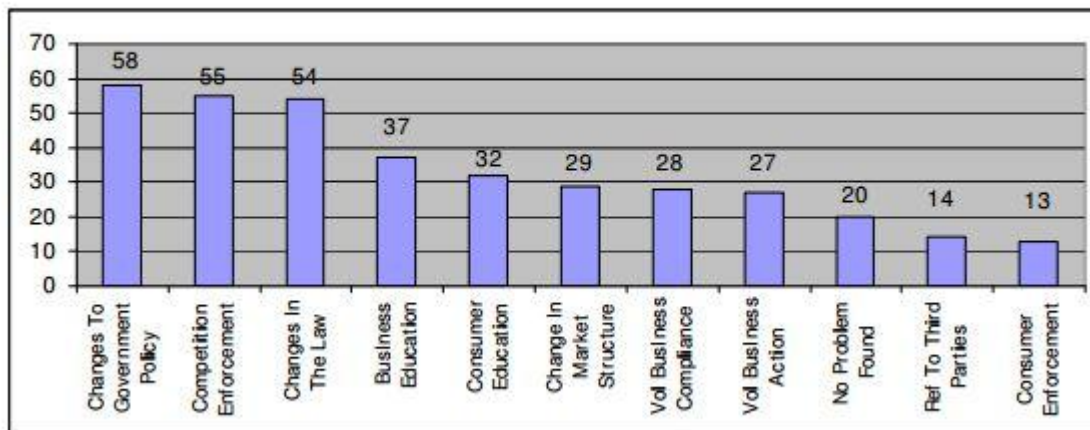


Submission on the 2nd interim report , 'Boosting productivity in the services sector'

- 1) Thank you for the opportunity to make a further submission on your report. I would like to concentrate of the issue of market studies and to respond to your questions 4.1 and 4.2.
- 2) Since originally submitting on this issue I have read the article you cited (Indig, T., & Gal, M. (2013), "New powers – new vulnerabilities? A critical analysis of market inquiries performed by competition authorities") which I take as the most up-to-date appraisal of the potential downsides of market studies, and I have read the ICN (International Competition Network) Advocacy Working Group (2009) Market studies project report, which you also cited, which is a reasonably up to date summary of who conducts market studies and why, what they cover, and their degree of impact.
- 3) In my original submission (Submission 108) I advocated that the Commerce Commission should have the formal power to carry out market studies. In the light of the material I have read since, and on further thought, I remain of that view.
- 4) Going by all the evidence, market studies are now conducted by a large, and growing, number of developed economies. While widespread adoption of a policy or practice is no guarantee of its worth (agricultural protectionism, for instance, is an example where it isn't), it is remarkable that New Zealand, which has a long history of early adoption of progressive social and economic ideas under governments of all persuasions, has not yet reached for a tool designed to improve the operation of markets, for the benefit of consumers (including businesses who are customers of other businesses). It is little exaggeration to say that New Zealand's current position is now outright anomalous from the standpoint of modern, informed, competition policy. Best practice has evolved since the Commerce Act was passed in 1986, but in this important area we have not evolved with it.
- 5) In this regard I would point out the real and beneficial impacts that market studies have had, as shown in the graph below (from the ICN report). As the ICN report also states, some market

studies have not had the desired impact (principally because of governments' failure to follow up on the studies' recommendations) but this is nonetheless a sizeable impact, on any definition, from what would in New Zealand be quite a small and inexpensive institutional change.

Chart [11.6]: Outcomes of studies



- 6) While much of the benefit of market studies tends to lie in the detection and resolution of problems with effective competition, I was also struck by the comment (p10) of Indig and Gal, that "MIs [Market Inquiries] performed by the CA [Competition Authority] can also help refute mistaken public assumptions that anticompetitive behavior takes place, most notably in cases of price increases. Thus, MIs can prevent mistaken and costly regulatory interventions or public outcries. The UK Agency's power to give an industry a "clear bill of health" serves this end" (their emphasis). Attributing high domestic prices to local profiteering, when the true situation may simply be high world commodity prices, could readily but mistakenly lead to calls for domestic price controls.
- 7) A good example of how these pressures can arise in the New Zealand context was the Commerce Commission's inquiry into milk prices in 2011 (media release at <http://www.comcom.govt.nz/the-commission/media-centre/media-releases/detail/2011/price-control-inquiry-into-milk-not-warranted>). This was carried out under the Commission's powers to determine whether Part 4 of the Commerce Act (essentially, price control) should be applied.

But as you rightly note in the interim report (p80) the criteria for Part 4 market studies “are considerably narrower than the criteria typically applied in other countries”, and the Commission itself said that ““The threshold for undertaking a Part 4 inquiry is high”. It is unlikely that Part 4 studies will be routinely available to deal with the real risks of “mistaken public assumptions” and “mistaken and costly regulatory interventions” that Indig and Gal mention. A general power to conduct what might be termed prophylactic market studies would be a much better approach.

- 8) A general power would also obviate the need for other “workarounds” that the Commerce Commission has occasionally used to produce what is, in substance if not formally, a market study. I would note, for example, the Commission’s 2010 research into awareness of the Commerce Act in the construction sector (press release at <http://www.comcom.govt.nz/the-commission/media-centre/media-releases/detail/2010/commerce-commission-focuses-on-construction-sector>, full report published in 2011 at <http://www.comcom.govt.nz/business-competition/anti-competitive-practices/construction-sector/construction-sector-research-key-findings/>). This research found, for example, evidence of a questionable practice in the sector called “cover pricing” (“collaboration between tenderers to invent a believable but not genuine bid for a job. This 'cover price' is higher than the genuine bid, and is not intended to win the tender, but is meant to look like a legitimate bid”). This is exactly the sort of competition problem market studies are often designed to reveal. It would be better, on general principles of good institutional design, if the Commission were able to make a straightforward use of its agency powers to carry out useful work like this.
- 9) Indig and Gal’s critiques can be summarised, in their words (p17), as follows: “MIs performed by CAs may create significant benefits. Although they create both direct and indirect costs, such costs can largely be reduced by acknowledging them and structuring the MI accordingly”. I agree. I would urge in particular that there should be rigorous post-study reviews of the process, findings, and outcomes. I note that the Commission already has a process in place for

retrospective review of some of its merger decisions, and a similar process for evaluating its market studies would fit comfortably with how it operates more generally. Finally, for the avoidance of doubt (as the lawyers say), where Indig and Gal classify competition authorities into “Advisory” and “Supervisory” models, where (broadly) “advisors” report their findings for other central agencies to act on and “supervisors” have the power to act on their own findings, I would recommend the “advisory” approach for acting on the findings of market studies.

10) In response to your specific questions:

Q4.1:

Yes, there is a very strong (I would say almost unarguable) case for ongoing research or investigation into the state of competition in New Zealand markets. It is the default arrangement in the OECD.

Option 1 would be the simplest and most effective option: it is routine overseas for this function to be located in the competition agency, and our Commission has the largest and deepest domestic pool of expertise in the area (acknowledging the knowledge also available at the Productivity Commission, MBIE, Treasury, and bodies like the Electricity Authority).

Option 2 is not attractive. For the reasons noted earlier, the occasional studies conducted to date have severe limitations of scope.

Option 3 has merit in its own right, irrespective of the issue of market studies.

Option 4 looks like an unnecessarily complex arrangement (and given the small amount of funding likely to be at stake, likely to be administratively expensive to allocate). An alternative option, to gain the benefit of expertise or viewpoints outside the Commission, might be to make more use of the appointment of Associate Commissioners (s11 of the Commerce Act). Associates are “appointed only in relation to a matter or a class of matters to be specified in that member's notice of appointment,

and for such period, not exceeding 5 years, as is specified in that notice”, which is a flexible provision that could accommodate study-specific appointments of third parties to the Commission.

Q4.2:

1st point: yes, the Commission should have formal powers to compel the supply of information for market studies. Indeed it is hard to see how more egregious anti-competitive behaviours (which are likely almost by definition to be covert or tacit) would be uncovered otherwise.

2nd point: this is not an ‘either/or’ question. Indeed it would be best if the Commission could initiate studies on its own initiative *and* if the government could also require the Commission to undertake them. Government initiation would, for example, reduce the risk of regulatory capture of the Commission, as well as provide a different societal prioritisation to the Commission .

3rd point: yes, as a matter of good policy and governance design, government should be required to respond within some fixed timeframe.

4th point: it is not necessary to be prescriptive on other design features at this point. The Commission has well-established procedures for dealing with the sorts of issues that are also likely to arise with market studies (commercial confidentiality, for example) and a consultative process which includes publishing draft decisions, the opportunity to submit on the draft and to make cross-submissions, a public conference process which affords the opportunity for interested parties to appear with their advisers, and final reports which are potentially subject to judicial review. It is likely that its existing processes can comfortably accommodate market studies.

Donal Curtin

Economics New Zealand