A submission to contribute to the Inquiry into Price Gouging and Unfair Pricing Practices, by Elisabetta Magnani, Professor of Economics, Macquarie University

The term "price gouging" usually refers to the ability of companies to set their prices to the point that the increase is perceived as excessive and as unable to reflect actual increasing costs (labour, energy, intermediate inputs).

While price setting is not per se indicative of market power, in the last few years there has been increasing awareness that price setting in Australia happens in a specific context characterized by a complex interplay of the high and increasing market power of companies, lower wage growth, the declining power of workers' collective institutions, and high and increasing inequality (income and wealth). The most recent context has been shaped by an economic recovery from the effects of the Covid pandemic, the unsettling Russia-Ukraine war, and the structural change required to transit the economy to an ecologically sustainable path.

This submission aims to contribute to understanding how best to tackle the context where price gouging may occur, to highlight the impact of these practices on our most vulnerable groups and to make suggestions for suitable interventions.

According to the Reserve Bank of Australia (Beckers et al., 2023), the contribution to inflation of supply side factors overwhelmed the contribution of demand side factors at least from the second half of 2021 (see graph 4 of that report). This RBA study estimates that inflation without the supply contribution would have been between 3.1 and 3.5. While it is acknowledged that "inflation would still have been above the Reserve Bank's target range even if the contribution of supply factors was excluded in the estimates above", this RBA study also points to the fact that without these supply factors, inflation would have been much more contained than the inflation we have witnessed in the year ending in March 2023.

This observation prompts questions on the determinants of these supply factors. According to Beckers et al., (2023), Authors of the June 2023 RBA Bulletin contribution cited above, housing (driven by the rising interest rates that escalated rental prices) is certainly an important factor.

Since the start of the Coronavirus pandemic in early 2020 to early 2022, urban rental costs have increased in average by 9.4%, and housing prices have risen by 22% (see Pawson et al., ACOSS, 2021). Among the Australian poor, the share of income that goes to fund housing costs increased from 40.5% in 2019 to 45.7% in 2021. This picture becomes even more concerning if placed in the context of the current inflationary pressures in times where real wages struggle to keep up with CPI increases (see the 2022 RBA Economic Outlook).

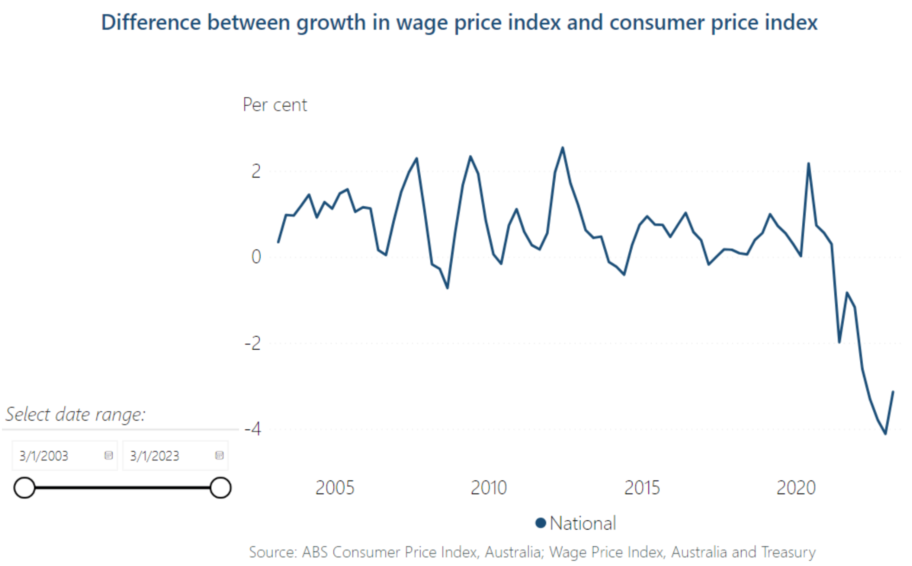
The RBA May 2023 Statement on Monetary Policy acknowledges that "high inflation after the COVID-19 pandemic has been accompanied by high corporate profits and falling real wages." Specific economic and legal forces in Australia have compounded to make high and rising corporate profits possible in Australia.

For a start, pricing strategies in many of our most important sectors are guided by extraordinary market power in the hands of few players. According to S&P Global, Australia banking sector is getting more and more concentrated (Sanglap and Taq, 2022). Currently the combined assets of Australia's biggest banks — Australia and New Zealand Banking Group, or ANZ; Commonwealth Bank of Australia, or CBA; Westpac Banking Corp.; and National Australia Bank Ltd., or NAB — makes up more than 72% of Australia's banking sector. In an industry where scale delivers competitive advantage, smaller banking and financial firms have no real chance to affect market dynamics. In retail, Woolworth's net profit rise in the last financial years has raised questions about corporations' pricing decisions in times of a painful rise in living costs. In the travel industry, rising costs have also been clearly identified (up to 50-60% higher compared to pre-pandemic levels). Importantly, these price surges are not explained by an airline's operating costs, but rather exploit demand and the need for travel in a multicultural society.

These price setting practices and the government inability (perhaps unwillingness) to contrast corporate rising market power have delivered unsettling truths about the travel industry's profits, which many Australian perceive have been possible at the expense of millions of Australians who have (often ageing) family members overseas they want to visit and care for.

Not surprisingly analysis of companies' market power and wage stagnation amplify concerns over the increasing inequality that Australia has experienced over time. According to a study by the Australian Council of Social Services (ACOSS) (Davidson et al., 2023), inequality today is still higher than in any year between 1999-00 and 2007-08. ABS data confirm that the Gini coefficient for wealth has consistently stayed above 0.6 since 2015 and has been rapidly increasingly from 2003 to 2019.

In an international perspective, Atkinson (2015) has traced the origin of a sharp rise in the income share of the top 1 percent of income recipients in all major OECD economies, including the UK and the US, to the late 1970s. Many have emphasized the exorbitant widening of the gap between pay levels – particularly the gap between CEOs' salaries and the average wage. Even in Australia, workers' ability to keep up with CPI growth has been limited. Using data from the Australian Bureau of Statistics, the Treasury has recently illustrated the widening gap between wage price index and consumer price index as illustrated below (The Australian Government the Treasury, 2023):



Several important factors have contributed to this loss of purchasing power of wage and salary earners. At the individual level, a person's ability to negotiate for higher wages is often limited by the lack of external labour market opportunities, particularly if this person is unskilled.

In this respect, the declining public expenses for families since 2015 and the failed attempts by the Gonski reform to properly fund public schooling, compound to ever increasing premia for education and skills to perpetuate poverty from one generation to the next. The 2023 ACOSS report illustrates that "on average in 2019-20, one in eight people (including one in six children) lived below the poverty line" and that the highest risk of poverty is experienced by people in households whose main income-earner was of working age and unemployed or not in the labour force, people in households receiving income support including Newstart Allowance/JobSeeker Payment, tenants in public housing and people in sole parent households and among the children in those households (Davidson et al., 2023).

The observed declining competition among businesses impacts on workers' ability to reallocate to expanding firms and industries when they experience wage stagnation. Companies' monopsony power and declining union coverage also play a role in fuelling wage stagnation (Hambur, 2023). The declining power of trade unions is particularly concerning if contrasted with the rising economic and legal power of corporations in key economic sectors including the banking and financial sector, retail distribution and the energy sector.

The rising corporate profits (to stratospheric levels in some instances) do nothing to alleviate the sense of inequity. The rising wealth inequality in Australia raises concerns over the adequacy of the current capital gain taxes, wealth taxation and heritage taxes. At stake here is not only the ability of large corporation to pass on more than the cost of inflation to their customers, but also the inability by smaller players, whether they are agricultural growers, small players in the distribution chains and smaller retailers, smaller banks or wage earners to counteract these moves.

Overall, these reports illustrate how price gouging may be the distressing tip of a much larger issue, driven by the increasing market power that compounds with complex market forces to deliver rising inequality in the Australian society. In this context the current debate about price gouging should be seen as an opportunity to revamp a political and socially shared commitment to fairness, inclusion and opportunities for all.

Granted it is not easy to talk about corporate tax or market design reforms that could address these issues in election times. The short political cycle biases any political plan towards caution or even worse, towards immobility. However, the current debate on price gouging is an expression of popular desire for transparency and equity.

Failing to read the debate on price gouging in this way carries relevant political risk. While price gouging is an appalling practice, governments of any persuasion should aim to reduce corporate market power, increase market competition among businesses, improve the effectiveness of taxation to fund public programs including those concerning housing, education and health care, and strengthen workers' solidarity institutions.

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