TRADE PRACTICES LAW: A BARRIER TO GROWTH ?

John M. Legge

Few people would argue against the proposition that economic prosperity is fostered by competition, although there are startling disagreements between different authors as to exactly what the term "competition" means. There is not even any agreement about the semantics: is competition a state, as described in elementary economics textbooks? Or is it an activity, its normal colloquial meaning, and the sense adopted by most management and marketing writers? If it is an activity, do competitors confront each other, as in a boxing match, or strive to reach a goal without interacting, as in athletics? Is it an individual contest, like the 100 metres? Or is it a team sport like football? If it is like football, what are the rules about tackling, shepherding or blocking, and offside? Equally to the point, if competition leads to prosperity, how?

A knowledge of the mechanism by which prosperity is enhanced, and the related competitive processes, will enable the most appropriate sets of laws to be drawn up, laws which will permit and even encourage behaviour which enhances prosperity and which will prohibit or discourage behaviour that detracts from it. Australia has an extensive set of laws governing commercial behaviour, of which the *Trade Practices Act* is only one. The *Trade Practices Act* is, however, by far the most intrusive in the matter of competition, proscribing certain forms of behaviour without requiring any demonstration that the behaviour concerned has caused harm to any person. Some forms of activity, such as misleading advertising, are unconditionally proscribed under the *Trade Practices Act*; others, such as joint ventures, may be permitted to continue on the grounds of overall public benefit if the Trade Practices Commission grants an "authorisation". Collinge and Clarke (1989: 52) provide an illustrative list of examples of authorisations that have been granted and of authorisations that have been refused. ICI Australia was, for example, permitted to acquire United Packages on the grounds that the rationalisation of production would save energy and reduce pollution; but the Real Estate Institute of NSW was not permitted to promulgate a set of standard charges and contracts in order to eliminate over-charging and other potential abuses.

The *Trade Practices Act* is administered by the Trade Practices Commission (now the Australian Competition and Consumer Commission) and the Commission's rulings on authorisation matters can be appealed to the Trade Practices Tribunal. (Appeals on matters of law are heard in the Federal Court (Collinge & Clarke 1989: 40).) The Tribunal, in one of its early decisions, set out a philosophical basis for the *Trade Practices Act* and its interpretation of it:

> Competition may be valued for many reasons as serving economic, social and political goals. But in identifying the existence of competition in particular industries or markets, we must focus on its economic role as a device for controlling the disposition of society's resources...
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> ... we think of competition as a mechanism for discovery of market information and for enforcement of business decisions in the light of this information. It is a mechanism, first, for firms discovering the kinds of goods and services that the community wants and the manner in which these may be supplied in the cheapest possible way. Practices and profits are the forces that register the play of these forces of demand and supply...
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> This does not mean that we view competition as a series of passive, mechanical responses to 'impersonal market forces'. There is, of course, a creative role for firms...
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> ... Or again, as is often said in US antitrust cases, the antithesis of competition is undue market power, in the sense of the power to raise price and exclude entry. That power may or may not be exercised. Rather, where there is sufficient market power the

> firm (or group of firms acting in concert) is sufficiently free from market pressures to 'administer' its own production and selling policies at its discretion...
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> Competition expresses itself as rivalrous market behaviour. In the course of these proceedings, two rather different emphases were placed on the most useful form such rivalry can take. On the one hand it was said that price competition is the most valuable and useful form of competition. On the other it was said that if there is rivalry in other dimensions of business conduct—in service, in technology, in quality and consistency of product—an absence of price competition need not be of great concern.
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> In our view effective competition requires that prices should be flexible, reflecting the forces of demand and supply, and there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers.
> (Trade Practices Tribunal 1976: 187)

The Tribunal seems to have placed a quinella bet on a two horse race in this judgement: competition is not driven by "impersonal market forces" but it doesn't exist if any firm can "administer its own production and selling policies". Competition, to satisfy the Tribunal, must be simultaneously "perfect", "reflecting the forces of demand and supply", and monopolistic[1], with "independent rivalry in all dimensions". The market provides an incentive to firms to discover newer and cheaper ways to address consumer needs, but having discovered such needs or means of satisfying them, a firm is not to be permitted to profit from using its discovery.

This judgement shows a strong element of Neoclassical General Equilibrium, in the initial emphasis on the allocation of society's resources, blended with the "discovery" paradigm of the Austrian/Chicago school. The Neoclassical model assumes that the

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1 Pure price competition implies homogenous products such that no consumer would prefer one over another except by reason of price. When competition extends into multiple dimensions different suppliers may emphasise different combinations of properties; price is no longer the sole discriminating factor and the resulting competition is "monopolistic".

economy is in a nearly perfect state where all resources would be put to their best possible use, and only "frictions" such as trade unions are stopping it going all the way. The Austrian/Chicago Discovery model (Kirzner 1982) assumes that the economy is far from equilibrium, with many resources inefficiently allocated, and entrepreneurs, by profiting from these mis-allocations, draw attention to them and lead to their gradual elimination.

Progress, if any, under these scenarios must come from improved efficiency, since neither the Neoclassical or Austrian schools concern themselves with the creation of new resources. The defects in such purely allocative analyses are glaring.[2] Mainstream economists have tended to ignore such paradoxes, and it is necessary to visit the outer reaches of the discipline to find serious attempts to explain growth.

Schumpeter and Economic Growth

Schumpeter interpreted capitalist competition in terms of innovation, the creation of new resources, rather than as a means for improving the allocation of a fixed resource set among competing demands. Schumpeter pointed out that the incentive that induces firms to invest in innovations is the prospect of above-average profits, profits that, according to conventional competition theory, can only arise by setting prices and restricting output. Schumpeter noted the correlation between the growth of large firms in the late nineteenth and early twentieth centuries and the simultaneous jump in average growth rates. This led him to suggest that large companies promoted economic growth through innovation, that, at least under some circumstances, monopoly produced better results than competition.

Schumpeter's favourite example was the railroad. Stagecoaches could carry up to twelve people at an average speed of about 15 Km/h. The per-passenger costs of operating a stagecoach were high and the fares

2 Grossman and Helpman (1992) show that the neoclassical model cannot explain sustained growth in *per capita* incomes, an obvious economic phenomenon that cannot be explained by orthodox economic theory.

were, in consequence, beyond the reach of most of the population. Competition prevailed on stagecoach routes, however: the capital required was modest and there were few other barriers to entry. By contrast the railroad, within a few years of its first appearance, could carry one hundred people at nearly 50 Km/h. The per-passenger variable cost of rail transport was negligible by contrast with the stagecoach, but the capital cost was huge. The railway companies had to reach out to the mass market in order to keep their expensive capital employed, and so set fares at a small fraction of the stagecoach rate. On most routes the capital costs and the legal difficulties of securing a right of way, to say nothing of the suicidal commercial implications of splitting the available traffic, excluded competitors. A monopoly replaced competition, and yet welfare was clearly and dramatically increased.

Schumpeter knew that Marshall shared his reservations about Walras's General Equilibrium Theory, and criticised him for not applying his mathematical skills to the study of innovation. The first formal account of innovation in a General Equilibrium framework was left to Grossman and Helpman in the late 1980s. Grossman and Helpman (1992) provided a demonstration that long run growth in *per capita* incomes could only be demonstrated in markets that were both vertically and horizontally differentiated.[3] Beath and Katsoulacos (1991) cite a separate proof that there are multiple equilibria in any market in which both horizontal and vertical differentiation are present. Taken together these results demonstrate that conventional economic theory does not describe an economy capable of supporting long-run increases in welfare. While many writers have produced biting criticisms of the unreality of the assumptions underlying conventional economics, this is a fatal internal flaw and cannot be assumed away. The economic emperor is not merely naked: his digestive tract is a closed system.

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3 Products are horizontally differentiated when different purchasers would rationally choose different although substitutable products: one person might choose red wine, another white, a third designer water. Products are vertically differentiated when practically all purchasers would choose one of a set of products if they were all offered at the same price: most red wine drinkers would prefer Grange Hermitage to cask red if price was no object.

Jennings and Munn (1994) found evidence that large firms are, as Schumpeter had suggested, responsible for a disproportionate number of innovations. Jennings and Munn suggest that this is because larger firms can both afford the cost of a new product infrastructure and because they are less vulnerable to the failure of a single initiative. This result confirms both Schumpeter's hypothesis and Marx's earlier assertions: capitalist progress is associated with the growth of large firms far more than with the predominance of price competition *per se*. Jennings and Munn cite substantial prior work which tends to contradict their findings, and explain the difference by their more general (and Schumpeterian) definition of innovation and the clear distinction they make between invention (having a good idea) and innovation (turning a good idea into a successful enterprise).

A central dogma of conventional economics is that of the unique equilibrium; that the long-run state of an economy reflects its resource endowment but not its history. Economic models in which history, and people, matter are referred to as "path dependent" and excluded from consideration by orthodox economists. Path dependence is, however, ubiquitous in the real economy. The "experience curve"[4] has been a commonplace of management writing since it was popularised by Henderson in the 1970s (Rothschild 1992); the "first mover" in a new industry acquires a quasi-permanent cost advantage, freezing history into industry development. The work of Arthur (1983) and others also demonstrates the ubiquity of path-dependent development. Adam Smith clearly recognised the importance of experience effects in producing the benefits of the division of labour as reflected in his discussion of the Scottish nailers. Recent work on complex self-organising systems (e.g. Kauffman (1993, 1995)) provides a mathematically consistent model of path-dependent evolutionary processes, and one in which Henderson's and Arthur's result emerge.

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4 Henderson's hypothesis is that the value-adding costs of carrying out an activity decline by a constant fraction with each doubling of cumulative experience. The empirical evidence for this hypothesis is overwhelming, covering up to five orders of magnitude of production history. Experience effects have been demonstrated in over 100 industries; even more significantly, no counter-examples have been proved.

Competition and Welfare

Economic welfare, narrowly defined, is measured by the level of consumption *per capita* without regard to its distribution, and economic policy may contribute to welfare by encouraging an increase in the overall capacity to consume. Distributional issues are important in a number of ways. Democratic governments provide social "goods" because they contribute to perceived welfare sufficiently to justify the sacrifice through taxation of some of the benefits of solitary consumption. There is persuasive evidence to suggest that extreme income inequality leads to economic stagnation. For a given set of distributional arrangements only an increase in the size of the economy that exceeds the growth in the population can increase welfare. Long-run growth in *per capita* incomes is not, however, compatible with perfect competition.

Innovations are needed to bring about economic growth and rising *per capita* incomes. Innovation is, however, undertaken (or at least financed) in the expectation of a reward in the form of above-average profits, and in a market economy this reward can only be obtained as long as the innovator has some "monopolistic" advantages. By the fundamental theorem of economics, if the price of something is reduced, so will the supply be: by restricting or eliminating innovators' monopolies, society restricts or eliminates innovation and long term growth in *per capita* incomes.

The term monopoly carries baggage that is not relevant to modern political and economic discourse, a fact noted by Schumpeter (1942). Tudor and Stuart England, and Bourbon France, sold monopolies for the benefit of the royal exchequer. These monopolies were administered through agents whose conduct aroused bitter resentment among the general public, making the term "monopolist" a useful term of rhetorical abuse, combining in one word gouging, corruption and extortion.

Very few modern firms have anything like the market position gained by a Tudor monopolist. Rather, the term is applied to firms who have developed an attractive product and want to control the supply of it. Although life is generally possible without the product in any form, and there may be many suppliers of functional alternatives, the original manufacturer may be called a monopolist and threatened with sanctions under the *Trade Practices Act*. Such manufacturers administer prices and production levels, but they know that their customers' tolerance for price increases is very limited and high prices can only be maintained when the delivered value is also high. Firms that ignore this find that their customers are quite ready to experiment with alternatives. It is not only manufacturers who can administer prices: Woolworth Ltd (the Australian, not the US or British firm), between 1987 and 1995, used price as a competitive weapon, forcing prices down to achieve a higher throughput at its stores, and applying some of the cost savings gained thereby to force prices down further, gaining yet more customers. Woolworth is using its formidable market power to keep prices down rather than raising them, and yet, in the terms of the Trade Practices Tribunal judgement excerpted above, it is (potentially) a monopolist subject to sanctions.

Woolworth's behaviour is not particularly altruistic, and neither is it driven by fear of competitive entry or any management compulsion to act "as if" it had more or stronger competitors than it actually has. The short term loss of profits involved in holding its prices below the long-run marginal costs its competitors incur is repaid by the firm's growth prospects. Whatever the shareholders are losing in terms of current profits they are gaining from improved growth prospects, and the share price, both as a ratio to earnings and to assets, is significantly higher than that of Woolworth's closest competitors.

Innovation and Growth

Growth requires continual innovation, the continuous introduction of new products, some of which are horizontally and some of which are vertically differentiated from existing ones. As Schumpeter (1934) pointed out, few innovations consist primarily of a technological advance, although many will only be rendered practical through access to relatively recently developed technology. Cellular mobile telephony would be impractical without access to modern technology, but practically none of the technology in use in a cellular telephone system was first used in that context.

Innovations leading to vertical differentiation are often completed without the development of any new technology at all, by applying a higher standard of design and more expensive materials to a standard grade product. Differentiation may be established by the level of service or even the standard of decoration used in a service business. Definitions of innovation that emphasise technology are unduly restricting and fail, in any case, to reflect reality. The Industry Commission (1995), in its report on research and development, looked at the sum of innovation-led growth, added up R&D expenditures, and concluded that the rate of return to investment in R&D was well over 100%. Had this really been so every commercial organisation in Australia would be ploughing every spare cent into R&D. In practice innovation requires large expenditures on design, tooling or equipment, and marketing in addition to any R&D investment. The total Australian investment in innovation is much larger than the sum recorded as R&D expense, and the returns to each element of this expense, while attractive, are far less than the Industry Commission supposes.

The Innovation Cycle

Successful innovations pass through several well-established stages. One frequently used model (elements from Drucker 1985; Timmins 1990 and others) is summarised in the table below.

The law, including the *Trade Practices Act*, is, as far as entrepreneurs are concerned, double-edged. Before they launch a new product entrepreneurs are vulnerable to subversion of key staff and to industrial espionage, matters which the common law of contracts and the criminal law are set up to deal with, but these are laws which can also be used against an entrepreneur by established firms.

Immediately following the launch of a new product, competitors may be tempted to spread rumours about the innovation or the entrepreneur's solvency and to discourage retailers or distributors from stocking the new product; such behaviour may give grounds for action under the common law or the *Trade Practices Act*. The leading example of such behaviour comes from the USA: in 1966 the start-up firm Control Data Corporation announced its 6600 processing system, a computer far more powerful then the top model in IBM's recently announced System/360. IBM promptly announced an even more powerful system, the System/360 Model 90, in spite of the fact that its engineers had no idea how to build such a machine. Control Data's customers decided that they would prefer to buy from IBM rather than an upstart, and for eighteen months Control Data took no orders. At the end of this time IBM were no nearer to making a working 360/90 than they had been at the start, and Control Data received a flood of orders and launched America's biggest ever anti-trust suit.

Stages of Innovation	**Time**	**Competition**	**Margins**	**Cash Flow**	**Profit**	**Strategic threat**
Development	pre-launch	latent only	n/a	negative	negative	delay
Launch	years 1–2	older products	high	negative	break-even	customer acceptance
Growth	years 3–7	imitators	falling	negative to neutral	high	lack of working capital
Maturity	year 8+	other innovators	low	positive	moderate	n/a
Decline	starts at any time	n/a	low but rising	high	high but declining	n/a

During the growth phase of an innovation's life cycle, competitors may attempt to imitate the new product, possibly giving grounds for action under the common law, the various intellectual property statutes, or the *Trade Practices Act*, or put the supplier under pressure with a bout of predatory pricing, an activity which the *Trade Practices Act* prohibits but defines in terms so restrictive as to make a successful legal action unlikely. Once the innovation becomes a mature product the only serious threat comes from superior innovations, and while businesses with an aging product portfolio might want to use trade practices law to contain the threat from newer products, there is no broad social interest in letting them do so.

Legal Support for Innovation

If welfare is to be improved by economic growth, then innovation must be encouraged. Schumpeter (1934: 66) gave a definition of innovation which specifically included opening of new markets and creating new forms of organisation, and in which he emphasised that innovation may, but need not, be associated with a new scientific discovery.

Innovators have various motives, but their economic incentive comes from the prospect of a monopoly profit earned from the exercise of market power. Such power may be earned either by cutting prices to the point that the innovator's competitors are driven out of the market, or by creating a new market in which there are no competitors. The Australian company IEI Pty Ltd (now a division of Vision Systems Ltd) developed the VESDA fire detection system, incorporating features that render it greatly superior to its competitors. VESDA systems are used to protect the Channel Tunnel and the Superconducting Supercollider at the Centre for European Nuclear Research (CERN) and other such installations where a fire could be a financial as well as a human catastrophe. The only restraint on VESDA's pricing is that Vision Systems do not want to provide an irresistible incentive to its competitors to emulate it. Matsushita and Sony produced fully transistorised TV sets while western companies persisted with thermionic valve systems; the lower prices and superior reliability of the Japanese sets persuaded their American competitors to abandon the consumer electronics market.

Whether an innovation leads to a superior product or to lower prices it adds to "welfare" on the narrowest definition: if the innovation leads to a fall in prices, the consumer benefit is obvious, while if it creates a new product that consumers buy, their act of choice shows that they consider their welfare increased by buying the new product rather than by limiting their purchases to the old one.

Laws intended to promote welfare through encouraging innovation and growth should have some of the following effects:

- they should make it easy to keep direct imitations of an innovation off the market for at least five years from the time an innovative product is introduced;
- they should prevent the erection of barriers to new innovations, including improved (not merely cheaper) versions of other supplier's recently introduced products.

Consumers need protection from unscrupulous or reckless innovators; such protection will tend to aid ethical innovators by reducing the risk consumers face in experimenting with innovations. Laws to this purpose should:

- severely penalise false and misleading claims about new products;
- regulate any monopolies over staple commodities;
- ensure that life-preserving innovations such as new pharmaceuticals or surgical procedures are available to all who need them through appropriate insurance and subsidy schemes.

The Trade Practices Act

The *Trade Practices Act (Clth)* combines three distinct approaches to protecting and promoting the welfare of the Australian community. There are quite uncontentious provisions banning direct abuse of consumers, as by misrepresentation or the use of "fine print" to deny consumers their reasonable rights. The *Act* also bans certain inter-business practices, either because they are obviously abusive or prone to lead to abuses: on these grounds the law proscribes harsh and oppressive conduct, and practices such as third line forcing. A third group of provisions is based on the assumption that "competition" is welfare-enhancing *per se*, and it is these provisions of the Trade Practices Act that have dubious social value if the foregoing analysis is valid. These provisions include the ban on resale price maintenance (ss. 48, 96–100); the restrictions on exclusive supply agreements (s. 47); the potential tort of "refusing to deal" (s. 46); and the limitations on horizontal agreements (s. 45 & 45B) and the complexity of the bureaucratic procedures involved in securing an authorisation for such agreements.

Resale Price Maintenance

Australia's laws against resale price maintenance are unusually severe by international standards. Apart from using some highly circumscribed rights to publish recommended retail prices, manufacturers doing or even appearing to do anything that can be construed as resale price maintenance risk heavy penalties. The original justification for the Australian law came from a presumed need to protect manufacturers from dominant retailers in the late 1960s. The Slazenger brand of sports goods was withheld from the Bourkes–ACTU store in Melbourne because of Bourkes' failure to maintain retail prices. This, it was insinuated, was because of pressure from Myer Ltd, whose store was a block a way from Bourkes; Myer, it was claimed, did not want their margins eroded by a discount store nearby.

The assumption that Slazenger's resale price maintenance policy was a result of pressure from Myer and not an unforced decision of their own is dubiously based. One underlying assumption is that Slazenger, and every other manufacturer, are indifferent to the place or manner in which their products are presented and only interested in the wholesale price. In fact, multi-product manufacturers such as (the then) Slazenger have a great interest in the presentation of their entire product range and the perception of their brands that follows this presentation. By entering into a detailed reselling agreement with Myer, Slazenger could influence the way their products were displayed, the range of their products that Myer carried, and the sales effort provided by Myer. The long-term gain in brand equity and shareholder value that Slazenger could anticipate would comfortably exceed any small revenue gains from sales through discounters.

In practice the ban on resale price maintenance has significantly increased the degree of power exerted by major retailers over manufacturers. Until the 1995 amendments to the Trade Practices Act sporting equipment and other suppliers could not secure distribution through prestige outlets by maintaining retail prices, because that was illegal. They could not even offer their products exclusively to specific outlets in return for agreements about stocking and display, because such exclusive dealing has been found by Australian courts to be a covert form of resale price maintenance. Manufacturers found it harder to establish their brands, and particularly hard to maintain vertical product differentiation; this did nothing to make the final product market more competitive or "perfect"; it just moved brand power from the manufacturer to the retailer.

Vertical differentiation is a significant source of profit to manufacturers and service deliverers and a major part of the economic growth engine. Tolerating, much less encouraging, vertical differentiation presents a challenge to egalitarian thinking because it leads to the visible expression of the unequal distribution of wealth and income. In contemporary Australia, wealth would be largely meaningless without vertical differentiation: the upper middle classes patronise patisseries while the less well off buy supermarket cake; members of the upper middle classes consider their welfare enhanced when they pay five times as much for a serving of cake as their less affluent fellow citizens, but they would not feel the same way about being required to eat five times the quantity of the supermarket product.

The prospect of wealth, and the associated ability to patronise patisseries, is a necessary incentive to innovators and others who make above-average contributions to society. Since ethical innovators create more wealth than they capture personally, there do not seem to be strong ethical grounds for depriving them of the benefits of that part of the created wealth that they do retain. The social problem lies in distinguishing between those who have become wealthy by their own extraordinary and socially valuable efforts and those who are flaunting inherited or ill-gotten gains. Rather than discouraging the production and consumption of high priced variants of common products, social reformers could look at the level of taxation of inheritances and of speculative gains from zero value added transactions. The social costs of Australia's resale price maintenance laws almost certainly swamp the benefits.

Exclusive Supply and "Refusing to Deal"

Vertical agreements (and exclusion of third parties from vertical agreements) are not explicitly outlawed, but are subject to a public interest test. The facts of a matter where some party has been refused supply, or has had supply stopped, may arguably be construed as resale price maintenance. Lawyers seeking remedies against the effect of exclusive supply agreements have tended to act under the resale price maintenance sections of the *Trade Practices Act*; although QWI Ltd, a Queensland-based supplier of fencing materials, scored a notable victory over BHP[5] by demonstrating, to the High Court's satisfaction, that BHP had an illegal exclusive dealing agreement with itself for the supply of Y–bar stock.[6]

The limitations on exclusive agreements act to the detriment of innovators, particularly those entering the "growth" phase of the innovation cycle. As shown in the table (p.76), such firms are at risk from a lack of working capital. In general their suppliers and major distributors are less prejudiced this way, and are in a position, by offering extended credit on the one hand, and cash deposits with their early orders on the other, to relieve the innovator of a major source of worry and business risk. Such extended credit and short debit facilities are less likely to be forthcoming without some reciprocal offer giving a longer-term advantage, such as an exclusive supply arrangement. Such arrangements may, however, be challenged by other materials and components suppliers and other distributors and retailers, hoping for a free ride on the original financing arrangement. The threat of such intervention makes suppliers, distributors and retailers less willing to support innovative small firms.

5 (1989) ATPR 40–925.

6 Y-bar stock is an intermediate product which is cut and punched to make steel fence posts.

Horizontal Agreements

Innovations can range in scale from globally revolutionary to matters of specialist interest only. There are indications emerging from systems theory that the largest may also be the most important; that, echoing Schumpeter, hundreds of improvements in the design and management of stagecoaches were, even cumulatively, less significant than the introduction of the railroad. It is true that "the railway" did not consist of a single innovation, requiring instead a long list of them, from the invention of a reversing valve gear for steam engines to the issuing of tickets. All these projects were, however, linked: a long list of them had to succeed if any were to be viable. This, in turn, required a source of cash sufficiently large and patient to fund the whole series of needed innovations (and in the case of the Liverpool to Manchester Railway, 40 miles of permanent way as well).

Major innovations bring about major changes in the economy, but their outcome, *ex ante*, is far from certain and the raising of the required amount of capital no small task. Historically, the hand of government has never been far away, either as a direct source of development funds as with commercial passenger jet aircraft; or a means to reduce development risk, as with the monopoly granted by the British Parliament for the Liverpool to Manchester Railway; or the extensive protection and support offered to the motor car industry in the recently industrialised countries such as South Korea and Malaysia.

When an industry in which a modest number of firms compete is presented with the opportunity to innovate on a large scale, it is clear that a joint project will have greater available resources and a lower overall risk than a project that any one of them could undertake in isolation. Even when the project is within the capability of the largest firm, committing the majority of its free cash flow to a single project would leave it vulnerable to an opportunistic attack by its competitors. The obvious solution to this problem is for the major firms in the industry concerned to form a joint venture of some kind, and the *Trade Practices Act* allows, under its public benefit provisions, such ventures to be authorised by the Trade Practices Commission if a sufficient degree of "public benefit" can be demonstrated.

The *Trade Practices Act* itself does not define public benefit in these circumstances, leaving it to the Trade Practices Commission and the courts to rule on a case by case basis. The requirement to seek prior authorisation must have a chilling effect on any intra-industry negotiations towards an agreement, particularly since the fact of such negotiations can be adduced as evidence of a price-fixing conspiracy in civil or criminal proceedings.

Martin (1994a, 1994b) describes his theoretical examination of the economic consequences of permitting oligopolists to make horizontal agreements to pursue cost-saving innovations. He contrasts joint R&D projects with "patent races". He concludes that joint ventures in research and development are likely to produce a net social benefit, but that joint ventures in production and marketing are not. Martin does not, however, analyse the new product case, and his method of analysis does not lend itself to doing so.

The 1995 Amendments

The *Trade Practices Act (Clth)* was amended in 1995 to give effect to the Hilmer report on competition policy. The main thrusts of the amendments were to replace the Trade Practices Commission and the Prices Justification Tribunal with the Australian Competition and Consumer Commission ("the Commission"), and to bring unincorporated businesses and state government-owned enterprises within the ambit of the act. Some technical amendments were also made to the act. Of these the most important, in the context of this paper, broaden and clarify the power of the Commission to authorise joint ventures and exclusive dealing agreements. Under the amended Act a properly authorised joint venture can no longer be ambushed by a suit alleging resale price maintenance or price fixing. Agreements incorporating third line forcing can be legalised by notification unless the agreement is rejected by the Commission on public interest grounds.

In principle, a firm attempting to establish a new line of high-quality goods or services in the Australian market can notify the Commission that it intends to appoint exclusive distributors, require them to maintain their resale prices, and insist that they buy certain complementary products from designated suppliers only. The practical problems lie in convincing the Commission that the introduction of new lines of high-quality goods and services conveys a public benefit sufficient to overturn the general presumption in the Act that welfare is enhanced by economic competition, and in finding the money to pay the notification fees.

There are further issues to be resolved by case law under the new act: how wide a class of goods can be that is the subject of a single notification, for example. On a naive reading of the summaries of the Act (AGPS 1995) and a commentary on it (ATPR 1995) each franchise or dealership agreement may require its own notification and accompanying cheque.

Conclusion

This paper has not sought to challenge the ban on misleading and deceptive conduct in the *Trade Practices Act* or the general requirement that authorisation is required before any joint action is taken in either horizontal or vertical arrangements which may have the effect of increasing the prices consumers pay for existing products. Harsh and oppressive conduct is properly prohibited, and consideration could be given to including a general ban on unfair competition. The remaining main headings of the Trade Practices Act are arguably defensible when applied to the sale of established products.

When the economic and social value of innovation is given its proper weight, the clauses of the Trade Practices Act relating to resale price maintenance, vertical supply agreements including exclusive dealing arrangements, and joint ventures need careful reexamination. I suggest that the effect of these clauses should be substantially reduced, if not waived altogether, in the matter of new products. The revised Act gives the Australian Competition and Consumer Commission the power to revoke the effect of notification of joint venture and franchise agreements on public benefit grounds, but it leaves the definition of "public benefit" open.

An early ruling by the Commission in favour of the principle that the introduction of new products constitutes *prima facie* a public benefit would give substantial encouragement to Australian innovators.

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