



Australian Government

The Treasury

18 September, 2009

Mr John Hawkins
Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Mr Hawkins

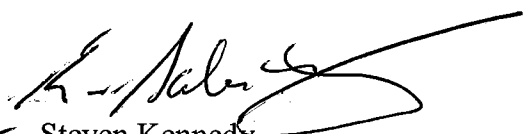
INQUIRY INTO THE TRADE PRACTICES AMENDMENT (GUARANTEED LOWEST PRICES – BLACKTOWN AMENDMENT) BILL 2009

Thank you for the opportunity to provide a submission to the Senate Economic Legislation Committee's Inquiry into the Trade Practices Amendment (Guaranteed Lowest Prices – Blacktown Amendment) Bill 2009.

The Trade Practices Amendment (Guaranteed Lowest Price – Blacktown Amendment) Bill 2009 contradicts the object of the Trade Practices Act (TPA) by prohibiting competitive behaviour. The Bill is contrary to recent trends in competition policy in Australia and overseas, where similar provisions have been found to unnecessarily harm consumers. Moreover, existing TPA provisions already achieve the stated intention of the Bill.

Our comments are further detailed in the attached submission. If you have any inquiries, please contact Simone Abbot by phone on 02 6263 3816 or by email at Simone.Abbot@treasury.gov.au.

Yours sincerely


for Steven Kennedy
General Manager
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Treasury Submission to the Senate Economic Legislation Committee's Inquiry into the Trade Practices Amendment (Guaranteed Lowest Prices – Blacktown Amendment) Bill 2009.

SUMMARY

The object of the *Trade Practices Act 1974* (the TPA) is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection. The Trade Practices Amendment (Guaranteed Lowest Prices – Blacktown Amendment) Bill 2009 contradicts the object of the TPA, in that it would significantly reduce competition in many markets, and cause harm to consumers and the economy in general.

The stated intention of the Blacktown Amendment Bill is to reduce predatory pricing through a broad ban on geographic price discrimination. In effect, the Bill would introduce a blunt and poorly targeted type of price regulation. It would replace the flexibility of the market mechanism with a legislative outcome that fails to address specific anti-competitive behaviour. The effect of the Bill would be to increase prices on average in the long term.

Section 46 of the TPA contains provisions that directly prohibit predatory pricing. The section 46 provisions are an appropriate mechanism for preventing unfair pricing practices as they only prohibit geographic price discrimination that is anti-competitive.

It is worth noting that the trend in Australia and overseas has been to repeal provisions similar to those contained in the Blacktown Amendment Bill because of the negative consequences of provisions.

GEOGRAPHIC PRICE DISCRIMINATION

What is geographic price discrimination and why does it occur?

Geographic price discrimination occurs when a business charges different prices for the same product in two or more different locations. This pricing flexibility is widely used by businesses in many different industries. There are various reasons why a business might use geographic price flexibility. These might be related to supply-side aspects, such as differentials in costs or the scope of operations between locations; or demand-side factors, including the size of the local population, and the nature of local competition. Each of these reasons, including competitive differences, is a legitimate reason for prices to vary among locations.

In its publication *Understanding petrol pricing in Australia: Answers to some frequently asked questions*, the Australian Competition and Consumer Commission (ACCC) lists various reasons why petrol prices, and competition in petrol retailing, might vary among locations, including some of the factors mentioned above. The ACCC concludes:

The influence of these factors can vary considerably between locations, resulting in substantial differences in prices. It is not surprising therefore that there are considerable variations in petrol prices across locations, including differences between city and country prices.

Similarly, Chapters 4 and 5 of the *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries* (the ACCC Grocery Report) discuss reasons for grocery price differentials between locations.

Should products in different locations be considered the same?

The Blacktown Amendment Bill seems to be premised on the assumption that a good that looks the same is the same, regardless of where and how it is sold. However location, surroundings, service and convenience are all significant components of any product. For example, a good that is sold with a high level of service is a fundamentally different product to one sold with a low level of service. For example, if a store maintains its own car park to sell the good, then it is a different product to the same good sold in a store that shares a car park or has no dedicated car park.

Effects of the Blacktown Amendment

The Blacktown Amendment Bill will lead to:

- mixed price effects in the short term as prices will rise in some locations but fall in others;
- reduced discounting activity and specials;
- lower service quality and convenience;
- loss of choice for consumers; and
- higher average prices for consumers in the long term.

The Bill will have mixed effects on price in the short term

If businesses were required to set a single price at all stores in a particular region (as defined by the '35 kilometre' rule in the Bill), they would choose a price somewhere between the highest and lowest prices in that region.

In locations of lower prices (in the presence of flexible pricing), the Blacktown Amendment Bill would cause a business to raise prices. The Bill would also have the effect of removing incentives for competitors to compete strongly on price, with the likely result that they also would raise prices. In such locations, consumers will be forced to pay higher prices under the Guaranteed Lowest Prices Rule contained in the Bill compared to a flexible pricing scenario.

In other areas, where prices are higher, prices may be reduced as a result of a 'single price' rule. However, this comes at the expense of potentially more consumers in other locations.

The Bill will cause a reduction in price discounting

Businesses often offer price discounting and specials on an individual store basis as well as at a regional or national level. When a business is free to price flexibly, strong discounting activity occurs, particularly in areas of strong competition. This kind of competition is beneficial to consumers, as it results in lower prices. The Guaranteed Lowest Prices Rule would prohibit this kind of activity on a localised level and eliminate the benefits to consumers that arise from it.

The Bill will discourage non-price competition

In addition to the consequences of the Guaranteed Lowest Prices Rule on price, this rule has the potential to distort incentives relating to non-price competition, such as service quality and convenience. As explained in the ACCC Grocery Report, firms tend to compete on both price and non-price aspects, depending on the demonstrated preferences of consumers. These non-price aspects of competition increase costs for the retailer and, to the extent that the costs are not captured by increased sales, they will be reflected in higher prices.

Consumer preferences will differ according to location. Consumer preferences in some places will favour lower prices, while consumers in other locations will be more willing to pay higher prices to obtain higher service quality and convenience.

Under a single price rule, a business might be discouraged from offering this kind of competition, as additional costs at one store would need to be passed on to all stores in the region. Conversely, in locations where costs are naturally higher, if a business is not able to reflect these costs in prices without reflecting them in prices at all stores in a region, it might respond by cutting service and convenience to reduce costs. Either way, the result would be reduced choices for consumers and increased costs associated with time and inconvenience. In a survey conducted as part of the ACCC grocery inquiry, the ACCC found that consumers place a very high value on non-price elements of competition.

The Bill will distort investment incentives, causing a long-term reduction in competition

In the longer term, a single price rule is also likely to distort investment incentives for businesses. Every store that a business opens (or owns) will affect the profitability of every other store the business owns in that region. A business may decide against opening additional stores in certain locations if it cannot lower prices to match competitors' prices or charge higher prices to reflect higher costs associated with that location. However, the business may have opened such stores and

run them profitably if the single price rule had not been in operation. The impact would be to reduce access for consumers and to reduce competition in that market.

The Bill will cause higher prices in the long term

To summarise the effects on price, if enacted the Blacktown Amendment Bill would cause prices to rise in some locations and fall in others. In the long term, the higher costs and inefficiencies arising from distorted investment incentives, combined with a reduction in competition in the market, will lead to higher prices on average under the Guaranteed Lowest Prices Rule.

PREDATORY PRICING

What is predatory pricing?

Predatory pricing is a two-stage strategy. In the first stage, a firm attempts to drive competitors out of a market by offering prices below cost such that the competitor cannot compete. In the second stage, having driven competition out of the market, the firm then charges higher prices to recoup the losses from the first stage.¹ For predatory pricing to be a profitable strategy, the firm needs reasonable assurance that its efforts to drive the competitor out of the market in stage one will be successful, and also that in stage two it will be able to sustain higher prices long enough to offset the losses, without re-entry from another competitor.

It is important to note that charging prices at a level where a competitor cannot compete is not, of itself, predatory pricing. More efficient firms will always be able to offer prices that cannot be matched by less efficient competitors. To be predation, there is a requirement that the prices charged are so low that the firm could not sustain them itself in the long term.

If this strategy succeeds, it hurts consumers in the longer term as competition in the market is reduced. In order for it to succeed though, the firm needs substantial size and market power so that it can absorb the losses in the short term, and maintain barriers to entry in the long term.

How is predatory pricing dealt with currently?

Subsection 46(1) of the TPA (see Attachment A) prohibits a business with a substantial degree of market power from taking advantage of that power for the purpose of eliminating or substantially damaging a competitor, or preventing the entry of a person or business into that or any other market.

This provision, in its current form, is well targeted to prevent predatory pricing since it takes into account the relevant requirements necessary for a firm to engage in predatory pricing. At the same time it also allows businesses sufficient pricing flexibility to compete effectively and to provide their products at efficient prices.

In contrast, the Bill's single price rule does not distinguish between pro-competitive and anti-competitive behaviour.

¹The recoupment aspect is not incorporated into the legal definition in the Trade Practices Act. That is, to prove that a contravention of the Trade Practices Act has taken place, it is not necessary to demonstrate that recoupment was possible.

REPEAL OF SECTION 49 PROVISIONS

We have had measures similar to the single price rule in the past

Until 1995, section 49 of the TPA (see Attachment A) prohibited a business from discriminating between purchasers of goods of like grade or quality in relation to the prices charged, or by other means such as discounts, allowances, rebates or credits, if it was likely to have the effect of substantially lessening competition in a market for the goods.

There are some key differences between the repealed section 49 provision and the Bill. In particular, section 49 only applied where the discrimination caused a substantial lessening of competition, whereas the Blacktown Amendment Bill would mandate uniform pricing within a region. The single price rule contained in the Bill would therefore be a stronger prohibition on predatory pricing since no proof would be necessary that the behaviour is anti-competitive or is harmful.²

Why was section 49 repealed?

In 1976 the Swanson Committee inquiry into the operation and effect of the TPA recommended that section 49 be repealed, observing that:

The prohibition on price discrimination has, in our view, operated substantially to limit price flexibility. The Committee believes that in the Australian context, s.49 has produced such price inflexibility that the detriment to the economy as a whole outweighs assistance which small business may have derived from it. It is price flexibility which is at the heart of competitive behaviour.

In 1993, the Hilmer Committee released its inquiry, *National Competition Policy* (the Hilmer Review), which also recommended the repeal of section 49. It concluded:

The Committee considers that price discrimination generally enhances economic efficiency, except in cases which may be dealt with by s.45 (anti-competitive agreements) or s.46 (misuse of market power). To the extent that s.49 has had any effect it seems to have been to diminish price competition.

The Committee recommends that a provision such as s.49 should form no part of a national competition policy and that the existing provision should be repealed.

Following the recommendations of the Hilmer Review, section 49 was repealed as part of the *Competition Policy Reform Act 1995*.

Apart from specific protection against predatory pricing, the Swanson and Hilmer reports recognised that there might be perceptions that section 49 offered particular assistance to small business by reducing the level of price competition faced from larger businesses. On that issue, the Hilmer Report stated:

² While the Blacktown Amendment Bill would preclude price variations for a business that has many stores within a region (defined by overlapping 35 kilometre radii), where a store is not within 35 kilometres of another, it could still act predatorily. Where a business owns large numbers of stores across the country, it would still be feasible to maintain predatory prices where just a small number of stores are connected by 35 kilometre radii. In such instances, there would still be a reliance on the section 46 provisions to deal with this behaviour.

The Committee does not consider that competition policy should be distorted to provide special protection to any interest group, including small business, particularly where this is potentially to the detriment of the welfare of the community as a whole. Sectoral assistance policy of this sort is generally most efficiently implemented by more open and direct assistance, including budgetary and taxation measures of various kinds. In any event, it seems clear that small businesses have not achieved any significant benefit from the presence of s.49.

In reviewing the repeal of Section 49, the Dawson Review reinforced the decision

More recently, in 2003 the Dawson Review found that:

The effect of price discrimination on competition should be considered on a case-by-case basis. Section 46 of the [TPA] provides an appropriate means to tackle anti-competitive price discrimination. There is no case for the reintroduction of a prohibition against price discrimination... There are reasons for differences in prices in the grocery industry which do not involve anti-competitive practices.

RECENT REPEAL OF CANADIAN PRICE DISCRIMINATION PROVISIONS

Canada had similar pricing provisions

There would appear to be a trend internationally towards removal of geographic price discrimination provisions, and greater reliance upon more targeted provisions.

Until recently, subsection 50(1) of Canada's Competition Act contained pricing provisions that outlawed price discrimination. Paragraph 50(1)(b) specifically prohibited geographic price discrimination where it was likely to cause a substantial lessening of competition. The subsection 50(1) provisions are included in Attachment A.

Canada repealed these provisions for similar reasons to Australia

This provision was repealed in the Budget Implementation Act 2009 following recommendations from a report by the House of Commons Standing Committee on Industry Science and Technology. The Standing Committee Report noted:

It is often pro-competitive to charge different prices to different consumers when there are different costs attached to serving them (in the same way as volume and quantity discounts imply different costs and are not anticompetitive in and of themselves).

Price discrimination may also result in additional sales... To the extent that the consumption of the good increases as a result, economic efficiency is being promoted.

The Standing Committee Report, in making its recommendations, draws heavily on another report, the VanDuzer Report, which finds that:

The economic analysis... concludes that price discrimination is not anti-competitive in many circumstances. Whether there is any possibility that price discrimination will have an anti-competitive effect will depend on the facts of each case.

The report recommended that subsection 50(1) be repealed and that anti-competitive pricing practices covered under subsection 50(1), including predatory pricing, be dealt with under the 'abuse of dominant position' provision³ contained elsewhere in the Competition Act.

The Canadian experience is very similar to the Australian experience where the price discrimination provisions of the TPA were repealed in 1995 following a recommendation by the Hilmer Review. That report found that such provisions were contrary to the objective of economic efficiency and that where price discrimination does not enhance economic efficiency, it can be better dealt with by other provisions of the TPA.

The 2009 reforms in Canada brought Canadian competition law into closer alignment with the current provisions under the TPA in Australia.

CONCLUSION

Geographic price flexibility is an important aspect of competition that supports pricing efficiency. If enacted, the Blacktown Amendment Bill would have the effect of restricting geographic price flexibility within regions. Without this flexibility, the incentives and ability for businesses to compete on price would be unnecessarily reduced. Businesses would be unable to set prices according to costs at a local level, and their capacity to adapt to localised consumer preferences would also be restricted. The rigidities caused by imperfect price regulation of this nature have the potential to cause inefficiencies in the supply and pricing of products. These effects would lead to higher costs for consumers. Trends in Australia and overseas in recent times have been to repeal provisions similar to those contained in the Blacktown Amendment Bill, with inquiries consistently finding that they unnecessarily reduce competition. The issue of predatory pricing, which the Bill seeks to address, is more appropriately dealt with by existing provisions already contained in the Trade Practices Act which more directly target anti-competitive behaviour without discouraging behaviour that is beneficial to consumers.

³ This is equivalent to section 46 of the TPA.

ATTACHMENT A

SUBSECTION 46(1) OF THE *TRADE PRACTICES ACT 1974*

(1) A business that has a substantial degree of power in a market shall not take advantage of that power in that or any other market for the purpose of:

- a) eliminating or substantially damaging a competitor of the business or of a body corporate that is related to the business in that or any other market;
- b) preventing the entry of a person into that or any other market; or
- c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

SUBSECTION 49(1) OF THE TPA (REPEALED IN 1995)

(1) A business shall not, in trade or commerce, discriminate between purchasers of goods of like grade and quality in relation to:

- a) the prices charged for the goods;
- b) any discounts, allowances, rebates or credits given or allowed in relation to the supply of the goods;
- c) the provision of services in respect of the goods; or
- d) the making of payments for services provided in respect of the goods;

if the discrimination is of such magnitude or is of such a recurring or systematic character that it has or is likely to have the effect of substantially lessening competition in a market for goods, being a market in which the business supplies, or those persons supply, goods.

SUBSECTION 50(1) OF CANADA'S COMPETITION ACT (REPEALED IN 2009)

50.(1) Every one engaged in a business who

- a) is a party or privy to, or assists in, any sale that discriminates to his knowledge, directly or indirectly, against competitors of a purchaser of articles from him in that any discount, rebate, allowance, price concession or other advantage is granted to the purchaser over and above any discount, rebate, allowance, price concession or other advantage that, at the time the articles are sold to the purchaser, is available to the competitors in respect of a sale of articles of like quality and quantity,
- b) engages in a policy of selling products in any area of Canada at prices lower than those exacted by him elsewhere in Canada, having the effect or tendency of substantially lessening competition or eliminating a competitor in that part of Canada, or designed to have that effect, or
- c) engages in a policy of selling products at prices unreasonably low, having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have that effect,

is guilty of an indictable offence and liable to imprisonment for a term not exceeding two years.