for social enterprises, allowing them to compete more fairly with for-profit entities.

5.145 By integrating social procurement practices, the Government can create opportunities for these smaller or socially focused organisations to participate in the procurement process. This could involve setting aside certain contracts specifically for these types of enterprises or incorporating social value criteria into the procurement evaluation process. Such measures would not only support the growth and sustainability of small and social enterprises but would also contribute to broader social and economic objectives.

Recommendation 24

5.146 In relation to the electronic market for homogenous goods, that the Government explore (and fund) pilots for the procurement of selected goods

and services where there is potential for material gains in cost savings, quality or both.

Recommendation 25

5.147 In relation to the procurement of goods or professional services, that the Government review the use of panels and whether there are ways to capture the efficiencies of infrequent firm vetting/contractual arrangements—versus arrangements that increase the scope for a wider range of firms to offer their services.

Recommendation 26

5.148 That the Government explore ways it could adjust procurement processes to allow for greater participation by Small to Medium Enterprises (SMEs) and social enterprises. This could include adjusting the way panels are used to be less exclusionary to SMEs and social enterprises.

Recommendation 27

5.149 That the Government explore ways packages of goods and services can be unbundled to allow for SMEs and social enterprises to effectively compete to provide the goods or services. In doing so, the Government should consider:

- How to optimally manage transaction costs, allowing for the possibility that unbundling increases competitive tension in some areas of service provision.
- The potential for SMEs or social enterprises to undertake parts of the work required for an overall project.

Recommendation 28

5.150 That the Government develop a social enterprise accreditation scheme to facilitate its procurement of goods and services from social enterprises, drawing from the models already in operation in Victoria and Queensland.

Transparency and Government data sharing

5.151 Evidence presented throughout the inquiry has reinforced to the Committee that transparency and accountability in government is foundational to public understanding of issues and to the design of sound policy responses.

5.152 Government also collects and funds large amounts of data and research, which have the potential to be better used for the public good.

5.153 Governments require transparency from businesses and not-for-profit organisations in many ways, including: requirements to publish annual reports; public reporting by regulators of financial metrics and disputes with consumers; and continuous reporting requirements for publicly listed companies. This transparency is an important element of good governance, consumer protection, competition and economic dynamism.

Committee comment

5.154 Government is already transparent in a number of ways, including through publishing departmental and agency annual reports; holding public hearings, including appearing before parliamentary committees and Senate Estimates; operating Freedom of Information procedures; and other reporting requirements.

5.155 However, the Committee believes that transparency requirements could be strengthened, in particular by publicly reporting the performance of key government agencies against a number of benchmarks.

5.156 The Committee recognises the significant impact of transparency in performance metrics, particularly in enhancing customer interactions with government services. Public reporting will be important in holding organisations to account for their performance. Ensuring easy access to essential information also means citizens are better equipped to make choices that suit their needs. Additionally, the Committee acknowledges that transparency in government processes will ensure better value for money.

Transparency in government performance

5.157 When government discloses performance metrics, particularly in how customers interact with government services, this can boost both dynamism and productivity, by providing better information and by incentivising improved performance. Furthermore, when citizens are well informed and can easily access relevant information, they are empowered to make choices that best suit their needs and preferences.

5.158 As stated by the New South Wales Government: ‘Customers interact with government services daily and expect those services to be easy, effective and trustworthy, no matter who they are, where they are or what they need’.⁹³

5.159 The website of the New South Wales Government’s key delivery agency Service NSW includes a dashboard that outlines the performance of key government agencies that interact with citizens. The metrics are easily accessible and regularly updated. The dashboard focuses on three critical metrics: the ease of interacting with the services, customers’ level of satisfaction, and the degree of trust in the services’ dedication to acting in the best interests of customers. There is information on the number of calls answered, the number of visits to customer service centres, and so

⁹³ NSW Government, *Key metrics*, www.nsw.gov.au/nsw-government/state-of-customer/key-metrics, viewed 13 February 2024.

on. Data on a number of programs is published, including licence processing and disaster support.

- 5.160 The Committee believes that greater transparency around these metrics in federal government services would lead to several positive outcomes.
- 5.161 A focus on simplifying how users interact with services would facilitate a dynamic approach towards improving service delivery. It would also help cultivate a culture focused on continuous service enhancement. By ensuring that services are readily accessible, the Government could significantly reduce the time, stress, and costs associated with how the public interact with government agencies.
- 5.162 The New South Wales Government website states that: 'Regardless of their interaction with us, customers should experience the simplest path to get something done and clearly understand what's needed, including the options and entitlements available to them'.⁹⁴
- 5.163 Drawing from this example, the Committee notes that making satisfaction reports from users publicly available would highlight the strengths and weaknesses of government services. This would lead to, and allow for, consistent adjustments and refinements in line with users' evolving needs, thus boosting productivity and ultimately leading to increased overall satisfaction.
- 5.164 Additionally, making publicly available how much trust users have in the service could contribute to a more general increase in public trust. When users are confident that services are tailored to their needs, and are provided in their best interests, people are more inclined to use these services.
- 5.165 The Committee believes that regularly updating these metrics is essential to accurately track trends and make better informed decisions. Timely updates will provide a clearer understanding of the evolving landscape, enabling more responsive actions based on current data.
- 5.166 On this point, the New South Wales Government is implementing the NSW Consumer Strategy, which focuses on placing the user at the heart of government services. 'This approach not only enhances customer experience, saving time and effort, but also boosts employee engagement and productivity. It leads to better decision-making, budget efficiency, and overall productivity. By focusing on impactful areas and avoiding waste, this strategy enhances customer compliance, reduces costs associated with escalations, and supports the reuse of service models for a more integrated experience'.⁹⁵

⁹⁴ NSW Government, *Key metrics*, www.nsw.gov.au/nsw-government/state-of-customer/key-metrics, viewed 13 February 2024.

⁹⁵ NSW Government, *Customer Commitments*, www.nsw.gov.au/nsw-government/projects-and-initiatives/towards-a-customer-centric-government#toc-why-customer-centricity-is-important, viewed 13 February 2024.

- 5.167 The Committee emphasises the need for transparency in government services to be coupled with accountability. In this regard, useful models to draw from are:
- The Queensland Government's Performance Management Framework, which emphasises the significance of strategic planning in setting goals, consistently monitoring and measuring performance, and publicly reporting outcomes to maintain accountability within the public sector.⁹⁶
 - The Service Victoria Customer Service Standards, which include a comprehensive complaint handling policy that transparently outlines the steps that will be taken in the event of any issues or service failures.⁹⁷
- 5.168 The Committee is also aware that the Victorian Government, through its Service Victoria initiative, has significantly streamlined and expedited the process of conducting online state government transactions. The Victorian Government states that this 'initiative not only simplifies the procedure for users but also ensures the protection and security of their personal information'.⁹⁸
- 5.169 The Committee, based on the evidence presented to it and drawing from examples across jurisdictions, believes that the development of a government service dashboard aligns with modern best practice in public service delivery. The service dashboard will enhance service transparency, improving user satisfaction and promoting efficient public service delivery. The Committee further believes that the creation of a service dashboard will generate a more responsive consumer-centric public service framework.

Transparency in Government Data

- 5.170 Government collects and funds large amounts of data and research. There are significant opportunities for government funded data and research to be better leveraged for the public good by not-for-profits and business. The Productivity Commission noted these opportunities in their report "Advancing Prosperity" and identified a number of recommendations in this area including Recommendation 4.3 Private Sector access to government data, Recommendation 4.4 Sharing data from government-funded services, Recommendation 5.5 Using government-held data for benchmarking purposes. This use of data should be undertaken subject to suitable privacy and public good limitations, including that the data not be used inappropriately for commercial gain.

⁹⁶ Queensland Government, *Managing government performance*, www.qld.gov.au/about/how-government-works/managing-government-performance, viewed 13 February 2024.

⁹⁷ Service Victoria, *Customer Service Standards*, service.vic.gov.au/about-us/service-victoria-customer-service-standards, viewed 13 February 2024.

⁹⁸ Service Victoria, *Customer Service Standards*, service.vic.gov.au/about-us/service-victoria-customer-service-standards, viewed 13 February 2024.

Recommendation 29

5.171 That the Government continue to develop and advance its digital strategy, particularly in areas where it can enhance client outcomes.

Recommendation 30

5.172 That the Government develop a dashboard that outlines in an accessible way key performance indicators. This could be started with pilots by Services Australia and the Australian Securities and Investments Commission.

Recommendation 31

5.173 That the Government actively develops greater opportunities to appropriately share or use government funded data and research, in ways that create public benefit, but also preserve privacy.



6. Finance

Regulatory grid for financial services

Context

- 6.1 Four main regulators operate in the financial system in Australia, each with a distinct role and mandate: the Australian Prudential Regulation Authority (APRA), the Australian Securities & Investments Commission (ASIC), the Reserve Bank of Australia (RBA) and the Treasury. These four bodies comprise the Council of Financial Regulators (CFR).
- 6.2 Due to the importance and complexity of ensuring stability in Australia's financial system, the sector is subject to considerable regulatory intervention. Regulatory costs for firms in the financial industry include training and recruiting staff in compliance, specialised technology and software, legal expenses, audit and reporting costs, and documentation and record-keeping.
- 6.3 While regulators can reduce the cost of regulation through proportionality—tailoring regulatory requirements to a firm's size, systemic importance, complexity and risk profile—the amount of regulatory change in the sector continues to grow as the risk environment becomes more complex and dynamic. Banks in particular 'sit in the middle of a lot of regulation', with the extended regulatory landscape also including the Australian Taxation Office (ATO) and the Australian Transactions Reports and Analysis Centre (AUSTRAC).¹

An Australian regulatory roadmap

- 6.4 A number of witnesses supported the introduction of an Australian regulatory 'roadmap' that would provide more certainty for industry.
- 6.5 A roadmap would be a coordinated strategic plan that outlines the timeline, milestones and key steps for the development, implementation and enforcement of emerging regulatory issues across the industry. While inquiry witnesses wholly accepted that regulation served an important purpose, they generally saw the current regulatory approach as needing greater coordination and visibility—to support stakeholders, facilitate competition and encourage innovation.
- 6.6 Similarly, the banking sector overwhelmingly supported a regulatory 'roadmap'.

¹ Mr Peter King, Chief Executive Officer, Westpac, *Committee Hansard*, 13 July 2023, p. 32.

- 6.7 Witnesses referenced the UK's Regulatory Initiatives Grid ('the Grid') as a leading model for consideration. The Grid was introduced in 2020 and sets out a two-year regulatory pipeline for the financial services sector. The Grid is published twice a year to help firms plan for, implement, and manage upcoming regulatory initiatives that may have a significant operational impact on them.²

Benefits

- 6.8 In its discussions with the banking sector and industry peak bodies, the Committee explored the pros and cons of implementing a regulatory roadmap. The concept enjoyed broad support across the industry.
- 6.9 The Australian Banking Association (ABA) has discussed a regulatory roadmap in depth with its UK counterparts (based on their experience with the Grid). The ABA told the Committee that the key benefits of the roadmap concept were the visibility it gave all participants of upcoming regulatory changes, and that it enabled regulators to prioritise and phase in potentially overlapping reforms.³ The ABA said that while knowing about upcoming regulations and proposals was important, the sheer volume of regulatory initiatives meant it could be difficult to prioritise them:

There are 130 new initiatives here for consideration in the next 12 to 18 months. These are all live. Some of these things will lead to a reduction in some of the regulatory burden, where it is appropriate. Many of them are very good proposals. Many of them are things that the industry would support. The prospect of trying to deal with them well at this pace, we think makes it impossible for the sector as a whole, and for government, to really identify which of the 130 should be the top 10 that people put their real effort into. Which ones more logically should come after those top 10? Which make sense to implement one after the other after the other?⁴

Smaller and customer-owned banks

- 6.10 Hearing the perspective of customer-owned and non-major banks was important, because they are disproportionately affected by the compliance burden of regulation. The Committee heard that a regulatory roadmap could improve the ability of smaller entities to compete. This greater competition would, in the view of many witnesses, by extension benefit consumers through more innovative and competitive products and enhanced economic dynamism.
- 6.11 The view of the Customer Owned Banking Association (COBA) was that a roadmap was necessary to reduce regulatory costs, which limit the ability of its members to grow by 'diverting funding away from growth initiatives'.⁵ For customer-owned

² Financial Conduct Authority, *Regulatory Initiatives Grid*, www.fca.org.uk/publications/corporate-documents/regulatory-initiatives-grid, viewed 31 October 2023.

³ Mr Chris Taylor, Chief of Policy, Australian Banking Association, *Committee Hansard*, 31 August 2023, p. 11.

⁴ Ms Anna Bligh, Chief Executive Officer, Australian Banking Association, *Committee Hansard*, 31 August 2023, pages 10-11.

⁵ Customer Owned Banking Association (COBA), *Submission 33*, p. 1.

banks—in contrast to for-profit banks with larger operations and resources—this can result in smaller retained earnings, because of the need to underpin loan growth in line with APRA’s capital requirements.⁶

- 6.12 BankWAW told the Committee that 80 per cent of the new roles in its business of 90 people were related to supporting risk and regulatory frameworks. For BankWAW, it was ‘challenging’ to simultaneously grow and invest in its network, develop competitive services and products for customers, and meet high regulatory and compliance standards.⁷
- 6.13 The customer-owned Bank Australia told the Committee that a more coordinated regulatory approach, through a roadmap, could ensure that smaller entities continue to provide a competitive alternative to the major banks.⁸

Larger banks

- 6.14 Larger banks, overall, also supported the concept of a regulatory roadmap.
- 6.15 Westpac saw a whole-of-community benefit to the better sequencing that a roadmap would bring:

We would certainly encourage the Government and the Treasury department to stand back and look at the combined impact and sequence it so that we can deliver the best prioritised initiatives for the community. Everything has merit, but, when you stand back and look at it, not from an individual regulator perspective but from a whole-of-community perspective, you might make a different choice about the sequencing of and the speed at which you do different regulations.⁹

- 6.16 Macquarie Group said that a roadmap made sense in an environment of quickly evolving regulation, where it becomes ‘very hard to plan things, automate...’ and it is difficult for new entrants to compete and be innovative.¹⁰

Insurance industry

- 6.17 The Insurance Council of Australia (ICA), in its December 2022 submission to the Productivity Commission’s 2023 Productivity inquiry, similarly advocated for a regulatory grid. The submission also referenced the UK’s Grid as a useful model, noting that this more transparent policy framework with clearly articulated expectations would ultimately benefit consumers, industry and community alike by targeting policy and regulatory resources to more clearly defined areas of consumer and economic benefit. More specifically, it would also assist insurers who operate in

⁶ COBA, *Submission 33*, p. 1.

⁷ Mr Michael Mack, Chief Executive Officer, BankWAW, *Committee Hansard*, 4 July 2023, p. 4.

⁸ Mr Damien Walsh, Managing Director, Bank Australia, *Committee Hansard*, 4 July 2023, p. 3.

⁹ Mr Peter King, Chief Executive Officer, Westpac, *Committee Hansard*, 13 July 2023, p. 32.

¹⁰ Mr Gregory Ward, Deputy Managing Director and Head of Banking and Financial Services, Macquarie Group, *Committee Hansard*, 4 July 2023, p. 20.

an increasingly volatile business environment due to more frequent extreme weather events.¹¹

Keeping consumers safe

- 6.18 Another driver of a regulatory roadmap was the need for collaboration between government and the banking industry to enhance customer safety, but without increasing the regulatory burden—particularly in the payments sector. ANZ, for example, raised the immediate challenges posed by scams, frauds, and cyber threats, and the need for coordinated efforts by the banking sector (better enabled by a roadmap) to address these issues collectively.¹²

Implementation

- 6.19 While witnesses acknowledged that Australia’s financial regulators already develop their own priorities and collaborate, implementing a regulatory roadmap would make this practice a formal requirement.
- 6.20 The Committee inquired into which agency was best suited to lead the implementation of a regulatory roadmap.
- 6.21 The ABA viewed the Council of Financial Regulators (CFR) as the ‘best place to start’, but equally saw Treasury as able to ‘play the same role’.¹³
- 6.22 The ABA added that other agencies that are not financial regulators but contribute to the broader regulatory environment, should thus also play a role in the process—for example the Australian Taxation Office (ATO) and the Australian Financial Complaints Authority (AFCA):
- ...there are other arms of government that are not financial services regulators as such but have a lot of activity that impacts on them, such as the ATO, Treasury and AFCA—which is not a regulator but a complaints authority. Nevertheless, it issues draft guidance that’s important for banks and others to respond to. There are a number of other arms of government involved—the review of the privacy legislation, for example, or the AML legislation review that is coming out of the Attorney-General’s Department.¹⁴
- 6.23 The Committee also heard that the ACCC should have greater involvement with the CFR to ensure competition was adequately considered in the regulatory environment. While the ACCC is not a member of the CFR (which comprises APRA, ASIC, the RBA and Treasury), it has been invited to participate in issues relating to

¹¹ Insurance Council of Australia, *Submission to the Productivity inquiry (2023)*, 1 December 2022, p. 4, www.pc.gov.au/__data/assets/pdf_file/0003/352137/sub203-productivity.pdf.

¹² Mr Ross McEwan, Chief Executive Officer and Managing Director, National Australia Bank (NAB), *Committee Hansard*, 12 July 2023, p. 47.

¹³ Ms Anna Bligh, Chief Executive Officer, Australian Banking Association, *Committee Hansard*, 31 August 2023, p. 11.

¹⁴ Ms Anna Bligh, Chief Executive Officer, Australian Banking Association, *Committee Hansard*, 31 August 2023, p. 11.

contestability and competitiveness.¹⁵ By contrast, the ACCC's UK counterpart, the Competition and Markets Authority, is a full member of the Financial Services Regulatory Initiatives Forum.

6.24 In this light, Bendigo and Adelaide Bank told the Committee that:

To have the ACCC at that table on a regular basis would be really beneficial to ensure that competition is also thought of...¹⁶

Committee comment

6.25 The Committee acknowledges that the stability and safety of the financial system is essential to the wellbeing of Australians. However, the pace and scale of regulatory reform in the financial sector to ensure stability is potentially inhibiting greater competitiveness and innovation. The considerable amount and complexity of regulatory intervention imposes material costs on the sector and consumers. Without appropriate coordination, well-intended reforms can hinder economic dynamism and regulatory effectiveness and have a disproportionate impact on smaller organisations and their ability to compete.

6.26 The Committee notes there is wide-ranging support from across the banking and insurance sectors for the implementation of a regulatory roadmap to better coordinate the efforts of Australia's financial regulators.

6.27 The Committee supports the implementation of a high-level roadmap setting out planned legislation and regulatory interventions. The enhanced visibility and coordination that a roadmap would bring would assist industry in meeting its obligations, benefit competition, and support better outcomes for consumers.

Box 6.1 Key finding

Regulatory Grid

The regulatory grid currently used in the United Kingdom and other settings has provided stakeholders within the financial services sector with greater visibility of upcoming reviews and reforms.

Recommendation 32

6.28 That the Government develop a fit for purpose 'regulatory grid' to provide greater visibility and coordination of regulatory interventions across the financial services sector.

¹⁵ ACCC, *Council of Financial Regulators*, www.accc.gov.au/inquiries-and-consultations/consultative-Committees/council-of-financial-regulators, viewed 31 October 2023.

¹⁶ Ms Marnie Baker, Chief Executive Officer and Managing Director, Bendigo and Adelaide Bank, *Committee Hansard*, 4 July 2023, p. 27.

Banks and mortgages

Measures of bank profitability

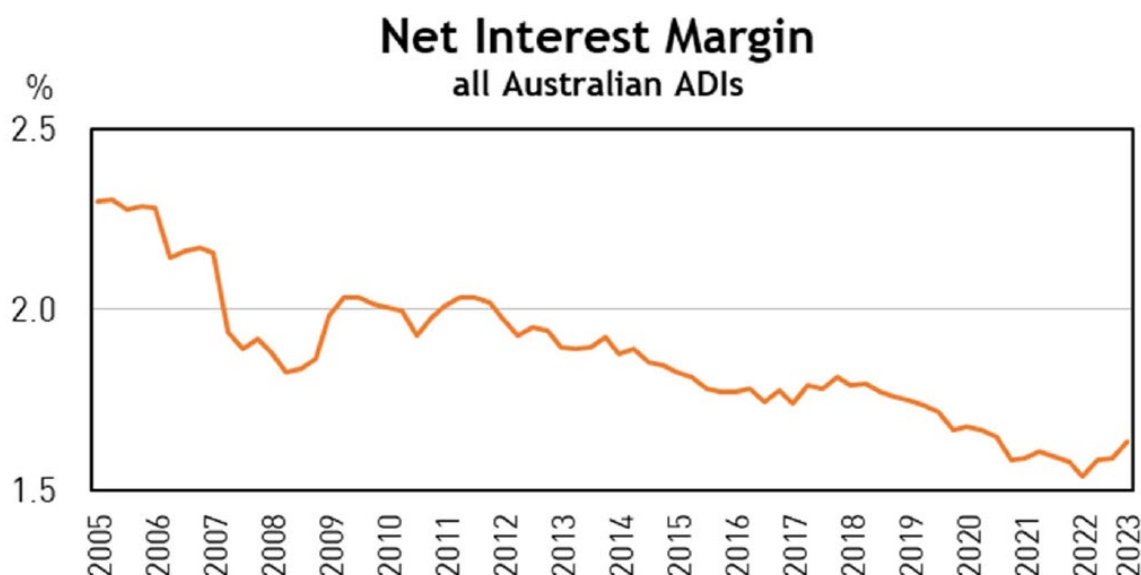
Net Interest margins (NIMs) and Returns on Equity (ROE)

- 6.29 Australia’s banking sector is generally considered to be highly concentrated. It is dominated by the ‘Big Four’—Westpac Banking Corporation (WBC), National Australia Bank (NAB), the Commonwealth Bank of Australia (CBA), and the Australia and New Zealand Banking Group Limited (ANZ).
- 6.30 When considering how much market power the Big Four exercise in Australia and the implications for the home loan sector, a useful starting point is to consider the two main measures of bank returns (or profitability)— net interest margin (NIM) and return on equity (ROE).

Net Interest margins (NIMs)

- 6.31 The NIM measures the difference between the interest income generated by banks or other financial institutions and the amount of interest paid out to depositors, relative to the amount of interest-earning assets.
- 6.32 Since 2005, there has been a long-term downwards trend in the average NIMs of Australian Authorised Deposit-taking Institutions (ADIs). Figure 6.1 (below), based on data from APRA, demonstrates this.

Figure 6.1 Net Interest Margin of all Australian ADIs



Source: APRA, *Answer to Question on Notice*, APRA-ED01QON, p. 2.

- 6.33 APRA analysis of the NIM data notes two key issues:

- Reductions in the average NIM of Australian ADIs over the past 20 years reflects ‘a combination of increased competition from within the sector and from non-ADIs, and the declining trend of interest rates over the period’.¹⁷
 - The increase in average NIMs since June 2022 has coincided with interest rate rises.¹⁸
- 6.34 Reserve Bank of Australia (RBA) research from 2021 suggests that NIMs may have a modest positive correlation to policy rates in the short term because interest rates on some liabilities (e.g. term deposits) may not adjust as quickly as interest rates on assets (e.g. mortgages). There is not a clear relationship over the long run.¹⁹
- 6.35 When asked by the Committee how Australian NIM trends compare internationally, APRA was cautious. It noted simply that average NIM rates of New Zealand banks had similarly reduced over the past two decades, though with an earlier uptick (in late 2021) than Australia, coinciding with increases in the cash rate by the Reserve Bank of New Zealand at that time. The average NIM of Canadian banks has also reduced over the past decade.²⁰
- 6.36 The annualised NIM for Australia’s Big Four banks from 2000 to 2023, including year-on-year declines (on average) and a recent upswing, is shown in Figure 7 below. Accompanying commentary from KPMG states that:

Net interest margins across the Major Banks continued to increase in FY23 by an average of 9 basis points compared with FY22. This is a result of improved interest earned on the loan portfolio driven by cash rate increases during the last 12 months. While net interest income has increased by 12.7 per cent compared to FY22 to \$74.8 billion, interest expense has increased by 504 per cent compared to FY22.²¹

¹⁷ APRA, *Answer to Question on Notice*, APRA-ED01QON, p. 2.

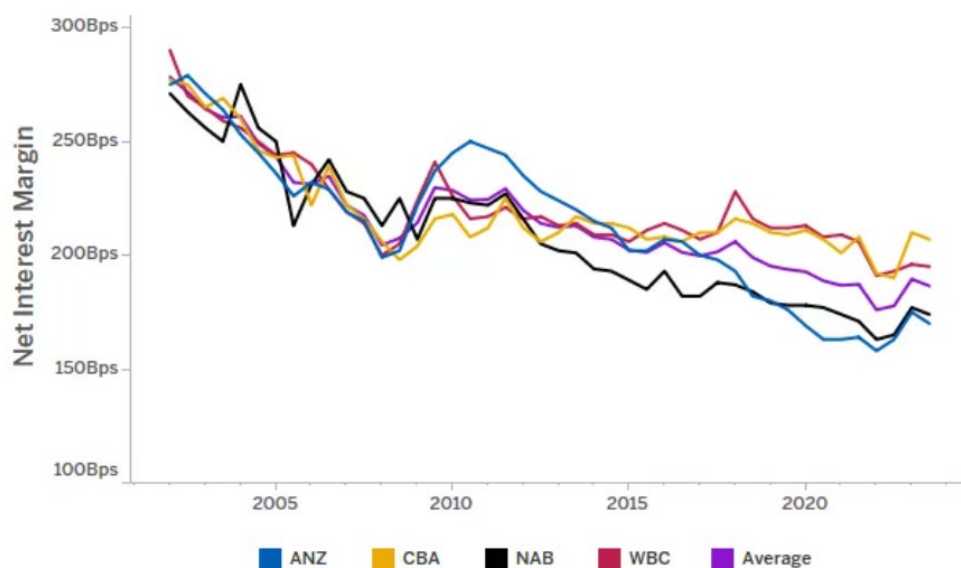
¹⁸ APRA, *Answer to Question on Notice*, APRA-ED01QON, p. 2.

¹⁹ M Hack and S Nicholls, Reserve Bank of Australia, ‘Low Interest Rates and Bank Profitability – the International Experience So Far’, 17 June 2021, p. 83, www.rba.gov.au/publications/bulletin/2021/jun/low-interest-rates-and-bank-profitability-the-international-experience-so-far.html.

²⁰ APRA, *Answer to Question on Notice*, APRA-ED01QON, p. 2.

²¹ KPMG, *Major Australian Banks: Full Year 2023 Results Analysis*, <https://kpmg.com/au/en/home/insights/2023/11/major-australian-banks-full-year-analysis-2023.html>, viewed 27 February 2024.

Figure 6.2 Net interest margin of the Big Four



Source: KPMG, Major Australian Banks: Full Year 2023 Results Analysis

6.37 In its 2023 Retail Deposits Inquiry, the Australian Competition and Consumer Commission (ACCC) offered the following analysis regarding the relationship between competition and NIMs.

In recent years, some major banks have argued that declining net interest margins (NIMs) of the past 25 years are an indicator of strong competition in the market. However, as discussed below, there are many factors that can impact NIM and their relationship with competition is not clear. A declining NIM is not in itself evidence of strong competition in the retail deposits market, or even across deposit and lending markets.

...

It is also useful to note that this measure relates to performance at an entity level, rather than a specific product segment, such as retail deposit products.

...

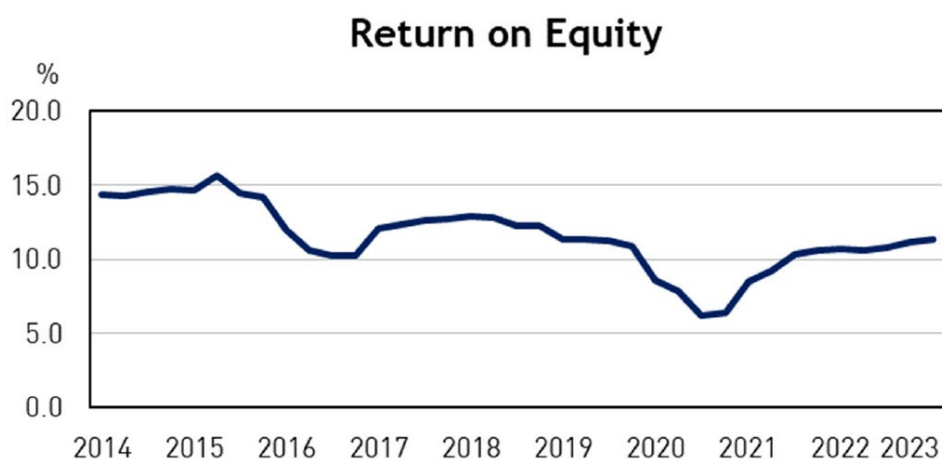
The ACCC considers that there are several factors that may be contributing to the reduction in NIMs, of which competition may be one. The recent low interest rate environment, from the onset of the COVID-19 pandemic up until 2022, is another factor that may have contributed. Now that the low interest rate environment has passed, we have seen some increase in the NIM since 2022.²²

²² ACCC, 'Retail deposits inquiry final report', 15 December 2023, pages 48-50, www.accc.gov.au/about-us/publications/retail-deposits-inquiry-final-report.

Return on Equity (ROE)

- 6.38 The ROE calculates the return that a company is able to generate with its shareholders' equity—in other words how efficiently a firm uses its equity financing to generate income. The metric can incorporate many inputs, including '...incomes, expenses, and certain balance sheet components'.²³
- 6.39 The long term downwards trend of the ROE of Australian ADIs since 2014, based on data from APRA data is shown in Figure 6.3 below.

Figure 6.3 Return on equity for all Australian ADIs, 2014-2023



Source: APRA, *Answer to Question on Notice*, APRA-ED01QON, p. 3.

- 6.40 APRA analysis of these ROE trends is:
- ROE for Australian banks has broadly declined since 2010. It reached a low point of around 6.2 per cent in 2020-2021 as a result of pandemic related provision increases. There has been an improvement in profitability over the past two years as those provisions were released.²⁴
- 6.41 Additionally, it is important to note that ROE is not calculated in a standardised way. APRA advised the Committee that it '...does not collect data to calculate ROE on a disaggregated basis that would allow for accurate product-level ROE analysis'.²⁵
- ...often costs can be hard to attribute because you've got shared services that may be cross multiple products. Investment in cyber resilience, for example, might be something you've got to make decisions to attribute. Although minimum capital requirements will be set asset class by asset class, banks will then determine an overall buffer that they'll maintain for their actual capital levels over

²³ APRA, *Answer to Question on Notice*, APRA-ED01QON, p. 3.

²⁴ APRA, *Answer to Question on Notice*, APRA-ED01QON, p. 3.

²⁵ APRA, *Answer to Question on Notice*, APRA-ED01QON, p. 3.

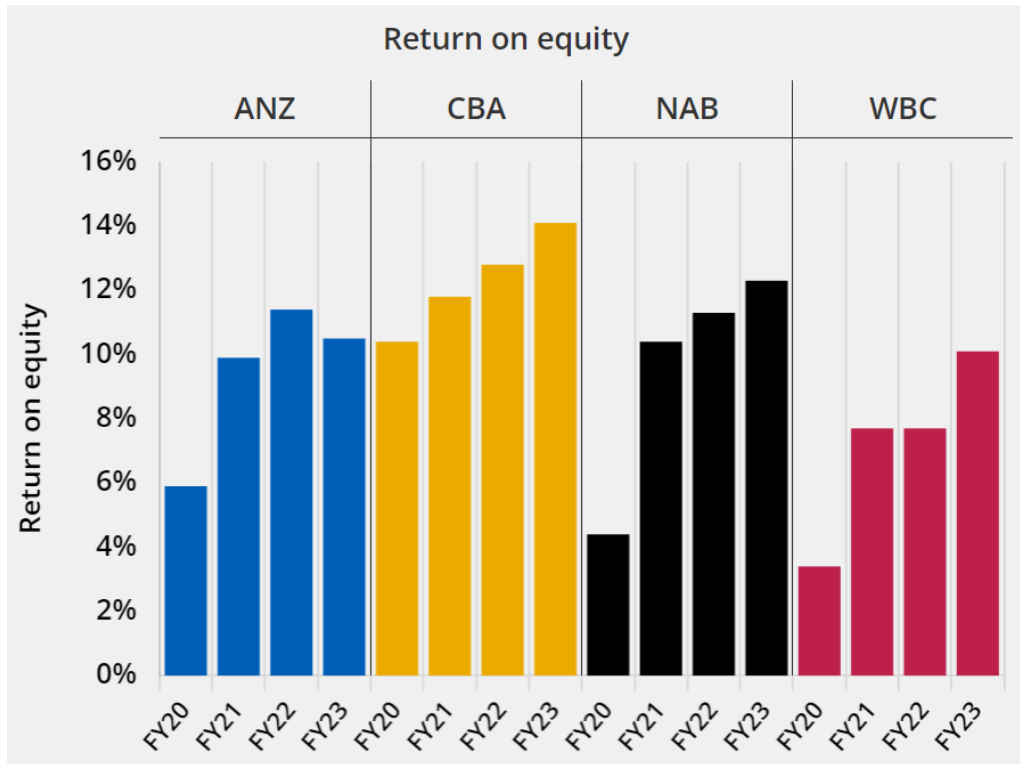
and above regulatory minimum. Again, there's a decision you have to make, a judgement you have to make, as to how you attribute that.²⁶

6.42 For a bank, the ROE can be assessed either on the bank's entire portfolio or on sub-components, such as residential mortgage loans.

6.43 The annualised ROE for the Big Four banks between 2020 and 2023, displaying year-on-year increases (on average), is shown in Figure 9 below. Accompanying commentary from KPMG states that:

Return on Equity (ROE) continued an upward trend in FY23 across the Majors. Average ROE increased by 85 basis points compared with FY22 to 11.7%, continuing the momentum from last year's ROE.²⁷

Figure 6.4 Return on equity for the Big Four banks, FY2020-2023



Source: KPMG, Major Australian Banks: Full Year 2023 Results Analysis

²⁶ Dr Sean Carmody, Executive Director, Insurance Division, Australian Prudential Regulation Authority, *Hansard Transcript*, 2 June 2023, p. 20.

²⁷ KPMG, *Major Australian Banks: Full Year 2023 Results Analysis*, <https://kpmg.com/au/en/home/insights/2023/11/major-australian-banks-full-year-analysis-2023.html>, viewed 27 February 2024.

Different Approaches to Improving Competition

6.44 Even though the market share of the Big Four banks is large, there are some signs of competitive tension. These include:

- Falling NIMs and ROEs (albeit these measures must be interpreted with care).
- Increased rates of customer churn over the past 18 months (though these rates could decrease if interest rates fall).
- Innovative product offerings and services from smaller and customer owned banks.

6.45 Improving the level of competition in Australia's banking sector is critical to improving the overall dynamism of the economy and for improving outcomes for consumers and business. There are three broad strategies for improving competition:

- 1 removing barriers for new entrants
- 2 increasing consumer churn and switching
- 3 facilitating products that provide good outcomes for disengaged consumers.

6.46 These will be addressed in turn.

A Public Residential Backed Mortgage Securities Market?

Context

6.47 One barrier to competition in mortgages is access to funding for smaller banks that offer home loan products, in particular customer-owned banks, a point made by several witnesses.

6.48 Smaller and customer-owned banks told the Committee that their profitability was considerably lower than the Big Four and reflected in part their comparative lack of scale and diversification.

6.49 Great Southern Bank advised that '...the return on equities (ROEs) of customer-owned banks, or certainly in our case, are around five per cent. For one of the big four retail banks it would be double that at least. For Net Interest Margin (NIM)...there'd be a 30 to 40 basis point differential'.²⁸

6.50 A major reason given for this difference in profitability was the high fixed costs in the banking sector, and the relative disadvantage of smaller banks in their capacity to absorb the costs of regulatory compliance. Customer-owned banks, which generally focus on residential mortgages, have higher cost-to-income ratios and lack the extra income sources of the major banks through their more diversified business models.

²⁸ Mr Paul Lewis, Chief Executive Officer and Managing Director, Great Southern Bank, *Committee Hansard*, 30 June 2023, p. 18.

Additionally, higher relative compliance costs can adversely affect the ability of smaller banks to deliver on a key point of competitive difference—their direct interaction with customers, a point made by Toowoomba-based Heritage and People’s Choice Ltd Bank.²⁹

- 6.51 Another disadvantage for smaller banks is that they generally face higher funding costs because credit markets perceive them as a higher risk than the Big Four.
- 6.52 Given the disparity in profitability and underlying risk between large and smaller banks, the Committee sought to explore the potential for government backed bonds (public securitisation) as a way to lower borrowing costs for smaller lenders and thus boost competition in the mortgage sector.
- 6.53 Mr Greg Medcraft— Chair of the Australian Finance Group and formerly Chair of ASIC and a senior official at the OECD—told the Committee that the big banks’ greater profitability, their lower capital costs, and the ‘implicit government guarantee protecting the savings of their customers’ translated into considerable market power and therefore advantage over smaller competitors in the mortgage sector.³⁰
- 6.54 Residential mortgage-backed securities have allowed smaller lenders to compete with large institutions by rolling up home loans into bonds and selling them to investors.
- 6.55 In a 2012 speech, ASIC’s Greg Tanzer stated that ‘the Government also recognises the importance of securitisation as a source of funding to smaller lenders, whose presence in the residential mortgage market assists in maintaining interest rates at competitive levels to enable more Australians to own homes’.³¹

The Canadian model

- 6.56 Canada—like Australia—has a concentrated banking system, with six large banks. The Canadian Government invests in some residential mortgage-backed securities (RMBS), which reduces the costs of accessing funding for all banks but disproportionately so for smaller banks. Through this public securitisation of mortgages, Canada has a lower spread between bank deposit and lending rates, i.e. a smaller margin between the interest rate banks charge on loans versus the interest rate banks pay out to depositors. In 2019, Canada’s spread was at 2.5 per cent, with Australia’s at 3.5 per cent.³²
- 6.57 In this vein, the Committee heard in depth from Mr Medcraft (see above), who has argued for introducing a RMBS scheme in Australia, based on the Canadian model.

²⁹ Mr Peter Lock, Chief Executive Officer, Heritage and People’s Choice Ltd, *Committee Hansard*, 30 June 2023 p. 5.

³⁰ Mr Greg Medcraft, Chair, Australian Finance Group, *Committee Hansard*, 23 August 2023, p. 1.

³¹ G Tanzer, Commissioner, ASIC, ‘Global developments in securitisation regulation – an ASIC perspective’, *Speech*, Australian Securitisation Forum Conference 2012, Hilton Sydney, 22 October 2012.

³² Mr Greg Medcraft, Chair, Australian Finance Group, *Committee Hansard*, 23 August 2023, p. 3.

6.58 Mr Medcraft explained to the Committee the concept of a private RMBS:

A bank or a non-bank takes a pool of diversified mortgages and sells that pool to a special purpose vehicle. The special purpose vehicle gets a credit rating from the rating agencies and is able to issue bonds that are tiered, base AAA down through the slicing of the risk. Those bonds are then priced and issued to institutions.³³

6.59 Mr Medcraft then expanded on how the Canadian public model works. He said that a lender might be a credit union, for example, that lodges a pool of mortgages with the Canada Mortgage and Housing Corporation. The corporation checks eligibility and then issues a 'national housing security' that is wrapped by the Canadian Government.³⁴

6.60 The Canadian scheme, Mr Medcraft stated, was safe, affordable, and had stood the test of time. It has operated for 35 years, with an independent review by the Canadian central bank finding that it had supported competition in the mortgage market while also preserving its stability—by providing access to funding to smaller lenders '...through a stable, cost-effective supply of funding'. It had adapted the Fannie May and Freddie Mac mortgage models in the US and '...made them far better from a sharing of risk perspective'.

In Canada...the maximum mortgage loan-to-value ratio is 80 per cent, so it is aimed at prime mortgages...On top of that, every mortgage has to be mortgage insured by a single-A rated mortgage insurer. Then you have the capital of the mortgage insurer protecting the situation. Then you have a third situation, which is that all the fees charged by the Canadians—they are quite low, at five basis points per annum—go into a reserve and are available so that, if there ever was a call on the guarantee, they would cover that. So it is pretty efficient and has stood the test of time.³⁵

6.61 Introducing such a matched funding model in Australia, Mr Medcraft believed, would provide multiple benefits.

...firstly, provide more competition and choice, creating a more level playing field between the big banks and the smaller players; and, secondly, result in lower interest rates for home buyers, with a reduction in both fixed and floating rate variable mortgages. It would also give those non-banks access to lower fixed rates, most importantly. Thirdly, it would result in less volatility in mortgage rates by stabilising funding margins. Fourthly, it would lower systemic risk for Australian lenders because it would enable matched funding through government supported mortgage bonds. Fifthly, it would improve liquidity access across the Australian market from a larger and more globally diversified investor base. Sixthly, it would reduce the liquidity costs for banks, as government-supported

³³ Mr Greg Medcraft, Chair, Australian Finance Group, *Committee Hansard*, 23 August 2023, p. 3.

³⁴ Mr Greg Medcraft, Chair, Australian Finance Group, *Committee Hansard*, 23 August 2023, pages 3-4.

³⁵ Mr Greg Medcraft, Chair, Australian Finance Group, *Committee Hansard*, 23 August 2023, p. 3.

mortgages can be used for liquidity with the central bank. Lastly, obviously, they could be a new source of investment, providing opportunity for wholesale and retail investors.³⁶

6.62 The Committee sought the ABA's view on Mr Medcraft's proposed RMBS model. The ABA cautioned that something that worked in a foreign jurisdiction wouldn't necessarily work in the Australian context. However, the ABA was enthusiastic about considering the proposal in more depth, given that anything which lowers funding costs for Australian banks would in turn reduce the costs that were passed on to customers.³⁷

Switching Mortgages

6.63 The Australian mortgage market has very high rates of variable rate mortgages by international standards.

6.64 And, as former ACCC Chair Professor Allan Fels has pointed out, as interest rates have increased, banks have wound back programs that try to win over rivals' customers through refinancing.³⁸

6.65 Mr Medcraft told the Committee that given the big banks' access to deeper pools of deposits and with lower capital costs, the big banks can charge existing customers (the 'back book') higher interest rates on their mortgages. This greater revenue is then used to offer 'discounts and cash-backs' to attract new customers (the 'front book'), who can eventually be converted to paying higher rates. Smaller banks, meanwhile, do not have the scale to compete with these tactics and risk being squeezed out of the market, thus reducing '...choice and competition for Australian borrowers'.³⁹

6.66 The price differential between customers on the 'back book' and new customers (the 'front book') is often referred to as the 'loyalty tax'. To the extent this is occurring it would represent a form of price discrimination.

6.67 Price discrimination is a pricing strategy in which identical or largely similar goods or services are sold at different prices by the same firm to different consumers. Price discrimination will result in higher prices for some customers.

6.68 First degree price discrimination involves personalised pricing or selling to each customer at a different price. For first degree price discrimination to occur:

- The firm must have market power (either monopolistic or oligopolistic). This market power is not just a question of market share, but can manifest itself

³⁶ Mr Greg Medcraft, Chair, Australian Finance Group, *Committee Hansard*, 23 August 2023, p. 2.

³⁷ Ms Anna Bligh, Chief Executive Officer, Australian Banking Association, *Committee Hansard*, 31 August 2023, p. 13.

³⁸ Professor Allan Fels AO, 'Inquiry into price gouging and unfair pricing practices final report', February 2024, p. 42, www.actu.org.au/wp-content/uploads/2024/02/InquiryIntoPriceGouging_Report_web9-1.pdf.

³⁹ Mr Greg Medcraft, Chair, Australian Finance Group, *Committee Hansard*, 23 August 2023, p. 1.

through consumer disengagement. If a consumer doesn't shop around and the firm knows this, it will present an opportunity for a firm to test prices higher than the market equilibrium—e.g. not offering the consumer the current (lower) rate for new clients.

- The seller must know the price that the consumer is willing to pay.
- The good or service must be non-transferable (otherwise the consumer could buy from another consumer at a lower price).

- 6.69 In the case of residential mortgages, these features are at least partially present for most consumers.
- 6.70 Even though rates of engagement have increased over the past 18 months, there remains a large cohort of passive, disengaged consumers who are at risk of being charged interest rates above the rate they could achieve if they sought a better deal from their own bank or a rival bank.
- 6.71 Switching accounts and associated behaviours has also been the subject of much study in the UK.
- 6.72 In 2018, the UK's Financial Conduct Authority (FCA) completed a study into behavioural prompts. The study noted the potential effectiveness of switching prompts in influencing consumers' thinking or behaviour. It found that effective prompts can increase consumers' awareness of account features, fees and charges, for both their own accounts and others.⁴⁰
- 6.73 Separately, in 2016 the UK's Competition and Markets Authority found that 'the older and larger banks, which still account for the large majority of the retail banking market, do not have to work hard enough to win and retain customers and it is difficult for new and smaller providers to attract customers. These failings are having a pronounced effect on certain groups of customers, particularly overdraft users and smaller businesses'.⁴¹

ACCC Home Loans

- 6.74 In 2020, the ACCC completed an inquiry into home loans. It found that the longer people had been with their bank, the higher the interest rate they were generally paying. It found there was a positive correlation between variable interest rates and the length of the loan. In other words, mortgage holders who had been with the same bank for a long time 'typically pay...materially higher rates', in effect a 'loyalty tax'—a trend that has been apparent since 2015.⁴²

⁴⁰ ACCC, 'Retail deposits inquiry final report', 15 December 2023, pages 117, www.accc.gov.au/about-us/publications/retail-deposits-inquiry-final-report.

⁴¹ Financial Conduct Authority, 'Our response to the CMA's final report on its investigation into competition in the retail banking market', November 2016, p. 6, www.fca.org.uk/publications/corporate-documents/our-response-cma-investigation-competition-retail-banking-market.

⁴² Ms Leah Won, General Manager, Competition Enforcement and Financial Services, ACCC, *Committee Hansard*, 17 March 2023, p. 7.

- 6.75 The ACCC's final report found that, as at September 2020, borrowers with home loans between three and five years old paid on average about 58 basis points more than the average interest rate paid for new loans.⁴³
- 6.76 Further, it found that borrowers with loans more than 10 years old were, on average, paying approximately 104 basis points more than the average interest rate paid for new loans. It outlined that a borrower with a home loan of \$250,000 could save more than \$1,400 in interest in the first year by switching to a loan with the lower, average interest rate paid for new loans. Over the remaining term of the loan, that borrower could save more than \$17,000 in interest.⁴⁴
- 6.77 Logically, the reverse might have been expected—i.e. that customers with longer lived loans would generally have higher rates of equity, and that the bank would know more about their risk profile and that they should be eligible for a lower interest rate.
- 6.78 The ACCC inquiry attributed this counter-intuitive trend to a lack of engagement in the mortgage market from these long-term customers ('customer inertia'). It found that had this cohort been more aware of the significant savings available on new loans, many may have switched lenders or home loan products, or asked their existing lender for a rate similar to those available for new loans. This would have resulted in fewer mortgages with interest rates substantially higher than the average rate for new home loans.⁴⁵
- 6.79 To trigger greater engagement from such customers and to stimulate dynamism in the home loan market, the ACCC inquiry recommended an annual notification be sent to customers on variable rates—prompting them to consider whether they could benefit from changing lenders. To reduce the friction involved in switching lenders, the inquiry proposed standardising and simplifying mortgage release forms.⁴⁶

A changed environment?

- 6.80 Notwithstanding the ACCC's findings in 2020, the number of borrowers negotiating a reduction in their rate has grown substantially since, as rising interest rates have increased the salience of the issue.
- 6.81 The ABA told the Committee that competition was now 'thriving' in the mortgage market.

...with customers switching bank products at record levels, driven by a desire for better prices, particularly in the inflationary environment. In the last financial year

⁴³ ACCC, 'Home loan price inquiry – final report', 5 December 2020, p. viii, www.accc.gov.au/about-us/publications/home-loan-price-inquiry-final-report.

⁴⁴ ACCC, 'Home loan price inquiry – final report', 5 December 2020, p. viii.

⁴⁵ ACCC, 'Home loan price inquiry – final report', 5 December 2020, pages viii-x.

⁴⁶ Ms Leah Won, General Manager, Competition Enforcement and Financial Services, ACCC, *Committee Hansard*, 17 March 2023, p. 8.

[FY 2022-23], nearly 650,000 mortgages worth \$376 billion were refinanced, the highest ever on record.⁴⁷

- 6.82 Overall, the major banks were sceptical that there was still customer inertia regarding their mortgages and questioned the need for behavioural prods to prompt customers to consider switching accounts, as proposed in the ACCC inquiry.
- 6.83 NAB pointed to significant changes in the market since 2020. At that time, 80-85 per cent of mortgages had been at standard variable rates but there had since been a 'dramatic' shift to fixed rates, reflecting rising interest rates and greater customer engagement. Additionally, 'offer management' had become simpler for customers, with the gathering of data for a home loan assessment for straightforward customers now occurring quickly.⁴⁸
- 6.84 ANZ warned of the risk of unintended consequences of an annual prompt from banks to home loan customers. For example, someone who is prompted to re-finance but whose application is rejected on suitability grounds risks having a negative credit score.⁴⁹

ACCC current view: Switching rates still a major concern

- 6.85 The ACCC remains deeply concerned, however, that the rate of switching is lower than it could be.
- 6.86 The final report of its Retail Deposits Inquiry, released in December 2023, clearly finds that 'consumer engagement is low and comparing products can be challenging' and that 'consumers find it difficult to switch accounts, so most do not'. Its recommendations aim to 'increase transparency' in the market, 'support more effective consumer engagement', and 'reduce barriers to consumer switching to drive competition'.⁵⁰ Notably, it recommends that:
- *Banks should tell consumers directly when they change interest rates, and prompt them to consider switching for a better rate* (Recommendation 5), and
 - *The Australian Government should review the merits of bank account portability* (Recommendation 7), including that 'the review should consider the likely costs, benefits, risks and opportunities that different approaches to bank account portability would present'.⁵¹

⁴⁷ Ms Anna Bligh, Chief Executive Officer, Australian Banking Association, *Committee Hansard*, 31 August 2023, p. 9.

⁴⁸ Mr Ross McEwan, Group Chief Executive Officer, AB, *Committee Hansard*, 12 July 2023, pages 57-58.

⁴⁹ Mr Shayne Elliott, Chief Executive Officer, ANZ, *Committee Hansard*, 12 July 2023, p. 27.

⁵⁰ ACCC, 'Retail deposits inquiry final report', 15 December 2023, p. 8.

⁵¹ ACCC, 'Retail deposits inquiry final report', 15 December 2023, pages 10-11.

Tracker mortgages

- 6.87 'Tracker mortgages', popular in the US, are variable rate mortgages that automatically move with the cash rate (or a related measure of bank funding) set by a country's central bank.
- 6.88 ASIC has long supported tracker mortgages. In 2016, it stated that 'While the introduction of tracker mortgages is a decision for the lenders themselves, ASIC would encourage lenders to offer this product. Tracker mortgages would bring a number of benefits to consumers and overcome some perceived issues in variable rate home loans currently on offer. No law reform would be required for lenders to introduce tracker loans'.⁵²
- 6.89 One of the advantages of tracker mortgages is that they reduce the likelihood of disengaged consumers drifting away from the best available rate.
- 6.90 The Chair of ASIC in 2016, Mr Greg Medcraft, advocated strongly for tracker mortgages at the time, arguing that bank funding costs track very closely with the cash rate. He said that rate tracker mortgages would benefit banks that routinely face customer backlash every time they do not pass on the rate cut.
- 6.91 The Committee sought Mr Medcraft's *current* views on whether tracker mortgages were applicable to Australia and could result in more transparent home loan rates.
- 6.92 Mr Medcraft told the Committee that the opaqueness of the mortgage market in Australia was a major problem. On offer were 'thousands of different rates about which nobody has any idea', indicative rates that vary, and additional discount mortgages 'that people don't know about'. As a transparency measure, therefore, tracker mortgages based on a margin above the cash rate were 'really the only fair way forward'. Mr Medcraft believed that banks might find the flexibility of tracker mortgages appealing because the mechanism could be reviewed regularly. Additionally, there was scope to trial the public securitisation of mortgages (see RMBS section above) based on tracker rates.⁵³
- 6.93 As for appropriate regulatory measures for tracker mortgages, Mr Medcraft pointed to Ireland and the United Kingdom, which have both used the mechanism.⁵⁴
- 6.94 Some of the Big Four banks have expressed concern about tracker mortgages.
- 6.95 When appearing before the House of Representatives Economics Committee in October 2016, CBA, NAB and Westpac said that when interest rates were rising the measure could be a risk to a bank and to the stability of the financial system—when funding costs are increasing but banks are unable to reprice their loans. NAB had

⁵² ASIC, 'Tabled Document No.2: Briefing on Competition and Tracker Mortgages', *Senate Supplementary Budget Estimates 2016-17*, 19 October 2016, p. 2.

⁵³ Mr Greg Medcraft, Chair, Australian Finance Group, *Committee Hansard*, 23 August 2023, p. 5.

⁵⁴ Mr Greg Medcraft, Chair, Australian Finance Group, *Committee Hansard*, 23 August 2023, p. 6.

added that its substantial holding of funds offshore was not linked to the cash rate, which would add further complexity and risk to pricing of tracker mortgages.⁵⁵

6.96 ANZ said at the time that there was a 'valid place' for tracker mortgages.⁵⁶

Box 6.2 Tracker mortgages

The consideration of tracker mortgages raises the broader issue of what mortgage products are on offer.

Australia has a higher proportion of households on variable interest rates than most OECD countries.

The preponderance of variable rate mortgages arguably has two major consequences that are worthy of further examination.

First, it transfers considerable financial risk on to households (compared to longer-term fixed rate mortgages).

For households with significant debt, the cost of servicing that debt can vary considerably across the business cycle. While it is possible to shift to fixed rate mortgages for a period of time, the length of time is limited to periods of several years. When rates are rising, this can generate unexpected repayment shocks and, in the short to medium-term, have a significant effect on household disposable income.

Second, it has an impact on the monetary policy transmission mechanism.

A rise in the cash rate particularly affects people who have mortgages with large outstanding balances. (Impacts on renters may follow after a period of time, the size of which will depend on the condition of the housing market.)

This means the impact of monetary policy is more uneven across Australian households than, say, in the US, where a high proportion of households have fixed interest rates across the life of the mortgage. (In the US, interest rates typically rise more in percentage points during a monetary policy tightening than in Australia, but the impacts on households are spread more evenly.)

Shifting towards a market with a higher proportion of longer-term fixed-rate mortgages would not be simple. It would probably involve the deepening of bond markets and changes to consumer expectations and behaviour. Not all of the consequences would be

⁵⁵ Mr Ian Narev, Chief Executive Officer, CBA, and Mr David Cohen, Chief Risk Officer, CBA, *Committee Hansard*, 4 October 2016, House Standing Committee on Economics, Review of the Four Major Banks, pages 5-6, pages 27-28; Mr Andrew Thorburn, Chief Executive Officer, NAB, and Mr Antony Cahill, Chief Operating Officer, NAB, *Committee Hansard*, 6 October 2016, House Standing Committee on Economics, Review of the Four Major Banks, p. 6; Mr Brian Hartzler, Chief Executive Officer and Managing Director, Westpac Group, *Committee Hansard*, 6 October 2016, House Standing Committee on Economics, Review of the Four Major Banks, p. 43.

⁵⁶ Mr Shayne Elliott, Chief Executive Officer, ANZ, *Committee Hansard*, 5 October 2016, House Standing Committee on Economics, Review of the Four Major Banks, pages 5-6.

easily foreseen and not all would be positive for all households but it is an issue worth exploring.

Other factors

- 6.97 There has been a general failure of recent new entrants in the Australian banking sector, principally the neo-banks. Neo-banks are generally digital-only companies that offer services such as checking accounts and debit cards, but do not have a physical location.
- 6.98 Mr Medcraft told the Committee that a lack of capital had been the key factor in the decline of neo-banks—specifically, these banks had used up all their capital before they were able to increase their scale.⁵⁷

Committee comment

- 6.99 The Committee notes the long-term reductions in NIM and ROE rates over the past 10-20 years as measures of reduced profitability in the banking industry over a very long timeframe. This was likely due to a mix of factors, including greater competition, improved technology which enabled increased customer engagement, and greater regulation to ensure the stability of the financial system.
- 6.100 The Committee also notes the recent rise in NIM and ROE rates over the past one to two years, coinciding with higher interest rates and the economy's emergence from the COVID pandemic. Consumer engagement with banks appeared to have increased during this time, particularly around mortgages, which had probably limited the size of the NIM and ROE increases.
- 6.101 The Committee acknowledges that it is difficult to compare the profitability of Australian banks with international counterparts and across sectors, given difficulties in disaggregating ROE data, and because of very different circumstances across borders and industries.
- 6.102 However, the Committee is troubled by the significant difference in profitability between the major banks and the smaller banks. Scale and diversification clearly confer significant advantages but the Committee also recognises the potential for major banks to leverage this scale to squeeze out competitors to the detriment of consumers, especially in the area of residential mortgages, and businesses. For smaller and customer-owned banks, the obligations of regulatory compliance could force them to direct resources away from areas of natural competitive advantage, such as customer service, innovation, and attractive product pricing. This situation does not reflect well on competition in Australia's banking sector.
- 6.103 While the Committee acknowledges the higher levels of engagement by mortgage holders with their banks, it remains concerned that engagement may fall away in the

⁵⁷ Mr Greg Medcraft, Chair, Australian Finance Group, *Committee Hansard*, 23 August 2023, p. 5.

medium to long term. Accordingly, the Committee supports measures to institutionalise such customer engagement.

6.104 The Committee also supports policy measures that facilitate new entrants to the sector or the growth of smaller banks.

6.105 In this light, the Committee notes that people with tracker mortgages are at less risk of paying an interest rate above the best available rate at the time, even if they do not pay attention to the market.

Box 6.3 Key findings

Banking Products

- Net Interest Margins (NIMs) will be determined by a combination of factors, including interest rates on outstanding loans (ranging from residential mortgages and small business loans through to large commercial loans), average deposit rates and international wholesale funding costs. Some of these are within the control of banks and some are not.
- NIMs have fallen over recent years. In its recently published review of deposits, the Australian Competition and Consumer Commission found that the link between this fall in NIMs and higher rates of competition is not clear.
- All other things being equal, a greater delay in the passing on of higher interest rates to deposit holders will put upward pressure on NIMs.
- All other things being equal, a higher level of consumer engagement with banks, particularly from mortgage holders with variable interest rate mortgages seeking a better deal and from deposit holders, should put downward pressure on NIMs.

Recommendation 33

6.106 That the Treasury Competition Policy Taskforce examine mechanisms to increase consumer engagement with mortgages and deposit products. Initially, this could take the form of pilots of one or more of the following:

- **examine mechanisms to increase consumer engagement with mortgages and deposit products. Initially, this could take the form of pilots of one or more of the following:**
 - **A requirement that banks should notify the base interest rate at the end of the introductory period where a retail deposit product is offered.**
 - **A requirement that banks should clearly notify retail deposit holders of changes to their interest rates, changes to the eligibility requirements for a bonus interest rate and, where practicable, alert customers when they are approaching a threshold for eligibility for a bonus interest rate (e.g. a minimum balance level).**

- That APRA provide an independent benchmark (or series of benchmarks) for variable rates for new/switching customers over the preceding 12 months. That this benchmark be published for use by mortgage brokers and financial advisers to improve their capacity to contact new clients to improve churn rates.

Recommendation 34

6.107 That the Government examine the merits of adopting a government-backed Residential Mortgage-Backed Securities (RMBS) scheme, taking into account the characteristics, and evaluation, of the Canadian RMBS model.

Recommendation 35

6.108 That the Australian Prudential Regulation Authority examine the suitability of macro prudential regulation of medium and smaller banks and, in particular, their capital holding requirements.

Recommendation 36

6.109 That the Government explore cooperating with the banking sector in the development and evaluation of a pilot in relation to tracker mortgages.

Foreign exchange transfers

6.110 Foreign exchange involves the process of converting one currency into another. It is a service facilitated by a range of providers including traditional banks, specialised money service businesses, and newer money transfer operators. This market is used by individual consumers and businesses requiring funds to be sent across borders.

6.111 Providers compete to offer money transfer services, charging clients through commissions and flat fees, and offer exchange rates that may differ from their internal rates used for transactions.

Context

6.112 In the past, the market for foreign exchange transfers has mainly been operated 'by incumbent major banks, but digital and technology innovation has allowed the entry of global fintech' which has brought about a 'reduction of foreign exchange fees and transfers'.⁵⁸ In the words of the ACCC, these new entrants have been:

⁵⁸ Ms Gina Cass-Gottlieb, Chair, ACCC, *Committee Hansard*, 17 March 2023, p. 6.

...making a material impact on competition—they were providing better and more innovative services and better prices, pretty much across the board.⁵⁹

- 6.113 In 2019, the ACCC issued best-practice guidance recommending money remitters make reliable online price calculators available to consumers and that they clearly disclose their prices, including all relevant fees allowing consumers to make better comparisons.⁶⁰

Effects of the ACCC best-practice guidance and market transparency

- 6.114 The Committee has received evidence indicating that the ACCC's recommendations have improved transparency in money transfers. This enhancement facilitates easy cost comparison across providers, thanks to embedded calculators within the system. CBA advised that:

The customer knows exactly how much they'll get. They can see the rate. They can do a comparison with other banks or they can go onto comparison sites. So we think actually the best thing from a customer's viewpoint is to know exactly how much they will get...or exactly how much they will get if they go to another provider.⁶¹

- 6.115 In response to the Committee's concern about why average charges from traditional banks are noticeably higher than those of some new entrants, NAB said that:

Some of it does come back to trust: do I trust the brand? I am sending money. Do I know it is going to get there? Are they going to back it up if it doesn't? It does come down to that. Trust in a brand is worth something. Some players who come into a market will cut the price down to get a foothold in to build over time. There were players in the UK where you would go in through the week and it was a cheap price and then you would go in at the weekend and the price of transfer had gone through the roof.⁶²

Still a complex market where consumer choices are difficult

- 6.116 Despite the increased competition in the money transfer market, the Committee has heard evidence about the lack of price transparency, which has made it difficult for consumers to understand the real costs from exchange money transfers.
- 6.117 The World Bank has noted that the actual 'charge' consists of different elements, such as the commission and the exchange rate mark up. This makes the actual price

⁵⁹ Ms Leah Won, General Manager, Competition Enforcement and Financial Services, ACCC, *Committee Hansard*, 17 March 2023, p. 6.

⁶⁰ ACCC, 'Money remitters improve price transparency after ACCC inquiry', *Media release*, 18 August 2021.

⁶¹ Mr David Cohen, Deputy Chief Executive Officer, CBA, *Committee Hansard*, 13 July 2023, p. 27.

⁶² Mr Ross McEwan, Group Chief Executive Officer, NAB, *Committee Hansard*, 12 July 2023, p. 62.

a 'shrouded attribute' to consumers, where it is not clear which provider is offering the best deal.⁶³

6.118 Wise, a global payments company, highlighted that consumers are unaware of the true cost of transferring money due to hidden mark-ups in the sector. This inherent opacity keeps prices artificially high, as consumers cannot easily compare or choose between services based on price, preventing effective competition. Wise told the Committee that:

...in order for consumers to know exact prices and therefore have the urge to compare providers and international payments, we need price transparency... people should know what they are paying for an international transfer upfront and in full... Traditional financial institutions... still charge exorbitant fees... The effect of hiding these fees in a marked-up exchange rate is that customers remain unaware of the costs of their international transactions and consequently can't even begin the process of trying to find a better deal, because they don't have a prompt to do so.⁶⁴

6.119 Separately, Wise has provided more specific detail on the banks withholding relevant price information on money transfers from consumers.

A bank will say transferring \$10,000 US to the US costs \$0, but they fail to disclose that there's a 3.6% mark-up over the mid-market rate, making the cost more like \$572 AUD than 'free'.⁶⁵

6.120 In response, the major banks claimed that their practices on money transfers were transparent, simple, and easily comparable for consumers.

6.121 ANZ Bank told the Committee that:

The fees are very transparent. The rate itself is more complicated in the sense that sending \$100 to the United States is a very different thing to what the foreign exchange mid-market rate refers to, which is pricing for people sending hundreds of millions of dollars and billions of dollars. So that's sort of a wholesale rate. I'm not sure that people would expect to get the wholesale rate. I'm not sure what the disclosure of that would actually achieve. What we do do is we disclose the exchange rate that you are receiving. People have access to the internet or the web. They can search all sorts of things to find comparison sites and to understand where there are better options, and people do.⁶⁶

⁶³ UK Government, The Behavioural Insights Team, 'The impact of improved transparency of foreign money transfers for consumers and SMEs', 2018, p. 7, www.bi.team/publications/the-impact-of-improved-transparency-of-foreign-money-transfers-for-consumers-and-smes/.

⁶⁴ Mr Jack Pinczewski. APAC Government Relations Lead, Wise. *Committee Hansard*, 03 May 2023, p. 27.

⁶⁵ Wise, 'White paper: Implementing transparency & fairness in cross-border payments for Australian consumers', p. 1, [https://wise.com/imaginary-v2/images/ad43ac35cada363f50ee3e072abfb9b6-Australian%20White%20paper_%20Implementing%20transparency%20&%20fairness%20in%20cross-border%20payments%20\(2\).pdf](https://wise.com/imaginary-v2/images/ad43ac35cada363f50ee3e072abfb9b6-Australian%20White%20paper_%20Implementing%20transparency%20&%20fairness%20in%20cross-border%20payments%20(2).pdf), viewed 27 February 2024.

⁶⁶ Mr Shayne Elliott, Chief Executive Officer, ANZ. *Committee Hansard*, 12 July 2023, p. 30.

6.122 Westpac highlighted simplicity, stating that:

The most important thing is just to make it simple. If you need to transfer a hundred dollars Kiwi to New Zealand, you need to know what it costs you in Australian dollars; or if you have a hundred dollars Australian, what it is going to become in New Zealand. Trying to break it down into the components is quite confusing.⁶⁷

6.123 Similarly, CBA's response focused on simplicity. It told the Committee that:

...our experience with customers is they just want to know how many US dollars they will get for their A\$100 and be able to compare that easily without having to make adjustments.⁶⁸

Effects of hidden mark-ups (hidden fees)

6.124 The Committee has heard evidence that the failure to provide adequate information has led to consumers and small businesses overpaying to make international payments. Wise, which has noted that 'hidden fees' disproportionately affect individuals with lower degrees of financial literacy as well as those in poverty, told the Committee that:

Traditional financial institutions—Australian banks—still charge exorbitant fees. These fees are hidden in uncompetitive and marked-up foreign exchange rates. The effect of hiding these fees in a marked-up exchange rate is that customers remain unaware of the costs of their international transactions and consequently can't even begin the process of trying to find a better deal, because they don't have a prompt to do so'.⁶⁹

6.125 The Committee is of the view that transparency in financial transactions enables consumers and business to make informed decisions, fostering competitive pricing and enhancing overall market effectiveness.

Recommendation 37

6.126 That the Government explore mechanisms to make the spread and fees on foreign exchange transfers more transparent for customers.

⁶⁷ Mr Peter King, Chief Executive Officer, Westpac Group, *Committee Hansard*, 13 July 2023, p. 53.

⁶⁸ Mr David Cohen Deputy Chief Executive Officer, CBA, *Committee Hansard*, 13 July 2023, p. 28.

⁶⁹ Mr. Jack Pinczewski, APAC Government Relations Lead, Wise, *Committee Hansard*, 03 May 2023, p. 27.

Payments system

Context

- 6.127 Australia has a world-leading financial technology (fintech) sector, which includes businesses such as digital banks, payments processing providers, and remittance and cryptocurrency services. Payment system providers are one of the largest fintech sectors, accounting for 38 per cent of Australian fintech companies.⁷⁰
- 6.128 Australia's payment system continues to evolve in size and complexity, with new payment methods and innovative services being built on top of traditional payments infrastructure. Payment systems generally refers to arrangements and instruments that facilitate the transfer of funds. Participants have grown in number and variety, and incumbents are changing the way they operate in response to evolving consumer preferences and technological developments.⁷¹ Australian consumers are increasingly embracing these digital payments and alternative payment methods, such as e-wallets and contactless payments.⁷²
- 6.129 The regulatory framework for payments systems—comprising of regulatory agencies such as the RBA and APRA—has remained relatively unchanged over the past 20 years.⁷³ The most recent review into the payments system was completed in 2021. Led by Scott Farrell, the Morrison Government requested the review to ensure the payments system was fit for purpose and that it supported continued innovation.⁷⁴
- 6.130 The Committee heard widespread support for the Farrell Review recommendations and the Government's ensuing Strategic Plan for the Payments System, released in 2023.⁷⁵ While there was also support for the broader direction government was taking in improving the regulatory landscape around fintechs, unresolved core issues remained that related to business formation and competition—such as the licensing of payment system fintechs and de-banking.

A more flexible licensing regime?

The current system

- 6.131 Regulation of banking provides stability and safety in a system that is essential to the welfare of Australians. An authorised deposit-taking institution (ADI) licence is required to conduct banking business in Australia. Because obtaining a licence

⁷⁰ FinTech Australia, *Submission 28*, p. 8.

⁷¹ Treasury, 'Review of the Australian Payments System – Final report', 30 August 2021, p. vii, treasury.gov.au/publication/p2021-198587.

⁷² Reserve Bank of Australia, 'Consumer Payment Behaviour in Australia', 15 June 2023, p. 21, www.rba.gov.au/publications/bulletin/2023/jun/consumer-payment-behaviour-in-australia.html.

⁷³ Treasury, 'Review of the Australian Payments System – Final report', 30 August 2021, p. vii.

⁷⁴ Treasury, *Terms of Reference for the Review of the Australian Payments System*, treasury.gov.au/review/payments-system-review/terms-of-reference.

⁷⁵ Treasury, 'A Strategic Plan for Australia's Payments System', 7 June 2023, p. 15, treasury.gov.au/publication/p2023-404960.

entails significant resources and capabilities, APRA offers multiple pathways to obtain one, including restricting the number of ADIs to ensure sustainable business models.⁷⁶ However, the cost of complying with this regulation can be significant and have negative impacts on innovation, business formation, and competition provided by smaller or new businesses.⁷⁷

- 6.132 The issue of fintech licensing in the payment system sector was raised in the Farrell Review. The Review recommended that a single payments licensing framework be introduced, with separate authorisations for the provision of payment facilitation services and the provision of stored-value facilities, and two tiers of authorisation based on the scale of activity of the provider.⁷⁸

Industry views

- 6.133 Throughout the inquiry, the Committee explored the concept of a more flexible and less onerous licensing arrangement for participants in the payment system – one that offers appropriate protections for consumers, but also lowers barriers to entry for new businesses.
- 6.134 Obtaining a licence is essential for fintechs seeking to grow, whether in Australia or in international markets. A licence provides credibility with investing partners, banking partners and customers. However, participants in the payments system industry held the general view that there was currently an ‘all-or-nothing’ approach to licensing. In other words, the licensing system was not flexible enough to cope with the pace of change and the diversity of risk exposure of entities across the sector.⁷⁹
- 6.135 FinTech Australia characterised the one-size-fits-all approach as ‘burdensome’ and stifling of the growth of new and emerging businesses. It suggested that a tiered payments licensing framework, with more tailored licences matched to the risk profiles and maturity of businesses, could promote economic dynamism by creating a regulatory environment that fostered innovation and new entrants.⁸⁰
- 6.136 Similarly, the Tech Council of Australia viewed the regulatory framework as not reflecting the needs of new and emerging service providers, such as fintechs, in growing their customer bases. A primary concern was that the framework often forces new entrants to cooperate with incumbents to obtain access to payment systems. This simply ‘consolidates the position of large incumbents rather than promoting competition and innovation’.⁸¹
- 6.137 Wise, a global payments company, highlighted the burden of obtaining and maintaining a limited ADI licence as a barrier to entry.⁸² Airwallex, a global payments

⁷⁶ APRA, *Licensing guidelines for authorised deposit-taking institutions*, www.apra.gov.au/licensing-guidelines-for-authorised-deposit-taking-institutions, viewed 28 November 2023.

⁷⁷ Australian Banking Association, *Submission 22*, p. 1.

⁷⁸ Treasury, ‘Review of the Australian Payments System – Final report’, 30 August 2021, p. xiii.

⁷⁹ Mr James Foster, Chief Executive Officer, Ezy pay, *Committee Hansard*, 3 May 2023, p. 34.

⁸⁰ FinTech Australia, *Submission 28*, p. 8.

⁸¹ Tech Council of Australia, *Submission 32*, p. 14.

⁸² Mr Jack Pinczewski, APAC Government Relations Lead, Wise, *Committee Hansard*, 3 May 2023, p. 34.

and financial platform, saw the current regulation as a blunt instrument that heavily favours incumbents by treating payment system providers as if they posed a similar level of risk as banks. It told the Committee that:

The regulations treat payment companies like Airwallex as if they pose the same risks to customers as banks. To be clear, at Airwallex, I can go into more detail about this, but we don't lend out customer funds—we're purely a payment provider in that way. So these regulations are insanely out of step with the technological advances we've seen in the Australian economy and with the regulations that we see in other jurisdictions, such as the UK and Singapore. The only group that benefits from the current system are the incumbents. So we would urge this inquiry to look at ways that economic dynamism can be achieved while also boosting productivity and lowering cost for businesses and consumers by promoting competition.⁸³

6.138 Another licensing issue was the lack of a consistent definition of a 'payments system'. Ezy pay told the Committee that while the Farrell Review acknowledged this problem—by referencing 'unnecessary complexity' for new entrants that do not fit under 'outdated' regulatory definitions⁸⁴—it remains the 'biggest challenge at the moment'.⁸⁵

6.139 The Committee followed up the issue of flexible licensing requirements with the major banks, which cautioned that more flexibility in the system carried potential dangers. NAB said that a more flexible licensing regime with different prudential requirements across the sector created systemic risks.

I think we should have one set of rules for all, so that people know what the rules are. We've seen what happened in the US market very recently where there was a two-tier. It had lower regulation for the second tier. That second tier actually got itself into difficulty. You saw SVB get into difficulty because it didn't have the scrutiny that other big banks had. I think that is the danger of having two or three tiers of regulation in a marketplace.⁸⁶

6.140 Westpac said that any weaknesses in the payments architecture could be exploited by bad actors, such as scammers. It advocated instead for the establishment of a clear minimum standard for capital requirements and liabilities in payment systems.⁸⁷

Regulators' view

6.141 The Committee asked APRA whether a more flexible licensing regime was possible. APRA stated that while the payments system was 'very complicated' due to its centrality to the efficiency of the financial sector, a number of financial system

⁸³ Ms Amelia Hamer, Director of Strategy for Australia and New Zealand, Airwallex, *Committee Hansard*, 3 May 2023, pages 2-3.

⁸⁴ Treasury, 'Review of the Australian Payments System – Final report', 30 August 2021, p. 18.

⁸⁵ Mr James Foster, Chief Executive Officer, Ezy pay, *Committee Hansard*, 3 May 2023, p. 34.

⁸⁶ Mr Ross McEwan, Chief Executive Officer, NAB, *Committee Hansard*, 12 July 2023, p. 56.

⁸⁷ Mr Peter King, Chief Executive Officer, Westpac, *Committee Hansard*, 13 July 2023, pages 55-56.

regulators supported making positive changes to the system.⁸⁸ It remains an ‘ongoing regulatory discussion’.⁸⁹

International models and comparisons

- 6.142 Overall, the fintech sector was supportive of the current scale and tempo of enhancements to regulation of the payments system. However, comparisons with international jurisdictions, such as the UK and Singapore, highlight areas for further improvement.
- 6.143 Witnesses cited the approach of the UK Financial Conduct Authority (FCA) to payment system licensing as the best model. The FCA has two licences available for payment systems—either a payment institution licence or an electronic money institution licence.
- 6.144 Wise described the UK e-money licensing regime as world’s best practice and ‘geared specifically towards new fintechs’.⁹⁰ Wise, which operates internationally, contrasted this regime with its experience in Australia, where Wise is considered ‘technically a bank’. This comes with significantly more burdensome licensing requirements.
- 6.145 Expanding on this, the Australian fintech company Yondr Money pointed to such inflexible regulation in Australia as a barrier to entry that had quashed the ambitions of neobanks in this country in recent years—the launch rate of neobanks in Australia had been about a sixth of the launch rate in the UK since 2015.⁹¹
- 6.146 While Australia has a strong regulatory framework around banking and payments regulation, it lacks a mandated focus on competition. Australia was compared to jurisdictions such as Singapore where there is a ‘genuine desire to encourage fintech growth and activity’.⁹² The Monetary Authority of Singapore (MAS) is mandated to help grow the banking and payments sector, a capability and perspective that Australia’s regulators lack, according to some witnesses. The fintech Paypa Plane described it thus:

...for competition to be truly driving forward and providing consumers and businesses with experiences that are world class, we need to have that competition endemic and systemic throughout our ecosystem. We have a strong regulatory background for our banking and payments regulation in Australia; that is not only our strength in the veracity of our banking system but also our weakness in the way that those regulators are structured and the mandates about what is important to them. In Singapore, the MAS has two priorities. One is to regulate and protect the sustainability and safety of their financial ecosystem.

⁸⁸ Mr John Lonsdale, Chair, APRA, *Committee Hansard*, 2 June 2023, p. 14.

⁸⁹ Mr John Lonsdale, Chair, APRA, *Committee Hansard*, 2 June 2023, p. 16.

⁹⁰ Mr Jack Pinczewski, APAC Government Relations Lead, Wise, *Committee Hansard*, 3 May 2023, p. 34.

⁹¹ Mr Shane Chanel, Chief Executive Officer and Co-founder, Yondr Money, *Committee Hansard*, 3 May 2023, p. 29.

⁹² Mr Jack Pinczewski, APAC Government Relations Lead, Wise, *Committee Hansard*, 3 May 2023, p. 34.

But it is also tasked with growing that ecosystem, so competition is baked into how the regulators think. We don't have that baked-in capability in Australia, but we are in a position where we can look at pulling that into our payments regulation at the current time.⁹³

- 6.147 Comparisons to the UK and Singapore were also made regarding Australia's capital requirements for prospective licence holders. In the UK, those wanting an e-money licence require initial capital of 350,000 euros and must satisfy ongoing minimum capital requirements of 2 per cent.⁹⁴ In Singapore, a fixed fee is used to determine the base capital requirements, depending on the type of licence. The Australian model requires a much higher 5 per cent of ongoing minimum capital and was viewed as an 'enormous barrier to entry', given that such funds could instead be used by companies to invest in technology to improve products or employ more staff.⁹⁵
- 6.148 The Committee did note, however, that the Government's Strategic Plan for the Payments System aimed to better align Australia's payments regulatory framework with international jurisdictions and intended to introduce legislation for a new licensing payments regime in 2024.⁹⁶

De-banking

Context

- 6.149 De-banking was raised as a serious challenge for the fintech sector, particularly for those in the payments system. De-banking refers to the practice by financial institutions of declining or limiting financial services to businesses across whole sectors if they are assessed as having a higher risk of their services being involved unknowingly in money laundering or financing terrorist activities.⁹⁷ Payment system fintechs are commonly affected by de-banking, which limits their ability—as emerging and innovative startups—to access the financial infrastructure needed to compete with established players.
- 6.150 De-banking that specifically related to fintechs, digital currency providers and remittance providers was explored by a range of financial regulators and government departments in a policy options paper put to the Government in August 2022. The agencies' view was that as Treasury and financial regulators continue to reform Australia's payments and other financial regulatory regimes, banks 'will become

⁹³ Ms Simone Joyce, Chief Executive Officer, Paypa Plane, 3 May 2023, p. 25.

⁹⁴ Capital requirements are regulatory standards for financial institutions that determine how much liquid capital (easily sold assets) they must keep on hand, concerning their overall holdings, to reduce their risk of default.

⁹⁵ Ms Amelia Hamer, Director of Strategy for Australia and New Zealand, Airwallex, *Committee Hansard*, 3 May 2023, p. 7.

⁹⁶ Treasury, 'A Strategic Plan for Australia's Payments System', 7 June 2023, p. 15.

⁹⁷ AUSTRAC, *New guidance released on de-banking*, 27 June 2023, www.austrac.gov.au/new-guidance-released-debanking.

increasingly comfortable' with providing core banking services to businesses in these sectors.⁹⁸

- 6.151 The Government, in its response to the options paper and its four recommendations, recognised the seriousness of de-banking, that inaction on the issue will stifle competition and innovation in the financial services sector and that de-banking may drive businesses underground. The Government also committed to taking action on de-banking and balancing support of affected businesses, while also acknowledging banks are commercial enterprises and must manage their own risk.⁹⁹
- 6.152 In its response, the Government agreed to Recommendation 1—that voluntary data collection be undertaken by the four major banks, with consideration to be given to a formal phase of data collection.¹⁰⁰
- 6.153 The Government supported in principle Recommendation 2—that all banks implement five related measures (including the need to document reasons for the de-banking; provide reasons to the customer and access to Internal Dispute Resolution procedures; and give a minimum of 30 days' notice) to improve transparency and fairness in relation to de-banking. The Government said such measures would address some of the main frustrations associated with de-banking.¹⁰¹
- 6.154 The Government also supported in-principle Recommendation 3—that the four major banks be advised of the Government's expectations that they publish guidance applicable to the digital currency exchanges (DCE), FinTech and remittance sectors concerning their risk tolerance and their requirements to bank these sectors.¹⁰²
- 6.155 The Government noted Recommendation 4—that consideration be given by government to fund targeted education, outreach and guidance to the FinTech, DCE and remittance sectors.¹⁰³
- 6.156 In June 2023, AUSTRAC released new guidance on de-banking. It said de-banking had been increasing over the past decade and that it can have a devastating impact on legitimate businesses. Some sectors commonly affected by de-banking include remitters, digital currency exchanges and financial technology businesses. Additionally, de-banking can increase the risks of money laundering/terrorism

⁹⁸ Council of Financial Regulators, AUSTRAC, ACCC and the Attorney-General's Department, 'Potential Policy Responses to De-banking in Australia', August 2022, p. 1, www.cfr.gov.au/publications/policy-statements-and-other-reports/2022/potential-policy-responses-to-de-banking-in-australia/pdf/potential-policy-responses-to-de-banking-in-australia.pdf.

⁹⁹ Australian Government, 'Government response to Potential Policy Responses to De-banking in Australia', 28 June 2023, <https://treasury.gov.au/publication/p2023-404377>, viewed 29 February 2024.

¹⁰⁰ Australian Government, 'Government response to Potential Policy Responses to De-banking in Australia', 28 June 2023.

¹⁰¹ Australian Government, 'Government response to Potential Policy Responses to De-banking in Australia', 28 June 2023.

¹⁰² Australian Government, 'Government response to Potential Policy Responses to De-banking in Australia', 28 June 2023.

¹⁰³ Australian Government, 'Government response to Potential Policy Responses to De-banking in Australia', 28 June 2023.

financing. AUSTRAC continues to discourage the indiscriminate and widespread closure of accounts across entire industries.¹⁰⁴

- 6.157 AUSTRAC has also said that the closing of accounts leads to businesses being less open with their relationships and can have negative impacts on law enforcement. It might also lead to financial services companies having to regularly change financial institutions, which could cause issues with customer loyalty.¹⁰⁵

Witness views

- 6.158 The Committee heard from stakeholders on the impact of de-banking. FinTech Australia considered de-banking a significant barrier to competition that can have a 'devastating impact on legitimate businesses', and that the practice was anti-competitive and discriminatory.¹⁰⁶

The practice of de-banking poses a significant threat to the entire fintech industry and undermines the goal of positioning Australia as a world-class centre for financial technology. Fintech companies must have access to banking services to thrive and ensure business continuity. It can mean ADIs effectively become the gatekeepers to innovation, with the power to determine which companies should and should not be granted access to banking services, and ultimately, the opportunity to succeed in Australia.¹⁰⁷

- 6.159 Cloud-based subscription payment platform EzyPay viewed market concentration in the payments ecosystem as the key issue needing to be tackled 'rather than guidelines and further regulation on the banks in terms of how they decide to service—or not—fintech organisations'.¹⁰⁸
- 6.160 On the issue of market concentration, the ACCC referred the Committee to its 2019 inquiry into international money transfers and remittances, which found that new entrants were making 'a material impact on competition'. However, that inquiry also found that the main issue limiting the scope for fintechs to challenge incumbents was their inability to access banking services.¹⁰⁹

Major banks' perspective

- 6.161 The Committee raised with the major banks the issue of de-banking and asked for their perspective on how to ensure that de-banking did not suppress innovation.
- 6.162 Westpac told the Committee that the anti-money laundering and counter-terrorism financing regime was the biggest driver of de-banking, given that the fines for non-

¹⁰⁴ AUSTRAC, *New guidance released on de-banking*, 27 June 2023.

¹⁰⁵ AUSTRAC, 'AUSTRAC statement 2021: de-banking', *Media Release*, 29 October 2021.

¹⁰⁶ FinTech Australia, *Submission 28*, p. 3.

¹⁰⁷ FinTech Australia, *Submission 28*, p. 4.

¹⁰⁸ Mr James Foster, Chief Executive Officer, EzyPay, *Committee Hansard*, 3 May 2023, p. 26.

¹⁰⁹ Ms Leah Won, General Manager, Competition Enforcement and Financial Services, ACCC, *Committee Hansard*, 17 March 2023, p. 7.

compliance were very high. Accordingly, 'we need to have a high standard and expectation'.¹¹⁰

6.163 NAB, considered one of the leading funders of non-bank lenders and fintechs, noted that there were areas that extended beyond the bank's risk tolerance and could therefore lead to de-banking.

There will be some sectors where...we just don't have the skills or the capability at both the banker level and the credit decision level to understand the risks that are in an industry, particularly an emerging industry. We continue to monitor all industries and look to build our capabilities. There will be some industries where the regulatory framework is very different on a state-by-state basis. It's hard for us to apply a consistent approach to an industry when you've got different state-based regulation and so on. Some industries, we think, have heightened risks associated with either financial crime or other issues, so we'll take an extremely cautious approach to any of those. In fact, where we think the customer is presenting additional risks to us, we might seek to exit that relationship. But that, again, is on a case-by-case basis, based on customer behaviour and our own risk assessment.¹¹¹

Committee comment

6.164 The Committee acknowledges the Government's commitment to ensuring the safety, affordability, trustworthiness, and accessibility of Australia's payments system. Recognising the potential for digital payments to increase competition, innovation, and productivity across the economy, the Committee emphasises the need for a regulatory framework of the sector that balances consumer safety with fostering innovation.

6.165 To further advance these objectives, the Committee encourages the Government to collaborate with stakeholders from financial institutions, technology companies, and regulatory agencies. Despite Australia's positive standing in the financial technology space, the Committee believes there is room for improvement—particularly around licensing— and emphasises the need for ongoing collaboration to achieve these shared goals.

Box 6.4 Key Findings

Payments System

- The Committee notes the increasing prevalence in the use of new and emerging payments systems, including digital wallets.

¹¹⁰ Mr Peter King, Chief Executive Officer, Westpac, *Committee Hansard*, 13 July 2023, p. 46.

¹¹¹ Mr Shaun Dooley, Group Chief Risk Officer, NAB, *Committee Hansard*, 12 July 2023, p. 48.

- The Committee notes that the rapid take-up in the use of new payments arrangements could introduce risks into the system. It is important that this be monitored.
- The Committee welcomes the recent announcement that the Government will examine possible Reserve Bank of Australia oversight of new and emerging payments systems.

Recommendation 38

6.166 That the Government explore the suitability of more flexible licensing arrangements for participants in the payments system, as part of the next review of the Government’s Strategic Plan for the Payments System (scheduled to commence by mid-2024).

Access to capital

6.167 The Committee received evidence that capital markets could better drive economic dynamism in Australia, particularly through reforms that improve access to financing for smaller and newer businesses.

The capital challenge for SMEs

6.168 The Productivity Commission cited research that about 19 per cent of small to medium enterprises (SMEs) say that a lack of finance restricts their capacity to innovate. A key issue is that while an SME may understand its risks well, a lender or equity provider may not. (Lenders are more accustomed to working with larger businesses and therefore have a better understanding of their risk profiles.) This is the primary reason lenders require collateral for lending and are incentivised to only seek finance for likely successful investments. Additionally, when an SME does obtain finance, borrowing costs are higher than for a larger business, reflecting the higher default risk.¹¹²

6.169 Despite these disadvantages for SMEs, the Productivity Commission remained optimistic about the increasing opportunities for SMEs to access innovative finance options, given the expanding technology and data capabilities of lenders and government-promoted information-sharing initiatives.

The advancements made by lenders in technology and data capabilities, along with government initiatives promoting information sharing, have also created new avenues for SMEs to obtain loans. Although these developments are relatively recent, many lenders are improving their digital processes and considering new ways to leverage data on prospective borrowers to evaluate credit risks. The potential for scalability and the growing number of lenders participating in the

¹¹² Productivity Commission, *Submission 1.1*, pages 5-6.

market indicates that technological and data advancements will continue to enhance SME access to finance.¹¹³

Underdeveloped capital markets

6.170 Several witnesses suggested Australia's capital markets were too small and inflexible for the development needs of SMEs and start-ups.

6.171 Westpac told the Committee that lack of scale, particularly compared to the US, and regulatory requirements would continue to inhibit equity capital markets in Australia, unless a new kind of equity exchange mechanism could be developed.

'Where can you get access to equity, the high-risk capital?' You've either got to go to private equity—you can't really use the ASX because the requirements to be a listed company are through the roof—or there might be an option for a different style of equity exchange where people can raise money.¹¹⁴

Capital collaborations with government: mixed views

6.172 National Australia Bank agreed that Australia's equity capital market was underdeveloped. It advocated for the expansion of initiatives such as the Business Growth Fund, a partnership between the Government and major banks 'where equity capital has been made available to smaller businesses that are not able to demonstrate a track record of the size that might attract capital in more mature equity markets'.¹¹⁵

6.173 Zepto, a fintech payments company, noted that Victoria had recently started a government-backed venture capital fund and that the concept could be explored at the federal level.¹¹⁶

6.174 On the other hand, the Grattan Institute pointed to a government initiative to source capital that the Grattan Institute believed was not working—the business innovation investment visa program. The Grattan Institute stated that in its meetings with the 'broader innovation community' that nobody had indicated enthusiasm for this visa program. The Grattan Institute felt this was because the visa was not delivering significant venture capital as intended and said that groups such as the Tech Council of Australia were likely to share its view.¹¹⁷

¹¹³ Productivity Commission, *Submission 1.1*, p. 6.

¹¹⁴ Mr Peter King, Chief Executive Officer, Westpac Group, *Committee Hansard*, 13 July 2023, p. 54.

¹¹⁵ Mr Shaun Dooley, Group Chief Risk Officer, NAB, *Committee Hansard*, 12 July 2023, p. 60.

¹¹⁶ Mr Gabe Perottet, Senior Legal Counsel, Public Policy and Regulation, Zepto Payments, *Committee Hansard*, 3 May 2023, pages 12-13.

¹¹⁷ Mr Brendan Coates, Economic Policy Program Director, Grattan Institute, *Committee Hansard*, 2 May 2023, p. 13.

Banking sector

6.175 In the banking sector, a common regulatory issue raised by smaller and customer-owned banks was around capital requirements.

6.176 BankWAW, which predominately operates in the business space, told the Committee that the large amount of capital it was required to hold had ‘limited our ability to get out there and do what we do well’. BankWAW welcomed recently introduced capital standards, however from a competitive standpoint, ‘there is still a disparity between us and our competitors’.¹¹⁸

6.177 The customer-owned banks also viewed the capital funding requirements as not accurately reflecting the fact that their risk profile differed from major banks. Bank Australia commented that:

You can look at any of our balance sheets and see that our risk profiles are significantly different from those of larger for-profit institutions. When your customers own your business, as a responsible lender—and being close to the customer as well—the risk that we are writing is at a much lower level, even though we have to hold higher capital... The capital we have to hold for commercial lending is disproportionately high.¹¹⁹

6.178 Bank Australia also noted that the capital requirements impacted its ability to provide social housing, noting that:

Our focus tends to be around social affordable housing and disability accommodation. The capital that we have to allocate constrains our ability to serve that segment of the market.¹²⁰

6.179 APRA said that the biggest challenge for start-up or customer-owned banks that required a licence was capital funding, followed by access to technology platforms. Nonetheless, APRA told the Committee, proportionality—which takes into account the size and experience of a potential new player—is an important consideration in its regulatory framework.

It requires a reasonable amount of investment in order to be granted a full banking licence on the day of becoming licensed. It's \$15 million of capital that we require. It is not an overly substantial amount, but it is still found to be challenging. In order to be able to run a bank and build those technology platforms it is expensive. That's what we're finding the main challenge is with the entities that we have at the moment that are looking to be licensed.¹²¹

...

¹¹⁸ Mr Michael Mack, Chief Executive Officer, BankWAW, *Committee Hansard*, 4 July 2023, p. 9.

¹¹⁹ Mr Damien Walsh, Managing Director, Bank Australia, *Committee Hansard*, 4 July 2023, p. 9.

¹²⁰ Mr Damien Walsh, Managing Director, Bank Australia, *Committee Hansard*, 4 July 2023, p. 9.

¹²¹ Ms Renee Roberts, Executive Director, Banking Division, APRA, *Committee Hansard*, 2 June 2023, p. 6.

There are lots of examples that we have in the prudential standards where we apply a set of regulation to a major bank and, if you like, a slimmed down set of regulations or simpler set of regulations to try to get the same outcome with a smaller player. Often we're giving more time for smaller players to ease that burden as well. That's another key thing we do. Ms Roberts mentioned the licensing arrangements that apply. That is really an attempt by APRA to have a bifurcated system in terms of getting a licence. If entities would like to get a full licence, there's a full process that provides that, but there's actually a more streamlined process that enables newer players to come into the market and experiment in a safe zone, get confidence, get their capital, practise with their products to get a foothold in as a new player. There are a number of things we try to do within our remit to improve that.¹²²

- 6.180 NAB agreed that sustainable access to capital was a significant barrier to entry into, or remaining in, the banking industry. Noting the complex regulatory environment in the sector, NAB said that even fintechs in the UK, which had been operating for a decade and with significant numbers of customers, were still 'struggling' to be profitable.

With the capital stream to run a bank, you need probably a minimum of 10 years to get up and running.

...

It's a long path to profitability in banking. I don't think that's going to change. We operate in a complex regulatory environment.¹²³

Social enterprise

- 6.181 Access to capital is also an issue in the expanding social enterprise sector.
- 6.182 The Social Enterprise Council of New South Wales and the ACT told the Committee that the sector required financing in a number of forms, including 'grants, low- or no-interest loans, shared debt or equity', as well as co-funding from government and philanthropy.¹²⁴
- 6.183 Social Enterprise Australia said that a grant may be most appropriate for an early stage enterprise trying to secure working capital, while an 'outcome payment' may be an option for a 'more mature' social enterprise.

We think it is worthwhile for the Government, where it is seeking a specific outcome, and often where it is already spending money on paying a service

¹²² Mr John Lonsdale, Chair, APRA, *Committee Hansard*, 2 June 2023, p. 6.

¹²³ Mr Ross McEwan, Group Chief Executive Officer, NAB, *Committee Hansard*, 12 July 2023, p. 57.

¹²⁴ Ms Kylie Flament, Chief Executive Officer, Social Enterprise Council of NSW & ACT, *Committee Hansard*, 5 July 2023, p. 4.

provider to deliver something, to test different ways of doing things through different forms of payments to deliver outcomes.¹²⁵

The perspective of tech start-ups

6.184 FinTech companies provided various perspectives on the challenges of access to capital for start-ups. A common theme was the need for regulatory certainty to provide confidence for investors.

6.185 Airwallex said that a concern for start-ups was excessive capital requirements, which potentially came at the expense of the ability of a company to invest in future capability.

That's where we need to be really cognisant of the cost of every incremental percentage of capital requirement that's put on start-ups in the Australian economy, because it does make it more difficult to raise money.¹²⁶

6.186 Wise, a global payments company, observed that Australia's licensing requirements—including for capital—were developed more than 20 years ago and are burdensome and complex for fintechs. Wise said that the UK's prudential regime and licensing framework was world's best practice, noting that the UK e-money licence is 'geared specifically towards new fintechs like us'.¹²⁷

6.187 Block Payments cited the recommendation of a 2019 Senate inquiry into the Buy Now Pay Later sector that resulted in an industry code of practice.¹²⁸ This was preceded by a collaboration over two years where the regulator (ASIC) collected information from industry, leading to better mutual understanding and 'a little bit of regulatory certainty'. Expanding further, Block told the Committee that:

I would definitely support the Committee endorsing that type of approach and giving, I guess, regulators the mandate to be more creative when it comes to understanding emerging industries—not necessarily having them focused on just their own patch and actually thinking more broadly about how their regulatory perimeter might be expanding as a result of the creation of new products and product adjacencies as well.¹²⁹

6.188 Birchal, an equity crowd-funding platform, discussed its crowd-sourced funding (CSF) model, which enables equity funding of SMEs. It said that CSF 'enables eligible proprietary limited and unlisted public companies to make a regulated public offer of securities to retail and wholesale investors, all online'. Under the current regulatory

¹²⁵ Ms Jess Moore, Chief Executive Officer, Social Enterprise Australia, *Committee Hansard*, 5 July 2023, p. 24.

¹²⁶ Ms Amelia Hamer, Director of Strategy, Australia and New Zealand, Airwallex, *Committee Hansard*, 3 May 2023, p. 13.

¹²⁷ Mr Jack Pinczewski, APAC Government Relations Lead, Wise, *Committee Hansard*, 3 May 2023, p. 34.

¹²⁸ Senate Standing Committee on Economics, *Credit and financial services targeted at Australians at risk of financial hardship*, 22 February 2019, www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Creditfinancialservices/Report.

¹²⁹ Mr Michael Saadat, International Head of Policy, Block, *Committee Hansard*, 3 May 2023, p. 14.

regime, companies that raise capital through CSF are required to prepare a regulated disclosure document in accordance with the Corporations Act 2001. The model, Birchal continued, brings ‘transparency and accountability to a previously opaque part of the financial system’.¹³⁰

- 6.189 In Birchal’s view, the CSF regime could be enhanced by offering better tax incentives for companies and investors, expansion of the CSF regime from ordinary shares to other types of securities, and improved liquidity by freeing up the ability of investors to sell or trade shares acquired under a CSF offer.¹³¹

¹³⁰ Mr Matthew Vitale, Chief Executive Officer and Co-founder, Birchal, *Committee Hansard*, 3 May 2023, p. 28.

¹³¹ Mr Matthew Vitale, Chief Executive Officer and Co-founder, Birchal, *Committee Hansard*, 3 May 2023, p. 28.



7. Digital Platforms

Background

- 7.1 Digital platforms refer to online systems that facilitate the creation, exchange and consumption of digital content and services. These platforms can take various forms and serve diverse purposes—such as enabling social connections, providing access to information and entertainment, the ability to conduct business, or for people to buy goods and services. Australians rely on digital platforms for these services, which are provided by a small group of global companies.
- 7.2 Preventing the abuse of market power by large digital platforms, such as Google and Apple, is essential to fostering a competitive and innovative digital landscape. Abuse of market power can stifle innovation, limit consumer choice, and harm smaller businesses. Issues raised with the Committee included self-preferencing (where a firm preferences its products over rivals'), the distribution of mobile apps, in-app payments and commissions, and digital advertising services.
- 7.3 The five largest digital platforms—Google, Amazon, Apple, Meta and Microsoft—appeared at the inquiry. The Committee also received evidence from the ACCC, which continues to examine competition and consumer issues in the sector through inquiries and legal action.
- 7.4 The ACCC's inquiry into digital platform services is considering several issues that have been raised in this Committee's inquiry. The ACCC's inquiry, announced in February 2020, has released a series of interim reports, with the final report to be provided to the Treasurer by 31 March 2025.¹

App marketplaces

- 7.5 App marketplaces, such as the Google Play Store and Apple App Store, are pivotal platforms in fostering innovation and competition in the digital economy. These marketplaces provide a central distribution channel for a range of applications and create an environment where developers can showcase their products to a global audience. The Committee received evidence about a range of practices used by Google and Apple that competitors stated exploited the market power of Google and Apple in the app store sector.

¹ Australian Competition and Consumer Commission (ACCC), *Digital platform services inquiry*, www.accc.gov.au/inquiries-and-consultations/digital-platform-services-inquiry-2020-25, viewed 22 January 2024.

- 7.6 Google and Apple account for close to 100 per cent of the global market (excluding China) for mobile operating systems (OS). In the Australian market, Apple and Google each hold about 50 per cent of the market. As highlighted by the ACCC in its digital platforms inquiry, this duopoly in the mobile OS sector gives Google and Apple significant market power.² The ACCC considered that this power was likely to affect the terms and conditions, including commission rates, that app developers must agree to in order to access Apple and Google's app marketplaces.³

App distribution

- 7.7 The market power of Google and Apple extends to control over the distribution of mobile apps in their mobile ecosystems. Only Apple's App Store can be installed on iOS devices. Apple does not permit the installation of other app marketplaces. While Google allows other app marketplaces to be installed, it pre-installs its app marketplace on Android devices and does not allow other app marketplaces to be downloaded from the Google Play store. Some 90 per cent of apps available on Android mobile devices, for example, are downloaded through the Play Store.⁴

ACCC response

- 7.8 In its report on app marketplaces, the ACCC's competition assessment stated that Apple and Google faced 'limited competitive restraints' in the distribution of mobile apps and that this market power is likely significant.⁵ Further, the ACCC noted that while app developers could use alternative app marketplaces to distribute their apps, such options are not available to all consumers, are not popular with most consumers, and are technically difficult to use.⁶

Witness views

- 7.9 Google and Apple's position throughout the inquiry was that providing a safe, trusted, and secure app marketplace was important, particularly for consumers. Both companies believed that the sector was competitive.
- 7.10 Google described the app marketplace as 'vibrant and competitive', and included Amazon, Huawei, Microsoft Xbox and Samsung Galaxy. Google stated that app developers had many choices and that nobody was 'locked into the Google Store'.⁷

² ACCC, 'Digital platform services inquiry: Interim report No. 2 – App marketplaces', 28 April 2021, p. 4, www.accc.gov.au/about-us/publications/serial-publications/digital-platform-services-inquiry-2020-25-reports/digital-platform-services-inquiry-march-2021-interim-report.

³ ACCC, 'Digital platform services inquiry: Interim report No. 2 – App marketplaces', 28 April 2021, p. 9.

⁴ ACCC, 'Digital platform services inquiry: Interim report No. 2 – App marketplaces', 28 April 2021, p. 4.

⁵ ACCC, 'Digital platform services inquiry: Interim report No. 2 – App marketplaces', 28 April 2021, p. 23.

⁶ ACCC, 'Digital platform services inquiry: Interim report No. 2 – App marketplaces', 28 April 2021, p. 28.

⁷ Ms Lucinda Longcroft, Director, Government Affairs and Public Policy, Australia and New Zealand, Google, *Committee Hansard*, 29 August 2023, p. 3.

- 7.11 Similarly, Apple told the Committee that it was ‘competing with a whole host of other platforms’, for example with games, and that courts had rejected the notion that its App Store was a monopoly. Apple explained that:

Sony PlayStation and Microsoft Xbox have great libraries of games. We are always working to try to bring as many of those games as we can over to IOS, so we are competing with them each and every day. We are competing with the Google system, with Windows and with Valve. There are so many options when you are talking about developers of games. From an Apple perspective, we have to compete in that market. How do we do that? We do that in a variety of ways. We create new APIs and new technologies. Games which were impossible 15 years ago on an iPhone are now possible because we have continued to invest in innovations. We will continue to drive to do that because we know that is the only way we will continue to get great content for our users. From our perspective, when we think about developers, it is incredibly competitive. It is instructive to look at court cases; all of them have rejected the idea that somehow the App Store is a monopoly. They have reflected consistently that there is competition out there, and choices for developers and for consumers.⁸

- 7.12 In contrast, Epic Games, the US games and software developer, labelled Apple and Google ‘coercive’ and described their apps ecosystems as ‘problematic’, specifically in relation to tying (where consumers are forced to buy a good they don’t want in order to buy the good they do want), self-preferencing and pre-installation. In the view of Epic Games, such practices harmed both consumers and app developers by restricting interoperability with services outside the Apple and Google ecosystems.⁹ The Epic Games submission highlighted that:

These practices have led to a number of competition and consumer harms including denying app developers the opportunity to innovate and/or choose how best to distribute their apps, locking consumers into their respective ecosystems through the high cost of switching operating systems and denying app developers choice and coercing them to use Apple or Google’s in-app payment processing.¹⁰

- 7.13 Epic Games told the Committee that alternative app marketplaces had the potential to open up the mobile ecosystem to competition. It viewed direct downloading as a ‘key component’ of putting pressure and constraints on the large digital platforms, commenting that:

Right now, the Google Play Store and the App Store are the only homes for every app on the planet. So, there’s a bit of a discoverability challenge for newer services, newer developers and newer apps. How do you present yourself and how do you get visibility in this massive store? There could be more bespoke

⁸ Mr Kyle Andeer, Vice President, Products and Regulatory Law, Apple Inc., *Committee Hansard*, 29 August 2023, p. 13.

⁹ Epic Games, *Submission 51*, p. 1.

¹⁰ Epic Games, *Submission 51*, p. 2.

stores curated for people with kids. I've got a four-year-old. An app store devoted to children's content might be something that a lot of folks are interested in, and it might be a natural home for developers focused on that type of content. Ideally, those additional stores could exist next to the traditional gatekeeper app stores, but also we think direct downloading, the same way as you have on traditional computing devices/laptops, should be a component. It takes time for new app stores to catch on. Even if we're ready and willing to offer a store the day that one becomes available to us—and other tech companies have expressed interest—there are considerable built-in network effects that Google and Apple have that mean it will take time for other stores to get traction.¹¹

In-app payment processing

- 7.14 The control of Apple and Google over the App Store and Play Store, and the market power that ensues, enable them to impose terms that prevent app developers from using alternative payment systems.

ACCC response

- 7.15 The ACCC's 2021 interim report on App Marketplaces found that both Apple and Google require certain in-app payments to be processed through their in-app payment systems. Further, both app marketplaces stipulate that an app is not permitted to direct users to an off-app payment option.¹²
- 7.16 The ACCC told the Committee that this was one way the major platforms could use their dominant position to restrict competition and consumer choice. Restricting in-app payments to incumbent-controlled systems only, went beyond an 'innovation mindset' and reflects a commercial interest in limiting the areas in which competing businesses on the platform can operate.¹³ The ACCC said that:

If one of those services—for instance, Epic Games—wanted to use a competing payment system, they would also be competing with an element of the platform services, and the platforms at this time have the capacity and the incentive, looking at behaviour, to remove the capacity of people who bring traffic onto their platform to take away their market position and revenue in relation to the services with which they compete. So they set rules, including that you have to use our payment system; you can't even steer people towards being able to pay in another way, so the app can't say, 'To qualify for an upgrade, you can pay through PayPal or pay online with your bank.'¹⁴

¹¹ Mr Bakari Middleton, Director of Global Public Policy, Epic Games, *Committee Hansard*, 26 July 2023, p. 4.

¹² ACCC, 'Digital platform services inquiry: Interim report No. 2 – App marketplaces', 28 April 2021, p. 79.

¹³ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, p. 44.

¹⁴ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, p. 44.

Witness views

- 7.17 Epic Games detailed its experience with Apple and Google’s in-app payment processing, emphasising that both companies imposed contractual conditions that limit developers from choosing cheaper alternatives. Further, the Apple and Google in-app payment systems imposed ‘exorbitant rates’ on developers.¹⁵
- 7.18 Epic Games proposed opening mobile devices to alternative app distribution and prohibiting the tying of proprietary in-app payment systems to app distribution. Implementing these measures together, Epic Games continued, would benefit competition and innovation.¹⁶
- 7.19 Google and Apple noted recent changes in their approaches to in-app payment processing—some they had initiated; some were required by changes in regulatory environments overseas.
- 7.20 In its submission, Google said it had recently put in place a pilot program that offered options for additional billing systems on the Play Store. The pilot, which was open to all developers of non-gaming apps, aimed to understand the complexities involved in supporting user choice billing for developers and users.¹⁷
- 7.21 Apple told the Committee that it had begun offering developers in South Korea alternative in-app payment processing, as required by changes to regulation. Apple explained that:
- In certain jurisdictions, as you mentioned, like South Korea and the Netherlands, there have been mandates to break the bundle of services that we offer to developers and offer some of them separately. One of the core focuses has been around payment processing, allowing third-party or alternative payment processors to integrate and to facilitate in-app transactions. We have made changes, for example, in Korea, where we offer developers that choice, as required by law. You can use the in-app purchase, but if you want to use an alternative, we make that available to developers in Korea. The Committee enquired into recent changes in international jurisdictions—such as in Europe, the US and South Korea—in relation to in-app payment methods.¹⁸
- 7.22 As to the impact of allowing alternative in-app payment methods, Apple told the Committee it was too early to tell and voiced ‘significant concerns that it will increase fraud and increase misleading subscriptions and subscription traps’.¹⁹

¹⁵ Epic Games, *Submission 51*, p. 1.

¹⁶ Epic Games, *Submission 51*, p. 2.

¹⁷ Google, *Submission 42*, p. 7.

¹⁸ Mr Kyle Andeer, Vice President, Products and Regulatory Law, Apple Inc., *Committee Hansard*, 29 August 2023, p. 19.

¹⁹ Mr Kyle Andeer, Vice President, Products and Regulatory Law, Apple Inc., *Committee Hansard*, 29 August 2023, p. 19.

- 7.23 Epic Games remained sceptical about the response of Google and Apple to the changed regulations in South Korea. Epic Games noted that while Google and Apple had facilitated the alternative payment methods, as required, both companies had imposed an extra fee on top of the processing fee of the alternative payment provider. As Epic Games explained:

South Korea proposed a law targeted at in-app payments, requiring the gatekeepers to open up alternative payment methods. I think a lot of folks thought that's going to be it, that if they have to open up then competition will be implemented and we can proceed from there. But I think many folks were surprised to see the response from Apple and Google, which is to say, 'We will allow an alternative payment method that may or may not decide to charge you 30 per cent, but we will charge you between 26 per cent and 27 per cent on top of what that alternative payment provider offers. That essentially makes it a nonstarter for developers and consumers. That definitely defeats the spirit of what was proposed in South Korea.'²⁰

Commissions and fees

- 7.24 Apple and Google, along with other app marketplaces, require app developers to pay a commission for every transaction made using their in-app payment systems. The commission on payments made is 30 per cent, and 15 per cent for subscription apps after the first year. However, these amounts are subject to change for certain apps. As outlined in the ACCC's 2021 interim report on App Marketplaces, Apple and Google have introduced reduced commission rates of 15 per cent for apps with lower revenue.²¹

ACCC response

- 7.25 In its interim report, the ACCC stated that it was 'highly likely that the commission rates are inflated by the market power that Apple and Google have in their dealings with app developers', though it was 'difficult to know by how much'.²²

Witness views

- 7.26 The Committee raised with Apple and Google the issue of the fees they charge in their app marketplaces in light of the limited alternatives available to developers for in-app payments.
- 7.27 Both Apple and Google disagreed with the characterisation that the commissions they charged were unreasonable or unique in the app marketplace sector. Further, both companies viewed the commission model as providing benefits for developers,

²⁰ Mr Bakari Middleton, Director of Global Public Policy, Epic Games, *Committee Hansard*, 26 July 2023, p. 5.

²¹ ACCC, 'Digital platform services inquiry: Interim report No. 2 – App marketplaces', 28 April 2021, pages 70–71.

²² ACCC, 'Digital platform services inquiry: Interim report No. 2 – App marketplaces', 28 April 2021, p. 72.

including access to development tools and infrastructure, as well as the expansive distribution channels each platform offers.

7.28 On the issue of the 30 per cent commission, Apple explained that ‘85 per cent of all developers pay no commission’ and of the remaining 15 per cent of developers, ‘a small handful pay that 30 per cent commission’.²³

7.29 Similarly, Google explained that the vast majority of app developers using its service did not pay any fees:

Ninety-seven per cent of all app developers pay no fees because they are not charging users, people who use their services, for those apps. Three per cent of developers pay a fee. The only people who pay a fee of 30 per cent are those who make over A\$1 million per year, and that is only one per cent of that three per cent. Of the three per cent, 99 per cent are paying a fee of 15 per cent.²⁴

7.30 Google viewed the graduated fee structure as a positive for competition because it allowed new entrants into the app developer market to build their businesses before they were subject to any fees:

We provide them with the whole infrastructure so that they can build their apps and bring them to market, and the tools that they need for that are completely free of charge. Then we have that graduated fee model. When you start enjoying revenue up to a certain level, you pay a much lower level of fee, but once you get across that certain threshold, you are paying the higher fee.²⁵

7.31 Apple stated that the commissions app developers had to pay were excellent value for money, describing the ability to market apps on the App Store as an ‘incredible opportunity’:

So the question is, ‘What do they get for that?’ They get a bundle of technology, a licence from Apple, access to APIs, access to software development kits, access to a suite of developer tools, and access to the App Store, which allows them to distribute their application in more than 175 markets around the world.²⁶

Digital advertising technology

7.32 Advertising technology—or ad tech—refers to the collection of technologies that advertisers use to plan, execute, analyse, and optimise their digital advertising campaigns. The ad tech stack, which encompasses various components that work

²³ Mr Kyle Andeer, Vice President, Products and Regulatory Law, Apple Inc., *Committee Hansard*, 29 August 2023, p. 13.

²⁴ Ms Lucinda Longcroft, Director, Government Affairs and Public Policy, Australia and New Zealand, Google, *Committee Hansard*, 29 August 2023, p. 3.

²⁵ Mr Justin Mining, Competition Policy Lead, Asia Pacific, Google, *Committee Hansard*, 29 August 2023, p. 4.

²⁶ Mr Kyle Andeer, Vice President, Products and Regulatory Law, Apple Inc., *Committee Hansard*, 29 August 2023, p. 13.

together and can vary in complexity, facilitates the buying and selling of advertising space on websites and apps.

ACCC response

- 7.33 In September 2021, the ACCC completed an inquiry into the markets for the supply of digital advertising technology services and digital advertising agency services. The ACCC identified that a competitive ad tech supply chain was important to Australian advertisers, publishers, and consumers. Without strong competition in the ad tech supply chain, advertisers were likely to pay more to ad tech providers for poorer quality services.²⁷ This would likely result in increased costs being passed on to consumers and the production of less and or lower quality online content—which is ‘particularly problematic’ where digital advertising is used to fund important content that has broader public benefits.²⁸
- 7.34 Google is the dominant player in the ad tech sector, with at least 90 per cent of advertising impressions traded via the ad tech supply chain passing through at least one Google service.²⁹ As highlighted in the ACCC’s inquiry report, Google’s access to a large volume and range of first-party and third-party data ‘appears to have provided Google with a competitive advantage’ in the supply of ad tech services.³⁰
- 7.35 The ACCC also considered that Google had engaged in self-preferencing conduct, due to its vertical integration and market dominance, which had ‘likely interfered with the competitive process’ and cumulatively lessened competition in the supply of ad tech services.³¹

Witness views

- 7.36 The Committee heard evidence from FreeTV—the peak industry body for Australia’s commercial television broadcasters—raising concerns about Google’s market power and conduct in the ad tech market. This was in relation to Google’s use of self-preferencing, bundling and tying of service. In Free TV’s view, Google had continued to strengthen its control of the video advertising sector. Google had an ‘inherent conflict of interest’ by being the dominant participant on both the buying and selling sides of the ad tech market with its product Display & Video 360 (DV360).³² Free TV explained that:

For example, all regulators have found evidence of self-preferencing, such as Google’s Ad Exchange being favoured by its own demand-side products such as DV360 and Google Ads. Regulators have found that Google engages in bundling and tying, such as forcing advertisers to use DV360 if they want to access inventory on YouTube. Google also bundles its search and browsing data into

²⁷ ACCC, ‘Digital advertising services inquiry – final report’, 28 September 2021, p. 3, www.accc.gov.au/about-us/publications/digital-advertising-services-inquiry-final-report.

²⁸ ACCC, ‘Digital advertising services inquiry – final report’, 28 September 2021, p. 3.

²⁹ ACCC, ‘Digital advertising services inquiry – final report’, 28 September 2021, p. 37.

³⁰ ACCC, ‘Digital advertising services inquiry – final report’, 28 September 2021, p. 6.

³¹ ACCC, ‘Digital advertising services inquiry – final report’, 28 September 2021, p. 7.

³² FreeTV, *Submission 45*, pages 7–8.

DV360, making it a must-have for advertisers. But it has a significant conflict of interest when attempting to act on behalf of those clients because it is also a seller in those same markets. Google also imposes interoperability constraints and refuses to engage in open industry platforms like header bidding, which cements the competitive advantage of Google's own supply side platform.³³

- 7.37 Google disagreed with the notion that it engaged in 'harmful self-preferencing' in the supply of services or that its practices restrict competition:

...we believe our ad tech products compete on their merits, and we strongly reject any suggestion that we would engage in any harmful self-preferencing in the supply of those services or that our practices restrict competition. There are many different services there that do compete with DV360, so we think that speaks for itself. We make decisions about our products very strongly around how we can better provide returns to advertisers and publishers on reasonable terms.³⁴

- 7.38 Google pointed out that only 17 per cent of the overall digital advertising market involved the ad tech industry. Citing studies that suggest publishers and advertisers use multiple platforms and play them off against each other to maximise their returns, Google claimed that the sector is 'fiercely competitive and dynamic':

...more players are entering the ad tech market. Not only are they providing services at one level of the ad tech stack, but also they are becoming more integrated because there are significant benefits to advertisers and publishers from having an integrated business model up and down different levels of the ad tech stack. This competition has given publishers and advertisers an extraordinary amount of ability to play the different ad tech competitors off against each other to maximise their returns. Studies have been done—various regulators have spoken about this—which show that, on average, publishers will utilise four different ad tech providers and advertisers will use six different platforms at the same time, in real-time, using them against each other to maximise the returns they get from the advertising transaction they are engaged in.³⁵

Service-specific codes of conduct

ACCC proposal

- 7.39 The ACCC's digital platform services inquiry found that the 'dynamic nature and economic characteristics of digital platform services' meant that sectoral harm from

³³ Mr Ross Mitchell, Broadcasting Policy, Free TV Australia, *Committee Hansard*, 26 July 2023, p. 30.

³⁴ Mr Justin Mining, Competition Policy Lead, Asia Pacific, Google, *Committee Hansard*, 29 August 2023, p. 9.

³⁵ Mr Justin Mining, Competition Policy Lead, Asia Pacific, Google, *Committee Hansard*, 29 August 2023, pages 6–7.

anti-competitive conduct could be significant.³⁶ The ACCC inquiry's main recommendation was the introduction of ex ante service-specific codes of conduct. These codes would apply to digital platforms that meet designation criteria for the specific digital services they supply, such as app marketplaces. These new service-specific codes could, in the ACCC's view, support targeted obligations to tackle such issues as:

- Anti-competitive self-preferencing
- Anti-competitive tying
- Exclusive pre-installation
- Frustrating consumer switching
- Denying interoperability, and
- Unfair dealings with business users.³⁷

7.40 The ACCC told the Committee that the proposal for a service-specific code of conduct would be a two-step model. The first step was a designation process for specific platforms that 'are sufficiently influential as intermediaries in the Australian economy and in relation to particular services where they are important and influential and exhibit elements of market power'. Second, a service specific code would apply, which would take account of the benefits of the investment the service is providing, and 'would have the flexibility to change over time, as markets change'.³⁸

7.41 The ACCC's recommended code of conduct would align Australia with the latest international developments in platform-specific regulation. The ACCC told the Committee that:

Overseas jurisdictions like the UK, the European Union and Japan are all taking a strong stance by introducing comprehensive platform-specific competition regulation. South Korea has done so in relation to app stores and their payment systems and services. However, experience has shown the leading platforms do not always bring pro-consumer and pro-competitive changes to Australia, even when legally required to do so overseas. There are indeed strong financial incentives for them to maintain current business models and conduct in the absence of effective regulatory intervention.³⁹

7.42 In relation to app marketplaces, the ACCC's digital platform services inquiry identified potential measures to reduce harms arising from Apple and Google's market power.

³⁶ ACCC, 'Digital platform services inquiry: Interim report No. 5 – Regulatory reform', 11 November 2022, p. 8, www.accc.gov.au/about-us/publications/serial-publications/digital-platform-services-inquiry-2020-25-reports/digital-platform-services-inquiry-september-2022-interim-report-regulatory-reform.

³⁷ ACCC, 'Digital platform services inquiry: Interim report No. 5 – Regulatory reform', 11 November 2022, p. 13.

³⁸ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, p. 44.

³⁹ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, p. 38.

These initiatives included providing users with information about alternative payment options, greater transparency, and providing consumers with more choice through an ability to change any pre-installed default app on their device.⁴⁰

Witness views

- 7.43 Epic Games supported the ACCC's digital platforms recommendations. It stressed, however, that service-specific codes of conduct also required 'robust anti-circumvention provisions' to ensure that digital platforms complied and did not shift their anti-competitive behaviour into an adjacent area.⁴¹
- 7.44 Free TV also supported the introduction of service-specific codes of conduct for digital advertising. Its submission noted that existing competition law is not sufficient to promote economic dynamism and protect competition.⁴²
- 7.45 The big tech platforms that appeared before the Committee generally opposed the notion that more regulation was needed in the sector.
- 7.46 Google emphasised that the technology sector was not 'unregulated'. The costs and benefits of additional regulation needed to be carefully weighed up – given the context of innovation, rapid growth, zero or low costs for consumers and businesses, and the need for incentives and investments to protect users. Google instead proposed voluntary measures as the best approach, rather than additional regulation that could risk productivity and product quality.⁴³
- 7.47 Meta raised concerns with the designation criteria for digital platforms, stating that designation risks 'jump[ing] over a whole range of competition analysis' rather than identifying the consumer harm. Meta told the Committee that:

It may be challenging to find the right criteria. Typically, with competition law you are trying to focus on consumer harm first and then work backwards from that, and in the Australian context there have been a number of investigations and complaints in relation to violations of consumer protection law. So it's quite clear that, where there are concerns around that, the laws can be actively enforced, but in relation to competition law, that hasn't been the same. Certainly in the reports and engagements we've seen in relation to the digital sector in particular, a lot of it has been theoretically identified harms and not actually identified harms. It's very important to have these conversations, because I certainly appreciate the perspective of people with a wealth of experience in economic policy such as you and obviously the ACCC as a very seasoned regulator—that you don't necessarily want things to have been significantly harmed. But I think trying to

⁴⁰ ACCC, 'Digital platform services inquiry: Interim report No. 2 – App marketplaces', 28 April 2021, p. 14.

⁴¹ Epic Games, *Submission 51*, p. 2.

⁴² FreeTV, *Submission 45*, p. 3.

⁴³ Google, *Submission 42*, p. 6.

identify criteria ex ante can be challenging as well, because you might get the wrong criteria and skip over some of the other harms.⁴⁴

Committee comment

- 7.48 Australia needs to keep pace with international developments in the digital platforms space. As technology becomes ever more essential to our lives, the appropriate protections need to be in place to ensure that competition and innovation can thrive and not be hindered by the market power of dominant platforms.
- 7.49 The Committee acknowledges that the work of the ACCC in its ongoing digital platform services inquiry had been critical in building awareness of the issues in the sector. The Committee supports the ACCC's recommendations for service-specific codes of conduct in areas of the industry where market power is problematic.

Box 7.1 Key findings

Tech Sector

- AI has the potential to generate very significant productivity gains in some contexts. It is also important to be aware of the potential anti-competitive impacts of AI, such as economies of scale, non-fungibility and advantages that accrue to incumbents through access to data.

Tech Platforms

- A range of issues, including market power, externalities and self-preferencing warrant continued regulatory monitoring.
- The Committee supports the Australian Competition and Consumer Commission's work in examining the possible application of a code of conduct in areas where market power is problematic.

Recommendation 39

- 7.50 That the Government examine the barriers to financing at the different stages of the innovation process to identify barriers and opportunities to increase investment.**

⁴⁴ Ms Mia Garlick, Regional Director, Policy, Meta, *Committee Hansard*, 15 September 2023, p. 9.

8. Aviation

Current environment

- 8.1 The domestic airline industry is one of the most concentrated industries in Australia, despite the recent domestic expansion of Rex Airlines and the entry of Bonza Aviation. The ACCC's June 2023 report *Airline competition in Australia* highlighted that Qantas Group (including Jetstar) and Virgin Australia consistently accounted for approximately 95 per cent of the domestic passenger market over the preceding 12 months.¹
- 8.2 The Committee received evidence from various stakeholders, including Qantas Group, Virgin Australia, Rex Airlines, Bonza Aviation, Sydney Airport Corporation, and aviation industry expert Mr Peter Harris.
- 8.3 Key issues raised were the allocation and potential misuse of aircraft slots at Sydney Airport, current slot demand and management regulation, access to capital for new entrants, pilot training, and airport fees and charges.
- 8.4 The Committee's interest in the aviation sector follows prior reviews and inquiries, including the Productivity Commission's 2019 *Economic Regulation of Airports inquiry*, the 2021 *Review of Sydney Airport Demand Management Scheme* ('Harris Review') and the ACCC's work on airline monitoring throughout 2023.²
- 8.5 There was considerable stakeholder support for the recommendations and findings of these reports. The Committee notes that many of the recommendations from the Harris Review are being considered by the Department of Infrastructure, Transport, Regional Development, Communications and the Arts' Aviation White Paper, expected to be released in 2024.

¹ Australian Competition and Consumer Commission (ACCC), 'Airline competition in Australia - June 2023 report', 5 June 2023, p. 18, www.accc.gov.au/about-us/publications/serial-publications/domestic-airline-competition-monitoring-reports/airline-competition-in-australia-june-2023-report.

² Productivity Commission, 'Economic regulation of airports', 22 October 2019, www.pc.gov.au/inquiries/completed/airports-2019; Mr Peter Harris AO, 'Review of the Sydney Airport Demand Management Scheme', February 2021, www.infrastructure.gov.au/infrastructure-transport-vehicles/aviation/airports/harris-review-sydney-airport-demand-management-scheme; ACCC, *Domestic airline competition monitoring reports*, www.accc.gov.au/about-us/publications/serial-publications/domestic-airline-competition-monitoring-reports, viewed 10 January 2024.

Competition at Sydney Airport

Background

- 8.6 Evidence presented to the Committee emphasised the strategic importance of Sydney Airport to the domestic aviation network. Any reforms aimed at increasing competition in the aviation sector must consider the current limitations at Sydney Airport, which ultimately have a major impact on the broader aviation network. These issues were raised consistently by witnesses.
- 8.7 Sydney Airport is governed by a complex regulatory framework administered by the Sydney Airport Demand Management Act 1997 and supporting legislation, including the Sydney Airport Curfew Regulations 1998, Sydney Airport Compliance Scheme 2012 and the Sydney Airport Slot Management Scheme 2013.
- 8.8 Evidence from the Harris Review and the ACCC's Airline Monitoring Review suggests that elements of this framework are inhibiting greater competitiveness in the sector. There are unique regulations within the framework that differentiate Sydney Airport from worldwide industry standards, such as the 80 per hour movement cap, a regional ring fence, a size of aircraft test, and a compliance regime.³ In the view of Sydney Airport Corporation, these elements and the broader demand management framework, are 'the most complex, unique and restrictive set of regulations of any major airport globally'.⁴
- 8.9 The main focus of the Committee's discussions was slot management and related issues, such as access to slots for new entrants in peak times, cancellations of flights, allegations of 'slot hoarding', and the 80-20 'use it or lose it' rule.

Slot access

- 8.10 Access to slots at peak time periods are essential for an airline to establish a base of operations, expand its network, and compete for customers. The slot allocation mechanisms at Sydney Airport were discussed throughout the inquiry—particularly access to peak slots and their potential misuse by incumbent airlines.
- 8.11 Airport slots are designed as a solution to a lack of airport capacity, where pre-assigned take-off and landing times are required at airports with high demands on their infrastructure. The stated primary objective of the Worldwide Airport Slot Guidelines (WASG) is to 'ensure the most efficient declaration, allocation and use of available airport capacity in order to optimise benefits to consumers, taking into account the interests of airports and airlines'.⁵

³ Department of Infrastructure, Transport, Regional Development, Communications and the Arts, *Slot management at Sydney Airport*, www.infrastructure.gov.au/infrastructure-transport-vehicles/aviation/airports/airport-planning-regulation/slot-sydney, viewed 10 January 2024.

⁴ Sydney Airport Corporation, *Submission 59*, p. 2.

⁵ Sydney Airport Corporation, *Submission 59*, p. 2.

- 8.12 Sydney Airport has operated as a ‘capacity-constrained’ airport since 1997. Its slots are a public asset owned by the Commonwealth but are administered and allocated by the Slot Manager at Airport Coordination Australia—with a Board consisting of members from Qantas, Virgin, the Regional Aviation Association of Australia, and Sydney Airport.⁶
- 8.13 The ACCC emphasised the importance of peak slots as an enabler of market access in its June 2023 report. It stated that the inability to access sufficient peak slots at Sydney Airport ‘disincentivises new entry and significantly impacts on how much meaningful competition expanding airlines can provide’.⁷
- 8.14 Expanding on this, the Australian Airports Association told the Committee that ‘what happens at Sydney affects all those other airports’, explaining that any constraints—such as access to slots—resulted in constraints across the rest of the network. The Association called for the recommendations of the Harris Review to be ‘looked at’, particularly those addressing more reliable access to slots.⁸
- 8.15 The newest entrant to the domestic aviation sector, Bonza, voiced frustration at not being able to access peak slots at Sydney Airport in seeking to establish a base of operations. While Bonza could access Sydney Airport in off-peak periods, that was not a desirable option. Bonza explained that:
- ...in terms of aircraft basing, is that it would be all well and good to be able to access slots in the middle of the day, which indeed you can access, between maybe 11 and two or thereabouts. That doesn't assist any airline in establishing a base whereby you are obviously wanting to fly in the morning as well as at lunchtime, and then again in the evening. The proposition of flying during the middle of the day is not a viable proposition for setting up a viable business in a location like Sydney. We would effectively have to base aircraft in Sydney. That necessitates us having access in the morning and in the evening to those peak slots, as well as in the middle of the day.⁹
- 8.16 In Virgin’s view, however, while peak access to Sydney Airport is not currently available, choosing to operate in non-peak slots is still a valid option for airlines to participate in the slot system—potentially aiding their ability to shift into peak slots as they become available.¹⁰ Virgin commented that it has had ‘less than ideal slot timings on a number of routes’ but had worked with the slot coordinator to improve its position over time.¹¹

⁶ Airport Coordination Australia, *About*, www.airportcoordination.org/about/, viewed 10 January 2024.

⁷ ACCC, ‘Airline competition in Australia – June 2023 report’, 5 June 2023, p. 28.

⁸ Mr James Goodwin, Chief Executive, Australian Airports Association, *Committee Hansard*, 23 August 2023, p. 20.

⁹ Mr Tim Jordan, Chief Executive Officer, Bonza Aviation, *Committee Hansard*, 30 June 2023, p. 33.

¹⁰ Mrs Susan Schneider, Chief Legal and Risk Officer, Virgin Australia Airlines, *Committee Hansard*, 30 June 2023, p. 25.

¹¹ Mrs Susan Schneider, Chief Legal and Risk Officer, Virgin Australia Airlines, *Committee Hansard*, 30 June 2023, p. 27.

- 8.17 Rex's experience, in gaining additional slots as it expanded operations, was that it was 'very hard' for a new or smaller operator to be a competitor in the domestic airline market. It told the Committee that:

For Rex to move into the domestic airline market, which we did just over two years ago, we have to apply for a slot. When we applied for slots, there were no slots. The previous government had grandfathered all the slots so that anybody who had a slot before the pandemic got to keep it during and after the pandemic. When we applied for slots, we got no slots and had to then wait for the international airlines, primarily, to hand back slots which they felt they couldn't use, and those slots became available to us.¹²

- 8.18 Qantas' view was at odds with those of other witnesses. It said that the smaller domestic airlines had either received significant additional peak slots during 2023 or had chosen not to participate in the seasonal slot allocation process.

In 2021, Rex commenced domestic jet operations out of Sydney, including during peak periods. In summer and winter 2023, Rex was awarded the overwhelming majority of the additional peak slots it sought, or perhaps all of them: 108 additional peak slots in total. Bonza chose not to participate in the seasonal slot process in summer or winter 2023 and, accordingly, did not obtain any slots.¹³

Historic slots and slot misuse

- 8.19 A major barrier to freeing up peak Sydney slots for new operators was that incumbent airlines received priority allocation for particular slots indefinitely (known as historic slots), as long as their number of cancellations stayed within the 80-20 'use it or lose it' threshold.¹⁴
- 8.20 The 80-20 rule and historic slots are not unique to Sydney Airport. However, given the fact that the aviation sector is heavily concentrated with two major airlines, stakeholders voiced concerns about the potential misuse of market power via 'slot hoarding' by Qantas and Virgin. 'Slot hoarding' refers to airlines holding slots for services they do not intend to actually operate – they then cancel the services but retain the slot under "historic usage" rules for the next season (provided they meet the 80-20 threshold).
- 8.21 The 80-20 rule, according to the WASG, is designed to promote effective utilisation of scarce airport capacity at the most in-demand airports, as well as to provide flexibility for unforeseen events. The rule also allows airlines the certainty to publish tickets

¹² Mr John Sharp AM, Deputy Chairman, Rex Airlines, *Committee Hansard*, 23 August 2023, p. 10.

¹³ Mr Andrew Finch, General Counsel and Group Executive, Qantas Airways, *Committee Hansard*, 29 August 2023 p. 39.

¹⁴ For further detail on the eligibility for historic precedence under the WASG Guidelines, see: International Air Transport Association, 'Worldwide Airport Slot Guidelines', 2023, p. 37, www.iata.org/en/programs/ops-infra/slots/slot-guidelines/.

almost a year in advance, and provides predictability of service patterns. This is beneficial for the planning and investment of both consumers and carriers.¹⁵

- 8.22 Criticisms of slot misuse are not new and have been raised prior to this inquiry. Sydney Airport Corporation has been advocating for reform to the Slot and Demand Management Scheme since 2017, and has contributed to the Productivity Commission's 2019 review, the Harris Review in 2021, and the ACCC's reviews between 2020 and 2023.
- 8.23 The Harris Review acknowledged the debate over whether the 80-20 rule was being responsibly observed, noting that:
- ...the potential for slot hoarding and other slot misuse is sufficiently present around the world that the WASG now deals explicitly with it. The Review believes it is unlikely that Australia is fully insulated from global bad practice.¹⁶
- 8.24 In its submission, Sydney Airport Corporation viewed the framework as no longer fit for purpose because it allowed incumbent airlines to 'accumulate more slots than they need'.¹⁷ Its main frustration was that airlines were 'incentivised to misuse the slot scheme as a reservation mechanism' where there is 'no cost to apply for a slot, no cost to hold a slot, and no cost to cancel a slot'.¹⁸
- 8.25 Similarly, the Productivity Commission's review into the economic regulation of airports found that Sydney Airport's historical precedence provisions 'could be exploited by incumbents to limit competition between airlines'.¹⁹ Further, the Harris Review found that for popular routes (Sydney-Melbourne for example) operated by incumbents, 'by being the most attractive (profitable), these routes are exposed to potential slot misuse if it can impede competition'.²⁰
- 8.26 Another issue relating to potential slot misuse was the current preference for historic slot allocation over new entrants. An operator is defined as a 'new entrant' if, after the initial allocation of historic slots, it has been allocated less than four slots on the particular day it is applying for.²¹ A new entrant, therefore, can vary from each scheduling season and the label of 'new entrant' does not necessarily mean that the airline is a new operator.

¹⁵ International Air Transport Association, *Worldwide Airport Slots Fact Sheet*, November 2023, p. 3, www.iata.org/en/iata-repository/pressroom/fact-sheets/fact-sheet---airport-slots/.

¹⁶ Mr Peter Harris AO, 'Review of the Sydney Airport Demand Management Scheme', February 2021, p. 36.

¹⁷ Sydney Airport Corporation, *Submission 59*, p. 2.

¹⁸ Sydney Airport Corporation, *Submission 59*, p. 4.

¹⁹ Productivity Commission, 'Economic regulation of airports', 22 October 2019, p. 32.

²⁰ Mr Peter Harris AO, 'Review of the Sydney Airport Demand Management Scheme', February 2021, p. 34.

²¹ Department of Infrastructure and Transport, 'Sydney Airport Slot Management Administration Manual', July 2013, p. 26,

www.infrastructure.gov.au/sites/default/files/migrated/aviation/airport/planning/files/Sydney_Airport_Slot_Administration_Manual.pdf.

- 8.27 Mr Peter Harris told the Committee that unlike at international airports, new entrants did not get the same priority under Sydney Airport's Scheme, and that the Harris Review had made a recommendation to alter this.

The hierarchy of preferences favours incumbents still, and altering it was a recommendation in the report, that is, to alter the position such that new entrants were able to obtain slots more readily at Sydney Airport. I think it's a straightforward recommendation because it just brings us into line with international practice. Really it shouldn't be terribly difficult for the Government to respond and put that in place.²²

- 8.28 This recommendation was supported by the ACCC, which told the Committee that:

We also support the recommendation of looking at the rule which currently favours the incumbent airlines by prioritising them first for a change of slot rather than making it equal for new entrants and incumbents, for example.²³

Cancellation rates

- 8.29 Cancellation rates are often referenced as an indicator of potential slot misuse, particularly at Sydney Airport. High cancellation rates along certain popular and profitable routes (such as Melbourne-Sydney, and Sydney-Canberra) potentially indicate misuse when compared to overall rates and accounting for factors such as inclement weather.

- 8.30 The Bureau of Infrastructure and Transport Research Economics (BITRE) reports regularly on the on-time performance and cancellation rates for the aviation industry.²⁴ Sydney Airport Corporation referred to BITRE's reported cancellation rates on the Sydney-Melbourne and Sydney-Canberra routes in June 2023 as potential evidence of slot misuse:

...8.3% by Qantas, 8% by Jetstar and 10.3% by Virgin on the Sydney-Melbourne route for the month of June 2023. For the same month, Qantas cancelled 11.5% of flights on the Sydney-Canberra route, against an average of 3.1% for June at Sydney Airport. This has been a recurring theme, noting that in the first half of 2023, Jetstar cancellations on Sydney-Melbourne reached as high as 16%.²⁵

- 8.31 Qantas and Virgin defended the level of cancellations on some of their routes and rejected assertions that they intentionally exploit and misuse the slot system to restrict competition.²⁶ Both airlines raised other factors necessitating flight

²² Mr Peter Harris AO, Private capacity, *Committee Hansard*, 25 July 2023, p. 23.

²³ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, pages 46-47.

²⁴ Bureau of Infrastructure and Transport Research Economics, *Aviation Statistics*, www.bitre.gov.au/statistics/aviation, viewed 11 January 2024.

²⁵ Sydney Airport Corporation, *Submission 59*, p. 5.

²⁶ Mr Andrew Finch, General Counsel and Group Executive, Qantas Airways, *Committee Hansard*, 29 August 2023 p. 38; Mrs Susan Schneider, Chief Risk and Legal Officer, Virgin Australia Airlines, *Committee Hansard*, 30 June 2023, p. 25.

cancellations—such as the complexity of Sydney Airport, staff shortages at Air Services Australia and Air Traffic Control, and unexpected weather.²⁷

- 8.32 However, this view was not shared by other witnesses, such as Rex, which viewed the cancellation rates as ‘clear evidence of an airline gaming the slots’.²⁸ It provided comparative evidence to the Committee as a direct criticism of Qantas misusing its slots—citing the cancellation rates of Rex and Qantas on the same route, with the same aircraft, at similar times:

Qantas will say, ‘We cancel these slots for good reasons; because of matters outside our control.’... in June of this year Rex had a cancellation rate of 0.7 of a per cent and Qantas had a cancellation rate of 8.3 per cent. Over the last financial year, Qantas had a cancellation rate on the Sydney-to-Melbourne route of 8.1 per cent, and Rex had a cancellation rate of 2.7 per cent. So you can see that, where Rex is trying hard to utilise its slots—we only cancelled 2.7 per cent on that route—somehow Qantas, operating the same planes in the same weather conditions and in the same circumstances as we do, had an average cancellation rate of 9.6 per cent.²⁹

- 8.33 This point was reinforced by Sydney Airport Corporation. It asserted that over the decade prior to the COVID-19 pandemic, the data showed a pattern of behaviour of the major incumbent domestic airlines strategically cancelling flights ‘over and above weather and the reasonable management of operational impacts’.³⁰

- 8.34 Qantas, however, in its defence referred to Sydney Airport’s strategic centrality to its domestic aviation network. Cancelling flights on Sydney routes, it said, is often preferable to imposing delays, which can impact multiple flights in one day across its broader network and affect more customers. Qantas added that while it understood that cancellations are frustrating for customers, overall it had achieved the highest level of scheduling performance:

...Qantas has had the highest level of on-time performance of the major domestic airlines for 11 months in a row and the lowest level of cancellations nationally for the past 12 months. Cancellations and runway throughput are driven by a range of factors, including weather and air traffic control staffing shortages. In June alone, a combination of these factors reduced capacity at Sydney Airport on 17 out of 30 days.³¹

²⁷ Mrs Susan Schneider, Chief Risk and Legal Officer, Virgin Australia Airlines, *Committee Hansard*, 30 June 2023, p. 25; Mr Scott Zeglin, Head of Network Strategy and Fleet, Qantas Airways, *Committee Hansard*, 29 August 2023, p. 48.

²⁸ Mr John Sharp AM, Deputy Chairman, Rex Airlines, *Committee Hansard*, 23 August 2023, p. 10.

²⁹ Mr John Sharp AM, Deputy Chairman, Rex Airlines, *Committee Hansard*, 23 August 2023, p. 10.

³⁰ Sydney Airport Corporation, *Submission 59*, p. 3.

³¹ Mr Andrew Finch, General Counsel and Group Executive, Qantas Airways, *Committee Hansard*, 29 August 2023, p. 39.

- 8.35 A related issue raised by Qantas was Sydney Airport’s inability to deliver the legislated 80 movements per hour. Qantas viewed this as more of a concern than the 80-20 rule, stating that:

When you're not delivering eight out of 80 in a peak hour, there is going to be a challenge in the system and it is going to result in either delays or cancellations throughout. A better planning process, which is done in the global industry, and even some of the Worldwide Airport Slot Guidelines—should be a part of the normal planning process. This has not happened in Sydney. That would be a focal point. We would actively welcome the consideration of what constraints in the system are causing ongoing concern.³²

- 8.36 Overall, both Virgin and Qantas stated that they were trustworthy players in their approach to slots, scheduling, and the reliability of the broader flight network.

- 8.37 Virgin explained that it had returned 6,000 slots between the 2022 and 2023 scheduling season.³³

- 8.38 Similarly, Qantas claimed that it had lost slots, particularly on the Sydney-Canberra route. However, while Qantas retained approximately 99 per cent of its historic slots in Sydney, it did concede that this was not the case for the Sydney-Canberra route:

We've lost slots. We have not satisfied the 80:20 on that market. As we look towards our future schedules, it will likely require fewer flights, which is not necessarily a benefit to customers in terms of choice and connectivity. But, to that point, we want to make sure that we can deliver an operationally reliable schedule system-wide. What we have seen with Sydney-Canberra has been an unacceptably high level of cancellations. That is something we are actively working towards for future seasons. The hope is that we can get there and reduce that cancellation rate on Sydney-Canberra.³⁴

Regional access to Sydney Airport

- 8.39 Regional access to Sydney Airport is an important part of the Slot Management Scheme. The Scheme provides for the allocation of slots to operators of regional services, where a regional service is defined as a service that takes off and lands within New South Wales.³⁵ The design of the Scheme guarantees at least some regional access to Sydney Airport through Permanent Regional Service Series (PRSS) slots, a concept known as a ‘regional ring fence’—though Sydney Airport has

³² Mr Andrew Finch, General Counsel and Group Executive, Qantas Airways, *Committee Hansard*, 29 August 2023, p. 47.

³³ Mrs Susan Schneider, Chief Legal and Risk Officer, Virgin Australia Airlines, *Committee Hansard*, 30 June 2023, p. 24.

³⁴ Mr Scott Zeglin, Head of Network Strategy and Fleet, Qantas Airways, *Committee Hansard*, 29 August 2023, p. 47.

³⁵ Department of Infrastructure and Transport, ‘Sydney Airport Slot Management Administration Manual’, July 2013, p. 25.

previously questioned whether the ring fence, designed in 1997 based on regional flying patterns at that time, is sufficient to meet contemporary regional demand.³⁶

- 8.40 The Harris Review considered regional access to Sydney and PRSS slots. It observed that not all PRSS slots were being used, with the number of regional carriers and ports served by access to Sydney Airport having fallen over the past 20 years. As an example, 59 per cent of PRSS slots in the 6am-7am hour remained unallocated at the time of the Review.³⁷
- 8.41 The Review favoured improving nationwide access to Sydney Airport and using unallocated PRSS slots to increase services to the regions. It recommended revising the definition of a regional service to cover services from airports that were not core regulated airports within the *Airports Act 1996*.³⁸
- Australian government aviation policy should favour national objectives rather than parochial State-based preferences. Sydney Airport is a national facility, as constantly emphasised by the airport, airlines and major users such as the tourism industry. This Review can find no reason to deny services from genuine regional centres outside the State to access PRSS slots.³⁹
- 8.42 The Committee raised the issue of PRSS slots with witnesses throughout the inquiry.
- 8.43 Rex told the Committee that the initial design of the regional ringfencing of slots aimed to ensure that regional NSW residents still had access to their major capital city airport at a time when the airports were beginning to be privatised. It commented that while the system had been in operation for 26 years and had ‘worked reasonably well’, it was ‘in desperate need of reform’.⁴⁰
- 8.44 Mr Harris shared this view, explaining the importance of reforming, rather than ‘getting rid of’, the ringfence to ensure continued regional access to Sydney Airport:
- ...as long as regionals are given first preference in how reallocation occurs as a result of reforming the ringfence—it’s not getting rid of the ringfence, it’s reforming it—we’ll guarantee continued regional access to Sydney Airport, and at the same time we will free up a small number of slots per hour, which will be a material contribution in an efficiency sense to the operator of the airport and therefore benefit the consumers.⁴¹
- 8.45 In a similar vein, Bonza proposed that the definition of regional be broadened to include regional locations across the country, which would allow it to start more non-stop services, including to Sydney. From a competition perspective, Bonza

³⁶ Sydney Airport Corporation, ‘Sydney Airport Demand Management: Discussion Paper’, 11 December 2020, p. 18, www.infrastructure.gov.au/sites/default/files/documents/35-sydney-airport-submission-demand-management-review-20210628.pdf, viewed 26 February 2024.

³⁷ Mr Peter Harris AO, ‘Review of the Sydney Airport Demand Management Scheme’, February 2021, p. 18.

³⁸ Mr Peter Harris AO, ‘Review of the Sydney Airport Demand Management Scheme’, February 2021, p. 19.

³⁹ Mr Peter Harris AO, ‘Review of the Sydney Airport Demand Management Scheme’, February 2021, p. 19.

⁴⁰ Mr John Sharp AM, Deputy Chairman, Rex Airlines, *Committee Hansard*, 23 August 2023, p. 10.

⁴¹ Mr Peter Harris AO, *Committee Hansard*, 25 July 2023, p. 27.

explained, the current definition was an ‘impediment’—while some regional markets already had services, they were generally operated by full-service carriers without a low-cost carrier alternative.⁴²

Proposed solutions

Changes to the 80-20 rule

- 8.46 The Committee heard from various stakeholders on changes to the 80-20 rule that would disincentivise the potential misuse of slots and enhance competition for peak Sydney Airport slots.
- 8.47 The Harris Review considered a recommendation to impose a stronger test on domestic interstate flights than the present 80-20 rule. However, the Review ultimately concluded that ‘the evidence is not there to justify this’. Instead other measures, such as revising and better resourcing of governance arrangements to be able to better identify slot misuse, would be essential in addressing slot misuse.⁴³
- 8.48 Both Virgin and Qantas also viewed potential changes to the 80-20 rule as unnecessary. Virgin, while understanding that improvements might be required, told the Committee that it felt the ‘slot system works well’.⁴⁴ Similarly, Qantas saw any changes as a ‘divergence away from global standards’.⁴⁵
- 8.49 However, other witnesses supported changing the rule. Rex, whose Chair John Sharp was involved in the enabling legislation for Sydney Airport’s operating restrictions as Minister for Transport and Regional Development in 1997, explained that at that time the 20 per cent cancellation figure was considered reasonable. In the contemporary era, though, Rex viewed the 80 per cent threshold as too low, stating that:

...when I put in place the 80 cap there was no science to that. The previous Labor Government were going to implement a cap of 85. There were a lot of aircraft noise complaints at the time; the airport had been blockaded on a couple of occasions.

There were a lot of political issues at the time about aircraft noise....so the figure of 80 is not a reflection of the capacity of Sydney Airport; it is just a political thing. It could have been 85. If Labor had been elected in 1996, it would have been 85.⁴⁶

⁴² Mr Tim Jordan, Chief Executive Officer, Bonza Aviation, *Committee Hansard*, 30 June 2023, p. 33.

⁴³ Mr Peter Harris AO, ‘Review of the Sydney Airport Demand Management Scheme’, February 2021, p. 36.

⁴⁴ Mrs Susan Schneider, Chief Legal and Risk Officer, Virgin Australia Airlines, *Committee Hansard*, 30 June 2023, p. 24.

⁴⁵ Mr Scott Zeglin, Head of Network Strategy and Fleet, Qantas Airways, *Committee Hansard*, 29 August 2023, p. 48.

⁴⁶ Mr John Sharp AM, Deputy Chairman, Rex Airlines, *Committee Hansard*, 23 August 2023, p. 12.

8.50 Rex proposed instead a 90-10 rule, citing Qantas reports that it uses 90 per cent of its allocated slots. In doing so, other airlines would then have greater opportunities to access peak slots at Sydney Airport.

If Qantas is only using 90 per cent of their allocated slots, clearly, 10 per cent are not being used, and those unused slots should all go into a pool, which others can then draw upon, whether it's a Rex, a Bonza, a Qatar Airways or another international airline operator. It would be to everybody's advantage, if that were the case.⁴⁷

8.51 Sydney Airport Corporation also supported a tightening of the rule. It proposed 95-5 as a possibility, noting that dispensation was often given to airlines for weather and other adverse events. This would still provide an adequate buffer of 2.5 times the long-term cancellation rate at Sydney Airport of 2.1 per cent.⁴⁸

Transparency, compliance and auditing

8.52 The Committee heard evidence that to benefit competition any changes to the slot management system at Sydney Airport must be accompanied by greater transparency and compliance from airlines around flight cancellations.

8.53 Currently, the *Sydney Airport Demand Management Act 1997* provides for a compliance Committee. This Committee's primary role is to develop, amend and administer the *Sydney Airport Compliance Scheme 2012*. Committee members are appointed by the Minister (or delegate) and Committee membership comprises up to 7 members with at least:

- Three members nominated by airlines that regularly use Sydney Airport with at least one nominated by a regional service operator,
- One member nominated by the operator of Sydney Airport, and
- One member nominated by the body that provides air traffic control services at Sydney Airport.⁴⁹

8.54 At present there is a lack of cancellation data, inhibiting the slot manager's ability to pursue potential slot misuse. Accordingly, Sydney Airport Corporation expressed deep concern with the current regime, viewing it as not meeting the industry's requirements for transparency and greater certainty to enable planning.

We don't have full transparency of how the slot coordinator makes decisions, so I don't have a view about whether they are or are not following the rules adequately. Some of the rules they are being asked to follow, like the 80-20 rule and the rules around potential patterns of cancellations and whether they have

⁴⁷ Mr John Sharp AM, Deputy Chairman, Rex Airlines, *Committee Hansard*, 23 August 2023, p. 14.

⁴⁸ Sydney Airport Corporation, *Submission 56*, p. 7.

⁴⁹ Department of Infrastructure and Transport, 'Sydney Airport Slot Management Administration Manual', July 2013, p. 36.

the requisite powers to address categories of slot misuse, need to be considered.⁵⁰

- 8.55 Further, Sydney Airport Corporation noted that any reform to the 80-20 rule would require a more meaningful compliance Committee framework, one with the authority to issue penalties for slot misuse. Not only did the compliance Committee lack these necessary powers, the Sydney Airport Corporation continued, the Committee had not met in its current form since 2015.

[the compliance Committee] is limited in its scope to determining only if an airline purposefully arrived late, or arrived without an allocated slot. With such a limited scope, even if the Committee had been meeting, it has no ability or power to consider or sanction slot misuse. In this sense, the Compliance Committee is a 'toothless tiger', and is not an effective deterrent to airlines cancelling services for strategic reasons and hoarding slots.⁵¹

- 8.56 The Harris Review made recommendations to strengthen the compliance Committee's scrutiny and enhance the transparency of cancellation data. In particular, the Review proposed that additional compliance resourcing focus on scrutinising cancellations data for selected domestic slots where gross cancellations materially exceeded the domestic services average. Additionally, the Review recommended independent auditing of slot management and cancellations, with the data and conclusions of the audits to be published in a timely manner.⁵²

- 8.57 Expanding on this, Mr Harris told the Committee that a 'forensic audit' would obtain meaningful cancellation data, enabling determinations to be made about whether alleged cancellation reasons were legitimate.⁵³ He believed that:

With better data it's quite plausible that a compliance Committee can pursue allegations of slot hoarding to a conclusion, which at the moment it's quite difficult to do. What I've suggested is there are good forensic and audit techniques to follow up a particular slot and get a report on each of the performances that did result in a cancellation and report that back to the Committee.⁵⁴

- 8.58 Airlines also supported greater transparency and a functional compliance Committee, including as a forum for data audits.

- 8.59 Qantas told the Committee that:

Anything that improves transparency and alignment with the global standards, the Worldwide Airport Slot Guidelines, we are very supportive of. We have nothing to hide. Anything that supports this transparency we would support. The

⁵⁰ Mr Robert Wood, Executive General Manager, Sydney Airport Corporation, *Committee Hansard*, 23 August 2023, p. 27.

⁵¹ Sydney Airport Corporation, *Submission 59*, p. 7.

⁵² Department of Infrastructure and Transport, 'Sydney Airport Slot Management Administration Manual', July 2013, p. 37.

⁵³ Mr Peter Harris AO, *Committee Hansard*, 25 July 2023, p. 26.

⁵⁴ Mr Peter Harris AO, *Committee Hansard*, 25 July 2023, p. 23.

Department of Infrastructure, through the Sydney Airport Demand Management Act, has a slot compliance Committee, which we have actively participated in in the past. That would be the appropriate forum for any audits to occur, should it be resurrected and continued.⁵⁵

- 8.60 Rex told the Committee that auditing, while it was ‘low-hanging fruit’, would have significant benefits for Sydney Airport if it resulted in misused slots being reallocated to other operators. It explained that:

...four extra flights could go into Sydney Airport to allow for more competition, to bring more people, more tourists, and more income into the country. That alone would make a difference.⁵⁶

- 8.61 More broadly, the Australian Airports Association proposed to the Committee that the Government reestablish monitoring of the airlines by the ACCC—introduced by the Morrison Government during the pandemic, the ACCC was previously directed to monitor prices, costs and profits relating to the supply of domestic air passenger services, a practice that was discontinued in June 2023. The Association described the decision to end monitoring as ‘disappointing to consumers and to the airports, regarding understanding what’s happening in the market’.⁵⁷

Reform intent

- 8.62 Projecting forward, Treasury told the Committee that it was considering aviation as part of the Government’s current competition review (for more on the review, see Chapter 4: Economy-wide measures to boost competition and economic dynamism). Though still in the early stages of its review, Treasury was ‘very interested’ in compliance mechanisms regarding demand management at Sydney Airport and noted that auditing had been put forward consistently by the Harris Review and by stakeholders as a reform imperative.⁵⁸

- 8.63 It is also noteworthy that the ACCC ‘strongly supports’ the implementation of the Harris recommendations relating to independent auditing and the capacity to enforce the 80-20 rule.⁵⁹ Summarising the potential benefits to competition, the ACCC told the Committee that:

...there are a number of the Harris recommendations that we think are very important, and it’s very timely to do it. We have Bonza, a new entrant, we have Rex wanting to expand, and we have a substantial level of demand by travelling

⁵⁵ Mr Scott Zeglin, Head of Network Strategy and Fleet, Qantas Airways, *Committee Hansard*, 29 August 2023, p. 40.

⁵⁶ Mr John Sharp AM, Deputy Chairman, Rex Airlines, *Committee Hansard*, 23 August 2023, p. 11.

⁵⁷ Mr James Goodwin, Chief Executive, Australian Airports Association, *Committee Hansard*, 23 August 2023, p. 21.

⁵⁸ Mr Marcus Bezzi, Chief Adviser, Competition Taskforce Division, Treasury, *Committee Hansard*, 15 September 2023, p. 33.

⁵⁹ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, p. 46.

customers, who are looking for the improvement in service and reduction in price which more competition would bring.

- 8.64 On demand management at Sydney Airport, the Committee notes the overwhelming weight of evidence supporting reforms to slot management, with an emphasis on improved transparency on cancellations, and on compliance. In particular, the Committee notes the Harris Review as an authoritative reference point.
- 8.65 It is also clear to the Committee that promoting competition and removing barriers to entry through stronger compliance are different issues to other elements of Sydney Airport's framework, such as curfew and the rolling movement cap—which should not be considered as within the purview of this inquiry.

Other competition issues

Pilot training

- 8.66 The ability to train and recruit pilots is crucial for smaller airlines seeking to expand their operations and achieve scale. Without dedicated investment in pilots and training, airlines are unable to operate larger schedules. Evidence provided to the Committee by Rex and Bonza—which have significantly smaller operations than Qantas and Virgin—highlighted to the Committee the challenges of obtaining and retaining pilots.
- 8.67 In Australia, there is both a 'gap in the market' and 'significant local constraint' on pilot numbers. Many pilots retired early or left the profession during the COVID-19 pandemic.⁶⁰ Additionally, higher salaries overseas had contributed to the shortage.
- 8.68 Generally, smaller startup airlines and potential future entrants to the aviation sector lack the pilot training capacity to inject greater depth into the Australian market. Currently, Bonza sends its pilots overseas for training and uses a simulator in Fiji for its operator proficiency checks and line training. 777 Partners, which owns Bonza, explained to the Committee that it would prefer to be able to train onshore—which would also help retain jobs in Australia.⁶¹
- 8.69 Rex, however, has made significant investments in its pilot training capabilities domestically. It explained to the Committee the importance of investing in pilots for its future and the sector's future, and how its approach differs from Virgin and Qantas:

We invest heavily in our pilots because we believe we need to invest heavily in our future, and pilots and the training of them are a very big part of our future. You won't find that with Virgin. Qantas pays some lip-service to it in Toowoomba

⁶⁰ Mr Manish Raniga, Chief Executive Officer, Airline Investments, 777 Partners LLC, *Committee Hansard*, 30 June 2023, p. 31.

⁶¹ Mr Manish Raniga, Chief Executive Officer, Airline Investments, 777 Partners LLC, *Committee Hansard*, 30 June 2023, p. 31.

with a service which is operated by another company, but which has the 'Qantas' name over the door.

...

We train both our cadet pilots and pilots for other airlines around the world; and we also train our flight attendants there. We are the only airline in Australia that actually has made that investment. We're the only airline that's trying hard to build people with the right skills to take our industry and our business forward. They are the main areas of training: engineering, flight attendants and pilots. As for the others, we have a facility in Sydney, for example, for check-in staff, ground staff and so forth; we have facilities in Sydney and other capital cities where we train those people in a much smaller training program.⁶²

- 8.70 Rex also accused the major airlines of potentially anti-competitive recruitment practices. It claimed that Qantas and Virgin have actively recruited large numbers of already trained pilots from Rex, restricting its ability to grow its operations.

In 2008 we lost just over 50 per cent of our pilots to Qantas and Virgin Airlines over a matter of months. They had ordered a significant number of new aircraft but hadn't planned any training of pilots and hadn't prepared to organise pilots until the last minute. They just came to Rex and took pilots from us. We are going through that same experience today. If you are a Qantas and you want to keep Rex on a short leash, the way you do it is you say from time to time, 'We'll take 40 or 50 of their pilots.' You don't take first officers—you take captains. You take those captains and you put them in your own airline business, knowing that it takes many years to take a first officer to the role of a captain. So taking our pilots from us will restrain our ability to grow and meet our schedule.⁶³

- 8.71 To help tackle the pilot shortage and its impact on airlines' daily operations and growth potential, Rex proposed enforcing training requirements on airlines. This would be a 'great help to the industry'.

If you are in government, why wouldn't you say to an airline: 'You need to invest in your future. You need to train people. You need to train them in-house for your own needs, rather than relying on other people to do it for you and then taking those people from them'.⁶⁴

Airport fees and charges

- 8.72 Evidence provided to the Committee by Qantas, Rex, Bonza, and Virgin Australia pointed to airport fees and charges, particularly security charges, as a factor in their rising cost bases. Increasing cost bases can erode competitiveness by reducing

⁶² Mr John Sharp AM, Deputy Chairman, Rex Airlines, *Committee Hansard*, 23 August 2023, pages 11-12.

⁶³ Mr John Sharp AM, Deputy Chairman, Rex Airlines, *Committee Hansard*, 23 August 2023, p. 11.

⁶⁴ Mr John Sharp AM, Deputy Chairman, Rex Airlines, *Committee Hansard*, 23 August 2023, p. 14.

profit margins and potentially lead to higher ticket prices. If airlines struggle to offer competitive fares, this can negatively impact their market position.

- 8.73 Qantas said that airport pricing was a ‘major cost pressure’ and that the current regulatory regime covering commercial dispute resolution between airports and airlines was not working. Qantas explained that the issue ‘is made worse by high levels of cross-ownership by the large funds buying into these monopoly assets’.⁶⁵

Dedicated pricing principles, for instance, drafted to solve this problem have never been formally enshrined and are, therefore, unenforceable and typically ignored by airports. In this Committee and in the upcoming Aviation White Paper process, consideration must be given to policy settings that will help with the efficient resolution of commercial disputes between airlines and airports, helping to unlock growth and put downward pressure on airfares.⁶⁶

- 8.74 Virgin Australia highlighted that lowering its cost base was key to being more competitive—however there was limited transparency around the basis for airport fees and charges.⁶⁷ It viewed an intervention mechanism as potentially beneficial in arbitrating airline discussions with airports about charges when negotiations have broken down. The intervention mechanism could potentially be administered by the ACCC. Virgin told the Committee that:

As airports are not incentivised to reduce operating expenditure, these costs are simply being passed on to airlines, increasing our cost base and increasing airfares. The same issues remain with negotiating with airports as have existed for many years. We have no choice but to accept their price offers, there is little to no transparency in relation to price and service levels are poor.⁶⁸

- 8.75 The ACCC, in its *Airline competition in Australia* report released in March 2023, expressed concern that the current regulatory regime for airports, based on monitoring of Sydney, Melbourne, Brisbane and Perth, ‘does not adequately constrain airports from using their market power in setting airport charges’.⁶⁹ Further, the ACCC viewed airport charges as a barrier to competition, entry and expansion where lower-cost airlines are ‘unlikely to be able to operate out of high-cost airports’.⁷⁰

⁶⁵ Mr Andrew Finch, General Counsel and Group Executive, Qantas Airways, *Committee Hansard*, 29 August 2023, p. 39.

⁶⁶ Mr Andrew Finch, General Counsel and Group Executive, Qantas Airways, *Committee Hansard*, 29 August 2023, p. 39.

⁶⁷ Mrs Susan Schneider, Chief Legal and Risk Officer, Virgin Australia Airlines, *Committee Hansard*, 30 June 2023, p. 26.

⁶⁸ Mrs Susan Schneider, Chief Legal and Risk Officer, Virgin Australia Airlines, *Committee Hansard*, 30 June 2023, p. 22.

⁶⁹ ACCC, ‘Airline competition in Australia – March 2023 report’, March 2023, p. 28, www.accc.gov.au/about-us/publications/serial-publications/domestic-airline-competition-monitoring-reports/airline-competition-in-australia-march-2023-report.

⁷⁰ ACCC, ‘Airline competition in Australia – March 2023 report’, March 2023, p. 28.

- 8.76 Additionally, the Committee heard from Treasury that the mutual interests of dominant airlines and monopoly airports in Australia would likely be considered in its competition review. This would include the price new entrants face when trying to access particular airports as a barrier to entry.⁷¹

Security fees at regional airports

- 8.77 Another element that can affect an airline's cost base is security charges at regional airports, which can be prohibitive and add to difficulties in operating services where profit margins are already minimal.
- 8.78 Airport operators and screening authorities are responsible for delivering the minimum legislated security requirements, and therefore impose fees on airlines. In some cases, an airport may even choose to implement security arrangements beyond the regulatory requirement, such as screening all passengers.⁷² Rex, for example, explained that security screening costs were a factor in it exiting the Whyalla to Adelaide route in July 2023—when the Whyalla City Council decided to impose legally non-required passenger security screening charges.⁷³ Rex described the screening costs as 'in the order of \$40 to \$50 per passenger' and 'prohibitive for us'.⁷⁴
- 8.79 To assist with these security cost pressures on regional routes, Bonza proposed that a national charging mechanism, such as allocating a national charge based on national throughput (rather than the throughput rate of the individual airport), would assist with growth. Bonza explained that:

Security costs are levied by airport, based on the throughput of the airport. That basically means that if you happen to have an airport with a couple of hundred thousand customers going through it each year, you may pay \$15 to \$20 per customer to go through that airport. That's a very prohibitive cost if you're trying to encourage people to fly. Driven by volume, in the capital city markets the security costs may be sub \$1.⁷⁵

Access to capital

- 8.80 The aviation sector is a high-cost and high-risk sector. It is often subject to external shocks. For prospective entrants, access to capital to fund operations is considered a barrier to entry and greater competitive activity.

⁷¹ Mr Jason McDonald, Division Head, Competition Taskforce Division, Treasury, *Committee Hansard*, 15 September 2023, p. 33.

⁷² The Department of Infrastructure, Transport, Regional Development, Communications and the Arts (DITRDCA) regulates passenger screening through its administration of the *Aviation Transport Security Act 2004* and the *Aviation Transport Security Regulations 2005*.

⁷³ The Rex Group, 'Rex Exits Whyalla-Adelaide Route Due to Council Imposed Security Charges', *Media Release*, 18 May 2023.

⁷⁴ Mr John Sharp AM, Deputy Chairman, Rex Airlines, *Committee Hansard*, 23 August 2023, p. 16.

⁷⁵ Mr Tim Jordan, Chief Executive Officer, Bonza Aviation, *Committee Hansard*, 30 June 2023, p. 35.

- 8.81 The ACCC notes that while barriers to entry into the airline industry remain, most of the new entries over the past 30 years have been made by airlines adopting the low-cost carrier (LCC) model as opposed to operating as a full-service carrier, which require interconnected routes, airport lounges, frequent flyer programs or interline agreements with other airlines.⁷⁶
- 8.82 LCCs generally need ‘less capital to enter and less revenue in order to cover their costs and remain profitable’, therefore supporting competition by increasing the number of airlines that can sustainably operate in the market.⁷⁷ Bonza is the latest LCC to enter the Australian domestic market—the most recent since Tiger Airways in 2007.
- 8.83 Qantas told the Committee that barriers to entry in Australia were ‘very low’ and that the successful entry into the market of Virgin, Rex and Bonza demonstrated this.⁷⁸ It pointed out that Australia’s rules on foreign owned carriers differed from other international jurisdictions, in allowing wholly foreign-owned entities to commence operations in Australia:
- Unlike virtually every other jurisdiction in the world, any foreign carrier, any foreign entity—take Virgin and Rex, for example—can set up here and start a domestic airline. In the US you have to be no less than 25 per cent American-owned. In other jurisdictions it is well above 50 per cent. The ability for well-cashed operators to start in this country is easy. Bonza's entry is an example of that. With very limited capital and using leased aircrafts they have started full jet operations between regional ports in the country and some main-line operations.⁷⁹
- 8.84 While airlines with adequate capital may face few barriers to entry, the Committee heard very different views from Rex and Bonza.
- 8.85 Rex stated that:
- As for access to capital, if you want to start an airline in Australia, it is extremely difficult to find anybody who will provide you with the capital to do that. When we decided to expand into the domestic market, we found a source of funding via a private equity firm called PAG. But capital is a problem.⁸⁰
- 8.86 Similarly, Bonza emphasised to the Committee that while Australia is ranked the 8th largest domestic aviation market in the world, it is the only market that had no

⁷⁶ Australian Competition and Consumer Commission, ‘Airline competition in Australia – March 2023 report’, March 2023, p. 26.

⁷⁷ ACCC, ‘Airline competition in Australia – March 2023 report’, 8 March 2023, p. 26.

⁷⁸ Mr Andrew Finch, General Counsel and Group Executive, Qantas Airways, *Committee Hansard*, 29 August 2023, p. 41.

⁷⁹ Mr Andrew Finch, General Counsel and Group Executive, Qantas Airways, *Committee Hansard*, 29 August 2023, p. 41.

⁸⁰ Mr John Sharp AM, Deputy Chairman, Rex Airlines, *Committee Hansard*, 23 August 2023, p. 12.

independent low-cost carrier prior to Bonza commencing operations in 2023. It stated that:

...the fact that, unfortunately, the last three major high-capacity airline start-ups in Australia have been funded by overseas investment is a sad indictment of competition and the centralised control of this market segment here in Australia. That is an unfortunate reality.⁸¹

8.87 Access to capital in the broader economy is discussed in Chapter 6: Finance.

International best practice in consumer protections

8.88 Travel services come with basic consumer rights. These include the guarantee that services will be provided within a reasonable time after being delayed or cancelled. However, there is no set definition of what constitutes a reasonable time.⁸²

8.89 Consumer rights are crucial to ensure that passengers are treated fairly in the event of disruptions. Various jurisdictions around the world have implemented measures to safeguard consumer rights.

8.90 For travel in Europe, Regulation (EC) No 261/2004, passed by the European Parliament, establishes common rules on compensation and assistance to passengers in the event of flight cancellations, delays or they are denied the right to board a flight.⁸³

8.91 In the United States, there is no statutory compensation scheme for flight delays or cancellations. Instead, each airline follows its own set of policies, detailed in its 'Contract of Carriage'.

8.92 The European Union, through Regulation (EC) No 261/2004, has set a precedent by establishing comprehensive rules around consumer protection for air travel. The various protection is laid out in the regulation's various articles.⁸⁴

- Passengers have the right to compensation in the event of a flight cancellation, unless they are informed of the cancellation at least two weeks before the scheduled departure time, or are offered re-routing that allows them to depart no more than two hours before the scheduled time.

⁸¹ Mr Tim Jordan, Chief Executive Officer, Bonza Aviation, *Committee Hansard*, 30 June 2023, p. 29.

⁸² ACCC, *Travel delays and cancellations*, www.accc.gov.au/consumers/specific-products-and-activities/travel-delays-and-cancellations, viewed 23 February 2024.

⁸³ *Regulation (EC) No. 261/2004 of the European Parliament and of the Council of 11 February 2004 establishing common rules on compensation and assistance to passengers in the event of denied boarding and cancellation or long delay of flights and repealing Regulation (EEC) No 285/91 [2004] Official Journal of the European Union L 46/1.*

⁸⁴ *Regulation (EC) No. 261/2004 of the European Parliament and of the Council of 11 February 2004 establishing common rules on compensation and assistance to passengers in the event of denied boarding and cancellation or long delay of flights and repealing Regulation (EEC) No 285/91 [2004] Official Journal of the European Union L 46/1.*

- Compensation is also available for flight delays. Article 7 specifies that compensation is determined by the flight distance and the duration of the delay and ranges from €250 to €600.
- There are also consumer rights around due care. Article 9 states that regardless of the reason for the delay or cancellation, airlines must provide passengers with meals, refreshments, and potentially hotel accommodation. Where passengers are denied boarding because of overbooking, they are entitled to compensation.
- Compensation is not required where airlines can prove the cancellation or delay was caused by extraordinary circumstances, such as extreme weather conditions or security risks.

8.93 In the United States, the Department of Transportation (DOT) has begun implementing rules that mandate airlines to compensate passengers and cover specific costs for delays and cancellations. The US Transportation Secretary Pete Buttigieg has stated that:

When an airline causes a flight cancellation or delay, passengers should not foot the bill.⁸⁵

8.94 Evidence suggests that following a two-year effort by the DOT, there has been a noticeable improvement in the treatment of travellers. The ten largest airlines now guarantee meals and free rebooking on the same airline, while nine of them also offer hotel accommodation.⁸⁶

8.95 The Department of Transportation provides an Airline Customer Service Dashboard, highlighting the airlines that provide cash compensation, travel credits, vouchers, or frequent flyer miles to compensate for delays or cancellations. The DOT's forthcoming regulations will mandate such compensation and services.⁸⁷

8.96 The Committee raised the idea of specific consumer entitlements for delays and cancellations with various witnesses.

8.97 Mr Harris viewed the design of a regulatory regime in relation to passenger rights in the event of a cancellation as 'complicated', particularly when considering the threshold between a delay and a cancellation. Further, Mr Harris commented that while it was 'plausible' to design a scheme without creating perverse incentives, he did not view financially compensating passengers as the 'highest priority'.⁸⁸

8.98 Sydney Airport Corporation also shared its view on a specific consumer entitlement and framework around cancellation and delays. Sydney Airport Corporation told the Committee that compensation does not 'address the root cause' of delays and

⁸⁵ United States Department of Transportation, 'DOT to Propose Requirements for Airlines to Cover Expenses to Compensate Stranded Passengers', *Media Release*, 8 May 2023.

⁸⁶ United States Department of Transportation, 'DOT to Propose Requirements for Airlines to Cover Expenses to Compensate Stranded Passengers', *Media Release*, 8 May 2023.

⁸⁷ United States Department of Transportation, *Airline Customer Service Dashboard*, <https://www.transportation.gov/airconsumer/airline-customer-service-dashboard>, viewed 23 February 2024.

⁸⁸ Mr Peter Harris, Private capacity, *Committee Hansard*, 25 July 2023, p. 25.

cancellations—and that addressing these would also address the need for a specific compensation scheme.⁸⁹

Committee comment

- 8.99 It is the Committee’s view that to promote greater competition in the aviation sector, previously discussed reforms to help new and expanding airlines obtain slots at Sydney Airport should be implemented. While aviation was not the sole focus of the inquiry, the sector is one of the most concentrated industries in the country, and this has significant impacts on the lives of Australians and the functioning of the economy.
- 8.100 Reforms, such as those recommended in the Harris Review, would allow greater competition through providing more choice to consumers, which is essential in a market where two operators control 95 per cent of the market. The evidence received by the Committee has demonstrated that there is resistance to change from incumbent airlines, which only serves to reinforce the importance of this issue.
- 8.101 There is also clear support for some, if not all, of the Harris Review’s recommendations from across much of the aviation sector and other stakeholder groups, such as the ACCC. The Committee encourages the Government to consider these recommendations as part of current and future work in the sector, such as the Aviation White Paper and the Competition Review.

Box 8.1 Key findings

- Flight cancellations and delays have increased in frequency on some routes.
- It is not clear that high rates of cancellations and delays are solely or primarily due to factors beyond the control of airlines.
- These trends have had significant negative effects on consumers.
- Accordingly, consideration should be given to greater monitoring of cancellations and delays and, in addition, consumer protection measures.

Recommendation 40

8.102 That the Government explore which longer term competition policy settings can provide appropriate oversight of the airlines.

Recommendation 41

8.103 That the Government consider, as part of the Aviation White Paper, strengthening consumer compensation arrangements and consider adopting

⁸⁹ Mr Robert Wood, Executive General Manager Aviation, Sydney Airport Corporation, *Committee Hansard*, 23 August 2023, p. 28.

measures to enhance consumer protection in aviation services, similar to other jurisdictions.

Recommendation 42

8.104 That the Government examine the suitability of current 'use it or lose it' arrangements for airport slots.

Recommendation 43

8.105 That the Government progress reforms to Sydney air traffic demand management.

9. Retail markets

Supermarkets: a highly concentrated sector

- 9.1 Competition in the supermarket sector was a key issue throughout the course of the inquiry. The Committee heard from the two supermarkets that dominate the retail food and grocery sector in Australia, Coles and Woolworths, as well as from Aldi Australia and Metcash Food—rising players seeking to build their presence further.
- 9.2 The Committee also heard from the National Farmers' Federation (NFF) and the Australian Food and Grocery Council (AFGC) about the downstream effects on suppliers from high concentration in the supermarket sector.
- 9.3 The AFGC described Australia's retail market as one of the world's most highly concentrated.¹
- 9.4 Nationally, Coles and Woolworths account for about two-thirds of the supermarket sector. According to evidence given to the 2024 Fels inquiry into price gouging and unfair pricing practices, in the UK, its top 4 grocers account for 65 per cent of the market.
- 9.5 Metcash Food told the Committee that in some areas of Australia the combined market share of Coles and Woolworths was more than 90 per cent and that the major supermarkets were continuing to grow their market share, particularly by acquiring independent stores.²
- 9.6 Aldi has a 10 per cent market share, while Metcash Food (including its Independent Grocers of Australia and Foodland brands, among others) has about 7 per cent.³
- 9.7 Metcash Food told the Committee that the entry of large international players – Aldi (2001) and Costco (2009)—initially changed the supermarket sector's competitive dynamics. However, there was now a renewed stability that does not translate into active competition, and that 'in local areas it's not uncommon for there to be only one or two players in that market'.⁴
- 9.8 The two largest players acknowledged there was debate about competition but ultimately disputed claims that the supermarket sector was not competitive. The Coles Group described the grocery market as intensely competitive and no less

¹ Australian Food and Grocery Council, *Submission 48*, p. 2.

² Mr Grant Ramage, Chief Executive Officer, Metcash Food, *Committee Hansard*, 25 July 2023, p. 42.

³ Hunt Export Advice, *Australia Market Overview 2023*, www.huntexportadvice.com/post/australia-market-overview-2021, viewed 8 November 2023.

⁴ Mr Grant Ramage, Chief Executive Officer, Metcash Food, *Committee Hansard*, 25 July 2023, p. 44.

competitive than overseas sectors.⁵ Woolworths told the Committee that customers had substantial choice among the major food retailers, specialty retailers and online retailers, and that customers moved around and made choices based on the best offer at the time.⁶

- 9.9 As the Fels inquiry has noted, 'High prices, including coordinated high prices, are not prohibited by competition law except where there is an unlawful communication or agreement between the parties. With that exception, duopolies are free to charge high prices'.⁷

Supermarket profits

- 9.10 In the December 2022 quarter, the Australian Bureau of Statistics (ABS) reported strong price rises across the food and grocery sector, with the weighted average change from the December 2021 to December 2022 quarter reaching 9.2 per cent.⁸ In the September 2023 quarter, annual food inflation eased to 4.8 per cent, down from 7.5 per cent in the June quarter and the peak of 9.2 per cent in December 2022.⁹
- 9.11 There has been considerable speculation about whether supermarkets have engaged in price gouging during this inflationary period and used it to increase their profits.¹⁰

Drivers of food and grocery price rises: Supermarket views

- 9.12 Woolworths told the Committee that the higher than usual food inflation had been caused by shocks that disrupted global and local supply chains—including COVID, the war in Ukraine, and natural disasters affecting local agricultural regions.¹¹ The accumulated impact had resulted in a fivefold increase in the number of requests for cost increases from suppliers in recent years.¹²

⁵ Ms Vittoria Bon, Government and Industry Relations Manager, Coles Group, *Committee Hansard*, 25 July 2023, p. 7.

⁶ Mr Paul Harker, Chief Commercial Officer, Woolworths Supermarkets and Metro, Woolworths, *Committee Hansard*, 25 July 2023, p. 8.

⁷ Professor Allan Fels AO, 'Inquiry into Price Gouging and Unfair Pricing Practices – Final report', February 2024, p. 53.

⁸ Australian Bureau of Statistics, *Consumer Price Index, Australia*, 25 January 2023 www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/dec-quarter-2022, viewed 29 February 2024.

⁹ Australian Bureau of Statistics, *Consumer Price Index, Australia*, 25 October 2023, www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/sep-quarter-2023, viewed 29 February 2024.

¹⁰ J Barrett, *Woolworths posts \$1.62bn profit with dramatic lift in margins despite cost-of-living crisis*, The Guardian, 23 August 2023, www.theguardian.com/business/2023/aug/23/woolworths-posts-162bn-profit-with-dramatic-lift-in-margins-despite-cost-of-living-crisis.

¹¹ Mr Paul Harker, Chief Commercial Officer, Woolworths Supermarkets and Metro, Woolworths, *Committee Hansard*, 25 July 2023, p. 8.

¹² Mr Paul Harker, Chief Commercial Officer, Woolworths Supermarkets and Metro, Woolworths, *Committee Hansard*, 25 July 2023 p. 9.

- 9.13 Similarly, Aldi highlighted a record increase in the number of requests it had received for cost increases from suppliers over the previous twelve months, with Aldi accepting 2,322 of 2,571 requests during that time.¹³

Is price gouging driving food and grocery prices?

- 9.14 Metcash Food told the Committee that the capacity of Coles and Woolworths to increase prices was substantially related to the level of competition they faced and that over time higher market concentration would lead to higher prices.¹⁴

It's hard for me to comment on their mark-ups versus other competitors because I clearly don't have visibility of their margins product by product. But I would say that over time, yes, we believe it would lead to higher prices. As cost increases have come through from suppliers over the last year and a half and prices have risen across the market, the nature of their ability to increase prices is substantially related to the competition they face.¹⁵

- 9.15 The Consumers Federation of Australia (CFA) similarly highlighted in their submission that a lack of competition was likely contributing to higher prices for goods and services, including in the supermarket sector.¹⁶

As an example, Australia has one of the most highly concentrated supermarket sectors in the world. While people are struggling to put food on the table, supermarkets have been increasing their profit margins. Sellers' inflation may be a possible cause of the recent profit announcements by Coles and Woolworths. Despite heightened cost of living pressures, Coles Group earnings increased 17.1% in the six months to December 30, 2022. Woolworths had a 14% increase in earnings over the same time period. Both supermarkets increased their gross margins, which indicates they are earning more profit from each customer.¹⁷

- 9.16 The major supermarkets' strong financial results for the full 2022-23 financial year have further heightened speculation that they are price gouging. Coles, Woolworths and Metcash Food all reported increased profits, while Woolworths and Metcash Food also reported increases to their EBIT (earnings before interest and taxes) margins for the financial year.

- 9.17 In the 2022-23 financial year, Woolworths' earnings from its Australian food division increased by 19.1 per cent to around \$2.87 billion, while its operating margin rose

¹³ Mr Adrian Christie, Director, Corporate Affairs, Aldi Stores Australia, *Committee Hansard*, 28 August 2023, p. 33.

¹⁴ Mr Grant Ramage, Chief Executive Officer, Metcash Food, *Committee Hansard*, 25 July 2023, p. 44.

¹⁵ Mr Grant Ramage, Chief Executive Officer, Metcash Food, *Committee Hansard*, 25 July 2023, p. 44.

¹⁶ Consumers Federation of Australia, *Submission 18*, p. 2.

¹⁷ Consumers Federation of Australia, *Submission to the Senate Select Committee on Cost of Living, Submission 62*, p. 3.

from 5.3 per cent to 6 per cent.¹⁸ This compares with a pre-pandemic operating margin of only 4.7 per cent, as reported in Woolworths' 2019 annual report.¹⁹

- 9.18 In the same period, the Coles Group's sales revenue from its supermarkets increased by 6.1 per cent to \$36.7 billion.²⁰ However, Coles recorded a small decrease in its operating margins for its supermarket division from 5.0 per cent to 4.8 per cent,²¹ albeit still well above its pre-pandemic operating margin of only 3.8 per cent for its supermarket division in its 2019 annual report.²²
- 9.19 Metcash Food recorded total food sales of \$9.6 billion normalised (adjusted to remove the effects of seasonality), up 2.8 per cent, and a 3.8 per cent rise in its EBIT.²³
- 9.20 Aldi does not publicly disclose its earnings but told the Committee that in 2022 it had recorded sales of around \$10.5 billion and recorded an EBIT of 2.7 per cent.²⁴
- 9.21 The margins of Coles and Woolworths are noticeably higher than the equivalent profit margins of the grocery divisions of the major chains in the UK—Tesco and Sainsbury's are at 3.8 per cent and 3 per cent respectively.²⁵

Is there a profit-price spiral?

- 9.22 The Fels inquiry into price gouging and unfair pricing practices has said that prices in Australia are often too high, reflecting the many markets where there is less than fully effective competition. It concludes that many consumers are overcharged continuously and that 'profit push' pricing has added significantly to inflation in recent times. The report argues that:

'Profit push' or 'sellers inflation' has occurred against a background of high corporate concentration and is reflected in the surge of corporate profits and the rise in the profit share of Gross Domestic Product. There is much support for the view that prices have added much to inflation. This is to be found in research from the OECD, the International Monetary Fund, the Bank of International Settlements, the European Commission, the European Central Bank, the US Federal Reserve Bank, the Bank of England and many think tanks globally and locally and many detailed research studies. Claims that the rise in profit share in Australia is explained by mining do not hold up. The profits share excluding

¹⁸ Woolworths Group, *2023 Annual Report*, August 2023, p. 31.

¹⁹ Woolworths Group, *2019 Annual Report*, August 2019, p. 20.

²⁰ Coles Group, *2023 Annual Report*, September 2023, p. 30.

²¹ Coles Group, *2023 Annual Report*, September 2023, p. 30.

²² Coles Group, *2019 Annual Report*, September 2019, p. 25.

²³ Metcash, *2023 Annual Report*, August 2023, p. 13.

²⁴ Mr Adrian Christie, Director, Corporate Affairs, Aldi Stores Australia, *Committee Hansard*, 28 August 2023, p. 29.

²⁵ J Barrett, *Australian food giants making more profit from grocery sales than overseas peers*, The Guardian, 27 July 2023, www.theguardian.com/australia-news/2023/jul/27/australian-supermarket-profits-rise-woolworths-coles.

mining has risen and energy and other prices associated with mining have been a very significant contributor to Australian inflation.²⁶

- 9.23 Separately, the Australia Institute's Centre for Future Work report *Profit-Price Spiral: The Truth Behind Australia's Inflation*, released in February 2023, stated that the main driver of inflation in Australia was the profit price spiral, when businesses obtain excess profits through increasing prices above their higher expenses and growth in real economic output.
- 9.24 Both Treasury and the Reserve Bank of Australia, however, have criticised elements of the Australia Institute's analysis.²⁷
- 9.25 Treasury found the report overstated the role of profits in inflation and failed to account for the major role played by high commodity prices.²⁸ And an RBA briefing note found the report methodology was not an appropriate way of identifying whether higher profits were actually a determinant of inflation, and that the report contained significant scope, coverage and conceptual issues.²⁹
- 9.26 The Productivity Commission, in contrast to the Fels inquiry and the Australia Institute, dismissed the notion of 'greedflation'. It told the Committee that it did not see firms using recent increases in inflation to increase profits by unfairly marking up prices over costs:

Some have gone further and claimed that 'greedflation' abounds at the aggregate level in Australia—the idea that firms across the economy are using recent increases in inflation to unfairly mark up prices over costs and increase their profits. The commission doesn't agree with this claim. As our submission notes, overall, aggregate evidence does not suggest that high price margins associated with the exploitation of market power have played a significant role in accentuating the higher input costs and supply constraints that precipitated the current inflation episode.³⁰

National Pricing Strategies

- 9.27 The ACCC's 2008 *Inquiry into the competitiveness of retail prices for standard groceries* found that consumers shopping at a major supermarket chain paid lower prices on average when there was a competing major supermarket chain or Aldi

²⁶ Professor Allan Fels AO, 'Inquiry into Price Gouging and Unfair Pricing Practices – Final report', February 2024, p. 5.

²⁷ R Mizen, Australia Institute urged to retract 'flawed' profit-inflation report, Australian Financial Review, 25 May 2023, www.afr.com/policy/economy/australia-institute-urged-to-retract-flawed-profit-inflation-report-20230513-p5d84j.

²⁸ R Mizen, Australia Institute urged to retract 'flawed' profit-inflation report, Australian Financial Review, 25 May 2023, www.afr.com/policy/economy/australia-institute-urged-to-retract-flawed-profit-inflation-report-20230513-p5d84j.

²⁹ R Mizen, Australia Institute urged to retract 'flawed' profit-inflation report, Australian Financial Review, 25 May 2023, www.afr.com/policy/economy/australia-institute-urged-to-retract-flawed-profit-inflation-report-20230513-p5d84j.

³⁰ Dr Alex Robson, Deputy Chair, Productivity Commission, *Committee Hansard*, 15 September 2023, p. 55.

store within 1 km—as opposed to when there was no major supermarket chain or Aldi store within 5 km.³¹

- 9.28 A national pricing strategy, where key products are priced at the same level across stores, can ameliorate the localised impact of price differences in major supermarkets that don't have a local competitor.
- 9.29 The Coles Group, Woolworths, and Aldi all told the Committee that they have national pricing strategies.³²
- 9.30 Woolworths said that 'when a customer comes into a Woolworths store, no matter where they are, whether they're in a remote part of Australia or in a metropolitan area, they would be paying the same price'.³³ However, Woolworths added, there were some exceptions in each state, typically fresh foods where there is more state-based pricing.³⁴
- 9.31 Aldi advised that while it used a national strategy for the bulk of its goods and ambient products, where there were differences in pricing often this was for locally sourced fresh produce—similar to Woolworths.³⁵

Downstream impacts of market concentration

Power imbalances between supermarkets and suppliers

- 9.32 The Committee heard that high concentration in the supermarket sector had led to a power imbalance between suppliers and the major supermarkets. The impact differed depending on the food sector and supplier location.
- 9.33 The NFF told the Committee that because more than 70 per cent of Australian produce was exported, producers that were solely reliant on the domestic market were more vulnerable to high market concentration.³⁶ Additionally, growers were increasingly dealing directly with supermarkets, which is changing the dynamics

³¹ Australian Competition and Consumer Commission, 'Inquiry into the competitiveness of retail prices for standard groceries', 5 August 2008, p. 97, www.accc.gov.au/about-us/publications/report-of-the-accc-inquiry-into-the-competitiveness-of-retail-prices-for-standard-groceries.

³² Mr Paul Harker, Chief Commercial Officer, Woolworths Supermarkets and Metro, Woolworths, *Committee Hansard*, 25 July 2023, p. 9; Mr Adrian Christie, Director, Corporate Affairs, Aldi Stores Australia, *Committee Hansard*, 28 August 2023, p. 33; Ms Vittoria Bon, Government and Industry Relations Manager, Coles Group, *Committee Hansard*, 25 July 2023, p. 2.

³³ Mr Paul Harker, Chief Commercial Officer, Woolworths Supermarkets and Metro, Woolworths, *Committee Hansard*, 25 July 2023, p. 9.

³⁴ Mr Paul Harker, Chief Commercial Officer, Woolworths Supermarkets and Metro, Woolworths, *Committee Hansard*, 25 July 2023, p. 9.

³⁵ Mr Adrian Christie, Director, Corporate Affairs, Aldi Stores Australia, *Committee Hansard*, 28 August 2023, p. 33.

³⁶ National Farmers' Federation, *Submission 23*, p. 29

within those industries.³⁷ Expanding on the importance of choice for suppliers in the supermarket sector, the NFF said:

It's about choice. When a producer has more choice, the impact of greater market concentration is lower on their business because they can go between options. When there is more choice, when the farmers are less beholden to one or two retailers, they are more able to deal with these issues for their farm businesses.³⁸

- 9.34 Echoing the NFF's views, the AFGC highlighted that the disruption to a relationship between a supplier and a supermarket would likely affect the supplier more. This is because supermarkets had access to thousands of suppliers while some suppliers may only supply the one supermarket.

A supplier may have 80 per cent—sometimes higher, almost up to 100 per cent—of their business split across those couple of supermarkets, whereas a supermarket has thousands of suppliers. So disruption to a relationship or a commercial trading arrangement for a retailer overall has significantly less impact than it does for a supplier. A supplier can have their whole business go under if they lose one of their major customers.³⁹

- 9.35 The Committee also heard from the Australian Competition and Consumer Commission (ACCC) that there were several ways the bargaining imbalance in the supermarket sector was reflected commercially for upstream producers.⁴⁰ Metrics around concentration in the sector as a whole may even understate the risks for particular producers who are more reliant on one of the big entities.⁴¹

The ACCC has seen examples where, for instance, a small group of independent stores in a particular area have actually fostered and grown a local producer. If they're acquired, they just will not be part of the SKU [stock keeping units] range that's going to be on the shelves of the larger acquirer because they offer a particular range. They have contracts near exclusive or they are the underlying producer of their own brand product, and that agreement is an important contributor to them meeting their costs in order to be able to produce their own branded products. As you indicated, Chair, there are quite a number of different ways commercially in which the bargaining imbalance is reflected for the upstream producers.⁴²

³⁷ Mr Kade Denton, General Manager, Trade and Economics, National Farmers' Federation, *Committee Hansard*, 25 July 2023, p. 17.

³⁸ Mr Kade Denton, General Manager, Trade and Economics, National Farmers' Federation, *Committee Hansard*, 25 July 2023, p. 18.

³⁹ Ms Tanya Barden, Chief Executive Officer, Australian Food and Grocery Council, *Committee Hansard*, 25 July 2023, p. 37.

⁴⁰ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, p. 51.

⁴¹ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, p. 51.

⁴² Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, p. 51.

Declining capital investment and productivity

9.36 Both the NFF and the AFGC told the Committee that upstream market concentration was decreasing the willingness of growers to invest in long-term productivity improvements.

9.37 The NFF explained that whenever a grower was dealing with more market power upstream, this would increase the risk for the grower and raise the potential, at least from the grower's perception, of imbalanced dealings. This in turn diminished a grower's willingness to invest in their long-term capability.

It does have an impact on their ability and their desire to impact on the long-term improvement of their farm. We are coming off three seasons of record production in Australia. A lot of farmers are in a good position. It's really about looking at it from the margins. We have farmers who are getting a return, but what additional capital would they have to invest in their property if they were receiving the proper return for their product, if they had a lower risk on their production.⁴³

9.38 And the AFGC agreed that buyer power could adversely affect a business's profitability and therefore its ability to invest.⁴⁴ In this light, the AFGC pointed the Committee to its *Sustaining Australia: Food and Grocery Manufacturing 2030* report. This found that Australia's food and grocery manufacturing sector was under pressure from declining profitability due to a highly concentrated retail marketplace—resulting in a decade of stagnant capital investment and low innovation.⁴⁵

Open-book pricing

9.39 The Committee heard from the NFF that market concentration in the agricultural supply chain provided wholesalers and retailers with a significant information advantage, through broad access to data on price and volume. By contrast, growers only had access to their own data, which represents a data asymmetry.⁴⁶

9.40 Businesses with significant market share, the NFF added, would leverage this lack of market price transparency to pay farmers and agricultural firms less for their produce than they would otherwise receive in a free market.⁴⁷ The greatest impact is felt in the perishable goods industry, where produce must be sold within a specific period before it spoils or degrades in value.⁴⁸

9.41 Adding to the risk for producers, the NFF continued, the increased market concentration of buyers within the supply chain created a potential situation where

⁴³ Mr Kade Denton, General Manager, Trade and Economics, National Farmers Federation, *Committee Hansard*, 25 July 2023, pages 17–18.

⁴⁴ Ms Tanya Barden, Chief Executive Officer, Australian Food and Grocery Council, *Committee Hansard*, 25 July 2023, pages 37–38.

⁴⁵ Australian Food and Grocery Council, 'Sustaining Australia: Food and Grocery Manufacturing 2030', www.afgc.org.au/industry-resources/sustaining-australia-food-and-grocery-manufacturing-2030.

⁴⁶ National Farmers' Federation, *Submission 23*, p. 21.

⁴⁷ National Farmers' Federation, *Submission 23*, p. 21.

⁴⁸ National Farmers' Federation, *Submission 23*, p. 21.

growers face potential retribution from supermarkets and wholesalers for their commercial decisions in relation to accepting or rejecting the market price'.⁴⁹

- 9.42 The information disparity between retailers and producers was so serious, the NFF advised, that it was undermining the long-term productivity of producers and hurting the wages of their employees.

The reduced pricing through asymmetric information is a key contributor to increased fragility within the agricultural supply chain. Farmers are often not able to receive a significant return for their product, increasing their susceptibility to disruption through market changes, natural disasters, and other unexpected changes. Increasing this fragility and associated risk undermines the long-term productivity of industry, reduces wages paid to employees and reduces the overall market signals that support supply and demand.⁵⁰

Non-price components

- 9.43 Adding to the strain on producers caused by market concentration in the supermarket sector, the NFF told the Committee, were additional compliance costs borne by farmers. This is because supermarkets and other purchasers were able to dictate terms and conditions beyond the price paid for goods.⁵¹ These 'cosmetic conditions, regulatory compliance and certification schemes, are often a baseline condition required to sell produce into major outlets', which increases the burden on farmers.⁵² Farmers do not receive any commensurate increase in price to offset these compliance costs.⁵³

Views of the supermarkets and wholesalers

- 9.44 The Committee sought responses from the supermarkets about the economic challenges facing producers who sole-supply to one supermarket, such as the higher level of risk they carry and their reduced willingness to invest.
- 9.45 In reply, the Coles Group stressed that Australia's supermarket sector was no less competitive than overseas markets and that suppliers work with Coles because they choose to, noting also that suppliers had a broad choice as to where they sell their product.⁵⁴ The Coles Group added that it did not know 'why we would look elsewhere if we have a good relationship with a supplier, our customers like the product, and they want the product'.⁵⁵

⁴⁹ National Farmers' Federation, *Submission 23*, p. 21.

⁵⁰ National Farmers' Federation, *Submission 23*, p. 21.

⁵¹ National Farmers' Federation, *Submission 23*, pages 23-24.

⁵² National Farmers' Federation, *Submission 23*, pages 23-24.

⁵³ National Farmers' Federation, *Submission 23*, pages 23-24.

⁵⁴ Ms Vittoria Bon, Government and Industry Relations Manager, Coles Group, *Committee Hansard*, 25 July 2023, p. 2.

⁵⁵ Ms Vittoria Bon, Government and Industry Relations Manager, Coles Group, *Committee Hansard*, 25 July 2023, p. 7.

- 9.46 Woolworths told the Committee that it was in its own interest to be a good partner to suppliers, to address any perceived or real imbalances with them, and to ensure that producers' businesses were viable in the long-term:

We take our relationship with our suppliers very, very seriously. We will try to work with them to make sure that we're a good partner and that they have a long-term, sustainable, viable business. It's not in our interests for that to not be the case. It's in our interests, and most of our supply relationships are quite longstanding.⁵⁶

- 9.47 Aldi explained that it had an interdependent relationship with suppliers—one cannot succeed without the other—and that it had a reputation as a 'fair and reasonable partner'.⁵⁷

- 9.48 Finally, Metcash Food advised that it always operated on the basis that customers and suppliers had a choice about their route to market:

Metcash's objective is to provide the most effective and efficient route to market to enable small businesses to compete with large businesses and for suppliers to be able to interact effectively with our network of stores. That's the key value that we add in the value chain. But, because they have choices, they are always able to deal one to one as well. That means there are always opportunities available for suppliers, and particularly fresh suppliers.⁵⁸

The Food and Grocery Code of Conduct

- 9.49 Coles, Woolworths, Aldi and Metcash Food are all signatories to the Food and Grocery Code of Conduct (the 'Code'), a voluntary code of conduct that is enforced and supported by the ACCC. Signatories are required to act in good faith towards suppliers and to establish a dispute resolution process to raise and resolve complaints.⁵⁹

- 9.50 The Committee received different views from the NFF and the AFGC about the future of the Code.

- 9.51 The NFF's submission recommended the Code be strengthened and made mandatory.⁶⁰

- 9.52 The AFGC's submission stated the Code had 'mitigated some of the more egregious retailer behaviours since its introduction in 2015. ... the FGCC [Food and Grocery Code of Conduct] represents the most significant safeguard against poor behaviour

⁵⁶ Mr Paul Harker, Chief Commercial Officer, Woolworths Supermarkets and Metro, Woolworths, *Committee Hansard*, 25 July 2023, p. 8.

⁵⁷ Mr Adrian Christie, Director, Corporate Affairs, Aldi Stores Australia, *Committee Hansard*, 28 August 2023, p. 28.

⁵⁸ Mr Grant Ramage, Chief Executive Officer, Metcash Food, *Committee Hansard*, 25 July 2023, p. 45.

⁵⁹ *Competition and Consumer (Industry Codes—Food and Grocery) Regulation 2015*.

⁶⁰ National Farmers' Federation, *Submission 23*, p. 24.

in the food and grocery sector'.⁶¹ However, the AFGC did not support making the Code mandatory.⁶²

- 9.53 Separately, the Fels inquiry into price gouging and unfair pricing practices supports a mandatory Code, with regulations that are legally enforceable by the ACCC and that makes Code membership compulsory for large retailers.⁶³
- 9.54 The Code has been subject to a series of reviews since 2018, with the Government announcing in January 2024 a culminating review as to whether the code remains fit for purpose. This review will be led by the Hon Dr Craig Emerson, with a reporting deadline of 30 June 2024. The full review process, including the terms of reference, is outlined in the Box 9.1 below.

Box 9.1 Food and Grocery Code of Conduct review process

The Competition and Consumer (Industry Codes—Food and Grocery) Regulation 2015 ('the Code') was introduced to improve transparency and certainty in the commercial dealings between retailers, wholesalers and suppliers, and provide an effective process for parties to resolve their disputes.

The Code was reviewed by Professor Graeme Samuel AC in 2018, resulting in amendments in October 2020 to improve the operation of certain provisions, particularly in relation to the dispute resolution procedures.

The regulations around the Code required the Government to initiate two separate reviews of the Code, the first to consider the operation of the dispute resolution provisions (Part 5 of the Code) and the second review to consider the operation of the remaining provisions.

Treasury delivered the final report to Government in September 2023. In January 2024, the Government released the report and its response to the review.

The second review commenced in October 2023.

The Code is scheduled to sunset (be automatically repealed) on 1 April 2025. Prior to sunset, a review of the Code is also required to determine whether it remains fit for purpose.

In accordance with these requirements, the Hon Dr Craig Emerson has been appointed to undertake this review of the Code, supported by a secretariat within Treasury.

The review will:

- Assess the effectiveness of the Code provisions (other than Part 5) in achieving the Code's purpose of improving the commercial relationship between retailers, wholesalers and suppliers in the grocery sector, and

⁶¹ Australian Food and Grocery Council, *Submission 48*, p. 4.

⁶² Australian Food and Grocery Council, *Submission 48*, p. 4.

⁶³ Professor Allan Fels AO, 'Inquiry into Price Gouging and Unfair Pricing Practices – Final report', February 2024, p. 8.

- Consider the need for the Code, including whether it should be remade, amended or repealed.

In evaluating the Code's purpose and features, the review will have particular regard to:

- The impact of the Code in improving commercial relations between grocery retailers, wholesalers and suppliers,
- Whether the Code's provisions should be extended to other retailers or wholesalers operating in the food and grocery sector,
- Whether the Code should be made mandatory, and
- Whether the Code should include civil penalty provisions.

The recommendations will be implemented as part of a broader package of reforms to the code following the conclusion of the 2023-24 review of the remaining provisions of the code.

A report of the review is to be prepared by 30 June 2024 for consideration by the Assistant Minister for Competition, Charities and the Treasury.

Committee comment

9.55 The Committee received consistent evidence that the supermarket sector in Australia was highly concentrated. It recognises the potential for the major supermarkets to exploit their market power through higher pricing or by dictating terms to suppliers. The Committee is deeply concerned about the implications of this for consumers at a time of intense cost-of-living pressures. It is also troubled by the information disparity between the major supermarkets and food producers, and the risks this poses to the viability and productivity of those producers.

Beer Industry

A concentrated market

- 9.56 The beer industry may be an example of a downstream market in which the bargaining power lies predominantly with the producer and not the retailer.
- 9.57 Australia has one of the most restricted beer sectors in the world, with two large foreign-owned companies dominating beer supply, and two large companies dominating the retail beer sector.
- 9.58 The committee heard several pieces of evidence which suggest that the beer market in Australia lacks competition:
- The beer market in Australia is regularly described as a duopoly, with around 85 per cent market share held by the largest two brewers
 - The two major brewers also maintain very high profit margins

- Australian beer consumers pay among the world's highest prices
- The brewers exert market power over the retailers, evidenced by retail margins in beer being significantly below margins in other categories such as wine and spirits.

9.59 Competition in this restrictive beer market was a key issue for the Committee. Throughout the course of the inquiry, the Committee received evidence from the major brewers—Lion, and Carlton & United Breweries (CUB)—as well as from Coopers Brewery (Coopers) and the Independent Brewers Association (IBA), the peak national body representing Australia's approximately 600 independent brewers, about competition issues facing the beer sector.

9.60 The Committee heard that the market power of Lion and CUB greatly limits the access of Coopers and other independent brewers to key distribution networks, taps and retail.

9.61 The long-term decline in beer consumption in Australia and the beer excise were highlighted by all witnesses as key concerns affecting the sector.

Breakdown of market share

9.62 Between 80 to 85 per cent of the beer market is in the hands of CUB, wholly owned by Asahi Group Holdings since 2020, and Lion, wholly owned by Kirin Holdings Company Ltd since 2009. CUB is estimated to have more than 50 per cent market share while Lion is estimated to have around 34 per cent market share.⁶⁴

9.63 Coopers holds a 5 per cent market share, independent brewers have a combined 5.5 per cent market share, and private label brands owned by the two largest alcohol retailers, Coles and the Endeavour Group (formerly part of Woolworths), account for around 5 per cent, while distributors of international products make up the remainder.⁶⁵

9.64 Around 65 per cent of the retail alcohol market is also in the hands of just two companies, Coles and the Endeavour Group.⁶⁶

Market Power of Lion and CUB

Margins

9.65 The Committee heard that Australian beer drinkers are paying some of the highest prices in the world.

⁶⁴ Brauwelt International, *Are Australia's Brewers and retailers abusing their market power?*, <https://brauwelt.com/en/international-report/asia-australia/646068>, viewed 5 December.

⁶⁵ Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30.

⁶⁶ Mr Richard Adamson, Board Representative, Independent Brewers Association, *Committee Hansard*, 26 July 2023, p. 36.

- 9.66 Unpacking the profitability of Lion and CUB can be difficult as both are foreign-owned companies,⁶⁷ and the Committee did not have access to detailed financial information. Brewer margins differ depending on the beer product and pack size. Cases of beer tend to be at a lower margin than six packs of beer,⁶⁸ while craft beer has the potential to be at a higher margin than other beer.⁶⁹
- 9.67 In the course of the inquiry, the Committee heard that the margins for brewers of beer were greater than the margins for alcohol retailers in general. Responding to a question on whether the retail margins on a case of beer in a major chain were on average lower than 10 per cent, Lion said: ‘In the realms, but you can’t be as specific as that’.⁷⁰ The Committee then asked Lion whether their margins were healthier than the retailer margins and Lion responded, ‘They are more than that, yes’.⁷¹
- 9.68 In 2019, when Asahi bought CUB for \$16 billion, CUB’s sales were reported at about \$2.5 billion, and its profit about \$1 billion, which implies a profit margin of about 40 per cent.⁷²
- 9.69 No witness was able to explain to the Committee why there was a difference between brewer margins and those of the major alcohol retailers. The Australian Competition and Consumer Commission (ACCC) told the Committee that ‘it is a great example of where further detailed work would best be done’.⁷³

A restricted market

- 9.70 With market power in the beer supply sector in the hands of two brewers and market power in the retail sector in the hands of two major retailers, the Committee heard Australia’s beer market was restrictive and anti-competitive.⁷⁴
- 9.71 The IBA told the Committee: ‘These conditions make it very challenging for independently owned small businesses to access key distribution channels and respond to consumer demand. This restrictive and anticompetitive marketplace, coupled with the challenging market conditions in the brewer space...threatens the existence of many independent brewers’.⁷⁵
- 9.72 Coopers said: ‘The beer market has become what is colloquially known as ‘pay to play’, with publicans accustomed to rebates for keg sales and retailers accustomed

⁶⁷ Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 32.

⁶⁸ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, p. 3.

⁶⁹ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, p. 6.

⁷⁰ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, p. 2.

⁷¹ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, p. 2.

⁷² J Kehoe, ‘“Ridiculously profitable”: Why Aussie beer is so expensive’, *Australian Financial Review*, 21 September 2023, www.afr.com/policy/economy/ridiculously-profitable-why-aussie-beer-is-so-expensive-20230915-p5e52f#, viewed 5 December 2023.

⁷³ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 17 March 2023, p. 50.

⁷⁴ Mr Richard Adamson, Board Representative, Independent Brewers Association, *Committee Hansard*, 26 July 2023, p. 36.

⁷⁵ Mr Richard Adamson, Board Representative, Independent Brewers Association, *Committee Hansard*, 26 July 2023, p. 36.

to promotional discounting, cooperative marketing and trading terms for packaged beer'.⁷⁶ Despite having around 5 per cent market share, one of Coopers' biggest growth challenges is its lack of 'market power or resources to be able to compete aggressively in this market'.⁷⁷

A duopolistic market?

- 9.73 With Lion and CUB sharing between 80 and 85 per cent of the beer market, and with their profit margins larger than the major retailers, the Committee asked both companies whether Australia's beer market could be described as a duopoly. Both Lion and CUB disagreed with this proposition, claiming that from a customer perspective it was certainly not a duopoly.⁷⁸
- 9.74 Lion said that a customer in a bottle shop sees 'a whole range of beer products, and hundreds of different brands'⁷⁹ and in pubs 'there's typically choice of different brands, typically from different manufacturers'.⁸⁰ CUB stated: 'You just need to walk into a retail venue to see, in store, the number of craft and other brands available for sale throughout a retail landscape'.⁸¹
- 9.75 CUB also put to the Committee that more than 600 brewers now operated in Australia, compared to 130 only 15 years ago, which suggested the beer sector was highly competitive.⁸²

Competition in taps

- 9.76 Tap beer, also referred to as draught beer, is, along with packaged beer, one of the two pillars of the beer market.⁸³ As with the overall beer market, the tap beer market is highly concentrated, with Lion and CUB having just over 80 per cent combined market share of national draught beer volumes.⁸⁴ The Committee heard that Coopers has around 3 per cent,⁸⁵ while independent brewers have around 16 per cent.⁸⁶

⁷⁶ Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30.

⁷⁷ Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30.

⁷⁸ Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, p. 31.

⁷⁹ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, pages 2-3.

⁸⁰ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, pages 2-3.

⁸¹ Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, p. 33.

⁸² Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, pages 32-33.

⁸³ Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, p. 31.

⁸⁴ Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, p. 31.

⁸⁵ Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30.

⁸⁶ Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, p. 31.

Locked out: Coopers and the IBA's views on taps

- 9.77 The Committee heard that the rebates offered by the two largest brewers to publicans, as well as the tap contracts agreed between the two largest brewers and publicans, were limiting access to taps for Coopers and independent brewers. Coopers told the Committee these conditions meant 'craft brewers are often unable to compete, with 80 per cent having their own tap rooms instead and gaining 50 per cent of their revenue from the same'.⁸⁷
- 9.78 Coopers added that 'our keg-share volume of the market is significantly lower than our retail volume' and that, similar to a craft brewer, in the eastern states, it [Coopers] may only get one or two products on tap or access to rotational taps.⁸⁸ Further, the key rebates offered by the large brewers were locking out other brewers from accessing taps, with the contracts of the large brewers designed specifically to exclude Coopers. Over the past 35 years:
- ...keg rebates have transitioned from being simple discounts off keg prices to now including significant up-front payments made by the large breweries in exchange for signing long-term exclusivity arrangements that often lock out other brewers by brand name or beer style. In South Australia, given our history in this state, we're often able to secure more taps, especially as consumers expect to see us on tap. Outside South Australia, CUB and Lion have a tendency to specifically exclude Coopers or its products in their contracts with publicans.⁸⁹
- 9.79 The IBA highlighted the same issue—that the large brewers' tap contracts are limiting access to taps for independent brewers and the rebate schemes offered by the large brewers are artificially restricting sales for independent brewers:
- It's commonplace for the large brewers to have a tap contract with a pub, and it would be either one of them. It may be that 100 per cent of the taps are contracted to that brewery.... It could go down even to, say, 51 per cent of the taps being contracted as well.
- If an independent brewer is lucky enough to get one of those free taps in a majority tap contract, what we are often seeing is that these rebate schemes, which have been put in place as an incentive to increase volume, restrict access to sales. The pub will actually short-order the kegs from an independent brewery, just to restrict how much is sold through as a percentage of the overall volume of beer they sell, in order to meet their contracted tap rebate. Having that sort of mechanism in place is artificially restricting how much beer an independent brewer can sell through that outlet. It's also depriving the consumer of access to those products.⁹⁰

⁸⁷ Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30.

⁸⁸ Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30.

⁸⁹ Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30.

⁹⁰ Mr Richard Adamson, Board Representative, Independent Brewers Association, *Committee Hansard*, 26 July 2023, pages 37-38.

9.80 In 2017, the ACCC investigated the contracts of CUB and Lion following allegations from craft brewers that exclusivity provisions and volume requirements were locking them out of taps.⁹¹ However, the ACCC did not progress the issue to enforcement. It told the Committee that:

We saw some submissions and evidence to you [the Committee] relating to their access to taps in on-premises sales. That was something that the ACCC did investigate some time ago. But the ACCC did not take that investigation through to an enforcement step, but we did look carefully at it. However, we are conscious of the capacity, and the situation is that a reasonable proportion of taps in hotels are going to sit under the ownership of the two largest brewers.⁹²

9.81 The IBA told the Committee that the ACCC's finding 'was met with bewilderment by most of our members'.⁹³

CUB and Lion incentive structure

9.82 The Committee questioned the major brewers on whether the incentives they offer venues had changed, and whether they were locking out independent brewers from being able to access taps.

9.83 The Committee heard from CUB and Lion that they do enter into contracts with venues, which offer rebates and other incentives, but that these arrangements had been in place for many years.

9.84 CUB told the Committee that it 'enters into formal contracts with some of our on-premises customers. These formal contracts offer a mix of rebates, up-front incentives or other support for providing a specified minimum tap representation for our products. In the great majority of our customer venues, it is a fact that there is flexibility to range small brewers' craft beers on tap'.⁹⁴ In response to whether these contracts have changed over the past decade, CUB told the Committee: 'Not significantly or materially at all'.⁹⁵

9.85 Lion, on the same issue, told the Committee that the 'biggest thing we do is obviously market our brands'.⁹⁶ Related to this, Lion offers discounts based on volume, and investments in infrastructure in pubs, such as putting in beer systems.⁹⁷ In response to a question about whether the incentive structure in the tap market had changed,

⁹¹ Australian Competition and Consumer Commission, 'ACCC releases findings of beer taps investigation', *Media Release*, 13 July 2017.

⁹² Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, p. 50.

⁹³ Mr Richard Adamson, Board Representative, Independent Brewers Association, *Committee Hansard*, 26 July 2023, p. 36.

⁹⁴ Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, pages 31-32.

⁹⁵ Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, pages 31-32.

⁹⁶ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, p. 5.

⁹⁷ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, p. 5.

Lion advised that its rebates based on volume 'have been in the market for a very long time'.⁹⁸

9.86 Both Lion and CUB disagreed with the claim by Coopers that the beer market had become 'pay-to-play' and the claim by the IBA that venues were short-ordering kegs to artificially restrict the volume of sales by independent brewers.

9.87 Lion added that it had a policy of not getting 'in the way' of taps for independents:

I don't know whether anyone on the Committee has ever been into a pub and asked for a beer and they said, 'Sorry. We don't have that beer because we're trying to sell more of this beer because we get a better rebate.' These are sophisticated retailers we're talking about that are passionate about their consumers/customers and want to give them what they come in and order.⁹⁹

...

There are a lot of independents looking for taps as well and that comes down to whether the publican thinks the consumer is going to buy their brands or not.¹⁰⁰

9.88 Similarly, CUB disputed that Coopers and independent brewers faced barriers in the tap beer market.

I would disagree with them. They are not terms I am familiar with. The majority of our customer venues are free to range smaller brewers and craft beer products. It is for the publicans to determine what they range in their venues, based on consumer demand.¹⁰¹

Retail concentration and packaged beer

Retail concentration

9.89 The retail beer market is highly concentrated with the two largest retailers, the Endeavour Group and Coles, holding the majority market share. Craft beer takes up 60 per cent of shelf space in retail outlets.

9.90 The Committee heard varying estimates of the combined market share of the Endeavour Group and Coles—the IBA estimated it to be 65 per cent,¹⁰² Lion estimated it at about 52 per cent,¹⁰³ and Coopers estimated it at 60 per cent.¹⁰⁴

⁹⁸ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, p. 5.

⁹⁹ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, p. 7.

¹⁰⁰ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, p. 6.

¹⁰¹ Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, p. 33.

¹⁰² Mr Richard Adamson, Board Representative, Independent Brewers Association, *Committee Hansard*, 26 July 2023, p. 36.

¹⁰³ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, p. 3.

¹⁰⁴ Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30.

- 9.91 The ACCC told the Committee that independent bottle shops were a ‘more competitive force than you would expect’.¹⁰⁵ For this reason, the ACCC monitors closely purchases of independent bottle shops by the Endeavour Group and Coles.

Being squeezed out

- 9.92 The success of the craft beer industry has seen both major retailers develop private-label beer brands. Despite being almost non-existent 20 years ago, the major retailers’ private-label brands are now estimated to account for 5 per cent of the beer market.¹⁰⁶
- 9.93 The remaining package beer market reflects the overall beer market. Lion and CUB have a combined 80 per cent market share,¹⁰⁷ Coopers has a 5 per cent share, and the IBA told the Committee that the independent brewers are at around 5.5 per cent.¹⁰⁸
- 9.94 The Committee heard that independent brewers and Coopers were being ‘squeezed out’ of major retail shelf space by the market power of the major brewers and their prioritisation of their own private-label beer brands.

Views of Coopers and the IBA

- 9.95 The Committee heard from Coopers that its market share with the major retailers was lower than its share with independent retailers. This is a consequence of the major brewers’ market power, which allows them to negotiate more favourable selling arrangements with the major retailers than Coopers can. Adding to Coopers’ difficulties, the major retailers then self-preference their private-label beer brands for sale. Coopers told the Committee that:

Our second biggest issue is retail concentration. Our market share means that we have less market power to negotiate with the two major retailers, who have just under a 60 per cent market share of the packaged beer market. By way of illustration, our market share in independent retailers is approximately seven to eight per cent, whereas our market share in the national retailers sits at approximately four to five per cent... Our argument has always been that our performance is much stronger in markets where consumer preference dictates what is on the shelves, which is more the case in the independent market.

The major brewers, especially Asahi post-merger, have been able to negotiate more favourable trading terms with the major retailers. These terms dictate ambient floor space; chilled space in fridges and cool rooms; and requirements for ranging, including any new products. We have also found that we're getting

¹⁰⁵ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, p. 50.

¹⁰⁶ Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30.

¹⁰⁷ Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, p. 33.

¹⁰⁸ Mr Richard Adamson, Board Representative, Independent Brewers Association, *Committee Hansard*, 26 July 2023, p. 37.

further squeezed by retailers preferencing private label products after they have met the terms of the majors. For example, in South Australia, four independent bottle shops were recently bought by EDG and converted to BWS stores; Coopers' sales went down by approximately 50 per cent, as we are unable to secure the same ranging and floor space as when they were independently owned.¹⁰⁹

- 9.96 The IBA raised similar concerns that independent brewers were being squeezed out by the major retailers self-preferencing their private-label beer brands:

Anecdotally, we're seeing that one in five to one in four shelf spaces for beer are now one of their private-label brands, so we are getting squeezed out of the major retailers' shelf space at the same time.¹¹⁰

- 9.97 Additionally, the IBA was concerned that the expansion of private-label beer brands in the retail beer market could increase further. Recent European experience has shown in some quarters that 'privately-owned brand space for beer is around 50 per cent of the market'.¹¹¹

Views of CUB and Lion

- 9.98 CUB insisted that competition in packaged beer and the retail space, as it is in the general beer market, was 'intense':

With more than 600 brewers and thousands of beers available for sale, competition for packaged beer sales and retail space is intense. Major liquor outlets have all dedicated sections and space for craft beers and have done so for several years. This competition is good for the category; it provides many opportunities for smaller brewers to secure ranging. Competition for packaged beer sales is also heightened by the private label beer offerings of major retailers.¹¹²

- 9.99 Lion told the Committee that while the retail market it engages with was reasonably concentrated, there 'are obviously a lot of independent customers as well'.¹¹³ It also highlighted the high number of number of products and brands a consumer would see in a bottle shop as evidence of competition.¹¹⁴

¹⁰⁹ Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30.

¹¹⁰ Mr Richard Adamson, Board Representative, Independent Brewers Association, *Committee Hansard*, 26 July 2023, p. 38.

¹¹¹ Mr Richard Adamson, Board Representative, Independent Brewers Association, *Committee Hansard*, 26 July 2023, p. 38.

¹¹² Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, p. 32.

¹¹³ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, p. 4.

¹¹⁴ Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, pages 2-3.

Long-term trends in the beer industry

Declining beer consumption

9.100 Both alcohol consumption and beer consumption (as a proportion of total pure alcohol consumption, compared to wine and spirits) have been in long-term decline in Australia. All witnesses highlighted declining beer consumption as a commercial challenge.¹¹⁵

9.101 There has also been a shift within the beer market towards higher-end products, with independent brewers growing their industry through a ‘premiumisation’ of beer, particularly before COVID.¹¹⁶

The beer excise

9.102 The differential tax treatment of beer compared to other alcohol was also raised by all witnesses as a challenge.¹¹⁷ The Committee heard that Australia’s beer excise taxes—which are raised in line with the consumer price index twice a year—are now the third highest in the world, whereas the wine equalisation tax percentage hadn’t increased since its introduction in 2000. Such unfavourable excise arrangements were put forward as a key reason for beer’s declining consumption relative to wine.¹¹⁸

Committee comment

9.103 The Committee notes that Lion and CUB exercise enormous market power in the beer sector, with a combined 85 per cent market share and margins higher than in the alcohol retail sector.

9.104 The Committee acknowledges too that it is difficult to determine the profitability of Lion and CUB as both are foreign-owned. However, the financial information reported at the time CUB was sold to Asahi in 2019 implies an enormous profit margin of about 40 per cent.

9.105 The Committee is troubled by the difference in profitability between the major brewers and the retail sector—it suggests excessive product pricing, and an uneven playing field for competitors of Lion and CUB or potential market entrants.

¹¹⁵ Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, p. 32; Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30; Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, pages 5-6; Mr Richard Adamson, Board Representative, Independent Brewers Association, *Committee Hansard*, 26 July 2023, p. 36.

¹¹⁶ Mr Richard Adamson, Board Representative, Independent Brewers Association, *Committee Hansard*, 26 July 2023, pages 38–39.

¹¹⁷ Ms Amanda Sellers, Group Chief Executive Officer, Asahi Beverages, representing Carlton & United Breweries, *Committee Hansard*, 29 August 2023, p. 32; Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30; Mr David Smith, Managing Director, Lion Australia, *Committee Hansard*, 28 August 2023, p. 4; Mr Richard Adamson, Board Representative, Independent Brewers Association, *Committee Hansard*, 26 July 2023, p. 38.

¹¹⁸ Dr Timothy Cooper, Managing Director, Coopers Brewery Ltd, *Committee Hansard*, 25 July 2023, p. 30.

Box 9.2 Key findings

- In some instances, there is unequal bargaining power between upstream suppliers and major supermarket chains. The relative bargaining power of retailers and suppliers will not always be imbalanced nor, where there are bargaining imbalances, will they always be in favour of major retailers:
 - For some producers of agricultural products, the possibility of market power on the part of supermarkets and other retailers is worth exploring. The Food and Grocery Code of Conduct review currently underway is a useful opportunity to examine ways in which the Code could be strengthened.
 - For some producers, such as the beer industry, it is worth exploring whether market power exists upstream from the retail sector.
- The Committee welcomes the reviews of supermarkets being undertaken by the Hon Dr Craig Emerson and by the Australian Competition and Consumer Commission.
- There appears to be evidence of high margins in the beer brewing sector which may indicate excessive market power. This would contribute to the high cost of beer for consumers.



10. Interoperability

Context

- 10.1 Interoperability refers to ‘the ability of a system, product, or service to communicate and function with other (technically different) systems, products or services. Interoperability issues in the digital economy will typically relate to information exchange and data’.¹
- 10.2 There are a range of sectors in which an incumbent enjoys a monopoly or near monopoly due, in part, to network effects that are exacerbated by interoperability issues. In some instances, a lack of interoperability between incumbents and new entrants (or potential new entrants) acts as a practical barrier to competition.
- 10.3 The Committee heard from Property Exchange Australia (PEXA) and Sympli regarding interoperability efforts in the electronic conveyancing market and from the FinClear Group regarding interoperability in the settlement and clearing of equities.

Land transfer

Electronic conveyancing

- 10.4 The electronic conveyancing (e-conveyancing) market allows parties in a property transaction to electronically prepare and lodge property titles with title registries, transmit settlement funds and pay relevant taxes and duties.
- 10.5 The Committee heard Australia has a total addressable e-conveyancing market of around \$300 million.²
- 10.6 New South Wales, Victoria, South Australia and Western Australia have mandated the use of e-conveyancing for all mainstream property transactions. Queensland has mandated the use of e-conveyancing for some property transactions. The ACT has not made e-conveyancing compulsory, while Tasmania and the Northern Territory are yet to commence e-conveyancing.
- 10.7 The move to e-conveyancing from the paper-based and in-person conveyancing system has improved efficiency and saved time, increased transparency, reduced

¹ Dr W Kerber and Dr H Schweitzer, ‘Interoperability in the Digital Economy’, *Journal of Intellectual Property, Information Technology and Electronic Commerce Law*, 8 (2017), p. 40.

² Mr Les Vance, Chief Customer and Commercial Officer, Property Exchange Australia (PEXA), *Committee Hansard*, 31 August 2023, p. 18.

fraud and errors, and led to faster and more reliable processing.³ The Committee heard that a report commissioned by the New South Wales Government in 2018 found e-conveyancing had reduced the time legal practitioners and conveyancers needed to work on a transaction by 60 to 70 per cent.⁴ The utility of e-conveyancing was highlighted during the COVID-19 pandemic, as e-conveyancing allowed transactions to still be safely and securely completed, which would have proved difficult under the previous in-person and paper-based system.⁵

- 10.8 The Australian Registrars' National Electronic Conveyancing Council (ARNECC) is the body established to facilitate the implementation and ongoing management of the regulatory framework for electronic conveyancing of real property in Australia. ARNECC is comprised of the Land Titles Registrars in each state and territory.

Electronic Lodgement Network Operators

- 10.9 Electronic Lodgement Network Operators (ELNOs) provide the networks for e-conveyancing transactions to be undertaken. The registrar in each state and territory will approve an ELNO to operate in that jurisdiction. Currently, there are two ELNOs approved to operate within Australia—PEXA and Sympli.
- 10.10 PEXA is approved to operate in the ACT, New South Wales, Queensland, South Australia, Victoria and Western Australia.⁶
- 10.11 Sympli is approved to operate in New South Wales, Queensland, South Australia, Victoria and Western Australia.⁷
- 10.12 PEXA, the first ELNO, was formed in 2011 by the state governments of Victoria, New South Wales, Queensland and Western Australia, and private investors, including the big four banks. It was the outcome of a 2008 Council of Australian Governments meeting where the Commonwealth Government and state and territory governments agreed to create a national electronic conveyancing network. In 2019, PEXA was sold to private investors—the Link Group, Commonwealth Bank of Australia, and Morgan Stanley Infrastructure Partners.

³ Mr Les Vance, Chief Customer and Commercial Officer, PEXA, *Committee Hansard*, 31 August 2023, p. 18; Mr Philip Joyce, Chief Executive Officer, Sympli, *Committee Hansard*, 28 August 2023, p. 24.

⁴ Mr Les Vance, Chief Customer and Commercial Officer, PEXA, *Committee Hansard*, 31 August 2023, p. 18.

⁵ Mr Les Vance, Chief Customer and Commercial Officer, PEXA, *Committee Hansard*, 31 August 2023, p. 18; Mr Philip Joyce, Chief Executive Officer, Sympli, *Committee Hansard*, 28 August 2023, p. 23.

⁶ Australian Registrars National Electronic Conveyancing Council, *Electronic Lodgement Network Operators*, www.arnecc.gov.au/resources/links/electronic_lodgment_network_operators, viewed 12 October 2023.

⁷ Australian Registrars National Electronic Conveyancing Council, *Electronic Lodgement Network Operators*, www.arnecc.gov.au/resources/links/electronic_lodgment_network_operators, viewed 12 October 2023.

A highly concentrated market

- 10.13 PEXA has a near monopoly over the e-conveyancing market, with 99 per cent of all digital transactions in New South Wales, Victoria, Queensland, Western Australia, South Australia and the ACT using the PEXA exchange process.⁸
- 10.14 Sympli was created by the Australian Securities Exchange and InfoTrack in 2018 to challenge PEXA's monopoly. Yet Sympli's market share remains tiny, less than one per cent in New South Wales and Victoria.⁹
- 10.15 The Committee heard that a key contributor to market concentration in the e-conveyancing sector was the decision by state and territory governments to mandate the use of e-conveyancing at a time when there was no competitor to PEXA.
- 10.16 Sympli noted: 'The mandating of e-conveyancing in these jurisdictions pre-dates a competitor entering the market, meaning that all financial institutions, lawyers, and conveyancers were required by law to become customers of PEXA'.¹⁰
- 10.17 Former Australian Competition and Consumer Commission (ACCC) Chair Professor Rod Sims joined Sympli in criticising state and territory governments for the approach they had taken.¹¹ He told the Committee:

I cannot resist saying this: why in this country in this day and age are we setting up private sector monopolies when there could be competition? We are getting a gun out and aiming it straight at our foot. This is just, I'm afraid, ridiculous. I'm sorry to sound so emphatic. I am annoyed that we are damaging our economy again and again and again by creating monopolies when we don't have to. We all know what happens with monopolies.¹²

- 10.18 The ACCC highlighted PEXA as a salient case study of why, at different stages of privatisation decisions being taken, there must be consideration in advance of a structure that ensures a monopoly is not created at the beginning.¹³

The ACCC think it is a very salient case study. Firstly, because they were services that were originally state government provided or assets and holdings that were put together and privatised without sufficient provision for a regulative framework at the very beginning. So, in effect, PEXA was created, sprung to life, as a privately owned monopoly. While there was policy intend for there to be competition, without that already existing, practically implemented and enforced interoperability obligations, it is very hard—even though Sympli has material

⁸ PEXA, Answer to Question on Notice, p. [1].

⁹ Mr Philip Joyce, Chief Executive Officer, Sympli, *Committee Hansard*, 28 August 2023, p. 25.

¹⁰ Sympli Australia, *Submission 37*, p. [5].

¹¹ Professor Rod Sims, Private capacity, *Committee Hansard*, 2 March 2023, pages 19–20; Mr Philip Joyce, Chief Executive Officer, Sympli, *Committee Hansard*, 28 August 2023, p. 23.

¹² Professor Rod Sims, Private capacity, *Committee Hansard*, 2 March 2023, pages 19–20.

¹³ Ms Gina Cass-Gottlieb, Chair, Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, p. 51.

shareholders—without strong enforcement and practical obligations to move through the steps to make interoperability accessible and able to work. It is difficult. The ACCC has participated in a sort of observer status, but we think it is a very strong example of why, at different steps of privatisation decisions being made, there must be consideration in advance of a structure that doesn't create a monopoly at the beginning. It commences with at least two participants or grants to them or has a very effective regulatory structure to ensure that interoperability and competition can be achieved in an end-to-end sense.¹⁴

Interoperability in land settlement

- 10.19 Currently, all parties to a property transaction must use the same ELNO, be it PEXA or Sympli, to complete the transaction because the data used by one network cannot be used by the other network. Sympli described the situation as 'akin to having one mobile phone to talk to anyone on Telstra and then having separate phones for every other network, like Optus, Vodafone'.
- 10.20 The Committee heard that this had created a network effect in e-conveyancing, where the value of services to users provided by an ELNO increases as more users use that ELNO's services, and thus benefits PEXA as the incumbent firm.¹⁵
- 10.21 Sympli told the Committee that this network effect was the biggest barrier to its customer usage today and would likely be the biggest barrier for any other potential market entrant.¹⁶ Until interoperability is realised, Sympli told the Committee, it was very difficult for Sympli or other new entrants to enter the market, which entrenches the incumbent firm's monopoly.¹⁷
- 10.22 Without competition in the market, Sympli told the Committee, 'this entrenched monopoly in our national economy has no real pressure to reduce prices, no drive for service innovation and no urgency to make the network more resilient'.¹⁸
- 10.23 Additionally, Sympli continued, the current resilience of the e-conveyancing market is limited by its complete reliance on PEXA's network, presenting a systemic risk.

It's only as resilient as the network is. Today we've got, I suppose, an analogy where we've only got one set of poles and wires and that leads to single point of failure. If any part of that network doesn't work—and that's happened on a number of occasions—it means settlements can't happen and the impact on end consumers as you can well imagine on moving day is usually emotionally and financially distressing.

¹⁴ Ms Gina Cass-Gottlieb, Chair Australian Competition and Consumer Commission, *Committee Hansard*, 15 September 2023, p. 51.

¹⁵ Mr Philip Joyce, Chief Executive Officer, Sympli, *Committee Hansard*, 28 August 2023, p. 25.

¹⁶ Mr Philip Joyce, Chief Executive Officer, Sympli, *Committee Hansard*, 28 August 2023, p. 25.

¹⁷ Mr Philip Joyce, Chief Executive Officer, Sympli, *Committee Hansard*, 28 August 2023, p. 27.

¹⁸ Mr Philip Joyce, Chief Executive Officer, Sympli, *Committee Hansard*, 28 August 2023, p. 23.

New entrants like ourselves have completely separate poles and wires, separate connections to banks, separate connections to land registries and revenue offices. So if you think of this as financially important infrastructure for Australia, in today's world 100 per cent of the traffic goes across one network. In a competitive future, we have two equally pervasive networks, so if one had any problems we could move to the other. That is not the case today. I can imagine the future that we should be going towards is to give a fail-safe solution to the most emotionally and financially important transaction of everyday Australians. That resiliency doesn't exist today.¹⁹

10.24 PEXA disputed these claims, telling the Committee that its exchange provided ‘...a reliable, resilient, secure infrastructure to efficiently execute property transactions across the country. System availability was 100 per cent during business hours over the 2023 financial year’.²⁰

10.25 PEXA added that it takes seriously its responsibility for operating and improving critical infrastructure, including through innovation and collaboration with other parties.

PEXA has continued in collaboration with our customers to innovate and drive further improvements to the PEXA Exchange to make it even more robust and create further efficiencies through the industry. PEXA recognises the responsibility which comes as the operator of critical infrastructure. In addition to our own innovation and development, we also recognise the need to collaborate and allow others to innovate...²¹

Competition in the e-conveyancing market

10.26 Interoperability would allow electronic lodgement networks to talk to and exchange information with each other, so that a user of one network could complete a transaction with the user of a different network. Accordingly, interoperability would remove the network effect from the e-conveyancing market.

10.27 In support of this argument, Sympli highlighted a 2021 NSW Productivity Commission White Paper *Rebooting the economy*. The paper cites an estimate that ‘interoperability will deliver a net benefit of \$83.6 million to New South Wales over 10 years compared with the status quo’.²²

10.28 PEXA took issue with the NSW Productivity Commission paper, specifically that the paper’s cost-benefit analysis evaluated benefits and costs to the whole of Australia rather than to New South Wales. PEXA told the Committee that the claimed net

¹⁹ Mr Philip Joyce, Chief Executive Officer, Sympli, *Committee Hansard*, 28 August 2023, p. 24.

²⁰ Mr Les Vance, Chief Customer and Commercial Officer, PEXA, *Committee Hansard*, 31 August 2023, p. 18.

²¹ Mr Les Vance, Chief Customer and Commercial Officer, PEXA, *Committee Hansard*, 31 August 2023, p. 18.

²² This refers to a cost-benefit analysis commissioned by the NSW Registrar-General dated 1 September 2020. See PEXA, Tabled document 1, Document for Tabling for the Standing Committee on Economics: Inquiry into promoting economic dynamism, competition and business formation, 31 August 2023, pages 2–3.

benefit of \$83.6 million to New South Wales over 10 years was inaccurate, while the costs related to interoperability were speculative.²³

I think we would say in that sense that since that report has come a number of the assumptions on which it was based have proven incorrect. That assumed there would be a relatively low cost to implement, that the time and effort to implement would be small, and that the impact on industry stakeholders outside the ELNOs would be minimal—all of which as we're approaching the first pilot transaction no longer seem to hold true.²⁴

10.29 PEXA told the Committee it welcomed competition on the basis of 'fair and considered policy'.²⁵

Risks of interoperability

10.30 PEXA outlined to the Committee its concerns about current plans for changes to the design of interoperability—that any alterations need to take account of the central importance of the PEXA network, or else risk the reliability, resilience and security of e-conveyancing.

.... Interoperability was not policy when PEXA was founded or when the PEXA Exchange was built. As a result, the design and architecture of the PEXA Exchange did not contemplate interoperability, and the current design of interoperability will cut across many of the aspects of the design of the PEXA Exchange. Given the now critical role of the PEXA Exchange, changes to the exchange and to e-conveyancing policy need to be designed and managed conscious of the importance of maintaining reliability, resilience and security of e-conveyancing as a whole. It is important to note that, while interoperability is now a topical conversation in the context of e-conveyancing policy, it's not a widely used model either here in Australia or internationally. In large part, this is because it's complex to implement, particularly when trying to embed into pre-existing systems, and it's complex to oversee.²⁶

10.31 In contrast, the Committee heard from Sympli that there were no technological risks from interoperability that could not be managed, and that the bigger risk was to competition if interoperability did not proceed. In this light it advised the Committee that:

We are a small company and it's a tough market, so I think our competitor wants to starve us out.²⁷

²³ PEXA, Tabled document 1, Document for Tabling for the Standing Committee on Economics: Inquiry into promoting economic dynamism, competition and business formation, 31 August 2023, pages 2–3.

²⁴ Mr Les Vance, Chief Customer and Commercial Officer, PEXA, *Committee Hansard*, 31 August 2023, p. 20.

²⁵ Mr Les Vance, Chief Customer and Commercial Officer, PEXA, *Committee Hansard*, 31 August 2023, p. 19.

²⁶ Mr Les Vance, Chief Customer and Commercial Officer, PEXA, *Committee Hansard*, 31 August 2023, p. 20.

²⁷ Mr Philip Joyce, Chief Executive Officer, Sympli, *Committee Hansard*, 28 August 2023, p. 27.

Current progress towards interoperability

10.32 The Committee heard that there was an ongoing process to establish competition between ELNOs in the e-conveyancing market—which will be achieved through the delivery of full interoperability. ARNECC, which is leading the reform, expects full interoperability functionality by the end of 2025.

10.33 Sympli, however, was sceptical about the process. It told the Committee there had been continual delays in delivering interoperability, given both the incentives the incumbent was trying to protect²⁸ and the lack of a credible enforcement regime, where the only sanction currently available to ARNECC was to suspend a network.²⁹ It stated that:

There is a very large difference between announcing a date and having that date as part of our regulation and that regulation being robustly enforced. In my time as CEO, which is nearly three years, we've had about 10 different date announcements. None of them have been kept because there's nothing in the regulation and there's no enforcement regime to hold to account people in charge of networks: myself, my counterpart and my competitor. The only sanction in today's environment, believe it or not, is the suspension of a network....

It's just not a credible threat. I think our competitor knows that. Until the dates are in regulation and until those dates are enforced using the powers that New South Wales have and the muted national enforcement regime, there's so much incentive in play here from a profit point of view, I think you're going to get the incumbent pushing back on these. So, yes, there's a schedule. It's announced but not regulated, and we need the enforcement powers such that that plan is kept to rather than getting any further delays.³⁰

10.34 Countering this, PEXA told the Committee that system complexity was the reason interoperability was taking time to implement.

The reality is that interoperability is far more complex to design, execute and build than was represented or assumed at the start. That's why it's taking time. That is also why even to get to this relatively early stage of two pilot transactions in September 2023 our next interoperability program has already had to consider over 120 change requests.³¹

Equities settlement and clearing

10.35 Interoperability was also raised as a key issue in the settlement and clearing of equities where the Australian Stock Exchange (ASX), through its subsidiaries ASX

²⁸ Mr Philip Joyce, Chief Executive Officer, Sympli, *Committee Hansard*, 28 August 2023, p. 23.

²⁹ Mr Philip Joyce, Chief Executive Officer, Sympli, *Committee Hansard*, 28 August 2023, p. 26.

³⁰ Mr Les Vance, Chief Customer and Commercial Officer, PEXA, *Committee Hansard*, 28 August 2023, p. 26.

³¹ Mr Les Vance, Chief Customer and Commercial Officer, PEXA, *Committee Hansard*, 31 August 2023, p. 19.

Clear and ASX Settlement, is the monopolistic provider of settlement and clearing services for Australia's cash equity market.

10.36 Settlement and clearing services refer to everything that happens after a transaction on financial markets, including the exchange of assets and legal title.³²

10.37 Although the legislation covering settlement and clearing services for Australia's cash equity market allows for competitors to the ASX, network externalities mean the monopolistic position of the ASX makes it difficult for competitors to emerge.³³ Currently, both participants to a trade must be members of the same central counterparty (CCP), which means a larger CCP can offer its participants wider access to other traders and therefore a deeper market.³⁴ By allowing a CCP to access another CCP's participant network, interoperability minimises the network advantages and market power that accrue to large CCPs, fostering greater competition between clearing services.³⁵

10.38 The Committee did not hear from the ASX as part of the inquiry.

Issues stemming from the ASX monopoly

10.39 The Committee heard from FinClear Group, a major technology and financial market infrastructure company, that significant issues stemmed from ASX's monopoly, including a lack of innovation in important financial market technology, which is causing Australia to fall behind other global financial markets.

Australia was once a leader in financial markets technology. CHES [Clearing House Electronic Subregister System]³⁶ was a radical innovation that offered direct name on register and was class-leading at the time. But others have innovated. We haven't in part because of the current monopolistic structure and ownership of key components of our financial market infrastructure. Just as we have ensured that one company does not own or control key parts of telecommunications infrastructure or that access rights are insured for freight infrastructure in mining regions, we need to ensure the same occurs for our financial markets. This involves reforms to market and regulatory structures, both

³² Mr David Ferrall, Group Chief Executive Officer and Managing Director, FinClear Group, *Committee Hansard*, 31 August 2023, p. 23.

³³ J Bragg, *New legislation set to challenge ASX monopoly*, InvestorDaily, 6 September 2023, investordaily.com.au/regulation/53912-new-legislation-set-to-challenge-asx-monopoly#, viewed 6 December 2023.

³⁴ Australian Competition & Consumer Commission, *ACCC submissions to external consultations: ACCC letter to NSW Ministerial Forum on interoperability in e-conveyancing*, 13 February 2019, www.accc.gov.au/inquiries-and-consultations/accc-submissions-to-external-consultations, viewed 6 December 2023.

³⁵ Australian Competition & Consumer Commission, *ACCC submissions to external consultations: ACCC letter to NSW Ministerial Forum on interoperability in e-conveyancing*, 13 February 2019, www.accc.gov.au/inquiries-and-consultations/accc-submissions-to-external-consultations, viewed 6 December 2023.

³⁶ CHES is the computer system used by the ASX to manage the settlement of share transactions and to record shareholdings.

legislative as well as within current regulatory powers, to promote new competitors in relevant parts of the value chain. This includes in our case the issuance of licences for private markets transactions which can over time provide competition to ASX.

.....

Significant issues stem from ASX's monopoly and the problems surrounding the replacement of CHES. There's a need to address Australia's position in global financial markets. Having led in the early 2000s, we're now falling behind due to the poor technology program associated with CHES.³⁷

- 10.40 The FinClear Group told the Committee that there was clear evidence that moving from a monopolistic arrangement in settlement and clearing services to a competitive market would lead to more efficient technology capability and lower pricing. The FinClear Group added that 'it's important that when you look at this you look at promoting competition in a proportionate way that doesn't put the financial infrastructure at risk'.³⁸

Market licence

- 10.41 The FinClear Group told the Committee that reforms were needed to incentivise the relevant regulators—the RBA and ASIC—to promote competition via new technology capabilities in a proportionate way and as part of their core business, as occurs in some overseas jurisdictions.

There's certainly a willingness to look at new technologies. We've demonstrated that. We've been talking to the RBA and ASIC now for some time about our distributed ledger capability. What we think needs to happen, and what there isn't at the moment, are some sort of incentives for those regulators to promote competition via new technology capabilities.

...

One of the things that we draw attention to is regulators should be encouraged to promote competition, to promote new technology and do that, as I was saying before, on a proportionate approach that doesn't put markets at risk. You're seeing this happen in offshore domiciles, both in the UK and in the EU. You're seeing sandbox capabilities, where the regulators will encourage new technology, particularly distributed ledger, that may disrupt incumbents but they're using it in a very confined space to start with.³⁹

³⁷ Mr David Ferrall, Group Chief Executive Officer and Managing Director, FinClear Group, *Committee Hansard*, 31 August 2023, p. 23.

³⁸ Mr David Ferrall, Group Chief Executive Officer and Managing Director, FinClear Group, *Committee Hansard*, 31 August 2023, p. 24.

³⁹ Mr David Ferrall, Group Chief Executive Officer and Managing Director, FinClear Group, *Committee Hansard*, 31 August 2023, p. 25.

10.42 The FinClear Group has applied to ASIC for a tier 2 financial market licence in order to provide its distributed ledger system, called FCX, to create a liquid market for private investors – including for venture capital and private equity funds – moving settlement to real-time transactions.⁴⁰ The Committee heard that ASIC had been considering the application for over a year which, the FinClear Group said, was a particularly long time in financial markets and demonstrates an inefficient process.⁴¹

Committee comment

10.43 The Committee notes the slow rate of regulatory review and approvals for innovation in this area.

Box 10.1 Key finding

The Committee supports efforts by state and territory governments and other stakeholders to move towards interoperability in land transfer as a key microeconomic reform.

The committee supports efforts to increase innovation in financial services, reduce unnecessary delays in approval times for new market entrants, and reduce monopolistic regulatory arrangements.

Recommendation 44

10.44 That the Government examine removing barriers to entry of providers of settlement and clearing services for equities, to boost competition in the sector.

Dr Daniel Mulino MP
Chair

20 March 2024

⁴⁰ Mr David Ferrall, Group Chief Executive Officer and Managing Director, FinClear Group, *Committee Hansard*, 31 August 2023, p. 23.

⁴¹ Mr David Ferrall, Group Chief Executive Officer and Managing Director, FinClear Group, *Committee Hansard*, 31 August 2023, p. 26.



A. Witnesses

Thursday, 16 March 2023

VIDEOCONFERENCE

Productivity Commission

Friday, 17 March 2023

VIDEOCONFERENCE

Australian Competition and Consumer Commission

Tuesday, 2 May 2023

VIDEOCONFERENCE

e61 Institute

Grattan Institute

Professor Rod Sims AO, Private capacity

Institute of Public Affairs

Professor Richard Holden, Private capacity

Wednesday, 3 May 2023

VIDEOCONFERENCE

Technology sector and fintech themes: Roundtable discussion

Tech Council of Australia

Airwallex

Block

Shift

Zepto

Microsoft

Fintech themes: Roundtable discussion

FinTech Australia

Adatree

Birchal

Ezypay

Financial Data and Technology Association (fdata)

Skript

Swyftx

Paypa Plane

Wise

Yondr Money

Thursday, 18 May 2023

VIDEOCONFERENCE

Professor Allan Fels AO, Private capacity

Professor Charles Plott, Private capacity

Professor Flavio Menezes, Private capacity

Professor John Quiggin, Private capacity

Center for Market Design

Professor Deborah Healey, Private capacity

Dr Rhonda Smith, Private capacity

Friday, 2 June 2023

Committee Room 1R3

Parliament House

Canberra

Australian Prudential Regulation Authority

Friday, 30 June 2023

Double Seminar Room, Level 3, Toowoomba City Library

155 Herries St

Toowoomba

Heritage and People's Choice

CUSTOMER OWNED BANKS: ROUNDTABLE DISCUSSION

Summerland Credit Union

Warwick Credit Union

Great Southern Bank

The Capricornian

Virgin Australia Airlines

Bonza Airlines

Queensland State Government Procurement

Tuesday, 4 July 2023

Edinburgh Room, Stamford Plaza

111 Little Collins St

Melbourne

CUSTOMER OWNED BANKS: ROUNDTABLE DISCUSSION

Customer Owned Banking Association (COBA)

Bank First

Newcastle Greater Mutual Group

BankWAW

Bank Australia

Macquarie Bank

Bendigo and Adelaide Bank

Victorian Chamber of Commerce and Industry

Victorian Government, Social Procurement

Wednesday, 5 July 2023

Edinburgh Room, Stamford Plaza

111 Little Collins St

Melbourne

Alliance of Social Enterprise Networks Australia (ASENA)

Social Enterprise Network Victoria (SENVIC)

Social Traders

Social Enterprise Australia

Business Council of Co-operatives and Mutuals (BCCM)

Yume Food Australia

STREAT

Wednesday, 12 July 2023

Committee Room 2R1

Parliament House

Canberra

Thursday, 13 July 2023

Committee Room 2R1

Parliament House

Canberra

Tuesday, 25 July 2023

VIDEOCONFERENCE

Coles

Woolworths

National Farmers' Federation

Mr Peter Harris, Private capacity

Coopers Brewery

Australian Food and Grocery Council

Metcash

Wednesday, 26 July 2023

VIDEOCONFERENCE

Epic Games

Mable Technologies

Victorian Government, Social Procurement

Hireup

Free TV Australia

Independent Brewers Association

Wednesday, 23 August 2023

Corinthian Room, Sydney Masonic Centre

66 Goulburn St

Sydney

Mr Greg Medcraft, Private capacity

Rex Airlines

Australian Airports Association

Sydney Airport Corporation

Monday, 28 August 2023

VIDEOCONFERENCE

Lion Australia

e61 Institute

Marriott Support Services

Sympli Australia

ALDI

Tuesday, 29 August 2023

VIDEOCONFERENCE

Google

Apple

Amazon Australia

Carlton & United Breweries

Qantas Airways

Organisation for Economic Co-operation and Development (OECD)

Thursday, 31 August 2023

VIDEOCONFERENCE

Minerals Council of Australia

Australian Banking Association

PEXA

Finclear Group

Adamantem Capital

Friday, 15 September 2023

VIDEOCONFERENCE

Meta

National Competition Council

The Treasury

Australian Competition and Consumer Commission

Productivity Commission



B. Submissions

- 1 Productivity Commission
 - 1.1 Supplementary to submission 1
- 2 Microsoft
- 3 Business Council of Australia
- 4 Business Council of Co-operatives and Mutuals (BCCM)
- 5 Professor Flavio Menezes and Professor John Quiggin
- 6 Financial Services Council
- 7 Institute of Public Affairs
- 8 Professor Ioana Marinescu
- 9 Professor Deborah Healey and Dr Rhonda Smith
- 10 Private Healthcare Australia
- 11 Australian Medical Association
- 12 Bupa Health Insurance
- 13 Wise
 - Attachment 1
 - Attachment 2
- 14 GrainGrowers Limited
- 15 NSW Farmers
- 16 Accord Australasia Limited
- 17 Alliance of Social Enterprise Networks Australia (ASENA)
- 18 Consumers' Federation of Australia
- 19 Finance Brokers Association of Australia Limited (FBAA)
- 20 Australian Automotive Dealer Association (AADA)

- 21** Social Traders
- 22** Australian Banking Association
- 23** National Farmers' Federation
- 24** Australian Chamber of Commerce and Industry
- 25** Social Enterprise Australia
- 26** Australian Retailers Association
- 27** National Competition Council
- 28** FinTech Australia
- 29** Intellectual Property Committee, Law Council of Australia
- 30** Insurance Council of Australia
- 31** Professor Allan Fels AO
 - Attachment 1
- 32** Tech Council of Australia
- 33** Customer Owned Banking Association
- 34** Australian Competition and Consumer Commission
 - 34.1 Supplementary to submission 34
- 35** Fremantle Herald Newspaper
- 36** Telstra Group Limited
- 37** Sympli Australia
- 38** Centre for Market Design, University of Melbourne
- 39** Australian Small Business and Family Enterprise Ombudsman
- 40** Victorian Chamber of Commerce and Industry
 - 40.1 Supplementary to submission 40
- 41** Block Inc
- 42** Google
- 43** Ben Blackburn Racing

- 44** Mable
 - 44.1 Supplementary to submission 44
- 45** Free TV Australia
- 46** Bendigo and Adelaide Bank
- 47** Hireup
- 48** Australian Food and Grocery Council
- 49** Employee Ownership Australia
 - Attachment 1
- 50** Australian Finance Group
- 51** Epic Games
- 52** Maritime Union of Australia
- 53** Lake Mac Airlines
- 54** Australian Friendly Societies Pharmacies Association (AFSPA)
- 55** John Hine
- 56** Queensland Consumers Association
- 57** Australian Pacific Airports (Melbourne)
- 58** Marriott Support Services
- 59** Sydney Airport Corporation
- 60** Emerson Economics
- 61** Screen Producers Australia
- 62** Professor Glenn Withers and Professor Ian McEwin



Additional Comments by Coalition Members

Additional Comments by Coalition Members of the Committee to Improve Australia's Economy

Introduction

A strong economy requires a diverse and dynamic business environment.

This inquiry sought to investigate and promote economic dynamism, competition and business formation. The Terms of Reference specifically noted a focus on anti-competitive behaviour, business consolidation and economic barriers which all have potential to negatively impact productivity and wages and contribute to anti-competitive market structures and increasing costs.

At a time when Australians and Australian businesses are experiencing cost of living pressures, the findings of this Inquiry are more critical than ever before.

Improvements to Australia's competitive environment, such as more efficient supply chains, reduced regulatory barriers, appropriate regulatory frameworks and flexible employment arrangements, may help to address high inflation and falling productivity.

The Coalition Members of the Standing Committee on Economics note the Inquiry's Final Report and make the following additional comments.

Opposition Comments

The Coalition Members of the House Standing Committee on Economics were pleased with the process of the Inquiry and the information obtained on a diversity of issues (including productivity, market concentration, competition and regulation) across a range of sectors (including mining, banking, aviation, digital platforms and retail).

Over a six-month period, the Inquiry received 61 submissions and interrogated almost 100 witnesses at public hearings held in major cities and regional locations, including Toowoomba which is located in the Deputy Chair's electorate of Groom in Queensland.

Productivity

- In relation to Chapter 2 Paragraph 1 (The opportunity for higher living standards), Coalition Members note the following:

- The “persistent decline in Australia’s productivity performance” (p. 3) is an accurate reflection of the current environment.
- Productivity has fallen by 5.4% in the past 21 months under the Albanese Labor Government. Contributing factors include red and green tape, new taxes, market interventions and onerous approval processes.
- Productivity is a key factor in economic growth and long-term prosperity is impossible without increased productivity.
- Increased productivity comes from working smarter – not longer – and using all the tools at our disposal to make our workplaces more effective, efficient, and innovative.
- With a continuation of this Government’s policies of additional regulation and Government interference, the findings of this Inquiry, and its recommendations, will be futile in achieving a dynamic business environment.
- Australia’s lost dynamism is reflected across many economic indicators including wages growth and productivity growth.
 - There are many underlying reasons for this loss of economic dynamism. They include rising risk aversion, increased uncertainty (including over government policy), dwindling foreign investment (and inbound talent), a rigid and heavily regulated labour market, a heavy burden of tax and regulation, dwindling market competition, declining trust in institutions, and unaffordable housing (Business Council of Australia, 2023).¹
- Unfortunately, this government is undertaking to implement policies that hurt Australia’s productivity performance, including:
 - A poorly managed migration system that is increasing pressure on the housing market, increasing rents and making housing unaffordable.
 - Intervention in the energy market that has cost the taxpayer billions, hurt investment and failed to reduce energy prices.
 - Rushed, poorly designed and unbalanced workplace laws that have added red tape for businesses, removed flexibility for workers and imposed new powers for unions that will lead to further economic harm, such as experienced with the DPWorld shutdown.
 - Higher taxes and broken promises that are reducing the incentive for Australians to invest and are undermining confidence in the consistent approach of the Australian Government, including in relation to franking credits, superannuation and personal income tax.
- Productivity is fundamentally connected to industrial relations, and each impacts significantly on the other.

Industrial relations

- In relation to Chapter 4 Paragraph 97 (How to improve conditions for new-entry businesses), Coalition Members note the following:

¹ Business Council of Australia, *Submission 3*, p. 15.

- A key area for reform, expressed by the Tech Council, was “an industrial relations system that upholds the rights of workers while enabling flexible forms of employment that can deliver better productivity and wage outcomes”.²
- Industrial relations reform is without a doubt one of the most important of all the economic reforms required to make Australia more productive and competitive and to ensure all Australians enjoy greater prosperity.
- A modified industrial relations framework should not add cost, confusion and complexity at a time when households and many businesses are struggling to pay their bills. We do not ease the cost burden on people by making life harder for business, nor do we drive productivity by tying businesses up in red tape.
- An industrial relations framework must be designed to improve productivity, grow wages, and enhance competition. However, the myriad of reforms undertaken by the Albanese Government have isolated employers and peak employee groups.
 - Recent changes to industrial relations, including the restoration of multiemployer bargaining could lead to increased disruption and a less innovative and dynamic economy (Business Council of Australia, 2023).³
- The Minerals Council of Australia gave evidence during the Inquiry that labour hire workers are necessary to ensure surge capacity for variable production industries such as mining, and that recently introduced Industrial Relations legislation undermines a dynamic business environment:
 - A dynamic economy relies on very dynamic arrangements across that economy to accommodate industries. We have seen two tranches of legislation that have sought to address issues. The government has gone well and truly beyond what they explained was a problem, as a starting point, and this applies much more broadly than just to labour hire. It reaches and extends, virtually, into any situation where a business provides a service to a contractor or another business, from major project teams across businesses and not just the mining industry; it goes to small business and to administrators. The government said that this was supposed to apply to limited circumstances, and it doesn't. It certainly creates barriers to rewarding workers for hard work and experience... it undermines enterprise bargaining arrangements, overrides agreements that are in place (Minerals Council of Australia, 2023).⁴
- The industrial relations system in Australian needs to be easier for businesses to navigate, promote employment and support people to start and run successful businesses – particularly small and family businesses. It should promote fairness, underpin decency and enable flexibility. A genuinely fair workplace relations system must be pro-employment, it must be small-

² Tech Council of Australia, *Submission 32*, pages 12-13.

³ Business Council of Australia, 2023, *Submission 3*, p. 10.

⁴ Ms Tania Constable, Minerals Council of Australia, *Committee Hansard*, 31 August 2023, p. 7.

business friendly, and it must be flexible to respond to both the needs of employers and employees.

- The current set of draconian reforms, based on an ideological agenda and introduced by the Albanese Labor Government, do the opposite and are making life more difficult for industries, businesses and families.
- The lack of consultation prior to the Industrial Relations legislation being finalised is another serious concern, and has been noted by the Minerals Council of Australia and the Council of Small Business Organisations Australia:
 - The minister saying that he's consulting doesn't mean that he actually has listened to the whole business community (Minerals Council of Australia, 2023).⁵
 - The Council of Small Business Organisations Australia is hugely disappointed the Government has rammed through significant elements of its latest industrial relations changes (COSBOA, 2023).⁶
- Australia needs a modern workplace relations system that delivers a safety net for workers, recognises the shared interests of managers and workers in an enterprise's success, and gives all enterprises the agility they need to compete and succeed.
 - We need to allow workers and employers to come up with smart ways to increase incomes for both businesses and employees too. This is how you drive productivity and growth.
 - We need to decentralise decision making to employers and employees – the opposite of what the Albanese Labor Government has done. They are centralising decision making to the Fair Work Commission and handing power to unrepresentative unions.
 - We need a system that empowers agreement between employers and employees – not one that encourages disputes and fights in the Fair Work Commission.

Regulation

- In relation to Chapter 2 Paragraph 46 (Regulation), Coalition Members note the following:
 - Regulation can significantly enhance or reduce economic dynamism, especially in the banking sector.
 - Banking customers... need a vibrant, dynamic and innovative retail banking market.... high regulatory costs hurt consumers because resources are diverted away from investment in product innovation, better

⁵ Ms Tania Constable, Minerals Council of Australia, *Committee Hansard*, 31 August 2023, p. 7.

⁶ COSBOA media release, 7 December 2023, <https://www.cosboa.org.au/post/rushed-ir-changes-bad-for-small-business>

service, and better pricing (Customer Owned Banking Association, 2023).⁷

- New regulations mean that businesses must negotiate the mine field that has been created by the union-backed Albanese Labor Government. This minefield makes it harder for small businesses to survive and grow and create more jobs.
 - Australia has become a more difficult place to do business. There is burdensome regulation and paperwork required across, and even within, governments (Business Council of Australia, 2023).⁸
- It would be useful for the Government to address the unfair funding advantages of the major banks and develop policies to address regulation and lower housing funding costs for customer owned banks.

Inflation

- In relation to Chapter 2 Paragraphs 85 and 90 (The impact of inflation), Coalition Members note the following:
 - Inflation is a problem in Australia and increasingly inflationary pressures are home-grown. Increasing government spending by the Albanese Labor Government – with at least \$200 billion in additional spending over the last 22 months – is fuelling inflation.
 - Inflation is running at 4.1 per cent and is persistent and well above the target of two to three per cent.
 - Australia’s core inflation is 4.2 per cent, higher than the US, Spain, the Netherlands, Germany, Singapore, France, Italy, South Korea, Canada, Japan and the entire Euro Area.
 - During the Albanese Labor Government’s term, the Reserve Bank has met on 19 occasions, increasing rates 12 times and keeping them on hold seven times.
 - Inflation is putting significant cost pressures on households and businesses: food has gone up 9 per cent, electricity up 20 per cent and gas up 27 per cent.
 - Australia is in an entrenched GDP per capita recession, a consumer confidence recession, and we are experiencing the slowest two quarters of consecutive GDP growth in almost 18 years outside of the pandemic.
 - Inflation continues to be a key concern.
 - Chapter 2 Paragraph 85 notes “there was no clear evidence about the effect on competition of the higher inflationary environment that Australia has endured in recent times” and Chapter 2 Paragraph 90 notes the rejection of ‘greedflation’ by the Productivity Commission. However, this fails to reflect the reality that limited price competition, in areas such as grocery retailing which

⁷ Customer Owned Banking Association, Submission 33, p. 2.

⁸ Business Council of Australia, *Submission 3*, p. 11.

is dominated by large organisations with significant buyer power, does have some impact on food price inflation.⁹

Other

- The Coalition Members of the Standing Committee on Economics note that the Albanese Labor Government announced on 11 March 2024 that it will introduce a financial sector regulatory initiatives grid.
- It is disappointing that this announcement was made prior to adoption and tabling of the report from this Inquiry, and prior to the Government's formal response to the report.
- Under the Albanese Labor Government, Australians have experienced a collapse in their living standards - with no plan to reverse it.
- Real household disposable income fell 2.2 per cent over the past year - and is down 7.5 per cent since Labor took office.

Conclusion

The Coalition Members of the Standing Committee on Economics thank all Committee members for their participation and contributions throughout the course of this Inquiry, and also thank the Committee Secretariat for their professional support of the Inquiry.

The Coalition Members also note the considerable time and effort of all witnesses and members of the community that developed and provided submissions, attended hearings and provided witness evidence.

Mr Garth Hamilton MP
Deputy Chair

Mr Bert van Manen MP

Mr Keith Wolahan MP

22 March 2024

⁹ ACCC, Submission to the Senate Select Committee on Supermarket Prices.



Additional Comments from Ms Allegra Spender MP

Introduction

A dynamic economy is one where every Australian can fulfil their potential; where life is rich with opportunity; where our society is diverse, cohesive, and fair; and where every Australian enjoys a high standard of living and can access the world-class services they need.

The significant decline in long-term labour productivity growth over the last decade¹, demonstrates that dynamism is the critical ingredient which has been missing from Australia's economic environment. I therefore welcomed the Committee's decision to embark on a serious, long-form inquiry into what is an essential policy issue. The majority report makes a number of useful, practical contributions and recommendations, particularly in relation to competition.

But it does not go far enough.

Australia can and must do better to unleash the creative opportunities in our economy and amongst our people. As a Parliament, we need to raise our ambitions and work together to make Australia the best place in the world to start and grow a business, as well as a beacon of effective government services. Realising that ambition will require broader action than that proposed by this report.

My comments build on the opportunities to enhance dynamism where either the majority report was mainly silent or where it did not go far enough, including innovation, taxation, industrial relations, regulation, the performance of government and climate action. As the main report covered a lot of ground in competition, my focus is more on dynamism.

Policy areas of taxation and industrial relations are highly political and so it is unsurprising that there are not recommendations in a majority report. However, their impact on economic dynamism is far too significant to be ignored. As well as suggesting specific changes in tax and industrial relations policy, my recommendations focus on what institutional changes could be made to improve the evidence base and debate in these areas.

I have made additional recommendations on improving government regulation, including the appointment of a Minister for Better Regulation because while the main report addressed regulation, the recommendations were too incremental. Every government tries to cut red tape, and most fail, so we need a much stronger approach.

¹ Labour productivity growth was 1.1% per year between 2010 and 2020, compared with an average of 1.8% between 1960 and 2020.

In the area of innovation, my recommendations are particularly around knowledge diffusion, where work from the Productivity Commission could be built on.

But a particular focus of my additional comments and recommendations is on the performance of government and the public sector. Let me explain why.

In any report on competition and dynamism, it is easy to focus on the changes we want to see in business – to stop rent-seeking, stop anti-competitive conduct, be more innovative and improve the behaviour of corporations as stakeholders in our society. These things are absolutely necessary and some key levers are addressed in the Committee Report.

But it is also necessary for government to focus on itself and the changes to both how government operates in the economy, and what changes are needed internally if we are to unleash dynamism and competition. Businesses and citizens have too much experience of government action which is not evidence-based, which is not accountable or high-quality, which does not deliver value for money, and which does not enhance living standards. Government is a significant part of our economy, and there is too little time spent looking into the mirror of how government can innovate and improve its operations. Bad business practices should be competed or regulated out of the marketplace, but bad government policies, services and regulation have few natural predators. It falls to the Government and the Parliament to supervise itself and we need to be much better at this work.

In the section on public sector administration my focus is on improving the quality of government investment decisions in infrastructure, but also services, increasing the accountability of public sector services and decision-making, and ensuring that Government responds to the inquiries and reports it commissions. Culture change is critical here and I am recommending, among other things, to appoint a Minister for Customer Service.

Finally, the climate transition will have profound implications for the economy and dynamism. For that reason, it is included below.

List of additional recommendations

- 1: The Government should convene a national taxation summit, bringing together stakeholders across business, the social sector, unions, government to kick-start reform dialogues.
- 2: The Government should establish an independent Tax Reform Commission as a statutory, parliamentary body.
- 3: The Government should provide federal financial support for state governments which undertake a transition from stamp duty to land tax.
- 4: The Treasurer should direct the Productivity Commission to review Australia's workplace relations system, with a particular focus on innovation and growth.
- 5: The Government should adopt a new objective which explicitly establishes productivity and wages as primary outcomes sought through workplace relations reforms.

- 6: The Government should genuinely commit to an award review process that urgently delivers shorter, simpler workplace awards.
- 7: The Government commission the Productivity Commission, or another body, to develop and oversee a whole-of-government regulatory framework, including the impact of regulation on competition and dynamism and regulatory consistency between jurisdictions
- 8: The Government commission the Productivity Commission, or another body, to identify priority sectors for review of the burden of regulation. Once the sectors are identified, the body should then undertake these reviews to reduce the compliance burden on the prioritised sector, without material negative impacts on the lives and protections of Australians.
- 9: The Government should assign deregulatory oversight functions to an executive-level official at every regulatory agency and require regular reviews of the regulatory burden imposed by the agency, plans for burden reduction where appropriate, and appropriate performance reporting.
- 10: The Government appoint a Minister for Better Regulation
- 11: The Government should introduce a reform fund to incentivise state government reforms that would accelerate economic growth and dynamism
- 12: The Treasurer to provide a formal public response to the Productivity Commission 'Advancing Prosperity' report within 3 months.
- 13: As part of its response to the Advancing Prosperity report, the Government should commit to the swift implementation of recommendations 5.1, 5.2, 5.3, 5.4, and 5.13.
- 14: The Government agree not to consider any major infrastructure projects for public funding until a credible cost-benefit analysis has been published and approved by Infrastructure Australia.
- 15: The Government collect post-completion project cost data and use this data to undertake reference class forecasts for infrastructure investment proposals.
- 16: The government to appropriately resource a body, potentially the Auditor-General or the Office of Impact Analysis or the Productivity Commission, to develop an effective evaluation methodology across an entire agency. This approach could then be refined and applied to larger agencies.
- 17: The Government appoint a Minister for Customer Service, whose responsibility is to ensure that the Federal Government delivers effective customer services to citizens, not-for-profits and businesses
- 18: The Government commits to Ministers making a statement in Parliament when portfolio agencies fail to meet performance targets, and a review process so that community stakeholders identify the performance targets that are most important to the community

19: The Government should introduce a Federal Small Business and Codes List into the Federal Circuit Court of Australia.

20: The Government should commit to publicly responding to all inquiries and reports, commissioned by ministers, agencies, and the Parliament, within 6 months, and Ministers should appear before Parliament to explain when they fail to comply with this commitment and how they intend to become compliant.

21: The Government should enhance competition policy to support economic dynamism and should ensure its climate policies are supportive of market competition and innovation.

1. Taxation

Despite agreement from a range of think tanks and stakeholders on the need for broad based tax reform, and evidence to this effect from bodies who presented to the Committee, deficiencies with the tax system was not addressed in the Committee's Main Report. For example, the Business Council of Australia submitted that:

Heavy tax and regulatory burdens have been handbrakes on investment and productivity. The problems with the tax system have been shown in multiple reviews. Tax is a major lever for governments to promote productivity growth. Addressing issues such as the over reliance on direct taxation, the mismatch between federal and state taxes and spending, the volatile and inefficient state tax base, a globally uncompetitive tax rate for companies with turnover above \$50 million, and fragmented payroll tax regimes all need to be on the table for reform. So too should be the heavy tax burden on incomes (both personal and business). There should be a coordinated approach by governments to reducing regulation and duplication.²

And Mr Brendan Coates of the Grattan Institute said:

[Australia's] tax system is a mishmash of taxes, some of which are less costly than others. We certainly think that there are big opportunities to probably increase the rate of taxation on various forms of savings that are taxed very concessionally at the moment. The most obvious one is superannuation. Others include housing. Obviously, Danielle Wood, our CEO, published a report a couple of weeks ago on how that's necessary to support the budget position. It's also necessary to support tax mix switch.

Finally, we massively under-tax resource rents in Australia compared to what would be ideal, be it land or the resources themselves, as Danielle has pointed out in her recent report with the petroleum resource rent tax. They [are] areas that are ripe for reform. Irrespective of whether it's about dynamism or just purely capturing the static gains from a one-off shift in the tax system, the huge static gains are there if we did tax rents more and we taxed the savings of some

² Business Council of Australia, *Submission 3*, p.13.

vehicles more. It would open up big opportunities to reduce income tax and reduce effective marginal tax rates, particularly for secondary income earners and women. That would be a big step forward.³

1.1 Kickstarting Tax Reform

There is now broad agreement that Australia's tax system is not fit for purpose. Witnesses who contributed to this inquiry, including the Business Council of Australia, the Grattan Institute, the Organisation for Economic Co-operation and Development, and the Productivity Commission, all referred to their previous work citing the need for broad-based tax reform – calls which have not been heeded by successive Australian governments.

Australia's tax system significantly inhibits intergenerational equity and economic efficiency, and its over-reliance on income tax makes it unsustainable given our ageing population. Successive governments, formed by both major parties, have failed to implement the reforms necessary to address these challenges, exacerbating the harms from existing policy settings and increasing the political difficulty of future action.

Tax settings can be a critical driver or obstacle for growth in investment, innovation, and productivity. Australia's rates (including effective marginal rates) of personal and company tax are high relative to international comparators and there is evidence this is creating a disincentive to investment in physical and human capital, impeding the country's economic dynamism. This is compounded by the high degree of complexity in Australia's tax system which imposes substantial costs on taxpayers and is demonstrated by the fact more than 70% of Australian taxpayers require professional assistance in submitting individual tax returns.

The Productivity Commission's *Advancing Prosperity* report advocated, in Recommendation 3.4, that 'governments should, including through the Council on Federal Financial Relations, systematically transition the tax system to be supportive of productivity growth through tax arrangement that:

- Promote skilled labour supply
- Improve tax neutrality in respect of savings and investment
- Encourage efficient asset transfers and capital allocation
- Foster market entry and competition
- Support efficient risk management by firms and individuals'.⁴

To achieve this, we should build on the lessons of previous governments in driving tax reform through broad stakeholder engagement.

³ Mr Brendan Coates, *Committee Hansard*, 2 May 2023, p.16.

⁴ Productivity Commission (2024). *'Advancing Prosperity'*, Volume 3, p.51.

Recommendation 1

The Government should convene a national taxation summit, bringing together stakeholders across business, the social sector, unions, government to kick-start reform dialogues.

1.2 Institutions to Drive Tax Reform

Over the last decade, a number of policy experts and stakeholders – including the Tax Institute, have endorsed the need for an independent tax reform commission to proactively propose reform options, to undertake detailed consultation on tax proposals, and to act as a source of independent expertise for the Parliament.

Such a body should have the independence of a parliamentary agencies, such as the Australian National Audit Office or the Parliamentary Budget Office, and the credibility and expertise of agencies such as the Australian Law Reform Commission or the Productivity Commission. Each of these agencies makes a meaningful contribution to the formation of government policy and it is appropriate for tax policy to benefit from the same independent advice, rigour, and scrutiny.

Recommendation 2

The Government should establish an independent Tax Reform Commission as a statutory, parliamentary body.

1.3 Stamp Duty Elimination

The impact of stamp duty on economic dynamism was raised repeatedly in evidence to the Committee. The Commonwealth Productivity Commission recommended ‘moving away from taxes that discourage the efficient use transfer of assets and capital allocation, such as stamp duty on property transactions’.⁵ Brendan Coates of the Grattan Institute described it as ‘probably [the] number one [tax holding back economic dynamism] because it is the one affecting at the household level where people choose to live and, therefore, where they can work’.⁶ And the Business Council of Australia (BCA) noted the lack of plentiful and affordable housing is ‘a drag on national economic performance as it constraints productive capacity of some of Australia’s most highly productive areas’ and further noted that stamp duties ‘are inefficient taxes that impede labour mobility’.⁷

If anything, these comments understate the concern which many experts have with stamp duty, which has been called the worst tax currently imposed on Australians.

The e61 Institute has estimated that stamp duty costs the average metropolitan home-buyer five months of take-home income, increasing to six months for residents of Sydney and

⁵ Dr Alex Robson, *Committee Hansard*, 15 September 2023, p.57.

⁶ Brendan Coates, *Committee Hansard*, 2 May 2023, p.16.

⁷ Business Council of Australia. *Submission 3*, p.12.

Melbourne.⁸ Their research has also demonstrated that Australians have delayed job changes, family formation, and moving houses because of housing costs. NSW Treasury has estimated that a stamp duty to land tax transition would produce a long-run increase in home ownership of 6.6% in that state, equal to 130,000 households or 345,000 people.⁹

Commonwealth Treasury has demonstrated the inefficiency of relying on stamp duty instead of efficient alternatives, such as land taxes.¹⁰ That research estimates stamp duty imposes a marginal cost of around 70 cents per dollar of revenue raised while land tax, along the lines of existing council rates, imposes a marginal economic benefit of around 10 cents per dollar of revenue raised. If a stamp duty transition led to an average reduction in the deadweight loss of 35 cents, this would increase the size of the Australian economy by \$4.5 billion (2015 dollars).

Although a transition from stamp duty to land tax is economically desirable, state governments have generally not proceeded with this change. This is partly explained by the impact of such a transition on state budgets from the loss of stamp duty revenue and the impact of a smaller GST distribution. Research by Prosper Australia has modelled a transition for Victoria, which would be cost-neutral in the medium-term, would have a net cost of \$8 billion over the forward estimates. Research by NSW Treasury has estimated the annual GST impact would be around \$1 billion. These impacts are a significant disincentive for state governments which might otherwise support a transition.

There is a strong case for federal financial support, given the transition will have a substantial and permanent impact on the size of state economies. A significant share of this growth will be captured by the Commonwealth in higher personal and corporate tax revenue. Given this, it is appropriate the Commonwealth estimate the financial benefits of state reforms and offer to temporarily share these proceeds with reforming states, to offset the budget impacts of the transition.

Recommendation 3

The Government should provide federal financial support for state governments which undertake a transition from stamp duty to land tax.

2. Industrial Relations

Evidence provided to the Committee demonstrated that there is serious concern about the impact of industrial relations on economic dynamism. However, the Committee's report is largely silent on industrial relations and the impact on dynamism.

⁸ Garvin, N. et al (2024). 'Stepped on by Stamp Duty', e61 Micro Note, Number 20.

⁹ Warlters, M. (2022). 'Property Tax Reform and Home Ownership', Technical Research Paper, TRP22-18.

¹⁰ Cao, L. et al (2015) 'Understanding the economy-wide efficiency and incidence of major Australian taxes', Treasury Working Papers, 2015-01.

2.1 The intersection between industrial relations and productivity

In its Advancing Prosperity report, the Productivity Commission devoted Volume 7 to improving labour market productivity, and said:

The workplace relations system has a fundamental role in driving productivity and wages, but needs repair to achieve those outcomes, including a greater emphasis on co-operation between parties.

The award system has grown in significance as enterprise bargaining has shrunk, but needs to become more efficient and flexible, in part because they set a floor on conditions in enterprise agreements. [...]

Enterprise bargaining needs reform to provide the mutual benefits and productivity gains that were its original intent.¹¹

This was echoed by Mr Dylan Broomfield, General Manager, Policy and Advocacy, at the Victorian Chamber of Commerce and Industry:

... competition could be further boosted by allowing businesses to get more access into markets through improved regulation, improved access to capital, greater availability of labour and more fluid industrial relations reforms.¹²

Industrial relations policies have impacts in capital markets as well as labour markets, as outlined by Ms Tania Constable, CEO of the Minerals Council of Australia:

Workplace or industrial relations is exactly the same sort of policy that deeply concerns investors at a global level.

Time and time again, we've heard companies saying, 'These policies are going to be killers for our industry.' When they sit in boardrooms at an international level, they consider all the investments that they can make around the world and prioritise those investments based on taxation, workplace relations and, next, environment, and then everything else will be prioritised based on whether they can get the skills et cetera to be able to make those decisions. That's how a company makes its decisions.

The head or CEO of BHP has already said that he will not be investing in Queensland, because of taxation settings. He has made comments about these workplace relations being a retrograde step for Australia; the heads of some of the oil and gas companies have said exactly the same thing. We will see more companies and more jurisdictions around the world making these comments about why they should invest in Australia.¹³

Dr Alex Robson, Deputy Chair of the Productivity Commission, told the Committee:

¹¹ Productivity Commission, *Advancing Prosperity*, Volume 7, p.93.

¹² Mr Dylan Broomfield, *Committee Hansard*, 4 July 2023, p.30.

¹³ Ms Tania Constable, *Committee Hansard*, 31 August 2023, p.5.

In a service based economy, fit-for-purpose labour market regulation is key, particularly in relation to the gig economy, which can be an important source of market entry, innovation and dynamism.

For the most part, as our research released today shows, real wages and productivity move together. Finding productivity improvements leads to increases in real wages, so labour market settings need to facilitate matching between workers and businesses and maximise cooperation between parties. They need to encourage innovation, reward skills, aspiration and effort, and preserve fairness. Shoehorning platform work into other employment categories would put at risk its productivity impacts and its benefits for gig workers.

On the other hand, as our report discussed, gig workers have genuine concerns that need to be taken very seriously—in particular, in relation to improved safety protection and access to dispute resolution. We think that reform in those areas is warranted.¹⁴

These concerns have been reinforced by the Government's recent changes to industrial relations laws. For example, the Business Council of Australia said in its submission:

The labour market has become more regulated, with more restrictions and legislated barriers. Recent changes to industrial relations, including the restoration of multiemployer bargaining could lead to increased disruption and a less innovative and dynamic economy. Reforms to the Better Off Overall Test are welcome and will reduce the complexity of getting agreements that pay Australians more.¹⁵

And an Australian tech success story, Mable, provided evidence of how its services provide the opportunity for substantial productivity gains to be realised in the care sector in a way which benefits both service providers and recipients.¹⁶ The care sector is one where productivity is poorly understood and so opportunities to grow productivity have not been realised historically. Digital technology offers one way to realise those opportunities but, in the case of Mable, the Commonwealth Government has actively sought to undermine and neuter its business model through its recent industrial relations reforms.

The impact of such interventions on productivity-enhancing investments in other parts of the economy cannot be understated. As Dr Robson, Deputy Chair of the Productivity Commission, told the Committee:

In particular, in relation to the gig economy, in *Advancing Prosperity*, we said, 'This is a key source of dynamism and innovation and entry, so, if that's what you're worried about, then you may want to treat it differently.'

The point we were making in *Advancing Prosperity* is that we don't want to cut off this emerging way of doing things, because, if we think it does produce

¹⁴ Dr Alex Robson, *Committee Hansard*, 15 September 2023, p.54.

¹⁵ Business Council of Australia. *Submission 3*, p.10.

¹⁶ Mable, *Submission 44*.

productivity benefits and efficiency benefits, then we don't want to shoehorn it into overt regulatory arrangements.¹⁷

Unfortunately, this is likely to have been the impact of the three tranches of industrial relations reforms agreed by the Parliament since the 2022 election. What Andrew McKellar, CEO of the Australian Chamber of Commerce and Industry, has described as the 'ideological pendulum' may swing back with the next change of government, imposing further adjustment costs and uncertainty on businesses and undermining confidence amongst international capital markets and investors.

For that reason, it is appropriate to reevaluate the industrial relations framework as it now stands, and determine whether it is supportive of growth in productivity and real wages, and whether opportunities exist to raise productivity and dynamism with a new and more enduring framework.

Recommendation 4

The Treasurer should direct the Productivity Commission to review Australia's workplace relations system, with a particular focus on innovation and growth.

2.2 The Objective of Workplace Reform

In conjunction with the review of the industrial relations framework, it is appropriate that the objective of the industrial relations system needs to be reconsidered to ensure that productivity and dynamism is an ongoing focus for government action.

The Tech Council of Australia have put forward a simple objective which should guide future workplace reforms:

An industrial relations system that upholds the rights of workers while enabling flexible forms of employment that can deliver better productivity and wage outcomes, and that do not prevent workplaces from innovating and adopting new forms of technology.¹⁸

Recommendation 5

The Government should adopt a new objective which explicitly establishes productivity and wages as primary outcomes sought through workplace relations reforms.

¹⁷ Dr Alex Robson, *Committee Hansard*, 15 September 2023, p.63.

¹⁸ Tech Council of Australia, *Submission 32*, p.13.

2.3 Simplification of the Awards

There is also a clear need for simplifying the complexity and administrative burden of workplace agreements where complexity does not obviously benefit employees or employers.

For example, Mr Paul Harker, Chief Commercial Officer for Woolworths, told the Committee the business had ‘156,000 people employed across 28 separate EA agreements, using 13 different awards’.¹⁹ Ms Vittoria Bon, Government and Industry Relations Manager for Coles Group, told the committee that although the business had negotiated ‘12 or 13’ awards and EAs since 2020 and ‘around 14’ different enterprise bargaining agreements.²⁰ The complexity imposed by the range of these agreements – and the much wider range of potential interpretations of the interactions of different clauses – doubtless creates unnecessary confusion and cost for businesses without necessarily benefiting workers. Both witnesses agreed they would welcome simplification of the award system.

While the Minister for Workplace Relations announced a review of the award system in September 2023²¹, based on a commitment made in 2022, little progress has been made to date and some stakeholders are concerned the review lacks the resources or institutional support to have an impact. There is an urgent need for the Government to commission a new process, with appropriate resourcing and urgency, which brings employer and employee representatives together to develop simplified modern awards. This would benefit employees in creating more opportunities for additional shifts or responsibilities, and employers through simpler workplace arrangements and reduced legal risks and uncertainty.

Recommendation 6

The Government should genuinely commit to an award review process that urgently delivers shorter, simpler workplace awards.

3. Regulation

As with any economic policy tool, regulation can be an enabler of competition and dynamism or a barrier to it. While we ought to look at opportunities to strengthen regulation where it can enable more competition, we must also look at where regulation has become an obstacle to dynamism. While recommendations 16 to 18 in the Committee’s report address the potential for regulation to reduce dynamism, they are couched in terms of incremental reform. In fact, a much more ambitious and deliberate approach is required.

¹⁹ Mr Paul Harker, *Committee Hansard*, 25 July 2023, p.11.

²⁰ Ms Vittoria Bon, *Committee Hansard*, 25 July 2023, p.4.

²¹ Letter from the Minister for Employment and Workplace Relations to the President of the Fair Work Commission, 12 September 2023, Reference MS23-000485, <https://www.fwc.gov.au/documents/consultation/letter-from-minister-2023-09-12.pdf>

3.1 Reducing regulatory burden

The Committee heard considerable evidence on the impact of regulation on dynamism and competition. Where the costs of complying with regulation are large, it can inhibit investment in other parts of a business and can be a deterrent to potential new competitions. As Mr Shayne Elliott, CEO of the ANZ Bank, told the Committee:

So almost five per cent of our revenue today we are investing just to comply with new stuff [regulation]. You can imagine—you can do the maths—it's getting close to a billion dollars. [...] In addition to that there is the day-to-day cost of managing scams and managing compliance with all the old regulations—just doing basic day-to-day risk management. This is just the investment required for new regulations that come along, so things like the BEAR [Banking Executive Accountability] regime.²²

In the financial sector and across the economy, there are regulations that create value for society and regulations that destroy value. Despite attempts in recent years to estimate and report the expected regulatory burden imposed by new legislation and regulations, as part of the Impact Analysis framework, proposals routinely lack credible quantification of costs and benefits. There is no clear evidence this work is yielding higher-quality policy proposals or lower-cost regulation to the community.

Therefore, the Government should impose additional obligations on regulators to proactively review the existing and potential new burdens the agency imposes on individuals or organisations and either reconfigure its regulatory framework to reduce the burden or to remove regulations which fail to create value.

Recommendation 7

The Government commission the Productivity Commission, or another body, to develop and oversee a whole-of-government regulatory framework, including the impact of regulation on competition and dynamism and regulatory consistency between jurisdictions.

Recommendation 8

The Government commission the Productivity Commission, or another body, to identify priority sectors for review of the burden of regulation. Once the sectors are identified, the body should then undertake these reviews to reduce the compliance burden on the prioritised sector, without material negative impacts on the lives and protections of Australians.

²² Mr Shayne Elliott, *Committee Hansard*, 12 July 2023, p.21.

Recommendation 9

The Government should assign deregulatory oversight functions to an executive-level official at every regulatory agency and require regular reviews of the regulatory burden imposed by the agency, plans for burden reduction where appropriate, and appropriate performance reporting.

Recommendation 10

The Government appoint a Minister for Better Regulation.

3.2 Incentivising Reform

A number of recommendations in the committee report require action by state governments, including changes to non-compete clauses, housing policies, support for start-ups, and procurement processes. Past recommendations of Commonwealth parliamentary inquiries and agency reports to state governments have not generally proven effective, except in some cases where the Commonwealth has provided financial incentives.

An example of this is National Competition Policy payments made by the Commonwealth to the States as part of the implementation of the Hilmer Review.

Recommendation 11

The Government should introduce a reform fund to incentivise state government reforms that would accelerate economic growth and dynamism.

4. Innovation

Innovation is the beating heart of economic dynamism. It is fed by public sector research, both basic and applied, and by private sector research and development, and free market competition providing the impetus for firms to invest, change, and growth. Innovation can partly be targeted directly in government policy, but can also significantly targeted indirectly targeted through a wide range of policies in competition regulation, education, procurement, tax, and other policy spaces.

4.1 Addressing Productivity Commission recommendations

In their appearance before the Committee, members of the Productivity Commission discussed their most recent five-yearly review of productivity, the seven volume *Advancing Prosperity* report.²³ The Government has not provided a formal response to the review, though government has acknowledged areas where they are taking action on findings. If we are truly to address productivity, we should at a minimum respond to the recommendations

²³ *Committee Hansard*, 15 September 2023, pp.54-71.

of the major productivity review. This applies to other government reviews, many of which reports are not made public and a further recommendation is:

Recommendation 12

The Treasurer to provide a formal public response to the Productivity Commission 'Advancing Prosperity' report within 3 months.

4.2 Diffusion of knowledge

Volume 5 of Advancing Prosperity is dedicated to the diffusion of innovation and knowledge in the Australian economy. Five particularly relevant recommendations of the report are:

5.1: An enabling environment for small business access to finance

The Australian Government should monitor the effects of APRA's changes to capital requirements and risk weights for loans to small and medium enterprises (SMEs) that are not secured by property, and the activities of the Australian Business Securitisation Fund, to understand whether they are having the desired impacts on SME lending. Adjustments or further responses could be required if barriers to SMEs accessing finance remain. APRA may need to collect more detailed data about business lending to enable the government to undertake this monitoring.

5.2: An industry-agnostic approach to the National Industry PhD Program

The Australian Government should actively promote innovation diffusion across a range of industries as part of its role in capability building. By adjusting the National Industry PhD Program so that it is industry 'agnostic' and does not preference applications aligned with the National Manufacturing Priorities, the Government could encourage diffusion of new knowledge and best practice into the services and social sciences.

5.3: Improving collaborative networks and knowledge transfer

Governments could strengthen collaborative networks for diffusion and facilitate knowledge transfer through:

- trialling government-funded extension services, which have so far been focused on the agriculture industry in Australia, to support diffusion of technical knowledge and relevant technologies in other sectors. The initiative should be tailored by sector depending on what services are relevant for most small businesses in that sector, with early engagement between government and businesses to identify the types of services that would be most beneficial
- requiring open access for government funded research in journals, papers and publications that is currently locked behind paywalls. In implementing this change, the government should compare the benefits and costs of

the Chief Scientist's proposed open access model with the benefits and costs of other potential approaches

- partnering with intermediaries — such as industry associations and other advisory or network bodies — that have existing connections between industry, government, researchers and markets when implementing programs to support diffusion (such as capability development initiatives and extension services). This would enable governments to reach a wider audience with their diffusion initiatives.

5.4: Reducing administrative barriers to academic consulting

The Australian Government should reserve the right to facilitate more consulting by university academics, should universities be unable or unwilling to lower unnecessary administrative barriers that disincentivise academics from undertaking consulting. This could be incorporated into the Australian Universities Accord, with the government setting guiding principles to govern universities' approaches to academic consulting and standardised processes and fee requirements.

5.13: No-cost or low-cost access to ideas that have large public good value

To support the diffusion of best practice and knowledge that has already been generated by innovative businesses, not-for-profits and government organisations, the Australian Government should:

- make mandatory standards freely available and look at new funding models for Standards Australia to reduce or eliminate the pricing of voluntary standards that have high public good value
- require open access to research principally funded by governments (see recommendation 5.3 of this report for further detail)
- reform fair use provisions in intellectual property regulations to adopt a principles-based fair use exception.

These are sensible, considered recommendations that would collectively help to stimulate more investment in private sector innovation. 5.1 may be partly addressed by recommendation 38 in the Committee's report but others are not significantly addressed. If the Government has concerns with the recommendations, it should say so publicly and outline its preferred alternative approach to supporting innovation diffusion. If it does not have such concerns, the Government should accept the recommendations and announce a timetable for implement.

Recommendation 13

As part of its response to the Advancing Prosperity report, the Government should commit to the swift implementation of recommendations 5.1, 5.2, 5.3, 5.4, and 5.13.

5. Public sector administration and performance

With the public sector comprising around 40% of the Australian economy, too little attention in general is paid to how government's own actions and dynamism affect the broader dynamism of the economy. The Committee's report acknowledged the role that government plays in dynamism – as a regulator and market steward, as a provider of services, sometimes in a monopolistic way, and sometimes in competition with private and non-profit providers, as a procurer of services, and as the owner of physical and virtual assets.

The Committee identified recommendations in the government's role as a procurer of services, as a service provider, as a regulator, and as a custodian of data. I support these recommendations but believe we need to go further and fundamentally challenge the complacency with which government can at times view its responsibility to its citizens and the economy. We have separately provided additional recommendations in relation to government's role as a regulator.

5.1 Government's investment in infrastructure

Government's spending and investment decisions make a profound impact on the dynamism of the economy.

One obvious area of this is public infrastructure. A number of submissions to the inquiry proposed greater public investment in infrastructure. Such investments are one way for governments to unlock opportunities to grow innovation and economic dynamism. To that end, the Commonwealth Government has a 10-year, \$120 billion infrastructure program.

The challenge with infrastructure investment is that realising economic benefits depends on effective project selection, design, and oversight. There is persuasive evidence that the Commonwealth routinely selects projects for funding in which the project costs exceed benefits – let alone failing to provide the maximum-possible net benefits to the community.

There is no justification for the current processes where the Commonwealth agrees to project funding with state governments, often prior to any cost-benefit analysis being undertaken, and without any public scrutiny of funding proposals. It is also not justifiable that the Commonwealth fails to collect cost data following project completion to inform cost estimates for future projects.

In the "Advancing Prosperity" report of the Productivity Commission, one of the few reform directives identified as having a high impact on growth, and a short timeframe under which the benefits could be realised was Reform Directive 22 – "Implement best practice resource allocation when funding public infrastructure." I concur with this recommendation and have tried to address this previously in amendments to government legislation, including with amendments that the Prime Minister previously put forward when in opposition, but so far these have been rejected by government and the opposition. These are the basis of my next 2 recommendations:

Recommendation 14

The Government agree not to consider any major infrastructure projects for public funding until a credible cost-benefit analysis has been published and approved by Infrastructure Australia.

Recommendation 15

The Government collect post-completion project cost data and use this data to undertake reference class forecasts for infrastructure investment proposals.

5.2 Government's role in investment in services

There are significant parallels between the government's role in investing in infrastructure, and its role in investing in other services in the economy, such as education and healthcare services. In both cases, investments are made, without adequate evaluation of the impact of the investment.

One example of this is the major increase in schools funding from 2018, generally known as Gonski 2.0. The actual funding envelope for this program is not known – the stated cost, \$319 billion, is total federal expenditure on education rather than the marginal cost of the program – but it was a multi-billion dollar program. A Productivity Commission review of the reform after five years found that the reforms 'have done little, so far, to improve student outcomes'.²⁴

Good evaluation in government services is difficult, time-consuming and expensive, and there are the political challenges of government's not wishing to acknowledge when money has not been effectively spent and the legitimate concern that any poor evaluation impacts government's appetite for appropriate risk and experimentation in the delivery of services. Nevertheless, the current level of evaluation and accountability of government spending is inadequate. I acknowledge the work the government has done in establishing the Australian Centre for Evaluation but, the small scale of that body – \$10 million over four years – and its very broad remit, suggests that it will not be enough to drive the still much more focus needs to be placed on this work across government.

We need to have regular, transparent evaluation of existing spending programs. This would allow policymakers to assess whether policies continue to create value, and so should continue to receive funding, or whether alternative policies might be more effective. This would also improve decision-making about whether an agency should receive new funding to pursue new policies or whether resources should be reallocated form within.

In addition to enabling enhanced, data-driven decision-making by policymakers, valuation transparency would enable more informed public policy debate.

²⁴ Productivity Commission (2022). 'Study Report: Review of the National School Reform Agreement', p.2.

Recommendation 16

The Government to appropriately resource a body, potentially the Auditor-General or the Office of Impact Analysis or the Productivity Commission, to develop an effective evaluation methodology across an entire agency. This approach could then be refined and applied to larger agencies.

5.3 Government Transparency and Accountability for Decision-Making

Government decision-making practices can have a significant impact on the dynamism of the economy. This can be at the individual level, where delay on decisions on say visas, impact individual's ability to make an economic contribution. This can affect small and medium businesses and not-for-profits, where delays on government contracts, or slow resolution of disputes, can significantly affect business decisions, and in some cases the entire viability of some organisations. And this can affect large enterprises, where delays in approvals can fundamentally change whether investments worth billions of dollars are made. There was evidence provided at different firm levels of the challenges with interactions with government in relation to decision-making.

The Committee Report acknowledged the need for greater transparency in the effectiveness of government services in its recommendations:

Recommendation 30: That the Government develop a dashboard that outlines in an accessible way key performance indicators. This could be started with pilots by Services Australia and the Australian Securities and Investments Commission.

I strongly support this recommendation as a way of increasing transparency and accountability in government. However, we need to go much, much further.

There needs to be a fundamental culture shift in government and its agencies perception of their roles, and the expectation of accountability of what they provide. In the world of professional services, if a service provider fails to provide a service within the contracted time, the provider may have to pay penalties or forego payments. However, for many areas where government is a monopoly provider of services, there is very little recourse when government does not meet its own performance benchmarks, or indeed, doesn't even have them, particularly for individuals and for small and medium-sized businesses and not-for-profits.

For example, the submission from the Australian Competition and Consumer Commission (ACCC) rightly highlights the work the agency is undertaking to prevent unfair conduct including disruption of anti-competitive mergers and acquisitions, regulation of monopoly operators, oversight of digital platform conduct, and studies of market competition.²⁵ This work is appropriate to ensuring a free and competitive marketplace, which supports Australia's economic dynamism.

²⁵ Australian Competition and Consumer Commission, *Submission 34*.

However, the value of this work is diminished where the ACCC fails to conduct its work in a timely and effective way. Its own annual report notes that the ACCC consistently fails to meet its performance targets of completing 60% of initial investigations within three months, and 70% of in-depth investigations within 12 months.²⁶ In the past financial year, just 34% of initial investigations were completed on time – less than half of its target – and 42% of in-depth investigations were completed on time. In the past five years, the ACCC has only managed to achieve either of these performance targets on one occasion.

The ACCC is not alone in consistently not meeting its benchmarks, and in this case at least the benchmarks are relatively transparent. Government will argue that it is taking steps to improve services – and certainly there is a commitment to invest more into Services Australia and marked improvement in the processing times of visas, both of which are very welcome and valuable. However, we are missing a culture within government of accountability of prompt and effective service delivery.

Recommendation 17

The Government appoint a Minister for Customer Service, whose responsibility is to ensure that the Federal Government delivers effective customer services to citizens, not-for-profits and businesses.

Recommendation 18

The Government commits to Ministers making a statement in Parliament when portfolio agencies fail to meet performance targets, and a review process so that community stakeholders identify the performance targets that are most important to the community.

A specific example of the challenges smaller operators have in achieving outcomes influenced by government, was provided by the Australian Small Business and Family Enterprise Ombudsman (ASBFEO). They have highlighted some of the challenges of small businesses accessing timely, low-cost redress for misconduct by larger businesses, who in some cases, can engage in unfair practices without consequences. While the government is not itself engaging in unfair practices, the paucity of options that the government controls in ensuring these unfair practices are dealt with, is an illustration of the need for a change in culture in public service provision. ASBFEO make a specific recommendation in relation to how this could be addressed which I believe is worth pursuing.

Recommendation 19

The Government should introduce a Federal Small Business and Codes List into the Federal Circuit Court of Australia.

²⁶ Australian Competition and Consumer Commission, *Annual Report 2022-23*, p.47.

5.4 Government Response to Reports and Inquiries

A basic aspect of public sector administration should be responding to official inquiries, reports, and other reviews, particularly those commissioned by the Government. But, as of 31 December 2023, more than 100 Senate inquiry reports had not received any response from the Government and more than 330 inquiries had only received interim responses.²⁷ There is, however, no source of data for estimating how many House inquiries or agency reports are yet to receive a response from Government.

Commissioning research and failing to respond – let alone implement change – has become business as usual in Parliament but it ought to be an unacceptable practice. It not only misses the opportunity to implement important policy changes but wastes public resources on those who undertake unnecessary work and the resources of those who give freely of their time and expertise to aid the work of the Government and the Parliament.

Other jurisdictions in the country have better standards in relation to responses to inquiries, and it is time the Federal Government caught up.

Recommendation 20

The Government should commit to publicly responding to all inquiries and reports, commissioned by ministers, agencies, and the Parliament, within 6 months, and Ministers should appear before Parliament to explain when they fail to comply with this commitment and how they intend to become compliant.

6. Climate Change

Climate change was a recurring theme throughout the evidence received by the committee but was not addressed at length by the majority report. The Productivity Commission outlined the interaction between climate change and economic dynamism:

Decarbonisation will have fundamental effects on industry structures and technologies, and must rely on a high level of dynamism to achieve governments' goals efficiently. While some measures will require strong levels of government direction, the growing evidence on economic dynamism gives substantial weight to giving people and firms incentives to innovate and change.

Three reforms themes have been identified as the most-valuable in responding to addressing climate change (efficient greenhouse gas abatement through an enhanced safeguards mechanism, adaptation in building to avoid costly adjustments in the future, and developing an updated electricity system).²⁸

²⁷ President of the Senate. 'President's Report to the Senate on the Status of Government Responses to Parliamentary Committee Reports as at 31 December 2023'. Senate Tabled Papers Register.

²⁸ Productivity Commission, *Submission 1*, p.38.

The Productivity Commission's views were further explored in Volume 6 of its *Advancing Prosperity* report, which made the following points:

Climate change looms large over Australia's productivity performance. Its potential physical impacts, and the policy steps taken in response, will affect Australia's productivity growth over coming decades.

A key productivity challenge will be achieving our 2030 and 2050 emissions reduction targets as efficiently as possible. Continued reliance on a suite of ad hoc sectoral policy measures will unnecessarily reduce productivity growth and living standards. Economy-wide settings that create enduring incentives for credible abatement could achieve our emissions targets at lower cost.²⁹

The report made a number of recommendations in relation to this. However, the Government has yet to respond to these recommendations but should do so as a priority.

Mr Jason McDonald, of the Commonwealth Treasury, also raised the interaction of climate and competition policies:

The reason why we're involved is that climate change is the biggest market failure; it's the most significant market failure. There's spillover on everybody who may or may not have actually emitted the carbon to begin with, both today's generation and future generations.

You can clearly see it's a spillover on future generations. What we're particularly interested in is helping the transition to net zero, to making sure the right workers and the right businesses can get into the right fields easily without barriers to competition to help the necessary transition of the economy.³⁰

Mr McDonald also explained to the Committee why Treasury's Competition Taskforce had a focus on climate change:

Competition is also critical for ensuring the [emissions abatement] path we choose is least cost, which means high innovation and opportunity for Australian businesses and workers.

There are barriers to competition that can impede businesses adopting and deploying the latest technologies, such as different regulatory standards across jurisdictions. Competitive processes for reducing emissions are essential to ensuring resources flow to more innovative businesses that can thrive in the new, clean economy.

Businesses also need confidence that they won't fall foul of competition rules when cooperating to address climate change.³¹

²⁹ Productivity Commission (2023). 'Advancing Prosperity', Volume 6, p.1.

³⁰ Mr Jason McDonald, *Committee Hansard*, 15 September 2023, p.34.

³¹ Mr Jason McDonald, *Committee Hansard*, 15 September 2023, p.20.

There is a clear argument that competition policy should be maintained even for climate and environmental policies.

Recommendation 21

The Government should enhance competition policy to support economic dynamism and should ensure its climate policies are supportive of market competition and innovation.

**Ms Allegra Spender MP
Independent Member for Wentworth**