ACTU Submission to the Competition Policy Review

10 June 2014

australian council of trade unions

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Introduction

The Australian Council of Trade Unions represents nearly two million working people and their families in Australia. Many more have their pay and conditions of employment shaped by the bargaining and campaigning performed by our affiliates.

We welcome the opportunity to offer views on some of the topics discussed in the Issues Paper published by the Review Panel.

We note the Panel has stated that matters relating to workplace relations are not within the scope of this review. However, should the Panel subsequently decide to discuss such matters in its reports we request that you provide the ACTU with the opportunity to comment on what the Panel intends to say prior to any final submission to the government.

The Panel will be aware that competition policy is a contentious area of public policy. There are good reasons for this. When some of the recommendations made by the Hilmer Inquiry were implemented via the *Competition Policy Reform Bill* in 1995 there was widespread public concern that the process lacked transparency, accountability and a sufficient grounding in evidence.[1]

In particular, reversing the onus of proof on the basis that one particular theory of competition could be assumed to be correct in nearly all circumstances, and then combining this with a 'public interest test' that was widely perceived to prioritise profits over the social and environmental impacts of competition, have generated a widely held sense that the making of competition policy is a top-down process with little regard for the experience and views of the Australian community.

The counter-argument to widespread public scepticism has been to assert the beneficial impacts of our National Competition Policy (NCP). This is the approach adopted by the Review Panel in the Issues Paper.

That the NCP has been overwhelmingly beneficial, and has played a vital role in increasing employment, incomes and productivity since 1995, has become an article of faith among its advocates. But it is also a contested faith. When the Productivity Commission conducted a review of national competition policy reforms in 2005, it urged policy makers to be cautious about assuming its benefits:

> '…it is difficult to disentangle the impacts of the NCP from other factors that have been driving recent outcomes. Some caution is therefore required in drawing conclusions about its effects on social welfare, employment, regional Australia and the environment.'[2]

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[1] Margetts, D. (2012) *A Critique of Australia's National Competition Policy: assessing its outcomes in a range of major sectors*, Doctoral Thesis, University of Western Australia.

[2] Productivity Commission (2005) *Review of National Competition Policy Reforms*, Report No. 33, Canberra, p. 87.

The Review Panel does not appear to share the Productivity Commission's caution. The Issues Paper contains some bold assertions about the role NPC has allegedly played in the Australian economy over the past twenty years, in particular the notion that it has been central to increasing labour productivity.

Determining the causes of increased labour productivity over time is a complex and contentious area of analysis. We would note, however, that the compound annual rate of growth in labour productivity of 2.6 per cent between 1997 and 2002 was no higher than that recorded for the years from 1975 to 1980 – some time before the 1995 competition reforms.

There is a weak relationship between the application of competition legislation and movements in productivity. There is better reason to believe that given the size and structure of the Australian economy phases of sustained productivity growth are driven in large part by the import of new overseas production technologies and the impact of increasing demand for Australian exports that result from periodic booms in the global economy.[3]

This is not to suggest that competition policy is irrelevant to Australia's future. It is rather to argue that such policy has complex and sometimes contradictory impacts. In some contexts it can stimulate innovation, productivity and lower prices. However, it can also encourage trends toward monopolistic and oligopolistic markets. It can reduce the time and resources firms have to train, up-skill and invest in new technologies. It can entrench a low-skill/low-innovation equilibrium as firms compete on the basis of minimising short-term production costs at the expense of investing in new resource-intensive products and processes.

We therefore hope that when considering what recommendations to make to government the Review Panel relies less on normative theorising and more on detailed evidence relevant to each industry, market and place. This will not only make for better public policy, it will help to create a policymaking framework that is more deserving of public confidence.

In this brief preliminary submission we will focus on three topics of particular concern to the ACTU. We would be happy to expand on these comments on request.

Secondary Boycotts

While the broad scope of workplace relations falls outside the remit of the Panel, certain provisions of the Competition and Consumer Act 2010 (CCA) do have relevance to unions in the context of secondary boycotts.

[3] ACTU (2013) *A Shrinking Slice of the Pie*, The Working Australia Papers, 1/2013.

In general, the CCA prohibits secondary boycotts but exempts from that prohibition certain forms of conduct such as where the dominant purpose of the conduct relates to remuneration or conditions of employment (subsection 51(2)).

In the Issues Paper the Review Panel asks: do the provisions of the CCA on secondary boycotts operate effectively and do they work to further the objectives of the CCA?

While subsection 51(1) provides exemption under certain conditions, in most cases it does not provide protection for secondary boycotts and sympathy action by unions engaged in industrial activities.

The International Labour Organisation's Convention 87 in respect of *The Freedom of Association and Protection of the Right to Organise* recognises that it is important and legitimate for trade unions to be able to engage in secondary/sympathetic industrial activity. This is a widely recognised principle of labour law in most modern democracies.

Australia is a signatory to the ILO's Conventions and is therefore obliged to observe the principles they affirm. However, the ILO's Committee of Experts has made clear to the Australian government on a number of occasions that a general prohibition on sympathy activity, such as that facilitated by the current provisions on secondary boycotts contained in the CCA, contravene Convention 87. The ILO has made clear that workers should be able to engage in such activities provided that the action they are supporting is lawful.[4]

The Australian government currently stands in contravention of its international obligations in this respect. The ACTU therefore recommends that the exemptions to the secondary boycott prohibitions of the CCA are widened to ensure protection of the specific right to engage in secondary/sympathetic industrial activity.

The Limits to Self-Regulation

The Terms of Reference for the present review ask the Panel to consider 'whether Australia's highly codified competition law is responsive, effective and certain in its support of its economic policy objectives' (para 3.1). Further, the Terms request the Panel to consider the most appropriate means of 'removing regulation' and 'working with stakeholders to put in place economic devices that ensure a fair balance between regulatory expectations of the community and self-regulation' (para 6).

The primary rationale for most competition policy is to combat anti-competitive behavior by businesses, such as the formation of cartels as a means to fix prices, share markets and rig bids. The effective policing and prevention of such behavior requires a clear statutory

[4] Romeyn, J. (2008) *Striking a Balance: the need for further reform of the law relating to industrial action*, Research Paper No. 33, Australian Parliamentary Library, Canberra; International Labour Organisation (2012) *Report of the Committee of Experts on the Application of Conventions and Recommendations*, ILO, Geneva, pp. 58-59.

framework within which public agencies are appropriately empowered and resourced to enforce the law.

The notion, implied by the Terms of Reference, that businesses who may have a strong commercial incentive to engage in anti-competitive behavior can be dissuaded from doing so by such means as 'economic devices' and mere encouragement by regulators to do so, is naive. It willfully ignores the self-interests involved and the clear incentive to engage in anti-competitive behaviors that 'removing regulation' would provide. It assumes a benevolence on the part of most businesses that is belied by the long history of anti-competitive behavior in many industries. This is why, in most developed economies, strong and clear anti-competitive laws are regarded as essential.

Therefore, the ACTU strongly favours the retention of the existing statutory framework for regulating competition. There is good reason to doubt that a dilution of that framework in favour of self-regulation would be in the best interests of our community.

The concept of self-regulation (or 'soft-law') has become increasingly influential among some groups of economists and policymakers over the past 30 years. Self-regulation involves the specification of regulations that are administered and enforced by relevant groups of business organisations. There are then degrees of self-regulation determined by the extent to which there is a statutory basis for enforcing certain modes of behaviour and the extent to which a public regulator maintains or delegates its policing and enforcement role.[5]

Among advocates it is seen as potentially offering a more flexible, responsive and lower-cost alternative approach to securing competitive dynamics than statutory regulation. There is a clear affinity between policy interest in the purported benefits of self-regulation and belief in the efficiency and optimality of free markets.

However, the extent to which self-regulation is an effective means of countering behaviour that is detrimental to consumers is highly contested. In part, this is because rigorous evidence-based analysis is difficult under circumstances where public regulators have little or no role in observing how firms behave under self-regulating conditions. As a result, advocates of self-regulation have tended to rely more on normative economic modelling than evidence gathering to justify their belief in the benefits of non-statutory enforcement.

While Australia is widely perceived to be a 'leader' in favouring self-regulation as a way of reducing the 'regulatory burden' on business, it has been considerably less pro-active in terms of attempting to systematically evaluate the outcomes for citizens and consumers.[6] In short, there is an 'evidence-gap'. This fosters the suspicion that moves toward greater self-regulation in recent decades has been driven more by lobbying and an uncritical embrace of particular economic theories than by a concern with community welfare.

[5] Bartle, I. and P. Vass (2005) *Self-Regulation and the Regulatory State: a survey of policy and practice*, Centre for the Study of Regulated Industries, University of Bath.
[6] Centre for Competition Policy (2008) *Benchmarking The Performance of the UK Framework Supporting Consumer Empowerment Through Comparison Against Relevant International Comparator Countries*, University of East Anglia.

We hope the Panel will take the opportunity of the current review to argue for an evidence-based approach to self-regulation based on concrete Australian experience and detailed analysis of particular markets.

In the absence of a significant evidence-base there are strong reasons to doubt the effectiveness of self-regulation as a means of shaping competition and securing better outcomes for consumers. The conditions under which such regulation may do so are limited and militate against the populist advocacy of self-regulation as a win-win remedy for business and consumers in an increasing number of market contexts.

The conditions under which self-regulation may be appropriate include the following:

- Markets where there is little or no risk of significant and systematic disadvantage to consumers;

- Markets with a relatively small number of larger business participants who communicate with each other, have a cohesive sense of industry identity and public responsibility, and are willing to voluntarily engage in collective self-regulation and bear the costs of doing so;

- A high-level of consumer understanding of relative product prices and qualities, and a high-level of preparedness to switch, complain and obtain redress;

- Firms that are strongly reliant on consumer and public perceptions of their integrity and responsiveness to community concerns;

- Strong consumer awareness of self-regulation and a willingness to favour those firms who regulate their behaviour by such means;

- The existence of a credible threat of timely and effective state intervention should self-regulation fail or perform poorly;

- A willingness by firms to act 'benevolently' in their relations with other firms and with customers, rather than prioritise profit-maximisation at all times.[7]

Even in a context where such conditions can be proven to prevail, the potential for price-fixing and other forms of anti-competitive behaviour is considerable. While self-regulation is often presented in popular political discourse as a means of 'reducing red tape', many forms of effective self-regulation still require the state to actively monitor markets and firm behaviour, and have the capacity and resources to intervene when self-regulation breaks down. Without such capacity and resources, self-regulation risks becoming self-interested regulation.

[7] Ogus, A. et al (2006) *Best Practices for Consumer Policy: Report on the Effectiveness of Enforcement Regimes*, OECD, Paris.

While there may be particular markets where self-regulation is effective, such instances must be proven on a case by case basis. A generalised presumption for self-regulation as the basis for weakening our existing statutory framework is likely to make for poor public policy.

Problems of Privatisation & Outsourcing

The Review Panel has been asked to 'examine whether government business activities and services providers serve the public interest and promote competition and productivity, including consideration of separating government funding of services from service provision, privatisation, corporatisation, price regulation that improves price signals in non-competitive segments, and competitive neutrality policy.'

In its 2005 review of national competition policy the Productivity Commission noted continuing public concern that those responsible for implementing it often held a strong a priori preference for the privatisation and outsourcing of public services regardless of the potential negative impact on jobs, service quality and the long-terms costs for taxpayers. The Commission concluded that 'community acceptance' of competition reforms required that assessments of what was in the public interest should be conducted in a rigorous, rounded, transparent and evidence-based manner.[8]

Public scepticism about the purported benefits of privatisation and outsourcing was fuelled, in part, by the decision of previous Federal governments to use multiple private providers to supply employment services. Following optimistic promises by government ministers that unleashing market forces would generate a more productive, cost-efficient and responsive service for taxpayers and job seekers, the government was compelled to re-regulate sector when evidence of poor quality outcomes and fraudulent behaviour became commonplace. Eventually, millions of extra public money had to be found to help prop up a dysfunctional and poorly performing network.[9]

Public concern has been further encouraged by the privatisation of electricity in some states. Again, the early rhetoric utilised by some to sell privatisation to a wary public was often euphoric. Markets, enterprise and innovation would all combine to secure levels of efficiency, investment and cost-savings that only the private sector could deliver. However, the reality has been disappointing. Privatisation has seen prices rise significantly while levels of efficient investment, reliability and customer satisfaction have fallen. Resources have increasingly been diverted into management and marketing. Customer bills now include the cost of the near 10 per cent per annum that private owners pay on their electricity asset debt. Meanwhile, the government faces borrowing costs of around 3 per cent.[10]

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[8] Productivity Commission (2005) *Review of National Competition Policy Reforms*, Report No. 33, Canberra, p. 125.
[9] Whelan, J. (2012) *Big Society and Australia*, Centre for Policy Development, Sydney.
[10] Quiggin, J. (2014) *Electricity Privatisation in Australia: a record of failure*, Report for the Victorian Branch of the Electrical Trades Union.

We share the concern of many of those who provide and use public and community services that the continuing enthusiasm for privatisation and outsourcing among policymakers is misplaced. It is often rooted in the view that private firms, because of their profit-maximising orientation, are superior to public institutions that do not organise their operations around competitive criteria. The relentless pressure to compete for customers, revenues and profits, it is argued, makes such firms highly efficient, innovative and responsive to customer demands.

However, this ideal of model of profit-maximising behaviour abstracts from the real dynamics of how such firms often behave when performing work for government.

Privatisation and outsourcing has been applied extensively across the UK public sector since 1980. It has also been subject to repeated examination by academics, research organisations and think-tanks concerned with evaluating the extent to which private firms and market processes have provided value for money for taxpayers over the long-term and increased the quality of services delivered to core government departments and service-users.

Reviewing this extensive body of evidence and historical experience, a report by the non-partisan *Institute for Government* in 2013 offered the following conclusion:

> 'In truth, the evidence on whether a more diverse and competitive landscape of public service provision has improved standards is extremely limited…It is clear, however, that the shift to competitive public service provision has not been a panacea for public service performance and productivity.'[11]

The UK experience is important because over the course of three decades it has allowed researchers to develop a detailed understanding of why the underlying rationale for privatisation and outsourcing is flawed, often resulting in perverse and unintended outcomes.[12] In particular, they have been able to identify the obstacles that mean the efficiencies and cost-savings policymakers assume will flow from having services provided by profit-maximising firms are often not realised in practice. Three obstacles are worth noting:

a) Vendor Dependency

'Vendor dependency' arises when the bargaining power in a principle-agent relationship shifts significantly toward the agent. This can be for a number of reasons. Over time, as the contract matures, it is common for the principle (e.g. the government department) to lose the internal skills and knowledge it needs to effectively monitor, check and evaluate the activities of the agent (e.g. the contracted service provider). This can make it difficult

[11] Gash, T. et al (2013) *Making Public Service Markets Work*, Institute for Government, London, p. 11.
[12] For example see: National Audit Office (2013) *The Role of Major Contractors in the Delivery of Public Services*, The Stationery Office; Pollock, A. (1995) *NHS Plc: The Privatisation of our Health Care*, Verso, London; Williams, K. et al (2013) *The Great Train Robbery: the economic and political consequences of rail privatisation*, CRESC, Manchester University.

for the principle to challenge the alleged necessity of cost increases or other changes to the original contract terms.

Vendor dependency is not a natural or accidental by-product of privatisation and outsourcing; it is actively cultivated by vendors. It has become common to under-price bids for government tenders, on the basis that once they are won and the government department becomes reliant on the service provider, costs can be significantly increased at a later date. In the words of one public sector contract manager in their evidence to the *Institute for Government* research:

'After two years of contracts, the costs go ballistic.'[13]

In theory, the principle can insist on the original agreed terms and prices. In practice, 'closed book' contracts make it difficult to question claimed changes to cost structures, and government managers are often wary of incurring the additional expenses and risks to services and reputation that can accompany the early unilateral termination of contracts. In reality, many UK government departments, when faced with escalating costs and poor performance, persevere with established service providers, partly because they have become reliant on the knowledge and goodwill of their agents and do not believe changing providers is a practical or cost-effective option.

b) Provider Concentration

Related to vendor dependency is the tendency toward the concentration of service provision: the temporal reduction in the numbers of firms able and willing to participate in markets for particular government contracts.

This concentration has become a matter of considerable public controversy in the UK. Despite widespread expectations among policymakers and economists that privatisation and outsourcing would result in government simultaneously promoting and benefiting from competition the reality has been the emergence of oligopolistic markets dominated by a small number of very large and powerful providers. In the UK the markets for a wide range of 'back office' and 'frontline' services, such as IT, bulk processing, prison management and nuclear weapon supervision, has become dominated by just four multinational corporations: Atos, Capita, G4S and Serco.

A recent assessment of the power of these corporations by the UK National Audit Office (NAO) found that many within government who had come to rely on their knowledge and scale now regarded these major providers as 'too big to fail'.[14] These companies have become so central to the provision of a vast array of services that government now has an interest in ensuring their viability and profitability as providers, substantially

[13] Gash, T. et al (2013) p. 13.
[14] National Audit Office (2013) *The Role of Major Contractors in the Delivery of Public Services*, The Stationery Office, London, p. 10.

weakening the bargaining power of public sector contract managers and effectively ensuring the continuous renewal of major contracts.

In short, the markets in which these companies operate have become characterised by 'high barriers to exit'.

Furthermore, the NAO found that it was impossible for contract managers, and MPs, to judge if these companies were receiving a reasonable return for their work because they refuse to supply the information on unit-costs and profitability needed to reach informed conclusions. There was a pervasive lack of transparency which made it impossible for contract managers to negotiate and manage contracts in the interests of taxpayers and service users.[15]

But the emergence of oligopolistic markets and 'too big to fail' service providers is not the contingent outcome of circumstances particular to the UK. It is the logical result of contracting to profit-maximising companies. On the government side, a key driver of contracting is to secure lower immediate costs. This generates strong preferences for large contractors who can offer significant economies of scale. On the provider side, all profit-maximising corporations routinely implement product, pricing and acquisition strategies with the intent of reducing or eliminating competition. Such trends are common for all major private providers of public services, reducing competition for contracts while enhancing their status as being 'too big to fail'.

In sum, over time the combination of preferences for scale and the strategic elimination of competitors in the context of high barriers to exit will tend to generate oligopoly structures that strongly favour a small number of large corporate suppliers to the detriment of the public interest.

c) Gaming

Gaming involves activities by corporate suppliers designed to increase revenues above those formally agreed or intended by the contracting party. This can take place in the context of agreeing and executing the contract, or in the context of delivering end-services to particular client groups.

In relation to the contract, one aspect of gaming has already been identified: the deliberate under-pricing of tender bids in the expectation of charging excess costs at a later date. Other aspects of 'contract gaming' involve using contract opacity and complexity to disguise additional costs and charges that will only become apparent once the contract is fully operational. Another is relying on changes in government policies, and the resulting need to vary contract terms, to charge high variation fees well in excess of the real cost of implementing such variations.

[15] National Audit Office (2013), p. 15.

In sum, experienced corporate contract negotiators rely on the relative inexperience of public sector managers to insert loopholes and ambiguities in contract provisions that will significantly increase profitability once a degree of vendor dependency has been established.

But the most well-known form of gaming in recent years has taken place in the context of delivering services to particular client groups such as job seekers. In this context a set of fees will be established that the service provider can legitimately charge to the government for performing particular types of work, such as helping the long-term unemployed to find work.

In theory, a large number of diverse, innovative and flexible service providers, more attuned than public sector bureaucracies to local conditions and needs, will be better able to help those in need of support. In practice, economies of scale mitigate against diversity in supply, with smaller providers tending to lose contract tenders. Commercial providers tend to prioritise revenues over outcomes, gaming the system of fees and incentives in ways that maximise profit.

The predictable result is what has become known in the corporate welfare business as ‘creaming and parking’: creaming the easy to serve in large numbers (such as those who have only recently lost their job and live in soft urban labour markets), while parking those with complex and resource-intensive needs (such as the long-term unemployed with few qualifications who live outside the large urban centres). Those in most need of assistance become those least likely to receive it.

When fee and incentive structures are changed to better align policy intent with outcomes, strong incentives are then created to game the system in other ways, such as falsifying claims, overcharging and misreporting costs. A contracted employment advisor gave the following evidence to *The Institute for Government*:

‘If providers cannot make money by doing the thing you expect them to do, then they will make money by doing the things you don’t want them to do.’[16]

Beyond Outsourcing

For much of the past three decades it has been the shared common sense of business that outsourcing offers the prospect of lower costs, flexibility and better quality. Those who know most about a particular business function, such as IT, are best placed to supply it in a low cost and innovative manner. This ‘common sense’ has then been used by policymakers to justify extensive privatisation and outsourcing across the UK public sector since the early 1980s. A similar logic has been evident within some parts of Australian government since the early 1990s.

[16] Gash, T. et al (2013) p. 50.

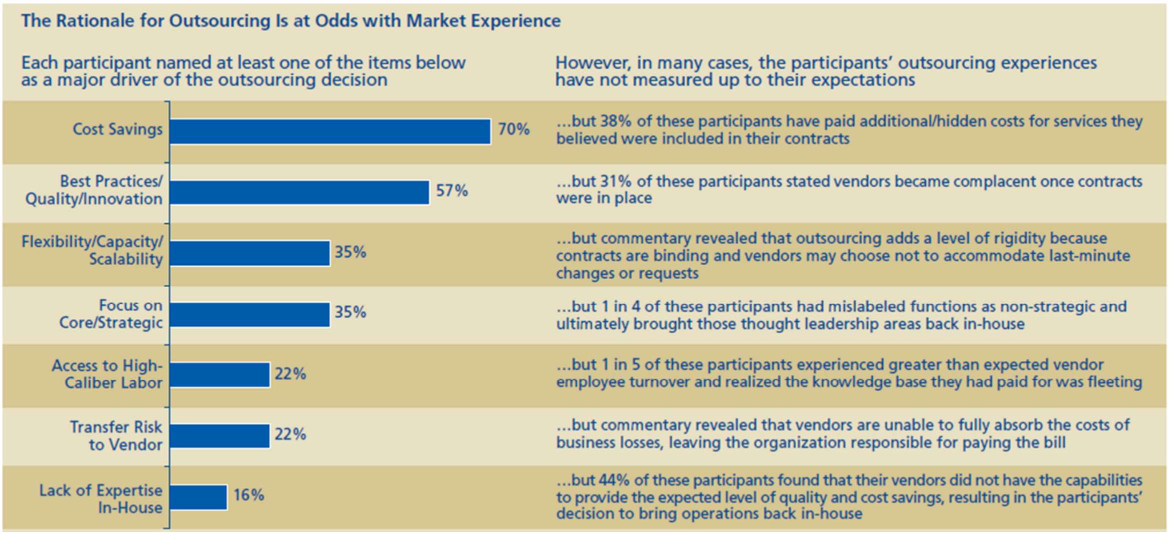
However, in recent years there has been a growing recognition among private sector companies that outsourcing is not the panacea it was once thought to be. This has provoked a radical re-thinking within many corporations. A similar re-thinking is now overdue within government.

Deloitte, a company at the forefront of advocating various forms of outsourcing, has conducted research into the real experiences of those corporations who have adopted the outsourcing business model. Figure 1 below summarises some of their key findings. The body of their report includes the following observations:

a) In many cases outsourcing simply fails to deliver. Deloitte concludes:

> '...contrary to the optimistic portrayal of outsourcing by vendors and the marketplace, outsourcing is an extraordinarily complex process and the anticipated benefits often fail to materialise...The world's largest organisations in this study are calling into question its efficacy in today's economy.'[17]

Figure 1: Outsourcing – expectations versus experience



Source: Deloitte

b) Many corporations report similar problems: loss of power, skills and control to the vendor; unexpected costs and charges after contracts have been finalised; significant cost inflation if standardised processes are tailored to particular business needs; operational rigidity imposed by long service contracts; further sub-contracting by vendors that undermines service quality; lack of cost and performance transparency making the benefits of outsourcing difficult to quantify and the contracts difficult to manage; vendors become complacent about quality and targets once a contract is in place.

[17] Deloitte (2005) *Calling a Change in the Outsourcing Market: the realities for the world's largest organisations*, Deloitte Consulting LLP, New York, p. 2.

c) Some corporations have found themselves 'trapped' in outsourcing relationships with vendors who underperform and charge more than expected, partly because the costs and risks involved in switching suppliers are regarded as being too great.

d) As a result of these problems two thirds of the large corporations that took part in the Deloitte survey decided to bring outsourced functions back in-house.

A subsequent research report by Deloitte confirmed this trend toward 'insourcing', particularly in the field of IT services.[18] The key drivers that were leading a growing number of corporations to insource their IT included:

a) Cost reduction. Because of unexpected costs and charges, and the additional expenditures generated by dealing with poor quality performance, 77 per cent of survey respondents stated it was cheaper to bring their IT back in-house.

b) Improve customer service. Voice-based functions, such as customer-facing call centres, had been widely outsourced over the past 20 years. However, service quality declined generating a loss of custom. For some corporations having a high quality in-house call centre function was viewed as a valuable means of cultivating customer loyalty.

c) Improve controls. Loss of control over key business processes was found to have undermined the operational and strategic capacities of companies. They became increasingly uncomfortable that important and commercially sensitive aspects of work were subject to rigid contractual relationships over which they have little direct control.

In conclusion, the ACTU does not agree that private firms can be assumed to be more efficient and effective providers of public services. The barriers to them being so are not merely contingent - the product of particular failures of judgement, regulation and contract negotiation. They flow from the nature of how profit-maximising firms behave as they exploit asymmetries in information, knowledge and market power to enhance their revenues at the expense of the taxpayer and the service-user.

We hope the Review Panel will engage with these issues prior to making recommendations to government in this area.

[18] Deloitte (2013) *From Bangalore to Boston: the trend of bringing IT back in-house*, Deloitte Consulting LLP, New York.

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