

CHOICE FREE ZONE?

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“Good economic policy is measured by its impact on the lives of individual families.”

These aren't my words ... although I agree with them.

They're the words of our Prime Minister.

They were uttered when Mr Rudd announced that the Australian Competition and Consumer Commission would conduct an inquiry into grocery prices.

The community knows that there is a problem with retail competition in Australia.

Choice conducted a survey of more than 1,000 consumers in February 2008.

64 per cent of consumers believe there is not enough price competition for groceries.

The ACCC's inquiry has the potential to pave the way for far-reaching reforms ... or it could lead to empty words and rhetoric.

I would prefer the former over the latter.

The ACCC inquiry is now nearing its completion.

It's due to hand its report to the government next week.

This is an opportunity for the ACCC to shine a light on things that have been kept hidden for too long such as the urban planning laws. And then for governments to act. In the meantime, Wednesday's CPI result showed rising grocery prices.

The *National Charter of Integrated Land Use and Transport Planning* was endorsed in 2003 by both Ministers for Transport and Ministers for Planning across Australia.

The Charter emphasises that activity-intensive development should be concentrated in hubs ... for the sake of efficient use of transport infrastructure.

While it is difficult to disagree with this proposition ... the Charter omits some other important principles.

The Charter should have recognised the possibility that the transport infrastructure for existing hubs may reach capacity and that new hubs would be essential.

The charter should have recognised the need to ensure that there are enough hubs ... and that hubs are large enough... to sustain a fully competitive market for goods and services.

The problems inherent in the Charter are typified by the 2001 NSW Government policy package promoting the integration of transport and land use.

The policy governs zoning decisions in NSW ... and is considered in the development assessment process.

It sets out to influence investment decisions in favour of certain shopping "centres". It says ... and I quote ...

"Centres with a mix of land uses are well established in existing urban areas ... but their success relies on continued investment. Investment confidence must be cultivated through ... decision-making that supports centres. ... "

It is hard to imagine that existing shopping centres ... such as Chatswood... Parramatta... Burwood and Bondi Junction ... are so unattractive to consumers that they will only receive investment if they enjoy regulatory protection.

The policy package also seeks to – and I quote – "avoid the unnecessary creation of new centres." All this sounds protectionist – something we have generally tried to get rid of in Australia.

Imagine if we had a law in place to ensure that we had no more restaurants than 'necessary' or no more factories than 'necessary'. Who decides what's necessary?

In our market economy... **consumers** should be in charge.

That means **they** ultimately decide whether or not new retail facilities are necessary... not government planners.

If an existing retail outlet is doing a poor job of servicing consumers ... or is charging its tenants excessive rents ... then an entrepreneur should be free to establish a new competing retail outlet.

Even the threat of a new outlet can be effective in ensuring that incumbent retail property owners invest in their assets and keep costs down.

Of course, planning laws are necessary. But they should not be taken further than their legitimate purposes – such as to protect the environment and heritage; to prevent congestion.

Our report highlights that planning laws go far beyond this. They have a strong bias to protecting existing businesses – whether centres or shops

For example, if someone wants to establish a new retail facility outside the existing centres they face this bias.

This is a tragedy for consumers.

If there is competition, those who are providing the service compete fiercely by:

- cutting costs ... sometimes accepting lower profits ... and
- Innovating ... through new formats ... and new add-on services ... to distinguish themselves from their competitors.

Complacent businesses can be placed under pressure ... and even exit the market ... while innovative new businesses take their place. This is not so if competition is restricted. The protection of competitors, rather than competition, has long been rejected as a principle in competition law and policy everywhere in the world. Planning should not be exempt.

The established centres ... or hubs ... so favoured by the planning rules are already generally each dominated by an existing shopping centre landlord.

The evidence aired at the ACCC reveals the restrictive mentality of shopping centre owners ... when it comes to securing anchor tenants such as supermarkets.

Second-string chains such as Franklins... Super barn or Aldi rarely get a look in. Shopping centres go straight for the big two.

Martin James... the general manager of development leasing for centre operator Colonial First State Property... laid it bare at the ACCC inquiry – and I quote ...

... "We would be choosing someone that from our research and from our knowledge of the market ... would generate the largest sales ... and typically that is Woolworths and Coles".

This creates a catch-22. Smaller chains cannot compete or increase market share because they just cannot get into major shopping centres.

Smaller chains are prevented from opening down the road because of "centres policy" planning laws... that concentrate major shopping centres in select areas ... banning or limiting competitors in surrounding suburbs.

If anything, the push by planning authorities to reduce competition has been increasing ... rather than decreasing.

In the second half of last year and the first half of this year ... eight draft subregional strategies were released by the NSW Government to plan the future of Sydney.

These subregional strategies ban supermarkets in 564 locations until 2031.

In 79 locations only one small supermarket is to be permitted – and these locations generally **already have** at least one supermarket.

In 40 locations only two supermarkets are permitted ... and these locations generally **already have** at least two supermarkets.

Only in 42 localities is there no express limitation on new supermarkets. In these locations the key shopping centre sites have already been secured by the dominant retail landlords.

This kind of restriction on the numbers and locations of supermarkets hurts consumers ... by depriving the market of the necessary competitive tension.

True supermarkets or large format stores ... range from 1,500 square metres ... six check outs ... for a typical Aldi or IGA Supa store ...

... to 2,500 to 3,500 square metres ... 12 to 16 checkouts ... for a full-line Woolworths, Coles, Franklins or Superbarn.

The Economist Intelligence Unit cost of living survey found that ... in 2007 ... prices in Sydney for food staples were ... on average ... 22 per cent higher in mid-size stores these in large format stores.

And for household and personal care products the prices were even higher ... between 33 and 39 per cent more expensive on average.

The Bureau of Infrastructure, Transport and Regional Economics carried out an Australia-wide study in which it collected over 80,000 prices in 132 locations ... from major cities to the most remote areas.

The outcome of the study was detailed in the Bureau's submission to the ACCC's grocery prices inquiry.

The Bureau looked at grocery prices in places that weren't within in easy reach of a major chain supermarket.

This is not small group ... in fact half of non-metropolitan Australians are in this situation.

These consumers were found to pay an average 20 per cent premium in prices ... although once adjustments are made for differences in the size of the local populations ... the price premium paid by consumers without ready access to a major chain supermarket was **17 per cent**.

The evidence clearly shows that large format chain stores are delivering groceries to Australian households cheaper than smaller independent stores. They have much lower costs – due to economies of scale, efficient supply chains, bigger floor space and other economies.

I am not necessarily fond of big retailers. In my time at the ACCC we successfully initiated action against Woolworths twice, securing many millions of dollars of fines.

We also got Coles fined many millions in one case and blocked a merger of Coles with Foodland. However, this does not mean I favour legal restrictions on the creation of large format chain stores. They bring benefits to consumers even though they need scrutiny under the Trade Practices Act.

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On another score, the Bureau's study **did** find that independent stores appear to compete with the major chains on price in some locations ... but more often competed on other factors ... such as variety, opening times and service.

Chances are ... if consumers are paying too much for groceries ... it is because of a lack of large format grocery stores rather than the presence of one.

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If Australian households are to have access to lower cost groceries we must question any regulation which might limit or prevent new large format stores.

We must also question any regulation that might hinder efforts by new-entrant grocery chains – such as Aldi ... the IGA Supa stores.... to set up large format stores in competition with the dominant players.

That's why the restrictions on supermarket numbers in the most recent draft subregional strategies – and in a long-line of NSW Land and Environment Court decisions do not make sense.

In his evidence before the ACCC Grocery Prices Inquiry ... John Schroder ... chief executive officer of major shopping centre owner Stockland Retail said that ... and I quote

... "in the middle of dense urban Sydney where there is an under-supply of supermarkets ... we'll drive up the rent. In fact... in some cases... depending on what the research tells us we'll almost bid the space out."

If the supply of supermarkets is constrained by planning laws ... retail landlords **will** charge higher rent ... and consumers will pay more for their groceries. There is evidence of this in our report.

Tackling the power of the retail landlords should be an important part of any reform recommended by the ACCC.

As the evidence of Stockland Retail suggests ... when the planning system constrains supermarkets sites ... it is handing increased market power to a limited number of land owners.

Consumers will bear the burden of increased supermarket rent through the prices they pay at in supermarkets ...

... however we also need to consider the effect on prices at speciality stores.

The MapInfo data provided to the ACCC ... shows that speciality retailers such as butchers... bakers and delicatessens ... account for 24 per cent of the grocery market.

Consumers may patronise an independent butcher in a shopping centre if they get service or quality that is not available at the nearby supermarket.

When Woolworths or Coles are negotiating rents with shopping centres owners they can bring at least some of their own market power to bear ... however when these small speciality stores are negotiating ... they have no such leverage.

We shouldn't find it surprising ... therefore ... that the ACCC was told that the base rent for Westfield Liverpool Coles was \$245 a square metre... versus a base rent for Bush's Meats of \$1,338 per square metre.

Economic forecaster Hill PDA projects that Sydney alone will need an additional four million square metres of occupied retail space by 2031 ... that's a 50 per cent increase over current levels.

How will that additional retail space be shared among the retailers?

If the market was free to operate properly ... the choices of **consumers** would determine future market share.... but unfortunately ... if current town planning policies aren't changed ... government regulation will funnel an undue proportion of this retail growth into small format convenience-type stores.

As the size of the retail market grows.... large format stores ... including challengers such as Aldi, Franklins and IGA Super stores ... will make up an increasingly smaller proportion of the total.

It will not be the choices of consumers that are funnelling extra market share into higher cost retail formats.... it will be planning regulations that limit the growth of the less expensive larger stores.

It is possible to gain some insight as to the impact that inflexible land use restrictions may have on productivity growth by examining comparisons of productivity growth in different international jurisdictions.

The Organisation for Economic Co-operation and Development ... the OECD ... has cited land use restrictions as an important constraint on productivity growth in the European Union.

Over time... countries that have allowed the retail sector to take advantage of economies of scale have experienced some of the higher rates of productivity growth in the retail sector.

Given observed differences in productivity growth in international studies... the potential gains to retail productivity from a more flexible planning system in Australia could reasonably be considered to be in the range of 1 to 1.5 per cent per annum.

Over 50 years... in net present value terms... this additional productivity growth in retail services could equate to between \$52-\$78 billion of NSW Gross State Product... and \$197-\$296 billion in Australian Gross Domestic Product

Restrictions on the level of retail development also have employment impacts. Where there is limited floor space... there is also limited job availability.

The full impact of a 10 per cent increase in retail floor space on employment could be 147,000 jobs Australia wide... 47,000 jobs in NSW and 16,500 jobs in metropolitan Sydney.

This loss of income to the State and national economies and missed job opportunities should not be viewed as academic numbers.

They reflect a cost of planning policies that is ultimately borne by consumers.

The bottom line is this:

The planning laws restrict competition. They protect the big shopping centres.

The consumer is being usurped by planning authorities who are keen to micromanage the retailing of essential household goods in Australia's cities and towns.

Planning laws that protect the quality of the urban environment are crucial.

.... But they should not go so far as to prevent retailers from giving consumers a better deal.

None of this means we should not pay close attention to other retail competition issues.

There is a case for requiring retailers to provide unit pricing information, and for some toughening up of the Trade Practices Act, as I have often said. We should look at a law regulating creeping acquisitions by retailers; review and, if necessary, strengthen retail codes of conduct; look at the deals between oil companies and retailers; and be ever vigilant in applying the Trade Practices Act. But I believe that the biggest gains would come from looking at planning laws and their impact on competition.

The politics are in alignment for both the ACCC and the Federal Government to start acting tough on grocery prices.

The states will be sensitive about Canberra applying pressure regarding zoning laws. But nonetheless... tough federal and state action will be crucial if anything is to be done about grocery prices.