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Mergers, Trade Practices Policy and Internal Competition
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MERGERS, TRADE PRACTICES AND INTERNAL COMPETITION

INTRODUCTION

This paper is designed to draw out some implications for business, economic analysis and policy of our experience over the last six years with new trade practices legislation in Australia. To apprehend the terrain it covers, it is convenient to read the title backwards: this paper is fundamentally about competition, and within that the role that trade practices legislation plays, and within that, it concentrates particularly on legislation designed to investigate or control mergers and take-overs.

There is an extremely close relationship between the merger provisions and other aspects of the "competition" parts of our Trade Practices Act. The relationship is two-fold:

1. Some would say a rationalisation for having merger legislation is to control structural changes within industry that may give the opportunity to produce undesirable conduct. This conduct is either elsewhere covered in the Act, so that the merger provisions constitute preventative medicine, or the conduct is not elsewhere covered, it being assumed that merger control obviates the need for them. Subjected to close analysis this argument is deficient, in that our merger legislation does not question the existing
structure of industries (only some proposals to change it through particular acquisitions). Only acquisitions from or to a position of "dominance" are affected by the current provisions, and the argument relies on the existence of a close and predictable relation between structural market factors and particular behaviour which a number of writers, including the author, have called into question during the 1970s. But it is sufficient for present purposes that many would see merger control making for an earlier and more efficient control of adverse trade practices that a close relation between the merger provisions and other parts of the competition sections of the Act is established.

2. It is much less contentious to say that several of the provisions within the merger sections have an economic flavour and are similar to tests or criteria found elsewhere in part IV of the Act. Three aspects spring immediately to mind: (i) the need to define a "market" in relation to which the merger coming within the purview of the Act is seen to take place and in which any "dominance" is assessed (as in other parts of the Act, notably S.45, S.46, S.47 and S.49); (ii) the close relation between the tests of "dominance" and those relating to "substantial lessening of competition" which arise elsewhere in the Act; and (iii) the similarity in the list of "benefits" which
applicants seeking "authorisation" (under s.90) for mergers thought to fall within the ambit of s.50 may advance (the arguments and their appraisal being quite similar to those arising in relation to other sections that are capable of authorisation).

Accordingly, in this paper devoted substantially to mergers, it is appropriate to make frequent reference to other aspects of the restrictive practices provisions of the Trade Practices Act, especially to set our current merger law into the context of a discussion about competition policy.

The Current Merger Provisions

Under the 1974 Trade Practices Act (as amended 1977), certain types of acquisition are prohibited. These acquisitions are defined generally as direct or indirect acquisitions of any shares in the capital or any assets, of a corporation (s.50 (1)), by way of purchase, exchange, lease, hire or acceptance (s.4 (1)). The prohibitions are contained mainly in s.50 of the Act, which is loosely referred to as containing the "merger provisions".

The acquisitions are prohibited, unless granted an "authorisation" (see below) if:

(i) the acquirer would come to "dominate" a market for goods or services, "as a result of the acquisition" (s.50 (1)(a)), or

(ii) where a corporation already dominates a market, the acquisition is of a competitor or a company
related to it, or if it competes with a corporation related to the acquiring corporation, and in each case the acquisition "would, or would be likely to, substantially strengthen the power of the corporation" to dominate that market. (S.50 (1)(b)).

The full text of S.50 of the Act is reprinted as an appendix to this paper.

Before proceeding it is necessary to clarify the meaning of some of the terms used in this description, or in these prohibitions.

Basic Jargon

In relation to general economic discussion of acquisitions, mergers or takeovers, we are normally concerned with an acquiring firm (A), the offeror; a target which is the subject of the bid (T), the offeree; and with related corporations (R) which may, according to the description and the circumstances, be "related" either to A or to T. By S.4 A (5) holding companies, subsidiaries and subsidiaries of holding companies are deemed to be related to each other, though it is also the presumption that bodies corporate are not related to each other, unless a party before the Federal Court, the Trade Practices Commission or the Tribunal establishes such relationships. (S.4 A (6)). (Furthermore, subsidiary or holding companies are defined in terms of control of the Board, voting rights, majority share holding and other criteria set down in 4 A (1) to (3).) For the purpose of determining "dominance" there is provided an aggregation of the market position of both the corporation and any other corporation related to it in this sense (under S.50 (2)).
The Market

As in many matters that come within the jurisdiction of the restrictive practices provisions of the Australian Trade Practices Act, the conduct or the position of corporations is assessed in relation to a market for goods and services. In the case of the mergers provisions, this is evident from the general description given above, a precondition is the dominance of a corporation "in a market for goods or services". While the Act gives very little guidance on the criteria to be applied to determine the extent of the market in this sense, there has been a substantial discussion within economics and considerable point is to be gleamed from our experience already under this legislation. This matter is of such significance that a section in this paper is devoted explicitly to it. But the Act does stipulate that the term "market" means "a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services." (S.4 E). Moreover, specifically in relation to S.50, "a reference to a market for goods or services shall be construed as a reference to a substantial market for goods or services in Australia or in a State" (S.50 (3)(a)).

The Concept of Dominance

In the descriptions given above I have consciously referred to a notion of "dominance", even though the Act at S.50 on all relevant occasions refers to a corporation being in a position "to control or dominate". For all
practical purposes, following judgement of the Federal Court in the case TPC v. Ansett Transport Industries (Operations) Pty. Ltd. & Ors. (1978) (ATPR 40-071), "the word "dominate" is to be construed as something less than "control". The word is to be construed in its ordinary sense of having a commanding influence on." And "In interpreting the word "dominate" it is not necessary to interpret the word "control" although regard must be had to certain aspects of the meaning of that word." (ATPR p.17, 717). The implication of this passage of the Ansett judgement is that a finding of "dominance" is sufficient to satisfy the pre-conditions of this section, so that evidence bearing on "control" adds nothing further; alternatively, if the test of "dominance" is not passed, then a corporation can not be in a position to "control" a market:we may therefore simplify the exposition and discussion by referring only to a test of "dominance".

The Act makes it plain (at S.50 (3)(b)) that dominance is assessed in relation either to the activities of a corporation as a supplier or as an acquirer of goods and services in the relevant market.

There is also, as is demonstrated below, a very close connection between the notion of "dominance" and the offence of "substantial lessening of competition" a phrase used elsewhere in the Act and especially at S.45 (2), S.47 (10), S.49 (1) and S.90 and S.93.

**Authorisation**

Under S.90 (9) the Trade Practices Commission can grant an authorisation to the conduct or acquisition that would
be likely to be prohibited under S.50, but only if "it is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place." Under the history of the application of this authorisation test, a number of such authorisations have been granted on the grounds that public benefits (usually scale economies resulting from the merger) are argued and accepted as relevant benefits; on other occasions no such benefit is demonstrable but the Commission effectively indicates that the merger is of such little consequence for competition or the public as a whole that it runs little risk of falling within S.50 in any event.

The difficulty for advice and economic interpretation of the authorisation provisions is the attempt within S.90 to apply different tests of apparently varying severity to applications for authorisation arising from different apparent offences under the Act. There are basically three tests of authorisation contained in S.90:

1. a test weighing up benefits to the public as against detriments to the public "constituted by any lessening of competition, with the onus on the applicant to show that the balance is in favour of the former, and in which present and future benefits may be included;

2. the same test but in relation to which past benefits may also be claimed; and

3. a test requiring the applicant to show that there stems from the practice or arrangement "such a
benefit" to the public that the contract, arrangement or understanding should be allowed to be given effect to. The test specified in S.90 (8) is apparently the same as that provided in S.90 (9) which relates explicitly to acquisitions within the ambit of S.50. Yet the matters the subject of authorisation under S.90 (8) – exclusionary provisions, secondary boycotts and third line forcing – are matters in relation to each of which the Act purports to take a very serious view. It is quite unclear why authorisations for mergers should be subjected to the same test, and not to the balancing test that applies to a number of matters falling within S.45 and S.47 (the test being specified in S.90 (6) and (7)).

A Classification of Criteria

Before discussing in detail the interpretation of "dominance" under the Act, it is necessary to introduce some of the jargon of industrial economics which will be useful in analysis and evaluation of economic tests supplied in trade practices legislation.

It is possible to identify three such types of tests, which may be specified as follows:

1. **Narrow structural criteria** – rules or procedures that are concerned with, or direct attention predominantly towards, situations in which the number of sellers is small or there exists great inequality as between their sizes or market shares, and in
general attention is directed to statistics or other indications of market share or market "concentration".

2. **Broader structural criteria** - incorporating 1. above but permitting and encouraging analysis and evaluation of barriers to entry, product differentiation, and internal structural features of corporations themselves. Approaches to trade practices legislation based on this broad structuralist approach vary from those that see these factors merely as supplements to market share and concentration considerations, to those who would see matters such as barriers to entry requiring much more significance and attention than market share and concentration statistics, even to the point of supplanting them.

3. **Behavioural (or conduct) criteria** - an approach quite different to that specified in 1. and 2. above and which for the most part consciously ignores the structural background within which business behaviour takes place, concentrating instead on the nature and form of business conduct. Accordingly, particular practices or conduct may be frowned upon, irrespective of the market structural situation from which they spring. Thus, under the present Act, practices or conduct such as exclusionary provisions within contracts arrangements or understandings (s.4D and s.45),
arrangements to "fix control or maintain" prices (S.45A), exclusive dealing arrangements (S.47), resale price maintenance (S.48) and discriminatory pricing (S.49) are illustrations of part of the Act that concentrate on conduct rather than structure, although in some of these cases proscriptions only arise if the conduct substantially lessens competition and it is commonplace for structural considerations to enter into the judgement about any lessening of competition (as we shall show below).

By its nature, prohibitions or control of mergers are founded on a belief that direct control of structure is desirable, and often on explicit premises reflecting narrow structural criteria. It is therefore difficult to imagine a wholly conduct-based merger law unless controls over particular practices thought to arise from mergers or takeovers are taken to such an extent that merger law became unnecessary. Nevertheless, some elements of behavioural (or conduct) criteria have entered into the assessment of "dominance" and therefore, into the operation of S.50 in a most novel and interesting which we must now pursue.

"Dominance" and "Substantial Lessening of Competition"

It is relevant both to economic analysis and to practical operations within the Act that these two concepts are so closely related. It follows that many issues concerning
market definition and the notion of competition arise with
similar force and effect in S.50 matters as they do in many
other sections of the Act. Much can be said about the
standard tests to be applied and the relation between the
consequences of this form of intervention and the apparent
intentions of the legislators; and much remains to be clarified.
But first we must establish the connection between the concepts.

In a most significant passage of the judgement in the
Ansett case, Mr Justice Northrop states that

"The unexpressed major premise contained in the section
is that it is undesirable for a body corporate to be
in a position to control or dominate a market or in
other words to have the power to control or dominate
a market since the existence of that power tends to
lessen competition in that market." (ATPR, P.17, 713).

In his determination in relation to the Ansett case,
Mr Justice Northrop lists five tests or criteria that may
be applied to determine dominance, as a "first step".
(p. 14)
These are reproduced below/in altered order and against them
are shown various criteria by which the Trade Practices
Tribunal had earlier sought to identify any "substantial
lessening of competition" in relation to the Queensland
Co-operative Milling Case (QCMA).

Table 1 assembles the criteria ascribed from the Ansett
case and the QCMA determination, classifying the tests as
between (broad) structural and behavioural considerations.
Four of the five principles of dominance outlined by Northrop, J. (i.e., those listed under 'A') are structural criteria which, as presented and compared in Table 1 are for all practical purposes identical with the structural competition criteria set down in the Tribunal's QCMA determination. It should be added that the (Ansett) judgement firmly rejects the relevance of profitability considerations in the assessment of "dominance". As the judgement states, "In my opinion, the profitability of a firm is not of real assistance in determining dominance." (ATPR, p.17,720). This rejection is in line with a strong comment in the United Brands case and differs from propositions put in that case by the TPC.

The application of the "structural" criteria of "dominance" in the Ansett/AVIS case suggest that the condition of entry is a very significant, if not the most significant, among these factors. On this matter, the Court, the Tribunal, the Commission and the economics literature seem to be in harmony:

"Of all these elements of market structure, no doubt the most important is (2), the condition of entry.
... it is the threat of entry of a new firm or a new plant into a market which operates as the ultimate regulator of competitive conduct." (QCMA, 17,246).

This statement has been recited and implicitly adopted in the TPC Second Annual Report at paragraphs 4.28 - 4.30. In the economics literature, the writings of Professor J.S. Bain (especially in Barriers to New Competition) on this theme
have been followed by most industrial economists. The relevance of the threat of entry was also adopted solidly in the Howard Smith determination at ATPR pp. 17,330 and 17,335.
A COMPARISON OF "STRUCTURAL COMPETITION" AND "DOMINANCE" CRITERIA

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<th>A. Structural Tests For &quot;Dominance&quot;</th>
<th>B. Structural Tests for &quot;Competition&quot;</th>
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<td>(Antitrust Case-KTR 40-071-p.17,720)</td>
<td>(OCRA Case-KTR 40-022-p.17,548)</td>
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<td>&quot;1. The firms operating in the market and the degree of market concentration, i.e. market share.&quot;</td>
<td>&quot;(1) The number and size distribution of independent sellers, especially the degree of market concentration.&quot;</td>
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<td>&quot;3. The height of barriers to entry, that is the ease with which new firms may enter and secure a viable share of the market.&quot;</td>
<td>&quot;(2) The height of barriers to entry, that is the ease with which firms may enter and secure a viable market.&quot;</td>
</tr>
<tr>
<td>&quot;4. The extent to which the products of the industry are characterized by extreme product differentiation and sales promotion.&quot;</td>
<td>&quot;(3) The extent to which the products of the industry are characterized by extreme product differentiation and sales promotion.&quot;</td>
</tr>
<tr>
<td>&quot;5. The character of corporate relationships and the extent of corporate integration...&quot;</td>
<td>&quot;(4) The character of &quot;vertical relationships&quot; with customers and with suppliers and the extent of vertical integration; and</td>
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| | "(5) The nature of any formal, stable and fundamental arrangements between firms which restrict their ability to function as independent entities."

BEHAVIOURAL FACTORS

C. Behavioural Factors in Relation to Dominance (same page reference as above)

"2. The capacity of Avis (the target corporation) to determine prices for its services without being consistently inhibited in its determination by other firms."

D. Behavioural Factors in Relation to Competition (same page reference as above)

"the usefulness of the "market" concept goes beyond the determination of market concentration to the identification of rivalrous relationships between sellers."
The classification of "barriers to entry" that is found in the literature of economics appears acceptable to the trade practices authorities. Three such barriers are considered, and these relate to excesses of unit costs (the first two) or deficiencies of unit revenue (the third) that new entrants incur or suffer as disadvantages in relation to existing established firms. The three barriers may be listed as follows:

1. "Scale economy" barriers - higher unit operating and distribution costs at the lower volume range to which new entrants might be initially confined;

2. "Absolute cost" barriers - excesses of unit production and distribution costs, in relation to existing firms, but compared at identical rates of output. Sources of this cost discrepancy may include capital charges, inefficiencies resulting from unfamiliar production and distribution operations, discriminatory input prices and any need for attraction wage payments in areas of skill or in periods of excess demand for labour.

3. The "product differentiation" barrier - disadvantages arising from unknown companies or brands which, on entry, would prevent the generation of unit revenues or given volumes of sale as high as those reaped by existing firms, or require heavier outlays on advertising and sales promotion.
In relation to the important "entry" test of dominance or competition it is necessary to show that there are, or are not, "barriers" in each case, and not simply that there are, or are not, scale economies, cost discrepancies and product differentiation. In relation to scale economies, for instance, there may exist both strong scale economies, but no significant scale economy barrier, providing that it is likely, in particular market circumstances, that potential entrants could commence operation at a large scale.

There is an important inter-relationship between entry, scale economies and rationalisation. In the shipping conference case, the Tribunal stated that an additional entrant would not upset rationalisation plans (p.17,217), this comment standing in sharp contradistinction to the view of the IAC in relation to the Australian motor vehicle industry (see the IAC Report on Passenger Motor Vehicles dated 10/7/1974). Compare also the A.C. Hatrick determination of the Tribunal (at p.17,589) where the exit of the applicant was considered to have anti-competitive implications, with the Harbon determination (at p.16,784) where an analogous rationalisation attracted much less concern about the detriment to competition.

Note also that difficulties of entry due to temporary or short-run factors such as the "prevailing market circumstances" cited by the Tribunal in the Concrete Carters case at p.17,463 are in fact invalid uses of the condition of entry concept. Entry is an explicit long-run phenomenon and only where demand is suffering long-term decline should "prevailing market
circumstances" be relevant to the assessment of entry barriers.

Two further matters fall from the Northrop determination in relation to (broad) structural criteria:

(a) Item 4. in the list of Northrop, J. is "extreme product differentiation" and not simply "product differentiation"; and

(b) Barriers created by capital requirements and the need for detailed technical knowledge of production technology and marketing techniques, or by the inflexibility and immobility of the capital stock are probably very relevant to the question of "entry". Conversely, as was the case in the Ansett determination, the absence of these barriers assists in the demonstration of the relative freedom of entry.

The important new addition to the list of test criteria for "dominance" is the capacity of the target corporation "to determine prices for its services without being consistently inhibited in its determination by other firms". This consideration clearly moves away from the concentration on structural tests, although it is consistent with the approach of the Tribunal on occasions. However, as the Commission has also argued, these approaches take longer and require more detailed investigation.

It would seem, on the evidence and judgement in the Ansett case, that defendant corporations in the Court in future seeking to demonstrate that a proposed acquisition fell
outside 8.50 could assist their cause if their business records and internal memoranda could establish that, on at least a significant number of occasions, their own serious proposals to raise prices had been delayed, or the magnitudes involved diminished, by the specific consideration of the likely competitive reaction of other firms sharing the market in which the target corporation participates. But is there not also the risk that records could be manufactured for this purpose, leaving the evidentiary basis of a defence based on "consistent inhibitions" rather questionable?

Delineation of the Relevant Market

Having shown the close connection between the tests supplied to establish whether a corporation is "dominant" (in a market for goods and services) and the relevance both of structural and some behavioural considerations, it now falls to draw out the extreme significance of procedures designed to delimit a market, given that competition is in the Act discussed in the context of such a market, and the nexus between "competition" and "dominance" criteria links market definition to dominance, as is apparent from the Ansett determination.

An Appendix to this paper gives a detailed account of the principles of market delineation that are applied in trade practices matters and which would seem to be relevant to establishing market within which it is considered whether a corporation participating therein is "dominant", the implications
of such a finding for the merger provision being gauged from
the significance of dominance to the section as discussed
above.

Bearing in mind R.F. Triffin’s warning that it may be
impossible in principle accurately to set the bounds of a
“market” circumscribing the activities of a “group” of
producers from those producing a spectrum of near to distant
substitutes, the fact is that the courts must come to such
a decision on this matter, and advisers must anticipate
what it will be. The detailed material contained in the
Appendix gives the following guidance:

- the “line of commerce” (product or service), geographical
  and functional bounds of the market must each be con-
  sidered;

- substitutability on the supply side is important
  in addition to the more obvious substitutability of
  in the mind of purchasers, the effect of introducing
  the supply side normally being to broaden the extent
  of the market;

- some time period is necessary in applying tests of
  “substitution”, the time being long enough to enable
  the substitution process to take place if it is going
  to;

- in general terms, the broader is the relevant market,
  the less likely it is that any corporation operating
in it will be held to be "dominant" for in the terms of the Northrop criteria, market share will tend to be smaller, entry barriers will appear to be lower around a broader market, and inhibiting activities will be more readily apparent. It is for this reason that a defendant in a mergers (or other trade practices) action would normally seek to persuade the Court that the market includes a very wide range of products, regions or functions in the process of fabrication from raw materials to final distribution; applicants seeking to prevent the merger will try to rely upon a narrow definition that makes individual corporations more likely to appear "dominant". Accordingly, careful consideration of the principles and the case experience in relation to market definition as reflected in the Appendix needs to be given. For present purposes it is concluded that many aspects of this subject remain unsatisfactory, both because they are unclear and because they are critical to the outcome.
SOME FUNDAMENTAL QUESTIONS ABOUT MERGERS AND COMPETITION

Leaving the preceding materials as background to the law and practice of present merger controls in Australia, we come to assess the economic effects and justification for such major laws that do exist, through the agency of a small number of important questions.

1. How effective are our merger laws?

Although based predominantly on structural criteria, the merger provisions are presently likely to catch only a small number of proposed acquisitions, and uncertainties in their application which still remain limit the amount of litigation taken in the face of a potential merger. Subject to the authorization provisions, S.50 prevents a dominant firm from being acquired, yet permits an already dominant firm to acquire other firms unless its market position is substantially strengthened by the acquisition of a competitor. This dualistic treatment is distinctly odd and the product of Federal/State politics rather than of any economic analysis. Moreover, as is evident from the Ansett/Avis case, there are some strong tests to be passed before a position of "dominance" which activates the section is reached. It is suspected that horizontal mergers (i.e., between competitors) would be more likely to pass the tests of "dominance" than conglomerate mergers of the Ansett/Avis type. As argued below, even this remains uncertain. Finally, a number of authorizations have been granted which acknowledge the economic case that scale
economy and other public benefits can flow from amalgamation. It would therefore be incorrect to allege that our present merger laws cause much disruption to the set of proposed acquisitions that are commonplace in Australia in the early 1980s.

2. Should the merger laws therefore be strengthened?

The answer to this significant question must ultimately be a political one, and it will reflect experiences, viewpoint and possible alternative mechanisms for expressing competition policy. For instance, it perfectly reasonable for a dislike of bigness to be expressed as a major premise for structural control policy through merger legislation. If a direct concern about size is not the major premise, then the rationale for merger laws is more likely to be that they foster market structures conducive to bad economic performance, or permit firms through amalgamation to circumvent the intentions of other arms of competition policy, including restrictive practice provisions. This second view is unsatisfactory in the light of developments in economic theory, the Australian evidence and alternative policy means that are available.

As to theory, the main developments in the analysis of oligopoly in recent years (remembering that market form is nearly always the most relevant to be applied in the Australian situation) stress the importance of business objectives, strategies and modes of behaviour, perceptions about the reactions of rivals, and other behavioural phenomena rather
than the (narrow) considerations of numbers of firms and their market shares. (This theme is developed and evidenced in R.F. Dorfman and N.R. Norman, *Prices and Markets in Australia: Theory and Applications*, especially chapter 7.)

On the evidence, it would strengthen the case for separate provisions controlling acquisitions and especially those controlling market share directly if some close and reliable relationship could be established between market concentration and economic performance (margins, price movements, progress etc.). It would then be easy to argue that the effect of merger controls would be to prevent in advance aggregations of economic power that would predictably increase distortions already existing in the economy. But the Australian attempts to discover such a relationship have been conspicuously unsuccessful, and attempts in other areas of economics to explain statistically the behaviour of prices, productivity, technological change and profits are unmoved even to consider a narrowly structural variable such as concentration, or alternatively test its influence with the result that any such influence cannot be identified.

The upshot of theory and the evidence is by no means to cast aside any suggestion that even the narrowly structural criteria should be disregarded in competition policy. But the balance of theory and evidence encourages much greater concentration on behavioural and the broader structural aspects, especially entry barriers. On this matter, the Trade Practices Tribunal seems to have parted company with
the TPC and to have adopted more readily the broader structural and conduct aspects. As the Tribunal stated in the QCMA case:

"An examination of the present state of competition, and the relevant flour and bread markets, requires an examination both of the structure of the industries and of the behaviour of the firms engaged in those industries." (P.17,252) and

"there appears to be some difference of emphasis between the Commission and this Tribunal in assessing the importance of market concentration as against other elements of market structure and the evidence on competitive behaviour." (P.17,269).

both

The Swanson Committee observed this difference of emphasis and the propensity of the Commission to express concern about "excessive concentration" even after the QCMA case (see paragraph 3, point 4.8 of the Commission's Third Annual Report). The Swanson Committee observed that "the most consistent criticism was that the Commission laid too much emphasis upon the structural aspects of the merger, and had a tendency to assume that after the merger the merged company would have a market share equal to that of the two companies prior to the merger ... the Committee is of the view that it is proper for the Commission and others called upon to judge competitive effects, to assess those effects by reference to conduct considerations as well as structural considerations because market structure of itself should not be used to impute conduct." (Trade Practices Act Review Committee, paragraph 8.41 - my emphasis). Previously I had advanced
the same view myself in the following passage:

"The results of this inquiry suggests that decisions for merger clearance should, wherever possible, be based on the details of the merger in the light of industry behaviour, rather than on structural information and the presumed implications of structural characteristics."


More recently, the Trade Practices Consultative Committee has proposed a strengthening of the monopolisation provisions designed to attack barriers to entry more directly, combined with a lowering of the threshold so that a corporation using "any power" which it may possess to exclude or substantially damage competitors or to prevent entry would be directly in breach of the Act and not capable of being authorised. ("Small Business and the Trade Practices Act", Volume 1, December 1979, a report of the Trade Practices Consultative Committee, especially chapter 9). This proposed amendment clearly concentrates on conduct or the broader structural features downgrading the significance of the market share or concentration situation of the potential offender. As such, it exemplifies changes in the Act that would pay more attention to behavioural considerations and which could replace either the merger provisions or the need for any substantial strengthening thereof if a case for doing so were made out.
If we did have much stronger controls on acquisition, then perhaps Ansett would not have acquired Avis, Kauri Bros., would not have moved to 96 per cent of the yeast market, ICI would not have acquired additional sodium silicate facilities and brought about a fundamental rationalisation of that industry. It would be useful for any advocate of the strengthening of Australia's merger provisions to argue that the failure of the present laws or procedures to prevent those mergers has led to any identifiable public detriment or social economic loss.

3. Should horizontal mergers be subject to stronger controls than other mergers?

The treatment of horizontal mergers (roughly, those between firms producing similar goods or services) is a little unclear under the present law of procedures for at least two reasons:

1. the definition of what constitutes a "horizontal merger" is contentious, arising from whether or not potential competitors constitute target or acquiring parties that make the merger horizontal or "conglomerate" (or, even vertical).

2. Horizontal mergers remain yet to be tested: it is quite probable that horizontal (or even vertical) mergers will face more difficult barriers under the Northrop tests than a conglomerate merger between Ansett and Avis in which context they were framed. This is especially because market share of the acquiring or target corporation will necessarily...
increase in the case of horizontal merger (in the other types of merger it will essentially remain unchanged unless it rises as a result of advantages gained by the acquisition), and entry barriers are more likely to be seen to have increased as a result of horizontal acquisitions, and graver fears may be raised about internal changes in the (new) corporate structure. Horizontal mergers remain yet to be tested under the law.

To elaborate the first point, in Donald and Heydon's Trade Practices Law at p.457 it is observed that under the second limb (§50 (1) (b)) of the Act "The relevant increase in power must occur in the same market as that in which the acquirer and target are competing." They then ask "Does the reference to 'competitor' mean that §50 (1) (b) applies only to horizontal mergers?" Probably not, because it applies where the target "is or is likely to be a competitor."

Yet more than twenty pages earlier the same authors define horizontal mergers as those that "take place between competitors or potential competitors" (p.434 - my emphasis). If in fact horizontal mergers embrace potential competitors (one of the debated definitions) then it seems inconsistent to conclude that the second limb relates to anything other than horizontal mergers.

4. How do the merger laws fit in with general competition policy?

Merger legislation - like so much of competition policy in Australia - attacks distortions in the market for goods and
services, either ignoring or leaving untouched persistent distortions in the labour market, capital market, foreign exchange market and in relations involving government. Further, like so much of competition policy in Australia including tariff policy, there is no general approach to competition that could be described as other than "piecemeal". A simple example based on the notions of "second best optima" may illustrate the dilemma involved here.

Assume that the economy comprises two types of industries - those "monopolized" and those that are "competitive". By analysis, the price-cost margin is sufficiently higher in the former to reduce the relative share of output of the monopolized industries from the share it would command if such distortions could be removed. This monopoly distortion will only correct other removable distortions if factor market distortions (also assumed to be prevalent and irremovable) produce a bias towards excessive output in the monopolized industries. If factor market distortions hold the wage-rental ratio higher than its competitive level, and capital intensity is correlated with concentration (as IAC analysis suggests), then the factor market distortions of this kind will bias the composition of output in favour of the monopolized industries so that some price cost excess therein is (second-best) optimal.

This analysis is too simplistic and insufficient as a guide to public policy making; but it illustrates the need to look broadly at competition policy and the other instruments (including tariffs, subsidies, distortions imposed by lack of information, externalities and government) before
arriving at any conclusion such that close scrutiny or control of highly-concentrated situations (the premise of merger law) would enhance economic efficiency.

FUTURE OPTIONS

The politics intervening in the structural approach to industry policy, together with a number of divergent and often conflicting motives that must be satisfied make it inevitable that developments in Australia's merger laws, and competition policy generally, will be influenced substantially and ultimately determined by the political process. But insofar as economic analysis and the analysis of regulation can contribute, it would appear from this close look at Australia's merger laws that the economic basis for their existence or strengthening is dubious, especially if strong and clear proscriptions of particular acts of conduct already exist or can be tightened elsewhere in the Act; many arbitrary considerations concerning the critical concepts of "dominance" and "market definition" and "competition" remain to be clarified and introduce an element of uncertainty, both to business and to the institutions, that cannot be said to enhance the efficiency either of the law or the economic processes. It is perhaps a challenge for policy makers to formulate laws, institutions and procedures which control undesirable practices or foster economic efficiency and progress without at the same time introducing/compliance costs and policy uncertainty. In many ways, our present merger laws (and almost certainly those relating also to "monopolization" and "price discrimination" in the Act) made very little progress in either direction.
depends ultimately on consumer attitudes, technology, distance, and cost and price incentives. ... in determining the outer boundaries of the market we asked a quite simple but fundamental question: If the firm were to "give less and charge more" would there be, to put the matter colloquially, much of a reaction?" (Re QCMA and Defiance Holdings (1976) ATPR 40-012, p.19,247). (My emphasis to highlight aspects of the definition that are sometimes forgotten or which often lead to an artificial narrowing of the market.)

Product Definition

The first specific set of questions relate to the field of "products" (goods or services) or to the relevant "line of commerce", as the Clayton Act puts it. The problem in practice is that relations between products in an area and at a given time are generally those of imperfection, but nevertheless of "some" substitution. A dividing line has to be drawn between degrees of substitution that are sufficient to put pairs of products conjointly in a market and those that are insufficient to do so. Although the literature and Australian determinations are most numerous on this particular point of market delineation, it is particularly difficult to advise on the likely finding of the width of the market on this "product basis" when the adviser is conscious of the Cellophane case at one end of the spectrum, and Top Performance at the other. It seems that the ultimate placement of market bounds is peculiarly sensitive to apparently minor considerations. As such, this area remains uncertain and unsatisfactory.

Some examples of the application of market tests include the following:

- Block and tackle is a conventional appliance and therefore a substitutable product for units designed for lifting and pulling. (C 3090, p.8703);
- Building societies are in competition with banks, terminating building societies, credit unions, short-term money market, finance companies and insurance companies. (C 20744, p.8822);
- Restaurants in the Sydney metropolitan area selling food other than steak but in a comparable range of services and quality are competitive with steak houses and part of the one market (p.15738);
- A narrower definition of market was nevertheless adopted relation to Wilsen Electrical Industries (p.16154) and in Mauri Bros. and Thomson (p.16156) where in the case of the latter the product market was the supply of butchers and smallgoods;
- Relying somewhat on the famous Colophane decision, the Caxton Paper Mills case involved the market definition of light-weight wrapping and packaging materials (p.1509);

- It was also felt that fruit juices and cordials should be included as part of the soft drink (aerated waters) market (in the Coca-Cola proposed takeover of Cohns) (A 15548, p.8906);

- It was felt useful to distinguish and to place into separate markets the services provided by tugs for small or large shipping, respectively. (C 18559 and C 21037 at p.8843 and p.8845-16);

- Narrower market definitions were also adopted in relation to the ANATIL proposed merger with BTA. The applicant argued for a definition including all snack foods, including all rice and nuts, ice cream and allied products, aerated soft drinks and some general confectionery items. The Commission believed that the market should be limited to potato crisps, sticks and straws. (C 345, p.8825); and

- There was held to be a specialist primary industry market for newspapers and journals with the area of competition narrowly defined in terms of weekly specialist primary industry newspapers and journals. (C 18286, p.8834).

The complexity and apparent conflict of some decisions do little to clarify the situation. For instance, in a determination in 1977 the Commission adopted a fairly broad definition of the buildings products and cladding market recognising a wide range of substitutes for A.C. sheeting. (P.16104). However, in a recent draft determination (involving the John Lysaght Company) it would seem that the building products and cladding sections of the market have been adopted on a narrower and more specific interpretation of an analogous market. Second, in a determination involving liquified petroleum gas, it was held that the relevant market depended on the particular end user (households, industry, commercial) to which different markets (from the demand point of view) the same physical product is sold. Such interpretations (as explained below) may arise from excessive concentration on demand characteristics of substitution. Third, the emphasis on the supply side of market definition (again, see below) has been taken up rather more fully by the Trade Practices Tribunal (especially in the QCMA and Howard Smith cases) than apparently by the Commission. In the QCMA case, for instance, the Tribunal said "We have reached a substantially different view of the anti-competitive effects of the proposed mergers from that taken by the Commission ... we have not assessed the likely anti-competitive effects of the proposed mergers to be as serious as the Commission found them to be." (17,269). Earlier, in the same matter, although the circumstances had changed, the Commission had found that "structurally
there is a significant lessening of competition in the flour
market and particularly in the northern Queensland and southern
Queensland sub-markets. In bread manufacturing the acquisition
would result in a substantial increase in concentration in the
smaller markets with the acquiring firm becoming dominant
in four of these. . . . the Commission therefore finds that
the merger would be likely to have the effect of substantially
lessening competition in at least the northern sub-market
for flour and for the bread markets." (P.4845-22). In contrast,
the Tribunal later concluded that "we do not feel that any
great significance attaches to the change of some 4%-5% 
which would occur in concentration ratios if (the target
 corporation) were merged with either of the applicants."  
(17,257). This is a small, but important, illustration of
the potential conflict between decision criteria when different
"weights" are assigned to concentration and structural features,
developments in particular sub-markets, and demand consider-
ations rather than supply responses in relation to market
definition. Nevertheless, the onus is on the applicant to
provide evidence of substitution relationships, and in this
regard the Trade Practices Tribunal has recently complained 
that "The evidence was less clear as to the definition of 
the product market and did not deal satisfactorily with the 
availability of substitute products or the extent to which 
pressure upon the producers arising from such availability 
operates to contain their collective market power and, in-
directly, that of the Applicants." (17,460). Incidentally,
this notion of "pressure upon the producers" may usefully
be compared with other aspects of this paper concerning 
"consistent inhibitions" as developed in relation to the
Ansett case and dominance criteria, and with the notion of 
"potential competition" especially from imports.

Geographic and Functional Bounds of the Market

These two tests are discussed together, for they are
often confused. For instance, the distinction between national
and "Australian" operators in the car rental market seems
 to be a functional rather than a geographic distinction, 
although geography is involved in the function.

The precise meaning in this case of a "national" operator
was a participant in the car rental industry actually, or
capable of, marketing services in most if not all states of
the Commonwealth. This functional distinction was regarded
merely as a sub-market (see below) by Northrop J, and instead
he adopted the definition of an Australian market on a more
geographic basis (p.17710). The functional basis of "national"
operator was previously adopted and enforced in the Commission's
approach to the Kay case which is reported in the Third
Annual Report of the TPC at paragraphs 2.43 - 2.47. In the
Howard Smith case the Australia wide definition was adopted
because it was easy, on a supply basis, for operators to
introduce new tugs at any particular part of their choice,
depending upon commercial considerations relevant to this
particular possibility for supply substitution. (See p.17,336).
(Cf the approach in the Commission reported at p.16,508).
A number of cases for determinations are available in
relation to geographical bounds and, fortunately, in relation
to specific circumstances of those cases, the matters were
fairly clear cut. Some examples of application of geographical
criteria include:

- in relation to Callide Valley Lucerne Growers' Co-
  operative Association (p.15,613) the Commission adopted
  a geographic sub-market of an individual town together
  with its environs of radius 50 miles;

- in relation to the Life Officers' case the clearance
determination defined an Australia wide market (p.15,542);

- in relation to Golden Poultry Farming, the service of
  breeding, rearing and end processing of poultry and the
distribution thereof (a fairly full functional basis)
was nevertheless confined to Tasmania;

- in relation to Ready Mixed Concrete, the market area
  was restricted to a very narrow geographical range due
to heavy transport costs (C 428, p.8641);

- very localised sub-markets were also identified and relied
  on to some degree in relation to retail footwear markets
  in individual suburbs (p.8845);

- in relation to the market for sewing machines, the
  Sydney metropolitan area was held to be relevant,
  although a special sub-market was being identified
due to the localisation of buying habits. (2,15,925);

- finally, in the determination relating to Derby Meat
  Processing (p.16,103) two markets were considered one of
  which was stated as the world market.

Now broadly the "function" should be taken normally
relates to the "length" of the supply, transformation and
distribution chain that is implicated for a particular purpose.
There seem to be insufficient cases and too little discussion
of the principles involved in this matter. For instance,
there are but two brief paragraphs in the otherwise detailed
and excellent discussion by Donald and Heydon on market
delineation, and only scant attention is paid to this factor
in an otherwise substantial discussion of market definition
There is a brief treatment in ATPR, Volume 1 at p.2191 and
The short treatment in Donald and Heydon nevertheless recognise the problem and
state earlier at p.94 that "the retailers may be more hard-
headed and may act as buyers from wholesalers in an entirely
different market concerning the product. The market in
that case contracts as the goods move further along the
distribution chain. This explains our earlier observation
that the functional aspect of markets is far more important
than is traditionally believed." The earlier comment, on the same page, would seem to be appropriate. "If the dimensions of the market are approached with flexibility, then it can be seen that the market for the same goods or services may expand or contract depending on circumstances."

There are few cases in which functional market criteria have been in dispute. Nevertheless, in relation to photocopying, in the determination involving Nashua (C 13827, p.8723/4) three markets were identified on a functional basis: those in relation to the supply of photocopying machines; in relation to the servicing of photocopying machines; and in relation to materials (paper and other consumables) used in the machines. A possible conflict for the interpretation of functional bases of market delineation is found by comparing the determination in the Interflora case with that in the Concrete Carters determination at the Trade Practices Tribunal. In the first (at p.15,618) it was held that "Interflora is basically in the communications and delivery market...," the alternative of "cut flowers generally" being rejected in favour of the more specific functional basis of "communications and delivery". In contrast, the Tribunal held in relation to Concrete Carters that there was in fact a composite market and it was necessary to consider both (even though they may be regarded as logically distinct) "and pay particular attention to the intimate relationship between the two". (P.17,460).

The Supply "Reaction"

The relevance for market delineation of substitution on the supply side was considered in principle and in application both in the CIMA and Howard Smith determinations of the Trade Practices Tribunal. The Tribunal indicate clearly the relevance of supply criteria in their statement rebutting the geographic narrowing of "market" on demand criteria alone, and in the following terms "It is inevitable, we think, that any initial dominance by one miller in a market, sub-market or town will call forth a response - both from rivals and customers." (P.17,263).

The Tribunal in the Howard Smith case state clearly the principle that "an important consideration in identifying a market is the ease of substitution by suppliers as well as buyers." They illustrate this principle in the particular case with the statement that "the major tug operators are now in a position to deploy a newly-constructed tug at any one of a number of ports. ... it seems to us that, in the light of these considerations, the concept of an Australia-wide market for the towage services of large harbour tugs is already a commercial reality." Elaborating the principle, which is worth re-stating here, the Tribunal put the relevant question: "Can suppliers readily substitute one type or quality of product or service for another or can they vary the quantities supplied at different locations if there
are differences in the prices which they can obtain at those locations." (P.17,336).

Substitution on the supply side has nevertheless sometimes been carelessly deleted from discussions of "reactions" that are relevant to market delineation, examples of this oversight being found both in annual reports of the TPC and in the Swannan Report. An implication of this deletion is that it tends to bias the defined market to a narrower set of economic activity (especially in relation to the geographical basis) than would have been found if supply reactions were more fully considered. For instance, the buyer in a localised regional market may not be induced to move outside that market (in the geographical sense) should the prices of basis products marketed therein increase significantly (say, as the result of restrictive actions). However, unless entry barriers are exceptionally high, suppliers (by the use of which term it is intended to include "potential suppliers") may be induced to enter or to contemplate entry in that same market under those circumstances.

Although the TPC in its Second Annual Report cite the QCMA definition of market which mentions supply criteria, none of the examples provided or the elaboration of principle move away from demand substitution. For instance, at paragraph 4.11 it is stated that "if another product is a substitute ... there will be significant positive cross elasticity between the demand schedules for the two products." (My emphasis). Also, the criticism levelled against industry classifications as a short-cut basis for identifying "markets" may be excessive if, on the supply basis, the industry classification system matches relevant market concepts a little better than if the latter were defined with reference to supply criteria alone. (Cf TPC Second Annual Report at paragraph 4.14).

At paragraph 4.22 the Swannan Committee recommend "that the Act should require that, in the determination of a "market" for particular purposes, regard shall be had to substitute products, being products which have a reasonable interchangeability of use and which have high cross-elasticity of demand, i.e. where a small decrease in the price of a particular product would cause a significant quantum of demand for a similar product to switch to the product in question." In my opinion, the explicit mention of "demand" and the difficulty of allaying "interchangeability of use" with supply criteria suggests that the Committee fell into the trap of again ignoring supply considerations as otherwise clearly expounded in the cases involving QCMA, Howard Smith and Ansett.

It generally happens that concentration on demand substitution criteria, to the neglect of supply substitution, leads to an artificial narrowing of the conception of "market". In the Marbon determination, there is a possible narrowing of the geographic dimensions of the market based on end-use
criteria (p.16,783); and in relation to liquidified petroleum
gas, the market on a "product line" basis was segregated on
demand for end-use criteria (as between industrial, commercial
and domestic uses) even though the elasticity of supply between
these uses must be very high indeed (p.16,740). Such narrowing
of the market can also be caused by providing insufficient
"time" to observe (actual or potential) reaction to disturbances
in price relativities, a point clearly recognised in relation
to Queensland Rugby Football League Inc. (p.15,677), where
a distinction is made clearly between the effects on competition
over one year and over five years.

Sub Markets

This concept arises, and is useful, only because there
may exist within a settled market definition distinctions
that are important in a short-run sense or are sufficient to
delimit a proper "market" only on the demand or supply side,
but not both:

"Sub-markets are the more narrowly defined, typically
registering some discontinuity in substitution possibility.
... the defining feature of the sub-market is the existence
of still closer and more immediate substitutes. Sub-
markets may be especially useful in registering the short-
run effects of change; but they may be misleading if used
uncritically to assess long-run competitive effects."
(QCMA determination, p.17,247). See also the Howard
Smith determination at p.17,337.

On the strict definition, sub-markets are a proper
sub-set of "market": if considerations suggest a narrowing
of a suggested "market" concept to what might have been
regarded as a "sub-market" then the latter term should logically
lapse. On this basis, it is not possible to support the
contention in Donald and Heydon that "there are just more
markets, not sub-markets." (p.98) Donald and Heydon explicitly
attack the notion of sub-markets and especially at pp.97-98,
p.108 and p.453.

The fundamental utility of the sub-market concept, both
to applicants and the determining authorities, is that it
conveys the sense of varying degrees of substitution without
attempting to catalogue the whole complexity of the market
place in reality. The notion may also build a bridge between
short-run or technological conceptions of a "market" - many
of them irrelevant or too narrow for the purposes of "market"
or "competition" as applied in the Act - and the notions that
are relevant to the long-run competitive issues to which
the Act is fundamentally addressed.

Some examples of the uses of sub-markets are found in
the Concrete Cartera case at pp.17,460 and 17,462 and in the
Ford authorisation determination of the Commission quoted in
the Third Annual Report at paragraph 4.9. Other examples
include:
- the recording industry as a sub-market of the music industry (p.8644);
- accommodation and hospitals are sub-markets within rental services (linen) and the associated laundry market (Ensign Holdings, p.16,164);
- geographic sub-market of the Spencer Gulf area is identified within a South Australian market (p.16,108);
- Port of Adelaide is a geographic sub-market in relation to the Mayne Nickless matter (p.16,109);
- in relation to CSR Services Ltd., a broad market was identified as resources and energy with a specific sub-market being stipulated as "coal". (P.16,126); and
- In the Allied Mills determination a large number of sub-markets were explicitly mentioned (p.16,119).

Although the concept of "sub-market" as defined and used in the CCWA determination of the Tribunal is not to be equated with the broader notion of "market", which is fundamentally more relevant, the description and analysis of competition would, in my view, nevertheless suffer if we were to abandon the concept.

**Competition**

Industry submissions often confuse, or invalidly equate, the "competitiveness" of individual buyers or sellers with the "competitiveness" of the market. The Act, as a principal objective, seeks to foster competition in or of the market; parties involved in trade practices proceedings should observe that the determining authorities reject, in general and in principle, the suggestion of a correlation between competition in the market and individual competitive strength. This is stated freely in the Tribunal's determination in the Ford case, and often by the Commission. Nevertheless, the Commission has, on occasions, apparently identified the enhancement of individual competitive ability with an increase in "market competition".

Arguments based on the individual competitive ability or "vigour" were advanced in the CCWA case (as reported at p.17,244) in the Top Performance case (p.17,118) in the Howard Smith case (p.17,341). In all cases they were rejected and most firmly in the Ford case in the following terms: "We reject the argument that an enhancement of competitive strength of a major participant in a market necessarily increases competition." (P.17,497). (See also the rejection in the Howard Smith determination of the Tribunal at p.17,342, and the discussion in Donald and Heydon at pp.120, 300 and 309).
Many Australian producers face import competition which, in principle, augments and strengthens competition. Import competition raises doubts about the validity of market share and structural indicators of competition. As F.M. Scherer argues "Import competition, both actual and potential, is nevertheless a significant factor in some ... industries... For members of the European Common Market and other nations (like England and Switzerland) heavily dependent upon foreign trade, national concentration ratios for many industries are next to meaningless." (Industrial Market Structure and Economic Performance, p.55) (My emphasis).

Although the full force of import competition is restrained by import barriers, the significance of this factor is probably greater than most trade practices practitioners and authorities acknowledge. Indeed there seems some reluctance to acknowledge the relevance and strength of import competition, and some detailed accounts of the competition process explicitly in relation to trade practices matters omit even to mention import competition. In the A.C. Battrick case, for instance, the Tribunal acknowledged the importance of import competition, but subsequently referred to the sole domestic supplier as a "monopolist".

Within a detailed discussion of market concentration the TFC mention in the Second Annual Report at paragraph 4.18 a number of qualifications to the conventional usage of market concentration ratios based on production or employment statistics. Contrary to normal practice, there is no mention of correction required for import competition, and no mention of import competition as such within the vicinity of that section.

P.17,589. Cf "In Alcoa the defendant aluminium producer had limited freedom to price as it wished; beyond certain limits it was subject to imports and the threat of new domestic entries. It was still held to be a monopolist." (Donald and Heydon, p.190).

It would be open to argue the significance of import competition on the grounds that tariffs restrict but hardly prohibit import competition; the trend in tariffs is nevertheless downwards, as expressed by Government commitment in its White Paper on Manufacturing Industry Policy; non-tariff barriers are explicitly temporary; and if the Act is genuinely concerned with longer run developments and incorporates the notion of "potential competition" within its ambit, then the significance of import competition can be very great indeed. Against this, it would have to be said, by inference, that the attitude of the determining authorities is at present not very receptive to these arguments. It is stated in the Ford determination of the Tribunal at p.17,505 that Government policy (presumably, tariffs) should be addressed to the employment problem and
competition policies should not be expected to perform this task. However, it is also argued by the Industries Assistance Commission that tariff policy should not be addressed to the employment question (First Annual Report of the IAC 1973/74, paragraph 52). In other matters, it was held likely in relation to Abbott Laboratories that there would be a decline in the availability of imports (C 472 and C 473, p.8809); that imports have not been important due to the high level of protection and high levels of overseas demand (both factors with, of course, some potential of changing) (P.8815), but it was in another matter conceded that a lowering of tariffs will mean greater competitiveness (p.8847-19, para. 2).
APPENDIX 2

SEC. 50 Mergers

(1) A corporation shall not acquire, directly or indirectly, any shares in the capital, or any assets, of a body corporate if -

(a) as a result of the acquisition, the corporation would be, or be likely to be, in a position to control or dominate a market for goods or services; or

(b) in a case where the corporation is in a position to control or dominate a market for goods or services -

(i) the body corporate or another body corporate that is related to that body corporate is, or is likely to be, a competitor of the corporation or of a body corporate that is related to the corporation; and

(ii) the acquisition would, or would be likely to, substantially strengthen the power of the corporation or to control or dominate the market.

(2) If -

(a) a body corporate that is related to a corporation is, or two or more bodies corporate each of which is related to the one corporation together are, in a position to control or dominate a market for goods or services; or

(b) a corporation, and a body corporate that is, or two or more bodies corporate each of which is, related to that corporation, together are in a position to control or dominate a market for goods or services,

the corporation shall be deemed for the purposes of this section to be in a position to control or dominate that market.

(3) In this section -

(a) a reference to a market for goods or services shall be construed as a reference to a substantial market for goods or services in Australia or in a State; and

(b) a reference to controlling or dominating a market for goods or services shall be construed as a reference to controlling or dominating such a market either as a supplier or as an acquirer of goods or services in that market.
42.

(4) Where -

(a) a corporation has entered into a contract to acquire shares in the capital, or assets, of a body corporate;

(b) the contract is subject to a condition that the provisions of the contract relating to the acquisition will not come into force unless and until the corporation has been granted an authorization to acquire the shares or assets; and

(c) the corporation applied for the grant of such an authorization before the expiration of 14 days after the contract was entered into,

the acquisition of the shares or assets shall not be regarded for the purposes of this Act as having taken place in pursuance of the contract before -

(d) the application for the authorization is disposed of; or

(e) the contract ceases to be subject to the condition,

whichever first happens.

(5) For the purposes of sub-section (4), an application for an authorization shall be taken to be disposed of -

(a) in a case to which paragraph (b) of this sub-section does not apply - at the expiration of 14 days after the period in which an application may be made to the Tribunal for a review of the determination by the Commission of the application for the authorization; or

(b) if an application is made to the Tribunal for a review of the determination by the Commission of the application for the authorization - at the expiration of 14 days after the date of the making by the Tribunal of a determination on the review.
Given the objectives of this conference in general and of this session in particular, Dr. Norman's paper seems unnecessarily narrow in conception. So much so that it may almost preclude discussion of some of the important issues of current industrial policy.

I think that it was legitimate to single out the area of Trade Practice legislation from the whole realm of regulation but to then concentrate on the narrower provisions seems to me to be a mistake. At the beginning of the paper Dr. Norman says, '...this paper is fundamentally about competition...' and this seems to me to be an apt judgement of priorities. Competition is at the hub of Trade Practice policy, whether the actual legislation makes that clear or not, and in addition competition is a sufficiently complex and elusive concept to merit considerable analysis. Dr. Norman however, having espoused this admirable sentiment, then proceeds to make a fundamental error. He virtually equates competition and in the actual words of the Act, '...the substantial lessening of competition...', with the notion of dominance. However, dominance is only an issue under Section 50 of the Act and thus this equality, even if it exists, may be of little assistance in interpreting any other part of the legislation. In addition, the interpretation of dominance used by Dr. Norman depends solely on Justice Northrop's decision in the one case that has reached the Federal Court, TPC v. Ansett Transport Industries (Operations) Pty Ltd and Ors. (1978), hereafter Ansett/Avis.

This seems to me to set up something of a straw man and narrow discussion of the regulatory environment confronting business to almost nothing. We might note for instance that the Fifth Annual Report of the Trade Practices Commission for the year ended June 30th 1979 devotes just
half a page (115) of its almost 200 pages to the question of mergers and
points out that, 'in no case looked at during the year did it appear that
the merger infringed Section 50'. If any further evidence is required that
mergers are not really central to the implementation of Trade Practice
legislation then we might consider the following. Both in the USA, the
Clayton Act of 1914 and the Celler-Kefauver Act of 1950 and in the UK, the
1965 Act, the control of mergers has been separated from the main monopoly
and restrictive practice legislation and in both cases was introduced later
than the other legislation. Finally, for one who has consistently stressed
behavioural rather than structural criteria, it seems odd that Dr. Norman
should select one of the most inherently structural features of business
organization. As he correctly points out mergers do have behavioural
implications, but in a sense they are of themselves not behavioural, unless
they represent a merger movement. In essence they are a change in
structure with the minimum of fuss, that is until someone questions the
possible behavioural implications of the structural change!

Let us return to the central issue, competition. As has been observed
by many scholars and others, it is an elusive concept despite its central
position in economic theory and its widespread use in everyday language.
The Commission itself in its First Annual Report, briefly, but quite
clearly rejected any notion that textbook perfect competition could be used
as the basis for its deliberations about 'substantial lessening of
competition'. Later in the Third Annual Report a valiant attempt was made
to present criteria for defining competition, but such attempts are almost
inevitably doomed to failure. In a sense they simply resurrect the notion
of workable competition and like that debate, they tend to degenerate into
a mass of particularities, which are of little use for general policy.
The notion of competition which is relevant in surely the one of competition as a process, the notion of 'animal spirits'. Schumpeter called it the 'gale of creative destruction' and in a famous passage outlines it as, '...the competition from the new commodity, the new technology, the new source of supply, the new type of organization...' etc.. The preconditions for such competition are complex and are not easily described and almost certainly cannot be created solely or even mainly by the inevitably rather negative prescription of conventional anti-trust. There seems often to be a presumption that competition is in there trying to get out and all that one needs to do is to release it. One sometimes wonders whether this is true and this doubt may throw emphasis on more positive policies to foster competition. In other words, one can take a horse to water, but one cannot make it drink! Our inability as economists to adequately define and measure competition, other than as a state of affairs, a static structural notion, seems to me to be a major problem in devising and implementing anti-trust policy. Without such a definition we are reduced to ad hoc prescriptions. It is still therefore tempting to look for some simple structural proxy for the presence of competition and much of the anti-trust debate really centres on the appropriateness of structural criteria as a proxy for the more subtle behaviour, conduct and performance patterns which are the real ends of policy.

Dr. Norman strongly reiterates his well-known view that the nexus between structure and conduct in Australia is at least unproven. Certainly, even the extensive US evidence in this area is ambiguous and the work of Norman, Round and others in Australia is plagued by a similar lack of clear results. Phillips for example has found that the relationship between profitability and concentration depends critically upon one's specification of profits and again we might note that there are problems in
defining and measuring a critical variable. Because of these ambiguities, Dr. Norman suggests that we follow a broadly based policy employing both structural and behavioural criteria for judging the competitiveness of markets. On this basis he suggests that there is no case at present for strengthening the merger laws since he sees them as largely irrelevant, because they impinge on structure, and there is little evidence that this systematically affects conduct and performance. However, he surely overstate his case and employs unfair tactics when on page 26 he says 'It would be useful for any advocate of the strengthening of Australia's merger provisions to argue that the failure of the present laws or procedures to prevent these mergers', (and he cites certain recent mergers), 'has led to any identifiable public detriment or social economic loss'. Clearly this is hopelessly counter-factual and thus the exercise might not even be useful even if it were deemed possible to attempt it.

If one views structure, conduct and performance as largely independent, then clearly there is no case for merger control. However, one should perhaps consider the possibility that structure may be significant even though we have as yet failed to prove it statistically. Two 'greats' of economic thought, Smith and Marx, each in his very different way, adduced the importance of the number of competitors in influencing the nature and extent of competition. Neither of them was talking about the narrowly defined static concept of neo-classical theory. We must allow that they understood competition as essentially a process and a social process at that. Further, recent work has suggested that the idea that structure matters may not be as arid as we thought. First, in the purely theoretical arena, Nutter and Moore in the Journal of Law and Economics, 1976, have shown formally that the greater the number of competitors, the greater the probability that any one of them will take a price initiative. For price we can presumably read product, process etc.
and it is surely such initiatives which are the very essence of what Downs has called the 'competitive process'. We might note that a criteria in Annett/Avix was that the target company Avis, had the capacity '...to determine prices for its services without being consistently inhibited in the determination by other firms'. Clearly not the stuff of which the perfectly competitive model is made, but nevertheless a good pragmatic view of the competitive process and one which Schumpeter would have no doubt espoused. Theoretical work, such as Nutter and Moore's depends on a series of assumptions and perhaps even more convincing are the recent revelations concerning what Leibenstein calls X-efficiency. He postulates that managerial or X-efficiency is a function of various features of firms and of markets, but that the most important is probably the competitive mores of the market. This is not an easily testable hypothesis, but work by Friskeeux on the US electric utility industry has shown that there is a systematic relationship between unit costs and the number of producers. Thus despite the presence of conventional economies of scale which one would expect to favour concentration, he finds that per unit costs are in fact significantly lower when there is duopoly as opposed to monopoly. Such cost differences are apparently related to the pressure to competition which forces more 'cost minimizing' behaviour on firms. We might note that conventional models of firm behaviour assume cost minimization, since they are primarily interested in explaining prices and price-cost margins. It is salutary to note that in reality costs are not normally minimized. If we accept the widespread presence of X-inefficiency and if we allow that it is a function of the level of competition, which may in a small numbers case be related to the number of competitors, then we have a strong counter argument to the normal scale economies argument in favour of mergers and concentration. Indeed, rationalization, that euphemism for concentration, may be viewed in a different light. I submit that recognition of
competition related cost reductions of this sort should give grounds for pause in discussing merger control. This is the more valid because the traditional scale economies which in the classic Williamson trade-off balance the allocative losses from monopoly, are often not fully realized or at best take a long time to be realized. In addition, mergers themselves absorb scarce managerial skills. Clearly one could assume that those involved in merger decisions know best and thus can be left to their own devices. However, mergers are essentially irreversible acts which alter the competitive potential of an industry and thus may involve considerable externalities. Because of this it is reasonable to adduce a wider social interest in them. Even if one narrowly confines oneself to mergers as an indicator of competition policy, they cannot be dismissed as lightly as Dr. Norman would seem to wish to do so.
I am sorry that Dr. Norman was unable to attend the Conference. I think that the difficulties which prevented him from attending must have prevented him from completing the paper as he intended. The paper is too narrow and addresses only part of the topic; moreover it bears too little relation to the conference theme - "Australian industry: pressures (or opportunities?) for change".

In the result, the paper brings forward a considerable amount of earlier reference material. To a large extent it is technical and could be directed at lawyers and other specialists in the field. It identifies a large number of cases without being able to go into them in any depth, and I cannot, in commenting, do that either. There is in the paper, however, a lot that is valuable by way of restatement in convenient form of principles and factors relevant to competition appreciation. It is put primarily for merger purposes, but it has a spillover value for other provisions of the Act. However, the method of quick reference to many cases is dangerous. One of Dr. Norman's own points is that analysis has to be an integrated process. Otherwise I perceive some risk of omission or of losing context. For example, page 39 (Appendix 1). In mentioning the Hattrick case, suggested lip service by the Trade Practices Tribunal to the importance of import competition where it first acknowledges the concept but subsequently refers to the sole domestic supplier as being a monopolist. What the paper omitted was that the Tribunal had stated its analysis leading to that conclusion, setting out the history and prospects of imports having regard to all the factors including strong natural protection.
Merger law used to have a much greater affinity with the rest of the Act than it currently has. It used to have the same test - "substantial lessening of competition". It is true that "dominance" (the current test) gets towards the antithesis of competition, so the analysis covers some common ground, but there is still an important difference of degree. That is what the 1977 amendment intended to bring about. The current merger law is very limited, and the rationalisation for that is that mergers are to be encouraged, as indeed they have been, unless they deal in or get close to monopoly situations. The law could threaten (recently) merger among metropolitan newspapers, and it could cause BHP to apply for authorization (which the Commission granted, although there is now an appeal by a third party) of its acquisition of 50% of Lygothts that it did not already own. Where, however, a merger leaves an industry to duopoly, that appears to be acceptable. The 1977 legislative policy obviously saw mergers as likely in general to bring benefits to the community, for example in terms of economies of scale and international competitiveness (the latter only applies of course in those cases where the product has to compete internationally). It is clear, of course, that many mergers are not aimed at either economies of scale or international competitiveness, but it appears to be assumed that, by and large, where they do no good, at least they do no harm and should not be put at risk.

Many, indeed most, mergers were not really at risk before the 1977 amendments. They could proceed if they were not likely to result in a substantial lessening of competition, and, if that was feared, they could be authorized on public benefit grounds - typically increased efficiency through scale economies. So the opportunity for "desirable" mergers was there before. The difference now is that the psychological barrier of some period of possible uncertainty has been removed. It follows then that there is now "opportunity for change" through mergers. But we must
discount somewhat our hopes for desirable change by remembering the importance of other motivations such as taxation, takeovers as a defence against takeovers, and the profitability of the takeover industry itself.

The merger issue is politically decided, and I leave it to you to theorize, if you wish, about the value of mergers in general and of increased concentration. If you do discuss possible strengthening of the merger law (which is one of Dr. Norman's questions), the issue is whether nearly all mergers (i.e. all except those that get close to monopoly) should remain free of even preliminary screening. It is not right to suggest (see page 26) that strengthening of the merger law might have prevented the "desirable" Mauti Bros.& Thompson acquisition in the yeast market and the ICI acquisition of additional sodium silicate facilities. Both those acquisitions were recognized as desirable and were authorized by the Commission on public benefit grounds. Authorization for mergers has always been possible, and it has never been suggested that authorization should cease to be possible, whatever the strength of otherwise of the primary legislative provisions as to mergers.

If, on the other hand, it be suggested that the merger law be repealed altogether, the likely cost of that is the growth of monopoly without any opportunity to consider public interest, one way or the other, in the individual cases. I find it not credible that the monopolisation provisions could then effectively replace the merger provisions. Such a theory would involve accepting monopoly, not because of benefit seen in it, but because of confidence that any abuse could be controlled. This controlling would have to come from very narrow provisions in the law (even as the Blunt Committee would propose their amendment) that do not take economic consequence as the test, but rather subjective purpose to abuse power as by barring entry. The Federal Court's decision in the very recent
CSBP case (W.A. Fertilizer) is far from encouraging on that. I find equally unconvincing the thought (page 28) that monopoly should perhaps be accepted, not for its own possible virtues, but because of inadequacies as to tariffs, subsidies and various other distortions. The same could be said if any of those inadequacies were to be attacked, and the result would be nothing until the unlikely event that every creak chimed at once.

Meantime there could be cases where the tariff etc. inadequacies were quite irrelevant for example in newspaper mergers.

It seems to be agreed that discussion should take the little time available and try to place competition policy (not just the merger law) in the broad economic context of the pressures or opportunities for change in Australian industry that come from macro-economic policy and from the need for international competitiveness reinforced by the lowering of tariff barriers to imports. I begin with some very general observations.

First, as economists you are accustomed to getting grossed-up information which you can manipulate and from which you can argue conclusions. You complain about the inadequacy of some sources of information, but at least you do have statistics and other generalized information. That is obvious from the other papers delivered at this conference. You are commonly concerned at least with industry sectors to which the information relates. By contrast competition law commonly operates at the level of the firm, so that information from which one can generalise is usually only available by way of example, unless economists are prepared to engage in research projects in the area, which hitherto most have been reluctant to do. Consequently the result of the pressures and opportunities provided by the law are not easy to quantify, particularly so early in the life of the law. Particular examples show changes by particular companies or groups, further changes occur as the
precedent and deterrent effects of the examples work through to others, and there is all the time the factor of voluntary compliance by companies who change conduct because of respect for the law or who want to compete more and grasp the new opportunities to do so. All this, however, is at the level of the firm, and it takes time to work through the economy. The immediate effect of domestic competition by particular firms is much less than a change in exchange rates that operates significantly on the whole economy and similarly much less than a broad cut in tariffs. Nevertheless, even where the effect is "at the fringe" compared with other forces, it is an important addition and to the parties directly concerned it may be quite vital in its efficiency-compelling or even structure-changing impetus.

Second, a great deal of domestic industry, particularly but by no means only in the tertiary sector, cannot be effectively replaced by imports. Services cannot usually be imported, and there are goods that enjoy a high degree of natural protection. Nevertheless the cost of such services and goods affects our international competitiveness in the cases where we do have to export or to compete with imports. Put shortly, the efficiency of our domestic infrastructure is vital, and that efficiency will often depend on internal competition. This runs as to consumer goods and services, building materials, construction, and transport - to take a few examples. Think, for example, of the consequences of licensing transport operators to control entry, which is being currently pressed for against the whole thrust of competition policy. Think also of the consequences if the Victorian legislation fixing minimum prices for beer became a model in other States and was applied to a wide range of consumer items. Even where local goods must compete with imports, it is a mistake to think of competition as being limited to the factory gate and the ship's side; that ignores the whole distributive process, where restrictive practices have flourished in the past. For example exclusive dealing
arrangements can blanket outlets with the result that import competition is denied the full opportunity that the tariff administration intended it to have. The Commission has dealt with such cases.

It is instructive to go back in history; it is not necessary to go very far. Price agreements and understandings are now prohibited, whereas until recent years they were permissible and respectable. Price competition is now expected, and indeed demanded. Of course, it is not just the law that has brought this about. New marketing methods have been a powerful influence, with the law creating or enlarging the opportunity or serving as a catalyst. Companies look for competition among their suppliers, and find their customers looking to them for the same. Such competition may be painful, and because of that the Commission has to show by investigation and by court proceedings where necessary, that price understandings, while difficult to prove are nevertheless very risky adventures.

Take some examples where restrictions retarded innovation and rationalisation and kept costs high; there has been marked improvement under the pressure of the law. I refer specifically to tyres and to distribution of petrol, liquor and pharmaceuticals. Recollect also the fibreboard container industry, whose products are in every factory, store and home in the country. They had a highly sophisticated system of equalising quotes for any size or shape of carton; note that the industry claimed excess capacity and that subsequently mergers have taken place.

Take also the growth and increasing range of supermarkets that proceeds now unimpeded by restrictions; the response has to be a competitive response, namely the encouragement of group buying - which is itself a significant structural change. A recent example of structural change being impeded by restriction was in the particle board industry, where excess capacity led
to a market quota system with obvious effects on price and against the
complaints of the furniture makers; the Commission denied authorization.
Even bread is subject to retail price competition in one or more States,
and where it is not, that is partly because of restrictions that still
remain. In general, where distributors are free from restrictions to
complete with each other, the competition that they feel is also passed
back onto their suppliers. This is a prime reason why the continued
enforcement of the prohibition of resale price maintenance by suppliers is
so important. An example is in the whitegoods area, where internal
competition has been a factor reinforcing the IAC thrust towards
rationalization.

Where competitive pressures are applied, they force improvement in
productive managerial or distributive efficiency, if necessary through
restructuring of companies or industries. In this way the pressures from
the administration of the tariff laws - towards industry restructuring to
meet external competition - are aided by the pressures of domestic
competition. It should never be forgotten that in many cases the real
competition, or at least the real competition at particular levels, is
wholly within Australia (notwithstanding that sometimes the goods may have
been imported beforehand). Nor should it be forgotten that there are many
cases where scale economies are not important or are quickly reached.
Where scale is important, competition policy should assist other forces in
moving towards it, as illustrated by the examples I have quoted throughout
my comments.

The pressures and opportunities there are for competition, and to that
extent for competition to encourage change in Australian industry, depend
partly on the law but significantly on businessmen themselves. My
observations lead me to believe that there are sufficient
competitively-minded businessmen in most areas to stimulate or take advantage of the process of change, slow as it might be to those who look for dramatic changes across the board. Business attitudes to restrictive arrangements have changed remarkably since competition law began to operate a few years ago, and the maintenance of the changed attitudes is important to the pressures for increased cost efficiency that we are all concerned about, whether we are talking about a contribution towards international competitiveness or whether we are talking about competition in those goods and services that are insulated from international competition.

In discussing competition, Dr. Norman made some useful observations on "structure". I take structure in the broader sense that Dr. Norman outlines on page 3 - namely as specially emphasising such factors as barriers to, or ease of, entry. However, I take it further and include well-established arrangements that have acquired an institutional character - I mean such things as traditional patterns of exclusive dealing or collective price fixing or market sharing or resale price maintenance. The Commission's position is that consideration of competition starts from consideration of the structure in which the competition takes place, that it is not possible to go direct to the nature and form of business conduct. In saying that, by no means do I want to suggest that "conduct" is less important than Dr. Norman says it is.
I seek to explain or comment briefly upon five matters arising from my paper, while agreeing with many of the useful remarks and observations made both by Mr. Bannerman and Dr. Nieuwenhuysen.

1. As to scope, the paper does concentrate on the mergers debate, but it is much broader than it seems. I did this because most of the "competition" issues concerning policy and the future industrial structure are those discussed in the mergers debate, and also because a broadening to the wider issues discussed by Mr. Bannerman seemed unable to do more than state the fairly obvious in a paper of this length.

2. Dr. Nieuwenhuysen is quite right that we need a Meeks-type study of the consequences of mergers in Australia, though I doubt that we have yet worked hard enough (Meeks included) to specify what we are trying to study. The problem arises directly from Meeks' work, which posits a rather unclear or even negative connection between merger activity and profitability. On the other hand, more traditional monopoly theories (X-inefficiency considerations aside) suggest a positive relationship between mergers and profitability. If the truth is some combination of these, together with non-structural influences on profits, then our econometric studies will have been poorly specified and unable to discriminate between alternative models that are useful for policy makers deciding how to arrange our merger laws. This is because of the apparent conflicting tendencies between monopoly power and the quest for a "quiet life". Before we rush to any Meeks-type study, I believe that the problem should be specified as a test between "nested" alternative hypotheses. Neither Meeks nor anybody else has yet provided this.

3. I do believe it relevant to the policy issues to ask the reasons for and consequences of a strengthening of our present laws. Mr. Bannerman
and I are agreed that, as they now stand, the merger laws are "very limited". There is no reason in theory or legislative practice why that strengthening should not take place, if it were so desired, either in the body of the Act that lays down the prohibition (s.50) or in the sections that provide dispensation from that prohibitive clause (s.90 - the authorization section). Unless we move towards a Monopolies Commission approach as in the UK, or some other institutional initiative, what else is meant by those who would like to see a much tighter control or scrutiny of mergers in Australia?

4. Mr. Rannerman expresses some concern about any removal of the merger laws on the grounds that "the likely cost of that is the growth of monopoly without any opportunity to consider public interest" (p.3 - my emphasis).

For two reasons I believe this defence either inadequate or too alarmist:

(i) If the present laws being defended are at the same time "very limited" (p.2) then it seems to me contradictory to imply that they are holding back a flood-tide of industrial concentration that would otherwise take place; and

(ii) When we ask deeply what we are concerned about, the answer will either be a dislike of large-scale industries and concentration structures on emotional grounds, or a fear that adverse conduct will take place.

While not pretending that the present laws or any amendment will catch all the undesirable conduct we will seek to prevent, they surely catch enough to give the public interest some opportunity to be expressed (against them if necessary).

5. Finally, there remains much resistance to accept in logic the principle of the "theory of the second best", not simply in general policy discussions, but also among economists. Naturally it only applies under fairly strict conditions. They are, in a nutshell, that some distortion that cannot be removed already exists and interacts with a distortion created by a removable policy that is the subject of investigation. Given
irremovability and interaction, and more precise knowledge about the
latter, it is quite probable that some degree of monopoly is, in Lipsey and
Lancaster's words, "not only desirable but necessary" in the interests of
economic efficiency.