BULOKE SHIRE COUNCIL
Big Sky Country

Our Ref: FM/14/03

4th November 1998

Submission
Impact of Competition Policy Reforms Inquiry
Productivity Commission
P O Box 80
BELCONNEN ACT 2616

Dear Commissioner Cosgrove,

I am pleased to provide a submission, on behalf of Buloke Shire Council, to your Inquiry.

Buloke Shire occupies approximately 8,000 square kilometres in the North West of Victoria. It has a population of approximately 7,900 citizens.

This population is employed within the agriculture and associated sectors. This Agriculture Industry provides $200M worth of production annually which amounts to more than $25,000 of annual production for every man, woman and child in this municipality.

That production earns export dollars for Australia and also contributes to the quality of life within Australia.

Council respectfully submits that the Buloke community provides a significant contribution to this country.

Yours faithfully,

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CHIEF EXECUTIVE OFFICER.

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IMPACT OF COMPETITION POLICY REFORMS INQUIRY

Buloke Shire Council Submission

Section A of this submission will provide an analysis of the level of competitiveness in the general economy.

Section B of this submission will analyse the impact of competition policy reforms on the structure and competitiveness of the following major industries from a rural perspective:

- **Banking**
- **Grain Handling**

SECTION A

Analysis of a Competitive Environment

If the objective of competition is to maximise the efficiency of resource usage, then our society should benefit from the application of competition in all pursuits.

An Economist would agree that a supplier of goods or services to a market is a "perfect competitor" if that supplier has no control over the market price. A "perfect market" would mean that all production would be sold at the prevailing market price but if a supplier sought a higher price, then none of that production would be sold. It also means that the supplier to the market cannot affect the market price by either withholding or increasing production.

This notion of pure competition may also be described as "atomistic" competition to convey the notion that numerous small firms combine like a multitude of atoms to make up the industry producing the product.

However, the real world is mostly classified as imperfect competition being neither perfectly competitive nor perfectly "monopolistic".

IMPERFECT COMPETITION:

The extreme example of this is a monopoly (one seller) operating within a market where there is no close substitute for the product.

Geographic location may also provide a seller with a measure of monopoly power. However, if the price becomes too high, the firm will lose custom to more distant competitors.

To a lesser extent, and more common in practice, oligopolies (few sellers) operate.

Oligopolies fall into two categories:

1. Few sellers producing an almost identical product;
2. Few sellers producing differentiated (rather than identical) products.

In the first category, while each producer may not be a monopoly, each producer may have an appreciable effect on the market price. This is usually true where a number of basic industries produce a fairly homogenous product and the size of the enterprise is large eg. oil or gas supply.

The second category is exemplified within the Automotive Industry where a few large firms dominate the industry but they produce somewhat differentiated products.
Further, less imperfect competition occurs where many sellers produce differentiated products. These differentiated products are those which differ somewhat in real or perceived qualities. Advertising, brand names, trademarks and patents may explain the product differentiation.

Throughout these examples of “market imperfections” the potential monopoly profit is not the greatest evil. The evil exists in the tendency to set the price too high. It is the price setting that delivers the inefficiency in resource allocation.

Measures to Minimise Monopoly Power.

The traditional measures used to limit this monopoly price fixing are:

1. Barriers of entry to the market are minimised;
2. Legislation to deter collusive dealing;
3. Mergers which have an objective of monopoly control over price are prevented.

NATURAL MONOPOLIES;

It would seem inefficient to provide two or more roads, railways, water services, power connections to the one consumer.

Traditionally these utilities have been regulated by the State to protect the consumer by setting maximum charge rates for the service provided. This is normally done by a price regulating commission. In setting these prices, it has been customary to pick a price that gives a fair return on capital. However this gives rise to the complex question of determining the capital-value base of the company to which the “fair rate” is applied.

It also provides no incentive for the company to pursue efficiencies and be cost-conscious.

SECTION B:

Having established the basic principles at work in the market, we will now address the impacts of the introduction of competition and competitive policy within the rural environment of the Buloke Shire on the issues of Banking and Grain Handling.

Banking

STRUCTURE:

The current trend within rural banking is directed by an emphasis upon rationalisation of existing branches. This is accompanied by a withdrawal of the human service element and relies upon technology to fill the void. While this strategy is effective in reducing the cost of operation and thereby maximising returns to shareholders, it is based upon the assumption that all banking services to rural areas are available through telecommunications infrastructure. This is not so. Not all telecommunication lines within Buloke Shire are ISDN capable. Further, Buloke Shire boasts only one Automatic Teller Machine within 8,000 square kilometres.

COMPETITIVENESS:

The current philosophy of bank branch closures is reducing competition and consumer choice and further encourages monopoly. This monopoly is reinforced by a lack of public transport available to an ageing population. Agency arrangements have not, to date, supplied the range of banking services required.

REGULATION:

The deregulation of the Banking Industry, a decade ago, did not result in an increase in customer choice of banking service providers in this area.

It did, however, cause the resident banks to modify their previously conservative attitude toward lending. No doubt this change in philosophy was driven within the metropolitan banking sector in which the new players had concentrated. The effect of this change within the rural areas caused the resident banks to offer novel financing arrangements including foreign currency loans. The impact of these loans was disastrous. Some customers did not understand the implications of such arrangements. The simple lesson from these events is that any change must be managed and must involve some degree of community education.

FURTHER DEREGULATION:

It has been suggested that further deregulation of the banking industry should allow access to such organisations as American Express. As companies such as these successfully operate without any branches, the market would place pressure on the traditional banks to further reduce the number of branches. Agencies do not provide the answer and may be cynically viewed as a "phased in" total withdrawal of service. In these circumstances the future of rural banking services seems bleak.

COMMENT:

Banking in rural areas enjoys a natural monopoly created by geographical location. Satisfactory alternatives are not available due to the inadequacy of telecommunications infrastructure. New entrants to the market have usually chosen areas where the traditional banks have completely withdrawn. Those entrants may be tempted to seek the monopoly profit.

The positive actions available to Government would suggest that the telecommunications infrastructure should be upgraded and also that new entrants be encouraged.

The upgrade of infrastructure would ensure consumer choice in most services.

Non traditional service providers, which will always require a presence in the area, may seek to enter the market. Buloke Shire Council is one such organisation and would be pleased to further investigate this possibility.

Grain Handling

STRUCTURE:

The deregulation of the Grain Handling Industry is likely to result in the closure of smaller receival centres. These smaller centres will be seen as less profitable because they will not meet the target return on assets as set by the major grain handler. This does not mean that they return a loss. It means that wherever the benchmark return is set, failure to meet that mark will be used as the excuse to close the facility.

This will allow the major grain handler to shift the cost of additional transport to the larger facility, back to the producer. It will also cause more grain to be shifted by road to the larger facility and avoid the most efficient means of transport, the existing railway infrastructure. This would be a classic example by the grain handler of "skimming the cream" i.e. providing service to only the most lucrative area and, at the same time, shifting transport costs to growers and more subtly; redirecting the infrastructure costs from a rail system capable of handling the traffic, to a road system that was not designed to bear such freight.

COMPETITIVENESS:

Increased competition has encouraged private grain traders into the market. However these grain traders, in practice, deal with selected customers only. Wheat is sold to export markets through a single desk. In effect, the domestic wheat market is the only one that allows competition within wholesale and retail.

REGULATION:

Deregulation of the Grain Industry has provided some benefits to the consumer. However, it has also provided the opportunity for certain sectors with complimentary objectives eg. storage and transport, to integrate.

These mergers are currently being discussed with a view to gain productive efficiencies.

However it could be equally be argued that the real objective is monopoly control over market price.

COMMENT:

This industry exhibits the hallmarks of a natural monopoly due to the requirement for large storage sites at specific geographic locations. Interstate "rivalry" between bulk grain handlers, at best, will produce oligopoly sellers of an identical product. In Victoria, prices for consumers are fixed at a maximum by the Regulator General. This does not promote efficiency within the industry.

The positive action for government in this area is to prevent mergers aimed at monopoly control over price and to deter collusive dealing.

Prevention of a merger between transport and storage would enable the transport system to service the smaller (less attractive) storage sites. This would enable those sites to be operated by new entrants and these new entrants would enable some degree of price competition for the bulk handler.

Issue

These two examples are chosen to illustrate the responses available to two industries operating within a rural environment. These responses are only available due to a degree of market power and a spread of risk over a wide geographical area.

Neither of these responses is available to the primary producers of Buloke.

These producers cannot affect the market price of their product. They are closer to the "perfect competitor" than any other example in this submission.

Nor can they spread their risk as outlined above.

However they accept these conditions and continue to produce.

The grain example shows that some industries connected with rural activities may potentially affect the market price. This is also true of many of the inputs required by primary producers. Therefore primary producers could suggest that the emphasis on competition be focussed toward the inputs required specifically by primary production.

Conclusion:

The social impacts of National Competition Policy reform within government organisations will no doubt be advanced in detail within other submissions. All of the areas referred to within the terms of reference relate to services which have an element of natural monopoly in rural areas. Increased competition within these services should, given previous experience, concentrate within the larger markets. The government agency will be required to respond to this competitive pressure and, most probably, reduce service in the more marginal operations being mainly rural areas.

Therefore the question to this Inquiry becomes:

If new entrants to the market cannot be encouraged to the rural areas, to what extent will the government support those existing services given the economic significance of the Buloke region?