

NATIONAL COMPETITION POLICY AND THE RETAIL SECTOR

Dee Margetts

The time has come to proclaim that the great neo-liberal experiment of the past 30 years has failed, that the emperor has no clothes...Labor, in the international tradition of social democracy, consistently argues for a central role for government in the regulation of markets and the provision of public goods... The Liberals, embracing the neo-liberal tradition of anti-regulation, seek to reduce the agency of the state in private markets as much as possible...As President Sarkozy put it: “*Le laissez-faire, c’est fini*”. (Rudd, 2009: 25, 28, 29)

National Competition Policy (NCP), one of Australia’s major socio-economic policy changes, was introduced in 1995, providing significant powers to senior officials of the Council of Australian Governments and a range of other senior State and Federal bureaucrats to enforce deregulation and facilitate other forms of ‘free’ market restructuring of Australia’s domestic economy.

By 2009, Prime Minister Kevin Rudd was endeavouring to link neo-liberalism specifically with the Liberal Party in Australia and to claim that Labor has consistently promoted social democratic policy. Rudd did not acknowledge that the push to implement economic globalisation and NCP was greatest during the Hawke-Keating era and, although the subsequent Liberal Coalition Government became involved, the initiation and implementation of such a widely impacting policy change has played a major role in Australia’s current ‘neo-liberalism’.¹ In his essay in *The*

1 Rudd himself reportedly played a major role in the implementation of NCP when he was a Senior official in Queensland’s Goss Labor Government. (Mike Steketee 10/1/08, <http://www.theaustralian.news.com.au/story/0,25197,23029268-7583,00.html>, accessed 24 April 2009).

Monthly magazine, Rudd tended to link the Hawke/Keating era with only positive changes to Australia's political economy:

Examples of such a (social-democratic) government are the Australian Labor governments of Bob Hawke and Paul Keating during the 1980s and early '90s program of economic modernisation. Their reforms internationalised the Australian economy, removed protectionist barriers and opened it up to greater competition (*ibid*: 25).

Rudd then claimed that the Hawke/Keating Labor Governments were able to dramatically improve the productivity of the Australian private economy at the same time as expanding the role of the state in providing health and educational services (*ibid*: 25).

A more careful assessment of NCP, as a central feature of policies supported by both major parties in the last two decades, is needed. Research into the impacts of deregulation of important parts of Australia's grocery supply sector, such as Australia's dairy industry, has already put forward serious challenges to a range of NCP outcome assumptions (Margetts, 2007a) of the public 'benefits' of NCP such as 'lower prices and improved choice for consumers' (Hilmer *et al*, 1993: 1). Therefore the assumptions that new retail stores and new manufacturers resulting from NCP would be the main source of new jobs in Australia (Hilmer *et al*, 1993: xv) should also have been assessed by the Federal Government.

Rudd claimed that, while the Coalition was in government, it set about deregulating the labour market on the basis that human labour was no different from other commodities (Rudd, 2009: 28). This article will argue that the combination of labour market deregulation (which began under Labor) with forced deregulation of trading hours, and the combined impacts of NCP on Australia's retail and retail supply sectors such as the removal of Statutory Marketing Authorities and the Prices Discrimination Provisions of the *Trade Practices Act 1974*, have yet to be properly assessed by the Federal Government.

Prior to the 2007 Federal election, the ALP campaigned against rising grocery prices and in September of that year, as Opposition Leader, Rudd promised to engage the Australian Competition and Consumer Commission (ACCC) to conduct an inquiry into the prices charged by the major supermarket chains (ABC News, 2007). Soon after gaining

government, Labor announced that it would follow through on this promise by commissioning a full inquiry into Australian grocery prices.

The ACCC Grocery Price Inquiry Report strongly criticised Metcash (the major supplier of Australia's independent grocers) (ACCC, 2008: 153-199) but largely avoided criticising the much more market dominant Woolworths and Coles for their impacts on retail competitors and suppliers as well as consumers. The ACCC claimed that it analysed 'the extent to which competition (or lack of it) has contributed to increased grocery prices' but concluded that, despite a range of factors limiting the level of price competition, the grocery retail sector was 'workably competitive' (ACCC, 2008: xiii-xiv). This article presents a less benign view of combined impacts of NCP and labour market deregulation on market behaviour in Australia's grocery retail sector.

The Theoretical Basis of Australian Retail Deregulation

The implicit theoretical basis of the Hilmer Inquiry that led to the establishment of NCP had been promoted in the corporate-focussed Industry Assistance Commission's (IAC) inquiry into Government Non-Tax Charges (IAC, 1989; Margetts, 2001: 29). The IAC argued that the issue of market power was not just whether a natural monopoly existed but whether the entry or exit by rival firms is feasible, and so they supported private monopolies or oligopolies if the market was considered to be 'contestable' (IAC, 1989). As is explained below, Hilmer *et al* (1993) not only reflected the views of "contestability" theory (as promoted by the IAC) but they also treated the more mainstream market/competition theory as outdated.

However, even the classical supporter of free market entry, George Stigler,² had outlined what he considered the two features of competition necessary for the support for market deregulation. Firstly that each economic unit be sufficiently small so it exerts an imperceptible influence on prices; and secondly that neither government nor private associations erect obstacles to the movement of resources into and out of industries, or regulate the prices paid or received by economic units (Stigler, 1987: 13). The two points together could only fully apply in

2 Close friend and associate of the famous Chicago School monetarist economist, Milton Friedman.

cases of 'perfect competition'. Stigler had retained the view of the significance of market share despite the published work of economists such as William Baumol, who were pushing for further market deregulation as a result of the addition of their concept of 'perfect market contestability' to the concept of 'perfect competition'.

Baumol applied the concept of a 'perfectly contestable market' to monopolies and oligopolies in certain types of industry sectors, such as city-to-city air services (Baumol, 1982(b): 7), despite admitting that neither 'perfect competition' nor 'perfect contestability' were common. He also made it clear when including the possibility of oligopolies and monopolies in the concept of market contestability that 'perfectly contestable markets' were no more common on the real world than 'perfectly competitive markets' (Baumol, 1982(a): 2). He did, however, indicate that even though markets are rarely, if ever, perfectly contestable the concept of 'perfect contestability' could be more frequently applied than 'perfect competition' and that contestability was merely a broader idea and a benchmark of wider applicability than perfect competition (Baumol, 1982(a): 3).

Baumol's definition of 'perfect contestability' refers to the potential ability of free entry for a new market player as well as the potential for a cost-free exit. It also requires that the incumbent market operator/s will restrict their prices to that of marginal cost and hence no supernormal profit:

...a contestable market never offers more than a normal rate of profit - its economic profits must be zero or negative, even if it is oligopolistic or monopolistic. The reason is simple. Any positive profit means that a transient entrant can set up business, replicate a profit-making incumbent's output at the same cost as his, undercut the incumbent's prices slightly and still earn profit (Baumol, 1982(a): 4).

The Baumol emphasis on potential (and not necessarily actual) ease of market entry, has been challenged by economist William Shepherd for ignoring internal market features such as market structure, demand elasticity, lags, brand loyalties, price discrimination, cost differences, information gaps, and strategic behaviour. Shepherd criticised the fact that the rising preoccupation with oligopoly and monopoly ratios tended to neglect the differences amongst individual firms' behaviour, resulting in the ignoring of blown out market shares and the prevalence of price

discrimination (Shepherd, 1984: 574). Shepherd portrayed the push for acceptance of the contestability concept as part of an ‘...optimistic new-Chicago-school view...’, which regarded internal and external elements of market power as small and/or short lived. He claimed that existing market power was being justified on the assumption of greater economies of scale and better efficiencies (Shepherd, 1984: 575). Significantly, Shepherd noted that Baumol *et al* provided little in the way of practical examples of where such a concept of contestability in oligopolistic or monopolistic market circumstances existed or actually worked (Shepherd, 1984: 576). Shepherd later found that, as the ‘deductive results’ hold only when the pre-conditions of contestability exist, they were not observable in any markets (Shepherd, 1995).

For those in favour of strong market deregulation, the Baumol theory places the hypothetical benefits of contestability and deregulation above the impacts of blown out market shares and corporate market domination. Ironically, the Baumol theory of contestability has not influenced basic economic texts’ positions on competition. For instance, in the late 1980s, Samuelson and Nordhaus did not include a discussion of contestability in their definitions of free market competition. Instead, they pointed out that imperfect competition, monopoly elements and externalities amount to serious deviations from perfect competition (Samuelson & Nordhaus, 1989: 44).

What is meant by perfect competition? It is a technical economic term that refers to a market in which no firm or consumer is large enough to affect the market price (Samuelson & Nordhaus, 1989: 42).

The significance of these theories regarding competition and markets from an Australian perspective is that the focus of the Hilmer Report reflects the views of ‘contestability’ theory rather than mainstream competitive market theory and treats the more mainstream market/competition theory as outdated. Thus, its definition of ‘competition’ is substantially different from that of Samuelson (above):

Striving or potential striving: it was once thought that markets would be efficient only when a number of firms were actually competing. Recent work suggests that the real likelihood of competition occurring (potential striving) can have a similar effect on the performance of a firm as actual striving... Thus, a market which is highly open to potential rivals – known as a

highly contestable market – may be of similar efficiency as a market with actual head-to-head competition (Hilmer *et al*, 1993: 2)³.

Similarly, the Hilmer Report makes no specific mention of Galbraith's concerns about corporate market power abuse and mainstream economists' views on the significance of market share and the numbers of market competitors:

Two or more persons or entities: early economic work suggested that large numbers of competitors were important for the effective working of competitive forces. However, in some cases competition between a few large firms may provide more economic benefit than competition between a large number of small firms. This may occur due to economics of scale and scope, not only in production but also in marketing, technology and, increasingly, in management (Hilmer *et al*, 1993: 3).

Hilmer needed to have added that, even from Baumol's point of view, 'some cases' are those which fit within the definition of 'contestability'. That means that, if NCP was to use the Baumol theoretical position, it would be necessary to assess whether the basic pre-conditions of contestability existed in the sector which was being examined. Even though Hilmer seemed to accept contestability theory as if it was now unchallengeable, from the point of view of those such as Shepherd this is clearly not the case. Even Baumol admitted that 'perfect contestability' is uncommon. The preconditions for contestability, according to Baumol (1982b), are as follows:

- a perfectly contestable market must have free entry and costless market exit;
- contestable market prices must not be greater than marginal costs; and
- incumbent firms in contestable markets must never have more than a normal rate of profit and its economic profits must be zero or negative.

3 Hilmer's references cited Baumol (1982) and Gilbert (1989) (Hilmer *et al*, 1993: 2)

The benefits emphasised by contestability theory are that large corporations in a ‘contestable oligopoly’ can use their size to keep costs lower and, if they are in a position to achieve ‘equilibrium’, these lower costs can ‘guarantee optimality’. (Baumol, 1982a: 2). Apart from the fact that this presumption is an empirical proposition that needs to be tested, there was no discussion regarding how such corporations were likely to treat their suppliers.

Since the application of contestability theory is itself contestable, and this has been a major theoretical basis for the treatment of markets under NCP, both the mainstream market theory guidelines and the basic pre-conditions for contestability should have been carefully assessed in sectors such as retail after NCP-driven changes had been implemented. Hilmer himself has admitted that NCP had not been based on ‘proven principles’:

Many of the areas of competition policy are *not amenable* to simple answers based on *proven principles*. The economic logic on which competition policy is based is still being formulated...”
(Hilmer, 1994: xiii) (Emphasis added).⁴

Despite this admission of the lack of proven theoretical principles, the Hilmer report’s approach was applied to almost every aspect of Australian society via a compulsory (and draconian) national legislative review. John Brätland has recently stated that ‘...contestability theory presumes that [market] inefficiency can be detected and that corrective regulatory sanctions can be imposed...’ and adds that Baumol *et al* in 1998 had presumed that regulators could ‘...empirically detect situations in which no schedule of prices would be available to the incumbent monopolist that would forestall entry of competitors and the loss of production economies.’ (Brätland, 2004: 5). However, Brätland considers that such ‘objective’ information on opportunity costs never exists (Brätland, 2004: 26). These types of contestability assumptions and challenges to these assumptions make a systematic check of the outcomes of NCP-driven changes even more vital.

4 This statement was repeated by Hilmer in 1995 at the Higgins Memorial Lecture (Hilmer, 1995a), and in the *Economic Analysis and Policy* journal that same year (Hilmer, 1995b: 24).

What Changes Did NCP Make to the Australian Retail Industry? What Role Did the NCC Play?

In addition to the overall NCP legislative review, the Hilmer Report recommended that NCP changes should to be introduced via amendments to the *Trade Practices Act 1974* which included recommending removal of the Prices Discrimination Provision (S 49). This recommendation had the potential to take on greater significance after other NCP changes increased the market power of corporate retailers and diminished the market power of many in their supply sector (Margetts, 2009). The NCP Legislative Review required all local, state and federal legislation to be reviewed and repealed or amended if a case could not be put forward to gain the acceptance of the National Competition Council (NCC) and the Federal Treasurer that retaining certain laws and regulations was:

- in the public interest; and
- could not be replaced by a more market-based alternative.

For the retail sector, in addition to the move towards further deregulation of liquor licensing and trading regulations (which attracted considerable public interest debate), one of the most obvious targets pursued by the NCC, then under Graeme Samuel as President, was to push heavily for further deregulation of retail trading hours. Even though Samuel admitted that NCP agreements did not *mandate* the removal of retail trading hours regulations, he described them as ‘anti-competitive restrictions’ (Samuel, 1998: 7). The NCC also produced a Shop Trading Hours leaflet which said:

In 1995 all governments agreed to work together in a co-ordinated manner towards introducing greater competition into our economy where it benefited the overall community (NCC, 2000).

This statement is challengeable in two ways. First, as we have seen, NCP was based on ‘contestability’ theory, rather than the existing competitive market theory. That means that ‘contestability’ does not necessarily mean greater competition, especially if it is used to support market domination and/or oligopsonistic buying power. Secondly, there is a fundamental asymmetry in the prescriptions. Those seeking to retain existing regulations were required to convince the NCC that they were in

the public interest. There was no requirement for the removal of regulations to be proven to 'benefit the overall community' (NCC, 2000). Moreover, the NCC has shown itself a biased judge of what constitutes the public interest.

Even though Hilmer himself in 1995 had clearly stated that the recommended processes and institutions of NCP leave much of the competition policy squarely in the political domain (Hilmer, 1995b: 19), in areas such as trading hours deregulation the NCC only accepted State government political judgements of public interest if they coincided with the NCC's own decisions. An example of this inbuilt prejudice is that, when the majority of the Western Australian electorate voted in the 2005 Referendum that urban retail trading hours deregulation would not be in the public interest, the NCC chose to ignore the result, despite having promoted the results of a 'non-compulsory referendum' in Bendigo on their 'Shop Trading Hours' leaflet (NCC, 2000).

There has been considerable criticism over the years from small or independent retail competitors and suppliers, as well as many consumers, regarding the impacts of further deregulation on the market power of the Australia's major supermarket chains. For instance, 285 of the 332 submissions to the Joint Select Committee on the Retail Trading Sector Inquiry expressed opposition to the increasing market power of the corporate retail sector whilst there were only 22 which were supportive of further retail deregulation: the remainder were unclear or unspecified (JSCRTS 1999)⁵. A major incentive for corporate retailers to push for further retail trading hours deregulation would have been the labour cost advantages gained through changes to Federal employment relations laws.

Changes to Corporate Employment Relations Laws

In October 1997, Professor Hilmer had been asked by the Business Council of Australia to head a major research project to recommend reforms to Australia's labour markets.⁶ The Keating Government had

5 See Table 1 below.

6 In 1995, Bill Scates, who at that time was the Industry Commission Chairman, stated that the major waves of reform of traded goods and deregulation of financial

WA Trading Hours Surveys

In 2008, on behalf of the WA Department of Premier and Cabinet, Luscombe and Associates published a Retail Trading Hours Survey Preliminary Report three years after the WA Retail Trading Referendum. Respondents were asked ‘Are there any changes that you would like to see to the hours that shops are open at the moment?’ 49.8% said they would like to see changes, 48.8% said there did not have changes they would like to see and 1.4% were unsure. However, 53% of Respondents agreed that ‘Protecting smaller shops from bigger retailers is more important than allowing people a wider choice of shopping hours’ (Luscombe and Associates Pty Ltd, 2008)

The community opinions on retail trading hours tend to depend on how survey questions are asked. In recent years, major supermarket chains have conducted a range of surveys or petitions asking whether their customers wanted increased shop trading hours. For instance, in 2009, Coles said that four years after the WA Retail Trading Hours Referendum, public feeling had changed, however, they only surveyed suburban residents. Their press release said ‘...two thirds of Perth residents support longer shopping hours on weekdays and Sundays’. However, Coles did not provide any information about how the questions were asked (Palmer, Daniel, 2009)

already introduced enterprise bargaining when the newly elected Howard Government in 1996 introduced major changes to Australia’s employment relations laws via the *Workplace Relations Act (1996)* that enabled large corporate employers to offer individual contracts (AWAs) to their employees (Bray, Waring & Cooper, 2009: 279). As corporate market power had already been enhanced by changes such as the removal of the Prices Discrimination Provision of the TPA, these Federal Government legislative changes may have provided even greater potential for large retail corporations to improve their market share and profit margins.

markets provided the impetus for reform in the ‘non-traded’ sectors such as labour markets (Scales, 1995: 41).

David Peetz has argued that individual contracts increased flexibility in how employers pay for working hours. Peetz referred to the works of Cole, Callus & Van Barneveld (2001), Mitchell & Fetter (2003) and Rasmussen and Deeks (1997) to highlight that individual contracts focus on reducing or abolishing overtime pay, increasing the standard hours per week, and reducing or abolishing penalty rates for working at nights or on weekend (Peetz, 2005: 47).

AWAs could be used by corporations such as the major supermarket chains throughout Australia and by any businesses in Victoria or the Territories. AWA's would have created considerably more incentive for the major corporate supermarket chains at that time to push for extended trading hours, especially as the Federal employment relations legislation could be applied to corporations, whilst small businesses in States other than Victoria and the Territories were still under State employment relations laws and therefore could not necessarily force AWA's on their employees. This division meant that the major supermarket chains could prepare for a situation where longer trading hours did not require them to pay penalty rates and therefore facilitated and enhanced profit margins from after-hours trade compared to the conditions facing their independent retail competitors.

The Sources of Trading Hours Changes

Although there are some consumer bodies supporting longer trading hours, after NCP was introduced, the push to remove existing retail trading hours regulations tended not to come from the community or State governments themselves but from the NCC, the corporate retail sector and bodies such as the States' Chambers of Commerce and Industry.

Table 1 on the opposite page provides a summary of the 22 submissions to the 1999 Committee Inquiry in to the retailing Sector which expressed support for further retail deregulation, such as deregulated trading hours.

Table 1 Supporters of Further Retail Deregulation Making Submissions to JSCRT Retail Trading Inquiry, 1999

Sub. No.	Submission Source	Description	Additional Submission/s
19	Stapledon, G Dr, (Oxford, UK)	Visiting Law Academic invited by the C'tee secretariat to critique the NARGA submission	
20	Pengilly, W Prof, (NSW)	Visiting Law Academic invited by the C'tee secretariat to critique the NARGA submission	
57	Australian Retailers Association, Sydney (NSW)	(Dominated by the corporate retail sector)	
99	7-Eleven Stores (Vic)	Convenience Stores	
104	Baxt, B Mr (Vic)	Former Chair of the TPC (Predecessor of the ACCC) Freehills partner and long time supporter of corporate interests	
168	Coles Supermarkets (Vic)	MSC	168A, 168B, 168C, 168D
181	NT Chamber of Commerce & Industry	Chamber of Commerce	
191	ACCC (ACT)	Competition Commission	
197	Convenience Stores Australia (NSW)	Convenience Stores	
200	Franklins Ltd (NSW)	MSC	200B
228	Jebb Holland Dimasi, Melbourne (Vic)	Economists & Property Advisor (Report Commissioned by Woolworths)	228A
229A	Woolworths, Sydney (NSW)	MSC	229C, 229E
235	MC Australia (NSW)	Wholesale Distributors to Convenience Stores & Mini Supermarkets	
245	Australian Consumers Ass'n, Marrickville (NSW)	Consumers Association	
281	Australian Chamber of Commerce & Industry, Barton (ACT)	Business (mostly big business) Representatives	
283	Law Council of Australia, Braddon (ACT)	Long time supporter of corporate interests	
284	Barbara Maidment, Margaret River (WA)	Small Business Advisor	
299	Howard Smith Ltd, Sydney (NSW)	Major Hardware Distributors	
308	Visitor Information Services, Bendigo (Vic)	Visitor Centre	308A
309	Sandhurst Trustees, Bendigo (Vic)	Financiers	
310	Bendigo Trust (Vic)	Financiers	

Source: JSCRT (1999) "Volumes of Submissions" CD

Some Basic Questions Regarding the Retail Sector

- What impacts (such as prices, choice, convenience, service, etc) have NCP changes been having on consumers?
- What impacts have NCP changes been having on the grocery supply sector?
- If there are problems either arising or not improving, what might be the causes of the problems and what needs to be changed?

The ACCC Grocery Price Inquiry

In the lead-up to the 2007 Federal Election, Opposition Leader Kevin Rudd responded to growing media attention regarding rising grocery prices by promising that should they be elected to office, the new Labor Government would be commissioning an inquiry into Australian grocery prices. A few months after the Rudd Government took office, in his news conference announcing the commissioning of the ACCC inquiry, the Minister for Competition Policy, Chris Bowen, stated the main reason behind the inquiry:

While inflation has been low in Australia over the last few years, food inflation has been higher than the average. And there's considerable evidence to suggest that ... Australian food inflation has been higher than the world average. And of course, that affects working families and all Australians everyday as they go to the supermarket (Bowen, 2008)

Deserving of examination is the manner in which the ACCC handled the grocery prices inquiry and how its inquiry methods relate to testing the theories of market competition and contestability. Of relevance is that the ACCC avoided checking the impacts on NCP on Australia's grocery and grocery supply sectors.

The Grocery Prices Inquiry Announcement commenced on the 30th of January 2008. However, the Issues Paper, upon which the submissions to the inquiry were expected to be largely based, was not published until the 11th of February at which time the deadline for submissions was also announced for just four weeks later (5 pm on the 11th of March).

ACCC Inquiry Issues Paper

The release of the ACCC Issues Paper indicated some serious problems in the manner in which the inquiry was likely to be undertaken. Apart from the short deadline, two obvious indicators that the ACCC might be able to prevent considerable detailed evidence on what had been occurring in the retail and retail supply sectors since the introduction of NCP were:

the warning/threat that protection for vulnerable witnesses via evidence confidentiality would be restricted to some specific and limited commercial in confidence criteria, and

the limited years for which the ACCC was requesting data and evidence.

Lack of Confidentiality Protection

If the ACCC was not willing to provide any reasonable protection for those who may have been affected by market power abuse or who were vulnerable to abuse as a result of any evidence they provided to the inquiry, that would indicate that there was an unwillingness to find out what was really happening in Australia's grocery supply sector. Anyone wishing to present submissions to the inquiry was required to call their submission a 'public submission' and include their name; and then only apply for a 'confidential annexure', approval for which was limited to 'trade secrets' and 'costs of manufacturing'. This did not include detailed reports of market abuse; and the ACCC said it would decide if such requests for confidentiality were in the public interest, as opposed to the risks to those most vulnerable in the sector (ACCC, 2008a: 3).

With no protection for evidence from vulnerable grocery sector suppliers or competitors, at the very least, the inquiry should have made sure that widespread confidential surveys were undertaken so that whatever evidence they received regarding vulnerable suppliers or competitions could be properly assessed. This did not happen.

The ACCC Issues Paper contained 83 questions covering a wide range of examples of potential retail grocery and supply market problems. However, the lack of protection for vulnerable competitors and suppliers could have put them at serious risk from those with sufficient market

power to damage them for speaking out to provide evidence that such behaviour had been taking place (ACCC, 2008).

On the ACCC website, only 2 of the 250 submissions were stated as ‘confidential’.⁷ Clearly, although the discussions within the Issues Paper mentioned a wide range of potential market power abuse problems within the supermarket supply sector, the ACCC inquiry did not encourage confidential submissions which could provide them with detailed evidence of such behaviour. The significance of this stance can be seen months later from the ACCC Report’s Overview:

In scrutinising the information before the inquiry, it has become clear that some industry participants, representative groups and commentators have made unsupported claims to the inquiry and in the media. These claims were based on generalisations and there was a failure to provide facts to support these claims (ACCC, 2008d: xiv) (emphasis added).

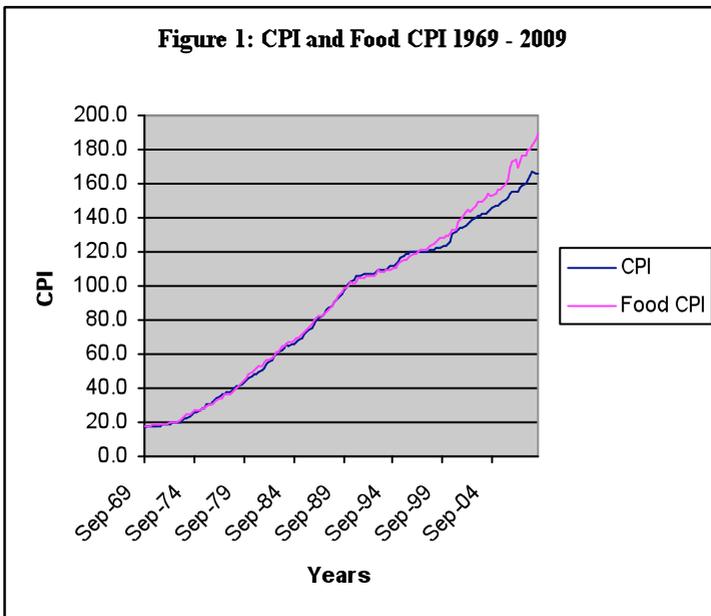
During the Inquiry, 39 of the 78 sets of witnesses attending public hearings for the Inquiry had been summonsed, all of whom, with the exception of Westfield and Colonial First State, were grocery suppliers. 35 of the total 78 sets of witnesses gave some of their evidence as ‘transcript-in-confidence’, and 20 of those 35 witnesses had been summonsed. As the major supermarket chains (MSCs) would have been aware both of who they were and the general nature of the questions asked, it is unlikely that those witnesses would have felt comfortable in providing evidence of market power abuse in specific circumstances. However, the submissions and evidence from the wide range of supplier representative bodies did provide frequent claims of the abuse of market power by the MSCs, but the time pressure for their evidence to be submitted made it difficult for them to conduct surveys of their members to back up their claims (ACCC, 2008b, 2008c).

7 Compare this to the 1997 Reid Committee Report, which accepted 83 of its 198 Submissions as confidential and another 3 as ‘name withheld’. It had received disturbing evidence of market power abuse in the retail sector and called for the ACCC to investigate such complaints and enforce the law in relation to the misuse of marketing light of the high degree of concentration in the retail sector (House of Representatives Standing Committee on Industry, Science and Technology, 1997: 135).

Limits on Data and Evidence Requested

Moreover, the Issues Paper also only asked for data going back ‘5 to 10 years’, which made the ACCC unable to assess whether changes affecting the grocery retail sector were a result of the introduction and implementation of aspects of NCP had been introduced in 1995. Such data would need to go back at least 15 to 20 years. Appendix A of the Issues Paper provided a list of public reviews of grocery mergers and acquisitions going back less than 4 years.

This limited data request, along with the restrictions on confidentiality, could be seen to coincide with the ACCC’s claims that the evidence provided failed to support many of the claims within submissions by representative groups. However, data and evidence in a timeline of up to only 5 years cannot provide a clear picture of the nature and possible major causes of current grocery market problems in Australia as the graphs below indicate.

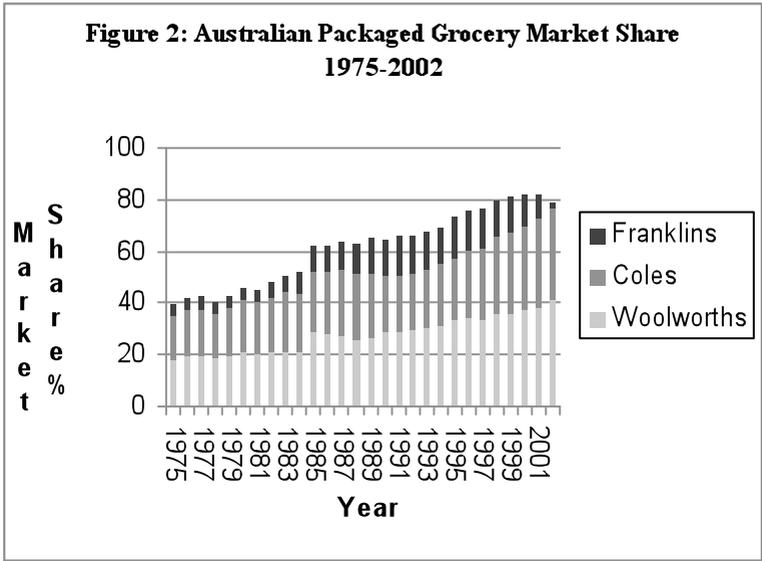


Source: ABS data via Reserve Bank www.rba.gov.au/Statistics/Bulletin/G02hist.xls

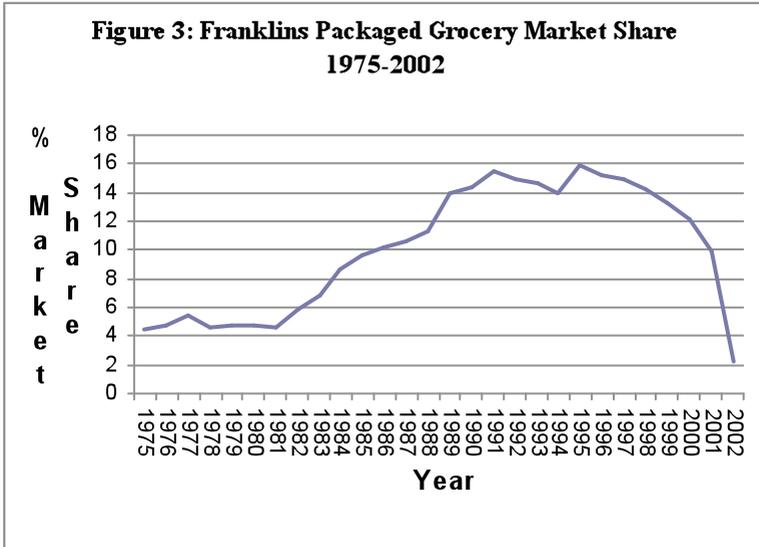
Figure 1 (on the preceding page) indicates that it was in the mid-1990's that the index of food price began to rise at a higher rate than the overall Consumer Price Index (CPI).

The years during which CPI and food price inflation appear to have become more disconnected indicate that 5 to 10 years does not give us the full picture of what has been happening to food (and overall grocery) prices.

Figure 2 illustrates the published dry packaged grocery market shares of Coles, Woolworths and Franklins. In 1975, their combined market share was 39.6 percent (Woolworths 17.7, Coles 17.5 and Franklins 4.4). By 1995, their combined published market share had grown to 73.3 percent (Woolworths 33.1, Coles 24.3 and Franklins 15.9) but Figure 3 shows that, from 1995, Franklins discount grocery chain began dropping from its highest market share to insignificance.



Sources for Figure 2 and Figure 3 - Retail World Annual Reports (1975-1992), Australian Grocery Industry Marketing Guides (1992-2002)



By 2002, Coles and Woolworths’ combined dry packaged market shares had reached 76.7 percent, and Franklins by that time was just 2.3 percent. From then on, the dry packaged market shares of each major supermarket chain ceased to be annually published. This begs the question of how much impact NCP legislative changes, such as the removal of the Prices Discrimination Provision, has had on market dominance and what impacts such growing market dominance had on retail competitors, consumers and suppliers over the last 15 to 20 years.

Timing of the Inquiry

As the time available between the release of the Issues Paper in February 2008 and the official deadline for submissions was a mere four weeks, the number of submissions accepted after the official deadline (129) exceeded the number before the deadline (119 with 1 number missing). As noted, this time would have been insufficient for most representative groups to effectively survey their members to respond on time to the ACCC. There would, however, have been time during the inquiry for the

ACCC to conduct confidential surveys of those sectors whose members would have been reluctant to provide public evidence to those questions in the ACCC Issues Paper, which may have made them vulnerable for abuse by those with greater market power in the sector. The ACCC chose not to undertake such surveys. The public hearings were held between April 1 to 30 May 2008 and the reporting date was 31 July 2008.

How Did the ACCC Handle It?

When Graeme Samuel was President of the NCC, he had played a significant role in the push for retail trading hours deregulation in all States and Territories. The decision to appoint Samuel to head the ACCC Grocery Prices Inquiry should therefore be questioned. Under his leadership, the NCC had threatened to hold back NCP Tranche Payments for any State which did not agree to full trading hours deregulation; therefore it is unlikely that he would encourage the inquiry to assess whether he had been right or wrong in his previous behaviour as head of the NCC.

To put the ACCC Report in some context, the structure of NCP was ‘not about the pursuit of competition *per se*’ (Hilmer *et al*, 1993: xvi) but rather to enable the businesses in the nation’s corporate sector to find ways to reduce their costs (Margetts, 2007b: 19). As noted, rather than apply basic market theory and its application in trade practices decisions, NCP was based on the Baumol theory of ‘contestability’, which is why so much more of the emphasis appeared to be on deregulation rather than market power, competition or avoiding market failures.

If the ACCC were really interested in whether the Australian grocery retail sector was ‘contestable’, it would be necessary to accurately assess whether and how much the sector fitted within the following guidelines:

- a perfectly contestable market must have free entry and costless market exit;
- contestable market prices must not be greater than marginal costs; and
- incumbent firms in contestable markets must have zero or negative economic profit (never above normal).

Did the ACCC inquiry assess the level of competition in terms of market domination in Australia’s grocery sector and if, so what did it conclude?

The ACCC admitted that the Australian grocery retail market was criticised as being too concentrated and that the ‘regular statements’ being made by industry commentators were that the two largest grocery retailers, Coles and Woolworths, accounted for 80 percent of grocery retail sales⁸ (ACCC 2008d: 54). However, the ACCC took the following view⁹:

Based on the information available to it, the ACCC’s view is that the MSC’s account for between 55 to 60 percent of consumer expenditure on grocery items. Woolworths accounts for at least 30 per cent and Coles around 25 per cent. Although each of these shares of retail grocery sales are large for a single company, to say that the MSC’s enjoy an 80 per cent share of the grocery sales exaggerates the position of the retailer (ACCC, 2008d: 58).

The ACCC’s conclusion was that, even though the MSC’s maintain a large share of the sales of packaged groceries and that this ‘may raise concerns’, this position needed to be assessed in conjunction with other factors such as ‘barriers to entry and expansion before any conclusions are drawn’ (ACCC 2008d: 80). That means that the ACCC was dependent on establishing that the grocery sector could be considered ‘contestable’, which it manifestly failed to do.

Free entry and costless market exit? The ACCC admitted that there was ‘...limited room for more major grocery retailers’ and that to enter the market effectively it was necessary to obtain competitive wholesale grocery prices (ACCC, 2008d: 217). It had already accepted that access to such levels of wholesale marketing in the current grocery market situation would be extremely difficult as Metcash had increased in size considerably in order to survive competition from the MSCs. The ACCC also admitted that the entry of a new and competitive wholesaler operation would be very hard to achieve:

The implication of another large-scale wholesaler entering the market are unclear. As the only national wholesaler to the independent sector, Metcash can take advantage of significant

8 The MSC grocery market share of around 78 percent was based on the ACNielsen published data of packaged grocery market share (ACCC 2008d: 59).

9 This was based largely on the argued position of Woolworths, that grocery market share should be based on the ‘share of stomach’ which included all food retailers, specialty food markets, take-away foods, cafes and restaurants (ACCC 2008d: 56).

economies of scale. If there were two large-scale wholesalers it is possible that neither would achieve the same economies of scale that Metcash has achieved. (ACCC, 2008d: 153).

The ACCC Report also stated that they considered that a wholesaler would need to have guaranteed annual sales of at least \$800 million to be viable (ACCC, 2008d: 193). Cost barriers to entry were therefore substantial given the nature of the retail and wholesale grocery market dominance, so this precondition to contestability was highly challengeable.

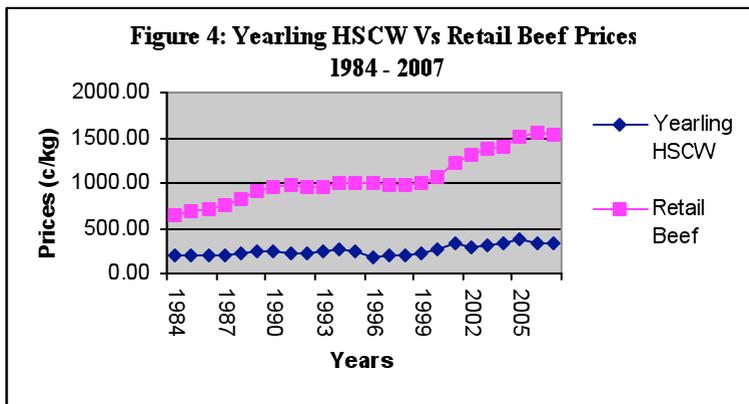
Contestable market prices must not be greater than market costs.

The ACCC tended to assess market costs on the average margins of the MSCs, claimed to be small.¹⁰ However, given the substantial profit levels of the two major MSCs, this emphasis tends to ignore the fact that vertically integrated MSCs can enable their retail margins to look small as they can create their own wholesale margins by retaining a higher percentage of their profits from their wholesale rather than their retail sector.

An example of this phenomenon is beef retailing. The ACCC states that the ‘average decline in the gross margins of meat was 1.5 percentage points from 2002-03 to 2006-07’ (ACCC 2008d: 143). However, whilst there were strong criticisms regarding the gaps between costs and supermarket prices, the ACCC avoided providing data to show comparisons between retail prices, farmgate prices and marginal costs. Their explanation for leaving it out was as follows:

The supply chain for beef is long and complex with the farm gate price of livestock only one of the numerous inputs into the eventual cost of a cut of beef. As such, direct comparisons between farmgate and retail prices are difficult and not necessarily instructive (ACCC 2008: 355).

10 The ACCC cited Woolworths’ average supermarket (pre-tax) margins as around 6 percent and Coles around 3.5 percent (ACCC 2008b: 125).



Source: Australian Beef Association

However, as Figure 4 above clearly shows, in recent years there has been a growing gap between farmgate yearling and retail beef prices. The trend in the data provided by the Australian Beef Association (ABA) for yearling beef was similar to that produced by the ACCC itself on beef in its 2007 report to the Minister for Agriculture, Fisheries and Forestry which examined the difference between farmgate and retail prices (ACCC 2007a: 13). The ACCC's response in 2007 was that:

The supply of fresh meat involves a long and complex supply chain. The cost of livestock is only one component of the total cost incurred by supermarkets (and other retailers) in providing fresh meat to consumers... (ACCC 2007b).

But the serious concerns expressed in the ABA's submission to the ACCC's 2008 Grocery Price Inquiry regarding the growing gap between farmgate and retail pricing were far from unique (ABA 2008). Of the thirty eight primary producers' organizations which made submissions to the Grocery Price Inquiry (covering virtually all of Australia's primary production) the majority (thirty) specifically claimed that there is a growing gap between farmgate and retail pricing (ACCC 2008c, 2008d).

There were also strong arguments put up in organizations such as GrowSA's submission that:

...There is a clear trend of these (MSCs) using their market power to push costs, risks and responsibilities down the supply

chain. Anecdotally, ten years ago growers worked on a rule of thumb of farm gate return being about 50 per cent of retail price. Today this margin is generally less than 20 per cent. Growers' profit margins continue to decrease, while the profit margins of the major retailers remain at record highs (GrowSA 2008: 5).

The Western Australian Department of Agriculture supported similar concerns:

The disconnect between their costs of production and the prices being offered is rapidly approaching a point where many small and medium sized food producers claim they are becoming unviable, or where alternative uses to agriculture become increasingly attractive because of better returns on investment... In addition, local consumers are becoming increasingly concerned about the high cost of food on top of other rising pressures on household incomes. Producers of our agricultural raw materials are also reaching a point where they are unable to see the basis for the large differentials between what they are being paid for their produce, and the prices being charged by the large retailers (WA Dep't of Agriculture and Food 2008: 1).

It can therefore be clearly stated that, for Australian primary produce, if 'contestable market prices must not be greater than market costs' the evidence strongly challenges the pre-condition that grocery retailing of primary produce in Australia is in a 'contestable market'.

Profit Levels of Incumbent Firms

The ACCC Report admitted that Woolworths was currently achieving one of the highest earnings before interest (EBIT) margins in the world and that Coles' EBIT margin was lower but similar to the average EBIT margins of major overseas grocery retailers. Nevertheless, similar to the ACCC's conclusions about the impacts of the other contestability pre-conditions, it avoided assessing contestability on this basis by saying:

...the size of MSC profits in recent years have been cited in public discussion as evidence of a lack of competition in grocery retailing. However, profits in simply dollar terms alone are rarely instructive about the level of competition in a market... (ACCC 2008: 125-126).

Conclusion

Market dominance, according to classical market theory, means that market prices can be manipulated and controlled. The level of market dominance of the MSCs in Australia's grocery sector is substantial. AC Nielsen's 'ScanTrak' data shows that the MSC's market share of the dry packaged grocery market was 78% (ACCC 2008: 75); even Woolworths' argument that MSC's market share was 55 to 60 percent of the 'share of stomach' (ACCC 2008: 56-58) confirms the existence of market dominance.

National Competition Policy was based on 'contestability theory', which accepted corporate market domination in 'contestable markets'. However, the three basic pre-conditions of 'contestability theory', as set out by Baumol *et al*, did not apply to the Australia's grocery sector at the time of the Grocery Price Inquiry. Whether the retail grocery sector was 'non-contestable' and/or market dominated, the impacts of NCP on corporate power abuse in Australia's grocery supply sector were not adequately assessed.

This article has focussed on the theoretical basis of NCP relating to the retail sector, the impacts of the ACCC's targeting of the retail sector and the improper assessment of market competition and contestability in the Grocery Price Inquiry, but there are many other aspects of how the ACCC's inquiry was conducted that need to be investigated. In particular, key unresolved questions are the impact that NCP has had on retail and wholesale market dominance and the impact that market dominance is having on Australia's grocery supply sector. There is a broader public interest at stake.

Dee Margetts is a former Federal and State parliamentarian who has been undertaking PhD research since 2006 on the impacts of National Competition Policy.

dee1@iinet.net.au

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