

## **Senate Standing Committee on Economics**

### **ANSWERS TO QUESTIONS ON NOTICE**

#### **Treasury Portfolio**

Inquiry into the Trade Practices Amendment (Guaranteed Lowest Prices –  
Blacktown Amendment) Bill 2009

25 September 2009

#### **Question: 1**

#### **Topic: (ie. Quick reference)**

#### **Senator XENOPHON asked:**

That is alright. I guess the issue is that you have made a number of assertions about the reduction in price discounting and discouraging of non-price competition. I would have thought the onus would be on Treasury to say on what basis you have reached that conclusion. Is that decision reached on the basis of an understanding or on empirical evidence, on any research or on any modelling? Can you take that question on notice? In other words, what is behind these assertions? Does it go beyond any understanding?

#### **Answer:**

The Trade Practices Amendment (Guaranteed Lowest Prices – Blacktown Amendment) Bill 2009 proposes to introduce a type of price regulation. In assessing the effects of this type of price regulation, Treasury identified two key aspects that need to be considered: the nature and operation of the markets that will be affected by the Bill, and the incentives that would result from regulation of this kind in a particular market.

*The Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries* (July 2008) and the *Report of the ACCC into the price of unleaded petrol* (December 2007) provide strong analysis and empirical evidence of how grocery and petrol retailing markets operate in Australia. These reports provide discussion and analysis of the nature of competition in these markets, including discussions of predatory pricing and price discrimination. Appendix D of the Grocery Inquiry Report provides empirical analysis of how grocery prices respond to local competitive pressures.

Numerous inquiries, both domestically and abroad, have considered the impacts of regulations designed to restrict geographic price discrimination and to reduce pricing flexibility.

Australia has had the Swanson (August 1976), the Hilmer (August 1993) and Dawson (January 2003) inquiries which have considered in detail issues surrounding geographic price discrimination, including in the context of the former section 49 of the *Trade Practices Act 1974*.

Over a period of thirty years, these reports have consistently found that price discrimination is often pro-competitive and that blunt price discrimination prohibitions operate to weaken competition and hurt consumers.

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Internationally the Canadian Report of the Standing Committee on Industry Science and Technology, *A Plan to Modernise Canada's Competition Regime* of April 2002, addressed similar issues and came to similar conclusions as the Australian inquiries. Similarly, the US *Antitrust Modernisation Commission Report and Recommendations* of April 2007 provides insight into the practical effect and operation of this kind of regulation.

The Blacktown Amendment Bill will apply to a number of different markets. While the Committee's inquiry has focussed on grocery and petrol markets, this Bill will have significant consequences in other markets.

General economic principles provide useful guidance for assessing how participants in a market are likely to respond to the incentives created by a regulation of this kind.

These principles demonstrate that replacing the flexible and dynamic nature of a market with rigid pricing regulations can have serious negative consequences on the operation of the market. The various impacts outlined in the Treasury submission are consistent with these micro-economic principles.

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**Question: 2**

**Topic: (ie. Quick reference)**

**Senator CAMERON asked:**

Is the Canadian retail market similar to Australia's retail market, with a huge dominance by two players?

**Answer:**

Chapter 3 of the July 2008 *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries* provides information on the concentration of the Australian and the Canadian grocery industries.

The two largest retailers in Canada are estimated to account for 43 per cent of grocery sales. In comparison, the ACCC assessed that Coles and Woolworths account for 55 - 60 per cent of expenditure on grocery items in Australia.

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**Question: 3**

**Topic: (ie. Quick reference)**

**Senator CAMERON asked:**

Will you take on notice what ‘highly functional’ means in the context of highly contestable and whether that meets this definition of the contestability theory that I outlined, which you said you understood? I would like to understand where Treasury is coming from on that issue.

**Answer:**

The reference made by Treasury at the hearing to a ‘highly functioning market’ refers to a market that services a large group of people over a diverse geographic area with a significant range of products and choice. This concept relates to the ability of the market to service consumer demand. This does not necessarily relate to the competitiveness of the market which can improve the efficiency of supply of goods and services.

The contestability of a market relates to the barriers to entry and exit that exist in a market. For example, a ‘contestable market’ could be a market that is served by only one firm (ie a monopoly), but where that firm prices in a competitive manner due to the threat of entry from a competitor. In a perfectly contestable market, where there are no barriers to entry and exit, if the monopolist earned above normal profits they would experience ‘hit-and-run’ entry from a competitor that would force prices back to competitive levels.

While the idea of a ‘perfectly contestable market’ is likely to be very rare in reality, the important lesson from contestable market theory is that high concentration in a market is not necessarily indicative of a lack of competition.

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#### **Question: 4**

#### **Topic: (ie. Quick reference)**

#### **Senator XENOPHON asked:**

I have two very quick questions. Dr Kennedy, in relation to the OECD figures of grocery price inflation, could you advise—again, you may wish to take this on notice—whether Treasury has done an analysis of those figures where Australia has been shown to have a rate of grocery price inflation in excess of other OECD nations.

#### **Answer:**

Treasury has done analysis of OECD data on consumer price indices (CPI), food price indices and hourly earnings indices. This analysis has shown that:

- While Australia had the fifth highest food price inflation between 2000 and 2008 out of 30 OECD countries, between 2006 and 2008, Australia had the third lowest food price inflation.
- Also, since 2000, wages have grown by over 50 per cent. This relatively high wage growth means that Australians have improved their purchasing power in the supermarket to a greater extent than a number of comparable OECD countries.
- Australian food price inflation experienced a clear shock in 2005-06. This was largely attributable to the banana shock caused by Cyclone Larry. This effect has now dissipated.