

**The PC Issues Paper**

Before specific discussion of the issues paper, I consider that the series of bold questions in this issues paper should have been numbered to make them easier to respond to.

The Productivity Commission (PC) had been asked, amongst other things, to inquire into the implications of globalisation on the retail industry. Given that in Australia, apart from the world free trade agreement, National Competition Policy was a means of introducing domestic corporate globalisation, this should have been one of their major assessments of the impacts on Australia's retail sector, but this was not properly considered in this Issues Paper.

It is also significant that regarding the *"drivers of structural change in the retail industry, including globalisation"* the PC has chosen not to mention the data that was provided by Michael Pusey's *"Economic Rationalism in Canberra"* (Pusey 1991) which clearly showed that Senior Federal Executives played a major role in the push for major policy changes to introduced domestic corporate globalisation in Australia.

In discussing the scope of the inquiry, (PC 2011 p 3) they said there *"...may be a question to which some wholesale activities...should be included"* and appeared to indicate that they were too *"blurred"* between retail and wholesale. However, there should be a proper assessment of the impacts of the Australian retail sector, especially their supply sector. Also, the connection between major retailers who are also their own wholesale suppliers SHOULD be properly assessed because the impacts on Australia's grocery supply sector was NOT properly assessed by the ACCC Grocery Price inquiry.

It is also difficult to understand why the PC have chosen to exclude assessing the impacts of fuel trading given the strong connection to Australia's major supermarket chains (MSCs) (PC 2011 p 3).

In addition, given the impacts of the major supermarket chains (MSCs) on Australia's pharmacy retailing, it is also hard to understand why the PC has chosen not to examine the impacts on the pharmacy retailing sector of such issues as retail trading hours deregulation under NCP. They have, however, suggested that an inquiry into the discount pharmacy sector may be included.

***"To what extent is current retail performance a result of structural rather than cyclical change? If it is structural change what are the implications and evidence of this?"*** (PC 2011 p 6)

In recent years, the *"current retail performance"* in Australia's grocery sector has included a rise in average prices at a higher rate than GDP (Margetts 2011). In more recent months, the *"retail performance"* also included *"price wars"* on specific high demand items such as milk. Structural changes, impacting such performances include the impacts of National Competition Policy (NCP) which was introduced in 1995.

***"What further evidence from the market is available in support, or otherwise, of the view that many categories of retail goods are continuing to grow in terms of volume, but that prices have decreased, thus squeezing margins? What specific categories of goods are affected and what***

***factors other than the strength of the Australian dollar are bringing about this price deflation?"*** (PC 2011 p 6)

There has been clear evidence of the impacts of National Competition Policy on milk prices and sales volume (Margetts 2007a), and now increasing evidence in the 2010 Senate Dairy Inquiry report of the concern of Australia's milk producers on their ability to survive as a result. Firstly, a significant impact of NCP was the removal of the Price Discrimination section of the Trade Practices Act. Research has been undertaken to explain the major reasons why the Hilmer Report, which was used as the basis of National Competition Policy, recommended the removal of the Prices Discrimination section of the TPA (Margetts 2011). This was largely because NCP was not based on classical market theory, but based on the Baumol et al "contestability theory" which supported corporate market dominance and demanded the removal of Price Discrimination law as they considered that it would be beneficial for consumers if corporations could reduce their supply costs to enable reduction in prices for consumers. BUT, it is significant to note that the Baumol et al contestability theory has been found to be itself highly contestable and it should be noted that Baumol et al did not bother to assess the potential impacts of monopoly /oligopoly market domination on the supply sectors (Margetts 2011).

In addition to the removal of the Prices Discrimination provision of the TPA, other major changes included the removal of Statutory Marketing Authorities (SMA) for vital food supply sectors such as Australia's dairy industry. The major impacts of the removal of the SMAs were the ability of the major supermarket chains to considerably reduce the farmgate milk prices for dairy farmers who produced Australia's daily milk supply. Australia's average farmgate milk prices at that time became some of the lowest in the world, and the farmgate prices failed to properly respond effectively to market conditions of dairy farmers such as droughts, floods or increased cost prices. As a result, the farmgate and supply pricing became disconnected to the retail market pricing (Margetts 2007a, 2007b).

Unlike small retailers, for large dominant retailers, decreasing prices do not necessarily mean decreasing margins as they now have the ability to use their market dominance to benefit from price discrimination to their suppliers. Given the large volume of supply of products supplied to major retailers, price discrimination means that there is a very great requirement for suppliers to charge higher amounts to other retailers, because of the waterbed effect of price discrimination. Furthermore, as shall be explained later, if you add the enormously greater lease charges to independent competitors of the major retailers, it can be seen how unfair the combination of such price discrimination and unfair lease agreements have been.

In addition, labour deregulation provided the major supermarket chains with the ability to utilise independent workplace agreements, which enabled them to offer much less overtime and rates of pay for extended working hours, enabling the major retailers to take such advantages from deregulated working hours. The National Competition Council convinced (and with the assistance of Federal Treasury, helped to force) most Australian states to embrace working hours deregulation to as many states as possible. This is occurring now in WA, even though the Western Australian electorate (in 2005) voted in a referendum that retail trading hours deregulation in WA was not in the public interest (Margetts 2011).

## **Profitability**

The PC stated that “Profitability can be measured by profit margins, which take profit as a percentage of revenue...” (PC 2011 p 6). The retail “profit margins” were then discussed. However, as the major supermarket chains are largely their own wholesale suppliers they can control their own retail profit margins by their market domination and by their ability to limit their “retail” margins by retaining greater percentages of profits in their wholesale supply section. The price management subsequently has a positive effect on shareholder funds, even if their retail margins do not appear to be as high as expected.

The PC states that “profitability may be related to firm size”, but, in addition to their ability to use their market power to pay substantially lower prices to their suppliers (Price Discrimination) there needs to be considerable investigation of how much of this profitability is gained by enormously subsidised lease costs, (if MSCs are required to pay only around 10% per m2 of the rates charged to many of their smaller independent competitors). The PC must investigate if the major supermarket chains can still require their shopping centre property owners to charge any of the MSCs’ small independent competitors even higher lease costs if they are making higher profits. If that is the case, the major supermarket chains have an extensive array of strategies which negatively impact on the ability of smaller and independent competitors to be financially secure, and they can use their market power to prevent effective competition from them.

It is important to note that PC state that in Research and Analysis (2011) “...it would appear that many of Australia’s large retail firms also enjoy higher profit margins than their overseas peers” (PC 2011 p 8). Given that it has been shown that National Competition Policy was based on “contestability” theory rather than classical market theory, and the previous versions of the Productivity Commission (The Industries Assistance Commission and then the Industry Commission) had been strong promoters of “contestability theory”) it is extraordinary that having admitting that “many” of Australia’s large retailers have higher profits, is part of the major challenge to the basic conditions of “contestability” because the Baumol et al contestability theory has been found to support corporate market dominance (Margetts 2011).

***“What are the major factors influencing the profitability of retail businesses in Australia? Why are some retail sub sectors more profitable than others?”*** (PC 2011 p 8).

As has been mentioned, factors influencing retail profitability include the use of:

- \* market power to increase the gap between farmgate and retail prices for primary producers;
- \* Price Discrimination to enable a higher profit margin than any smaller, independent retailers;
- \* individual workplace agreements to reduce overtime and extended hours wages; and
- \* lease arrangements that require any smaller, independent retailers to substantially subsidise the leases of the major supermarket chains.

***“Where both costs and profits are high by international comparison does this inevitably mean consumers in Australia are paying higher prices? If so, is this a likely permanent position? If not, what are the forces which are likely to change it?”*** (PC 2011 p 8)

It is argued that in major sectors like Australia's dairy industry, the Government should have ensured that the analysis of costs right through from 'producer' to consumer should have been assessed for longer than ONLY six months after NCP was introduced. The assumptions are not always real, and the real costs and profits should be properly assessed. But as so many of the submissions to the ACCC grocery price inquiry advised that there was a growing gap between farmgate and retail prices, and that the impacts on consumers are not necessarily just about "costs" but also about market dominance.

### **Retail employment**

It has been admitted that retail's share of total employment has fallen. It MAY mean some improved efficiency, but it may also confirm that those who are working for Australian retailers are being required to work longer for less pay. Fear and Denniss (2009) suggest that Australians were working the longest average hours in the world's developed countries and working more unpaid overtime than most other developed countries. This implies higher productivity but this scenario may also have been affected by the reduced bargaining power of Australian employees. The National Australian Retail Grocery Association (NARGA) have been advising for some time that further deregulated trading hours would lead to reduced retail employment, if the major supermarket chains managed to increase their market dominance. It could be suggested that this is one of the reasons that there is a reduced percentage of retail employees if there are more corporate dominated retail sectors in Australia and less smaller, independent competitors.

### **Productivity trends**

There is a mention of "the emergence of megastores (or 'category killers')..." (PC 2011 p 9). It should be noted that as major grocery retailers become even more dominant, the range of items and brand choices that are available for choice are being reduced considerably, especially as the numbers of home brand items are growing (and having some very negative impacts on the grocery supply sector when they are being required to supply home brand products at much lower prices than their own branded products). It should be investigated that if the vast majority of retail items that are available these days are more and more likely to be just those with a very high turnover, and how many retail items and brands are becoming very hard to locate these days. If this can be properly investigated as to how much this has changed in recent years, it could enable a proper assessment of how the major retailers are able to increase their overall retail turnover and profitability via home branding, high turnover goods.

This appears to be partially admitted by the PC:

*"A trend away from individual boutique stores towards speciality chains that could take advantage of economies of scale in the supply chain and better store management systems..."* (PC 2011 p 9).

There is also mention of "reforms to industrial relations legislation" (PC 2011 p 10), but as has been mentioned, the impacts tend to provide much less bargaining power to employees, reduce overtime rates for those in businesses such as the retail sector and require more unpaid overtime (Fear & Denniss 2009).

The PC's mention of growth in "big box retailing" admits this trend to some extent. Australia is following the trends of United States and Europe and the PC also state that "...since the 1980s has

*also seen a growth in big box or megastore retailing”* (PC 2011 p 12). This is described by the PC as *“proved successful in Australia”* but as this is beginning to help reduce the choice of brands and variety of retail items, for whom is this really *“successful”*? the PC admitted that the *“trend towards the use of ‘house’ brands by retailers, including supermarkets”* are able to be used as a mechanism for increasing profit margins” (PC 2011 p 13). But it should also be explained that there is a greater level of imported grocery home branded products and far more damage being done to the Australian retail supply sector.

The question is then asked:

***“Which retail models are likely to survive and which are likely to struggle given current industry trends”*** (PC 2011p 14). The question should also be asked which retail models are having the most damaging impacts on Australia’s retail supply sector.

***“Are there any significant examples of problems with regards to the safety, quality or performance of goods purchased by Australians from overseas online traders?...”*** (PC 2011 p 19) This may well be a useful question but as many retailers who are promoting *“home branded”* products are importing (or threatening to import more food products if their suppliers can’t lower their process significantly, there have been a range of criticisms lodged that locally produced food products need to meet certain health and safety standards but imported food such as pork and bacon do not have to meet the same standards. If this is happening, it is not fair for Australian producers and not fair for Australian consumers.

### **Retail trading restrictions**

The assumption that retail trading hours regulations impinge on consumer choice should be assessed not from just a short term basis. As the major supermarket chains have had greater market share in those states with deregulated trading hours, there has been considerable evidence that once their smaller and independent competitors go out of business in a particular area, there has often been a change in trading hours of the major supermarket in that same location, so rather than being greater choice, in many of those areas, the consumer choice has been removed after hours.

It is also important to note that the major supermarket chains themselves over the last few years have been reducing the choice of brands and have removed those items which do not have a major turnover (even though there may be a range of people who depend on the access to such brands and items).

The *“changing social patterns”* such as *“more flexible and non-traditional working hours”* do not just link to consumer demand, but the ability of the major retail chains to use individual workplace agreements which can considerably reduce the rates of overtime and non-traditional working hours. Thus should be investigated to properly assess the ability of the major retailers to gain far greater profits than many of their retail competitors by reducing the rates of their employees for non-traditional working hours and overtime.

***“How do retail trading hours restrictions impacts on the flexibility of retailers to respond to changing consumer preferences?”*** (PC 2011 p 29)

There has been quite considerable evidence over time, including that from J K Galbraith, that “changing consumer preferences” can be substantially impacted or even created by corporate advertising.

However, as mentioned above, the impacts on the “flexibility” of retailers are not just related to trading hours but the combination of such issues as the ability to pay less for after hours employees, place greater pressure on retail suppliers via the ability to use their market dominance to enforce price discrimination (which requires suppliers to charge higher average prices to the smaller and independent competitors to the major retail chain competitors), and the ability to now dominate the prices of major items such as milk and dairy products since the Statutory Marketing Authorities have been removed.

A proper investigation should be done (by confidential surveys) of the impacts of market dominance on retail suppliers as well as a proper assessment of the relative retail employee wages for non-traditional working hours. A proper inquiry should also be undertaken of the range of market power advantages that National Competition Policy and labour market deregulation have provided for major retailers considering it has been discovered that the basic pre-conditions of “contestability” do not exist in Australia’s retail grocery sector (Margetts 2011). The push for greater trading hours deregulation should not have occurred without a proper assessment of the impacts of corporate market dominance and the lack of fair treatment to retail suppliers and competitors.

The problems of competitors’ “flexibility” should also be properly assessed in relation to the ability of the major retail chains to require the supermarket property owners to charge around 10 times the lease costs per m2 to smaller competitors and to increase their lease costs if they make greater profits. If this is widely applied to small and/or independent retail competitors, this is not FAIR market behaviour.

***“What have been the effects of longer opening hours in those jurisdictions that have relaxed restrictions (for example, on retail sales and employment within different retail sectors)? Was there any redistribution of sales between small and large retail businesses following longer opening hours?”*** (PC 2011 p 29)

One very important response to this question is the impact on pharmacies in states which have had longer term deregulated trading hours such as NSW. In Western Australia there are many after hours pharmacies but in NSW it should be investigated how many pharmacies are still able to remain open after hours, in areas where the major supermarket chains have achieved greater market domination in most pharmacy items. For example, an assessment should be made of how many Sydney residents now have less choice to access their local chemist after hours than in WA.

***“Given the experience of the ACT and the Northern Territory with fully deregulated retail trading hours, what would be the implications of removing all retail trading restrictions in other Australian jurisdictions?”*** (PC 2011 p 29)

There are likely to be far more potential “implications” of removing all retail trading hours restrictions than have occurred so far in the ACT or the NT. For instance, not long after the WA state government announced the extension of weeknight trading hours, the major supermarket chains began their milk price wars etc, which could well be, rather a real competition between the MSCs

but the means by which both Coles and Woolworths could together remove more and more of the smaller and independents competitors, using the ability for oligopolies to combine their marketing power against both their retail competitors and their seriously impacted supply sector.

### **Retail tenancy leases**

As mentioned above, a proper investigation of whether the unfair differences in lease charges between major retailers and smaller or independent competitors are highly anti-competitive and allowing the major retailers to require the owners of the land to charge higher lease charges as a percentage of their competitors' turnover SHOULD not have been allowed. This has not been properly assessed or remedied by the ACCC.

While the PC suggested that COAG considers that as current governance processes are operating "effectively", it should be taken into consideration that Pusey (1992) had provided considerable evidence of the serious domination by major senior government advisors (who would have had significant impacts on the COAG "agreements"). The significant impacts of such a wide range of neo-liberal senior government advisors mean that such decisions are not simply the "the decisions" of the States and Territories.

***"Is there any evidence that owners of major retail complexes in Australia exert market power to command higher rental and occupancy costs than are experienced in any overseas markets?"*** (PC 2011 p 31)

This is a useful question but a confidential survey of Australian lease conditions is essential to assess who pays how much to whom.

***"Does this mean that Australian retailers will have to charge higher prices to maintain reasonable levels of profitability?"*** This is also a question as to why the average profit margins of the major retailers are so much higher than the smaller independent retail competitors.

### **Other competition issues: market structure and conduct**

As mentioned above, my research has shown that the Australian retail sector is not based on classical market theory but the Baumol et al, corporate based contestability theory. And even though "contestability" theory is itself highly challengeable, the basic pre-conditions of contestability have been found not to exist in Australia's retail grocery sector at the time of the ACCC grocery price inquiry (Margetts 2011).

I would also like to clearly state that this was just one of the major problems associated with the ACCC's grocery price inquiry. The manner in which they used their data, their major lack of acceptance of confidential evidence and the manner in which they chose NOT to properly assess the impacts of retail market domination of Australia's retail supply sector is serious. It is therefore NOT acceptable if the Productivity Commission chooses to fail to check what went wrong in the way the ACCC conducted and reported the outcomes of their inquiry.

It is also significant that while there is brief mention of the Senate's inquiry into the pricing in the Australian dairy industry, there is no mention of the range of important recommendations, which

include some serious concerns about the way the ACCC has behaved regarding the Australian retail sector and the NEED to properly assess the impacts of National Competition Policy.

***“Are there any important competition issues or specific aspects of the enforcement of competition laws, that have not been considered by recent reviews that need to be addressed?”*** (PC 2011 p 34).

Yes, there certainly is the necessity to properly assess the impacts of National Competition Policy on Australia’s retail and retail supply sector.

### **Other regulatory burdens imposed on the retail industry**

The term “burdens” in this section assumes that all that needs to be assessed are regulations that “are unnecessarily burdensome” when the removal or major changes to most regulations associated with National Competition Policy have never been properly assessed. It should therefore not be required for further deregulation, when the impacts of the levels of deregulation so far have not been properly assessed.

***“To support a case for change, the Commission invites participants to provide information, including quantitative information where this is possible, to shed light on the nature and extent of any unnecessary regulatory burdens impacting on the retail sector”*** (PC 2011 p 36)

This expresses only one kind of opinion; that removal of more regulation is beneficial. But there has never been a proper assessment, for instance of the full impacts of the removal of the Prices Discrimination provision of the Trades Practices Act, not just on the retail sector and the consumers but also on the retail supply sector. And there has never been a proper assessment of the impacts of the Baumol et al “contestability theory” instead of classical market competition theory.

Discussion of the “COAG reform agenda” should look much more carefully at Michael Pusey’s data (Pusey 1992) explaining the means by which economic rationalism in Canberra has been dominated by the senior bureaucrats who have had also had a major control of COAG.

### **Conclusion**

I assume that the Productivity Commission will continue to support neo-liberal approach to the Australian retail sector, but this should not be assumed to be beneficial without a proper assessment of the range of changes that have been introduced since the introduction of National Competition Policy in 1995.

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