Fair and affordable grocery prices

for a healthier community and a sustainable economy

Public Submission to ACCC Grocery Inquiry by Tony Zappia MP Federal Member for Makin on 11 March 2008

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Grocery prices became an election issue last November because their increases in recent years outstripped inflation adding further pressures on household budgets.
Consumer suspicions at the checkout are confirmed by figures from the Federal Parliamentary Library which show that grocery prices rose by 45% over the past decade.
Although this is not uncommon among developed countries the Australian rise in grocery prices has been the most marked. According to an OECD report Australian prices rose faster jumping 43.6% in the 10 years from 1996. The increase in other comparable countries was much lower with just 11.6% in the UK, about 25% in the US and Canada and between 10% and 20% in other European countries.

On face value it seems that increases are difficult to justify. For example, according to the peak horticulture organisation, Growcom, retail food prices rose by 17.8% in the four years to June 2006 while the price received by farmers rose by only 2.3% in that time.
The implications of this are manyfold not the least of which are the viability of primary producers and the ability of households to afford fresh, quality fruit and vegetables.
Fresh produce is the most important dietary component for nutritional well being and should be the most affordable item at the supermarket in order to encourage its consumption by Australians to tackle health issues such as obesity, diabetes and heart disease.

At a macro level grocery expenditure is a key cost of living issue and, as a consequence, a key economic issue too.
It would be fair to say that the public will expect the Federal Labor Government inspired inquiry into grocery prices, by the Australian Competition and Consumer Commission (ACCC), to provide a clearer picture of what happens to grocery prices from the point of production to the point of sale and consumption.
More importantly the inquiry raises legitimate expectations that a fairer pricing regime will result to:

- take the pressure off household budgets;
- reduce a key inflationary stress point;
- sustain economic activity;
- promote authentic competition which will play an ongoing part in regulating the grocery industry;

- make healthy eating affordable, and
- encourage sustainable environmental practices all along the retail chain.

The retail chain that connects the production of grocery items to their consumer end point, and its place in the economy, is complex. However, Australia and overseas experience, over problems linked to grocery price trends, points to the growth and influence of retail giants which dominate the market. It is clear from this experience, particularly with incidences of price exploitation, that regulatory measures are needed to ensure fair and affordable price structures and part of this includes greater transparency in relationships along the retail chain.

This submission argues that action is necessary and possible, as part of this inquiry and broader federal government policy, and recommends the following:

- criminalise predatory and price gouging and fixing offences which are now civil matters;
- increase the fines for price fixing;
- facilitating class action against cartels by affected parties;
- increase leniency for corporate lawbreakers and executives who report illegal conduct;
- support local produce markets via local government structures;
- facilitate the development of local consumer cooperatives;
- set up a grocery and supermarket ombudsman within the ACCC;
- develop a grocery industry code that covers price setting principles;
- support producers and retailers to minimise packaging and transport costs to reduce prices and climate change impact.

The economic impact

Although there are no direct figures on what part of the household budget is spent on groceries there are some key indicators. One is the grocery expenditure as a proportion of the total production value of goods and services (in other words the gross domestic product or GDP). Then there are grocery turnovers as a proportion of all retail turnover and the proportion of household budgets expended on grocery related items. None of these measures gives a definitive picture of grocery prices and their place in the community, and each can be interpreted differently. However, each provides some measure of the pervasiveness of grocery expenditure within the economy, the business sector and households.

Grocery expenditure as a proportion of GDP

GDP is used to measure the size of the economy at any particular time. One category of this measure is household consumption expenditure (HCE) which as the name suggests is the combined household expenditure across the economy. According to Australian Bureau of Statistics (ABS) figures, grocery like expenditures account for 18% of the proportion of all

household expenditures (HCE). Those grocery-like expenditures also account for 10.3% of GDP. This means that grocery price rises affect at least 10.3% of all expenditure in the economy.

Grocery turnover as a proportion of all retail

Again ABS does not provide a separate grocery category in measuring retail turnover. However, it is possible to gauge grocery retail turnover by looking at turnovers from sectors that could be considered grocery providers such as supermarkets and grocery stores, takeaway food retailing, food retailing not classified elsewhere and cafes and restaurants. These sectors make up 44.7% of the retail turnover and supermarkets alone at 28.7% are the highest proportion of the combined total. These results show that grocery prices affect at least 28.7% of all retail activity in the country but potentially as much as 44.7%.

Groceries as proportion of household expenditure

The Australian Bureau of Statistics (ABS) regularly publishes a Household Expenditure Survey (HES) which measures what an average household spends weekly on a range of goods and services.
The survey shows that an average household spends about 75.8% of its average weekly income on **all** goods and services. The pervasiveness of grocery prices can be gleaned from the proportion of household income that is allocated to the category of food and non-alcoholic beverages within the HES.
The most recent publication of HES, which was for 2003-04, shows that food and non-alcoholic beverage expenditure was 13.6% of household expenditure. If the consumer price index is applied to that figure to reset it to 2006-07 prices the household expenditure is a very similar 13.5%. Based on this it is fair to say that **at least** 13.5% of household expenditure is for groceries. The percentage is undoubtedly much higher given that grocery expenditure is broader than just food and non-alcoholic beverages.
What is also clear from HES is that at 13.5% expenditure for food and non-alcoholic beverages is the largest single item of household expenditure closely followed by housing costs (12.5%) and transport costs (12.1%). Therefore it is safe to assume that expenditure for groceries is by far the greatest item of household expenditure absorbing potentially up to 20% of the average weekly wage.

Anti-competitive conduct

The allegation of price fixing and anti-competitive conduct against powerful companies is not a conspiratorial claim. It is a well founded concern based on price fixing scandals that have seen courts impose multimillion dollar fines on businesses involved. The Australian trend has been for these fines to be of progressively larger amounts.

For about 20 years three of Australia's major transport companies and their senior executives colluded to fix prices and share the country's express freight market. In early 1995 the three, TNT, Ansett Freight Express and Mayne Nickless, had penalties of nearly $15 million awarded against them in one of the first major landmark fines for price fixing.

Also in 1995 under a new penalty regime, $21 million fines were imposed on Boral, CSR and Pioneer for price fixing for ready mixed concrete in South Eastern Queensland.

But, it was soon clear that higher fines would not be sufficient and there have been a considerable number of major price-fixing cases since.

A vitamin price fixing scandal in the 1990s resulted in fines of about $26 million by the Federal court. It also led to Australia's first class action against the price fixing cartel which was settled in October 2006 when the Federal Court approved a $30.5 million settlement against three pharmaceutical companies involved.

Extensive price fixing in the power transformers industry was found and companies involved were fined a total of $35 million.

In November 2007 the Federal Court judge Justice Peter Heerey fined billionaire Richard Pratt and his Visy group of companies a record $36 million for colluding in a price fixing deal with their arch rival in Australia's cardboard industry, Amcor.

The penalties became the largest ever levied in Australia for price fixing and Amcor was awarded immunity after blowing the whistle on cartel arrangement to the competition watchdog in 2004.

Justice Heerey described it as the "worst cartel to come before the courts in 30-plus years".

On the 28th of June 2003 the Australian Competition and Consumer Commission (ACCC) released a leniency policy in a bid to uncover cartel behaviour in the business sector.

It argued that the strategy, of allowing corporate lawbreakers and their executives the chance to report illegal conduct in return for leniency, had been very successful in the US, Canada and the European Union.

Outgoing ACCC chairman Allan Fels said at the time that he thought the leniency policy would uncover more of the secret cartels that operate in Australia.

On May 19 in 2005 ACCC chairman, Graeme Samuel, described price fixing as a cancer on the economy ripping everyone off to the tune of hundreds of millions of dollars.

Although he did not divulge details of the inquiries or what industries were being investigated he told a breakfast meeting in Melbourne that day that price fixing was a central focus of the Commission's work and that about 30 investigations were under way into suspected price fixing cartels, across a range of industries.

"And we regard it as the most serious breach of the law that we're administering that you can find."

In her report *Criminal Penalties For Contraventions Of Part IV Of The Trade Practices Act*, Julie Clarke, School of Law lecturer at Deakin University (Deakin Law Review 8, 2005), said that current civil penalty regime for hard core cartel conduct had fallen well behind international best practice.

“It provides insufficient deterrence against cartel conduct and raises issues of fairness when compared to other similar and often less damaging forms of conduct that attract criminal penalties,” she said.
“The introduction of higher civil penalties, together with a new criminal penalty regime for cartel conduct, including the prospect of jail time for offenders, should go some way to addressing these issues; in particular, it is likely to prove a more effective deterrent against cartel conduct which is estimated to cost the international economy billions of dollars each year.”
The only sector not feeling the stress from the tendency for big business in grocery, liquor and petrol to get bigger and more influential, was big business which strongly opposed proposals to strengthen the ACCC’s ability to tackle cartel behaviour.
"There has been huge, indeed hysterical pressure from big business against any change to the abuse of market power provisions," Professor Fels said in an ABC online news report (Thursday, October 4, 2007).

The grocery industry

The grocery industry has not been immune from the price fixing syndrome associated with markets where the major players are large and few.
Australia’s grocery sector is one of the most concentrated in the developed world and according to AC Nielsen data Woolworths and Coles jointly have about 80% of branded packaged grocery sales in Australia.
The National Association of Retail Grocers of Australia (NARGA) released a report last year highlighting the level of concentration of the grocery market, worth about $63 billion annually.
Coles and Woolworths account for 79% of the market, from just 35% in 1975, the report found.
The challenge for this current ACCC inquiry is to explore if and what connection this concentration has with the fact that food prices have risen faster than inflation since 1982 and recently surged higher.
The ACCC chairman Graeme Samuel, said on January 23 this year (ABC online news) that it would investigate dozens of claims from small retailers, big supermarkets and farmers about what is driving up grocery prices in order to identify any anti-competitive structures wthin the industry.
"The large retailers, Woolworths yesterday for example said its the result of the drought, there are export demands, there is bio-fuel demands on our food sources," he said.
"The smaller retailers say it's the fault of the big retailers.
"The farmers say they're being ripped off and the big retailers are forcing down the prices they receive at the farm gate so we want to get to the bottom of this."

Profitabillity

In February this year Woolworths Ltd, Australia’s largest retailer, announced an $891.3 million net profit for the 27 weeks to December 30, 2007.

This was up from $695.6 million in the prior corresponding period and represented a 28.1% increase in first half yearly profit.
In making the announcement Woolworths said it expected net profit for the 2008 financial year to grow between 19% and 23% above the $1.29 billion profit achieved in the 2007 financial year.
CommSec, a wholly owned subsidiary of the Commonwealth Bank of Australia that provides online share broking, has forecast a full year net profit of $1.59 billion for Woolworths. Revenue for its Australia supermarkets rose 7.8% to $18.17 billion, with earnings before interest and tax (EBIT) up 18.6% to $1.04 billion.

Also in February Wesfarmers, which last November bought the Coles Group's $18 billion retail assets, announced a $601 million profit in the first half of the 2007-08 fiscal year.
It was a 53% increase in overall profit in all of its divisions which was an increase from $392 million in the prior corresponding period.
The result included a first-time contribution from Coles of $357 million in earnings before interest and tax.
An article in the Brisbane Times (22/2/08) reports on the managing director of Wesfarmers, Richard Goyder's announcement of the first profit report since buying Coles and quotes the supermarket's boss, Mick McMahon. Two bits of information from the article could be indicative of future management dynamics of the supermarket chain.
One, revealed by McMahon, is that although sales of food and liquor at their supermarkets and bottle shops, that had been open for more than a year, were up by 2%, there had not been any volume growth.
"While improvement from no sales growth to 2% is good progress, we still have a long way to go to get back to where we want to be in terms of sales growth," he said.
The other revealed in the article is that preparation to refinance a $4 billion bridging loan used to buy Coles was underway and that the company could have to pay up to $40 million more in interest payments than initially expected.

Grocery price fixing

In May 30, 2003 the retail giant Woolworths admitted in the Federal Court to allegations of price fixing at one of its discount liquor outlets in the Northern Territory.
The ACCC took legal action against Woolworths for breaches of the Trade Practices Act and as part of the court agreement, Woolworths was ordered to donate $150,000 for alcohol education programs.
Woolworths was again in trouble and was fined almost $9 million by the Federal Court January 31, 2006, after being found guilty of fixing the price of bread and abusing market power in Victoria and New South Wales.
Growers, using the Fair Dinkum Food Campaign to highlight their inability to make money, at the time claimed they had to keep prices low to win contracts with supermarket chains.
Campaign spokesman Richard Bovill said the bigger the business, the more important government regulation was.

He said globally there was a concentration of retail power that wielded incredible power in the marketplace and grower returns over time were getting less and less.
In August 2004 food manufacturer George Weston Foods was fined $1.5 million by the Federal Court for trying to fix the price of flour in 1999. The ACCC took the action against the company for trying to fix the wholesale price of flour with a competitor.
The judge found that if the attempted price fixing had been successful, it would have caused widespread detrimental effects flowing through to consumers.

An American case

In the USA since 2005 the non-government body 'Food & Water Watch' has lobbied governments to oversee and protect the quality and safety of food and water.
During the first half of 2007, the American situation was similar to Australia. Food & Water Watch said food prices rose by 6.2% and contributed to almost one-fifth (17%) of the total increase in consumer prices. It said that modest wage and economic further heightened consumer anxiety over higher grocery prices.
The organisation believed the food industry was capitalizing on consumer fears about grocery prices by focusing on higher costs for corn - one of their key ingredients. It carried out an analysis of three decades of prices and found no connection between corn prices and grocery prices and its findings were summarised in a news release on 13 Sepember 2007.
"Although corn prices have risen over the past year in part as a result of increased ethanol demand, the correlation between crop prices and retail grocery prices remains elusive," said Food & Water Watch Policy Analyst Patrick Woodall.
During periods of farmgate corn price increases similar to the recent rise, there has been little interplay with retail food costs – in many cases retail food prices fell as corn prices rose, the statement said (the full analysis is posted at http://www.foodandwaterwatch.org/food/pubs/reports/retail-realities-corn-prices).

Recent UK experience

In December 2007 two of Britain's largest supermarket chains, Sainsbury's and Asda, were among companies that agreed to pay the Treasury near-record fines of more than £116m after admitting that they fixed the price of milk, cheese and butter in a scandal estimated to have cost consumers about £270m.
The fine was a negotiated with the Office of Fair Trading (OFT) which had been investigating the price fixing allegations since 2002.
The OFT said that customers had been overcharged for milk, butter and cheese but the supermarkets and dairies which admitted liability said it was to help British farmers affected by the outbreak of foot and mouth disease.

Britain's Association of Convenience Stores (ACS), which represents more than 33,000 local shops, has been concerned in recent years over what it sees as the grocery market's consolidation in the hands of a few large retailers. Today the 'Big Four' Supermarkets – Tesco, Asda, Sainsbury's and Morrisons – control 75% of the grocery market. This has coincided with a significant decrease in the number of independent convenience stores with 4,000 stores closing since 2000 overall, but over 9,500 unaffiliated independents.
The ACS has expressed its concern of the implications for the future of competition in the grocery market.
"This case proves that highly concentrated markets, where a few large retailers hold sway over suppliers, threaten the interests of the consumer. We should see the scandal over milk pricing as a symptom of the current grocery market, and this must be a wake-up call to the Competition Commission, who are proposing to allow these retailers to continue to hold substantial market power," James Lowman, ACS chief executive said in a press statement.
"It is also becoming increasingly clear that suppliers did not benefit from this price fixing in the way that the superstore PR machines would have us believe. The way to protect suppliers is to have greater transparency in the supply chain, or at very least to have a supermarket code of practice that works and that is pro-actively and independently enforced."
In a report in The Guardian (8 December 2007) The Forum of Private Business (FPB) described the fines as inadequate as they dwarfed the huge profits made by the supermarket chains.
"An opportunity has been missed to make them stop and think about the way they do business. It proves they do not have their customers' interests at heart, despite claims to the contrary," FPB's policy representative, Matthew Goodman said.

Global price fixing

Global price-fixing cartels are one of the most damaging abuses of market power which were a feature of the global economic landscape until WWII. ActionAid, an international anti-poverty agency formed in 1972 to fight global poverty said successful anticartel legal actions deterred their formation until a wave of global cartels reappeared in the 1990s.
In its January 2005 report *Power Hungry: Six Ways to Regulate Global Food Companies* ActionAid said "over the last several years, 85% of all fines imposed on global price-fixing operations were paid by food and agriculture cartels".
"Whether they actively force down farmgate prices, or take advantage of depressed markets to pay low prices, agrifood TNCs (Transnational corporations *ndr*) often keep the profits for themselves. The gap between farm and retail prices is growing, and is wider in countries where TNCs have concentrated market power. The World Bank estimates that the farmretail price gap is costing commodity-exporting countries more than US$100 billion each year, and that anticompetitive behaviour by agrifood TNCs is a key cause," the report said.
The report concluded that Tans National Corporations paid low prices in developing countries and captured the resulting value. It argued that

TNCs were not accountable for their impact on human rights and the environment and that corporate social responsibility was optional and insufficient (for ActionAid's full report visit http://www.actionaid.org/docs/power_hungry.pdf).

Beyond just monopoly risks

An investigation of grocery prices invests broader issues than just the impact of monopolies and marketing practices. It is also related to issues such as environmental impact, packaging, ethical and safe production practices and the promotion of healthy lifestyles and local products.
It may very well be that marketing strategies actually interfere and undermine a more transparent process or distort the production cost of a grocery item or its value. The common incentive mechanism of charging less for more for an item, which is adopted all the way along the sales chain, may be better replaced with incentives and rewards for refills, less elaborate packaging and any other measures that reduce the carbon footprint, the cost while improving quality.

Environmental pressures

Food, being an indispensable human need, means that it will always be a cultivated and traded commodity. It therefore means that it is a conduit for an ongoing flow of money and constant source of potential revenue.
It would be very unfortunate if social and economic stresses surrounding the current drought, energy prices and other climate change consequences were used to mask more grocery price increases.
Former Federal Treasurer Peter Costello was concerned enough about this possibility to get the ACCC to monitor fruit and vegetable prices.
"One of the areas we have got it monitoring prices is in relation to fruit and vegetables, particularly in the Murray –Darling Basin where there was an allegation that the drought was being used as a cover for price rise," Mr Costello told the ABC's 7.30 Report on Wednesday, 11 July 2007.
The community, and governments charged with looking after its interests, will have to be confident that extra food and grocery costs are legitimate. Transparent mechanisms will have to be in place that serve the interests of consumers, producers and retailers in assessing the merits of price increases such as the ones telegraphed earlier this year by Australia's biggest retailer Woolworths Ltd.
In an AAP report (Wednesday, 30 January 2008) Woolworths chief executive, Michael Luscombe, said upward pressure on food prices would continue over the next six months, as costs increased.
In the report Woolworth also said its total sales for the 27 weeks ended December 31 grew by 8.7% to $24 billion and that the largest component, supermarket sales, climbed 7.9%, to $20.324 billion.

An example of the environmental impact on grocery retail policies comes from France. Its leading retailers in January this year pledged to reduce their impact on the environment under an ambitious plan backed by the government (published in www.foodproductiondaily.com/news

30/01/2008). Most supermarkets and markets around the country signed a charter that aims to promote sales of environmentally friendly goods, as well as those produced organically. It will also seek to increase levels of recycling in the country and lower carbon emissions from supermarkets. Among the targets is the aim to reduce packaging waste by at least 10% and increase recycling of glass, paper and cardboard in stores by 74%. Britain's food industry's trade body, the Food and Drink Federation, last October also announced a range of targets aimed at making the sector more environmentally friendly.

Increasing consumer awareness of how food is produced is creating demand from for more environmentally friendly products while EU targets to reduce carbon emissions is forcing the retail industry to act.

The French action distinguishes itself by including organically produced foods in its environmental charter and has the aim of increasing the share of organic foods in the total range offered by 15% each year – a target that signatories to the charter admit will require "an evolution in French farming".

Price fixing and health

As mentioned food affordability, particularly quality food, can impact on community health. UK researchers identified the cost of healthy foods as a main barrier, along with hunger satisfaction, taste, and peer pressure, to young people adopting a healthy lifestyle.

The study funded by the British Heart Foundation monitored diet choices and physical activity levels at five schools to improve current knowledge of obesity - particularly amongst children.

The publication of the research in the Journal of Public Health (November 2007) coincided with the publication of the UK government's strategy on curbing obesity in the country in January this year.

The indications are that health and lifestyle issues will become more important and they will dovetail with environmental imperatives.

For example, organic foods, produced without using synthetic chemicals (such as pesticides) or genetically modified (GM) components are progressively seen as more desirable for a host of reasons. Free-range eggs don't depend on caged hens which aren't fed drugs such as steroids, hormones or antibiotics, to regulate or promote their growth. Organic farming also stresses sustainable land-management practices, natural farming cycles, use of renewable resources and conservation of energy, soil and water.

Summary

There has been enough qualified comment and salutary experience about the incidence and risks of price exploitation in general and in the grocery sector to warrant action.

The response to those threats has been for more effective regulations with the appropriate carrot and stick measures to encourage transparency, ethical behaviour, better production and retailing processes and more affordable and quality groceries.

Now is the time to do it and big business has a chance to play its part given that it continues to make good if not very good profits and economic growth continues to surpass expectations with nearly a 4% GDP for 2007. This was reflected in company gross operating profits which according to the ABS reached 3.9% during the December quarter. This was double the market forecasts of 2% and across all sectors profits were up 11.7% for the 2007 calendar year.

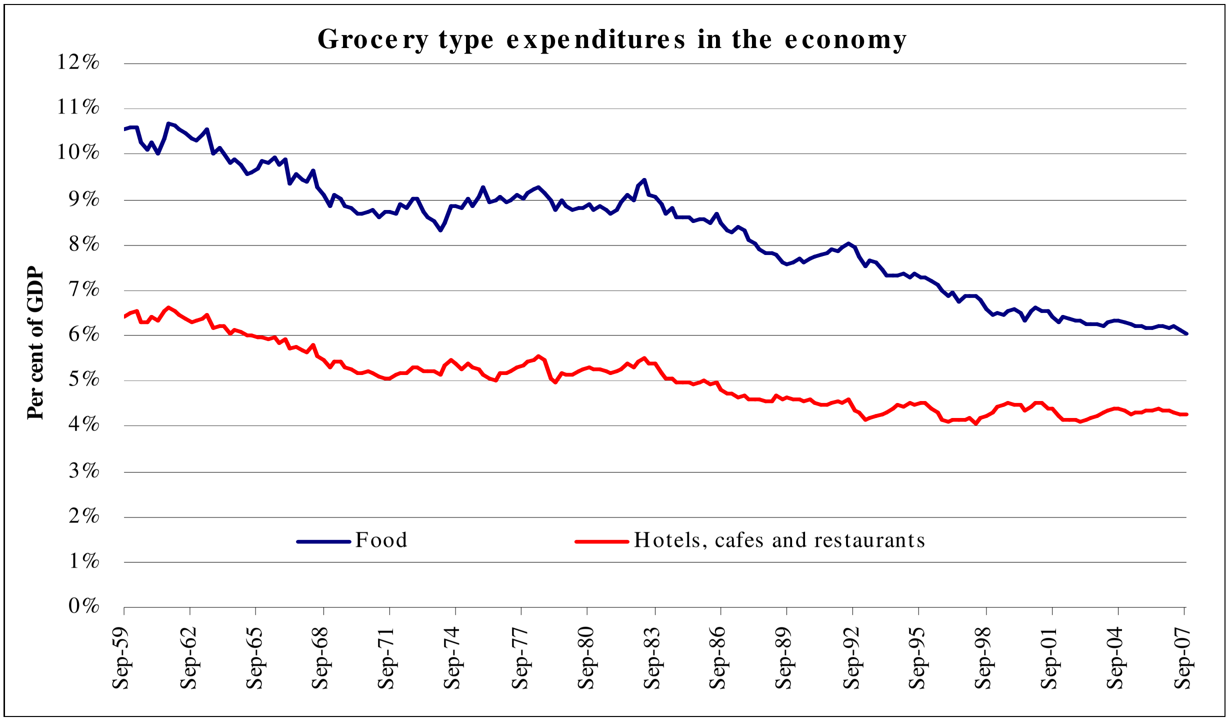
A lot is said about the inflationary impact of consumer spending but little is explored about the inflationary impact from inflated prices when price exploitation occurs.
Addressing price fixing is also a powerful method of fighting inflation that receives little attention.
There is also the case for big business to urge profit restraint, just as workers and consumers are forced to, to curtail inflationary pressures.

Part of the task is about making it easier, as well as affordable, for consumers to make better choices. Changes to supermarket practices, to provide economical and quality products, are necessary.
Consumer choice, or consumer democracy, is not enough. It needs regulatory backing to counter natural business tendencies to maximise advantage, which has been know for a long time and was commented on by Scottish economist Adam Smith in his magnum opus *An Inquiry into the Nature and Causes of the Wealth of Nations* published in March 1776.

"People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices ," Adam Smith wrote.
The recent history of price fixing seems to suggest that this is still very much a lucrative habit and the push to free up markets in the 1900s has had the opposite effect. It has created monopolies or environments that favour monopolistic practices.

It is true that competition has the potential to benefit consumers as the struggle for market share can lead to price cuts. However, the dynamics change as the market develops. Common sense alerts, and experience has confirmed, that a dangerous situation is reached when dominant players have more to gain from cooperating than competing. They can benchmark secure profits in an agreed share of the market instead of fighting a risky competitive battle. This is not lost on corporate leaders. James Randall, former president of grain trading TNC Archer Daniels Midland, was reported to have said (Fortune, Vol 139, No. 8, 26 April 1999)
'Our competitors are our friends. Our customers are the enemy.'
Government regulation has an important role to play to safeguard consumer interests in price and quality areas, to promote a fair and efficient economy, and, given the looming climate change impact, to avoid waste in energy and resources.

Appendices



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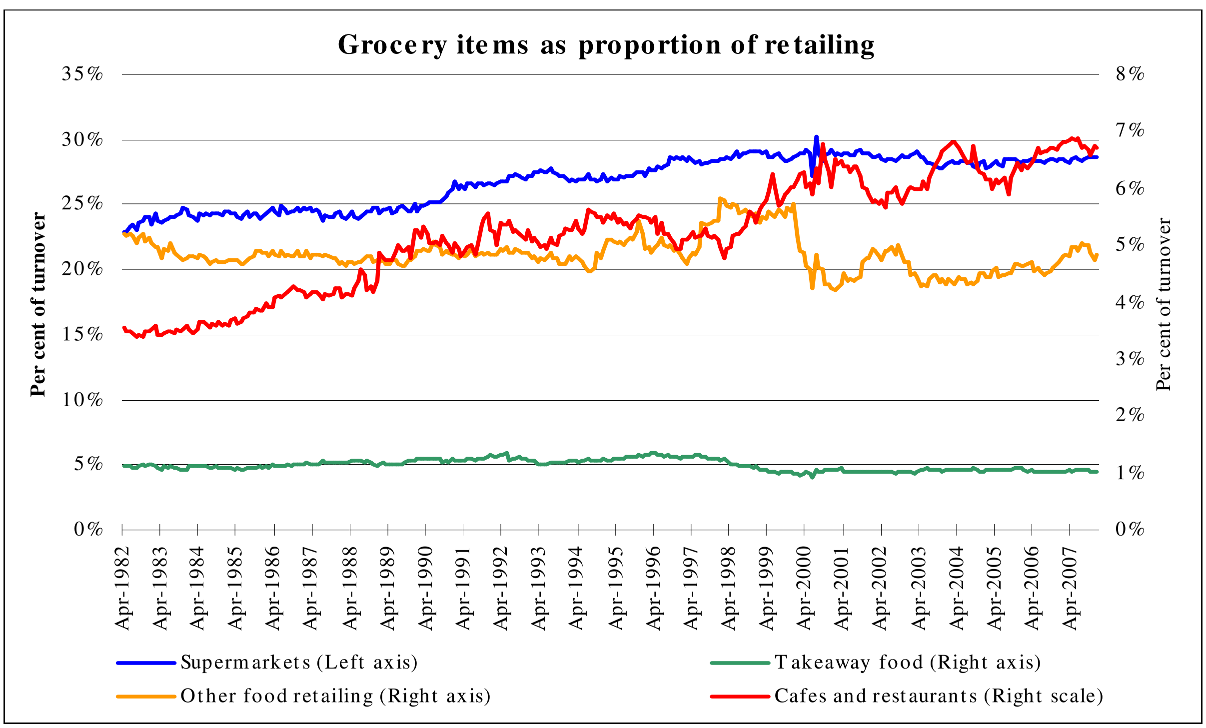

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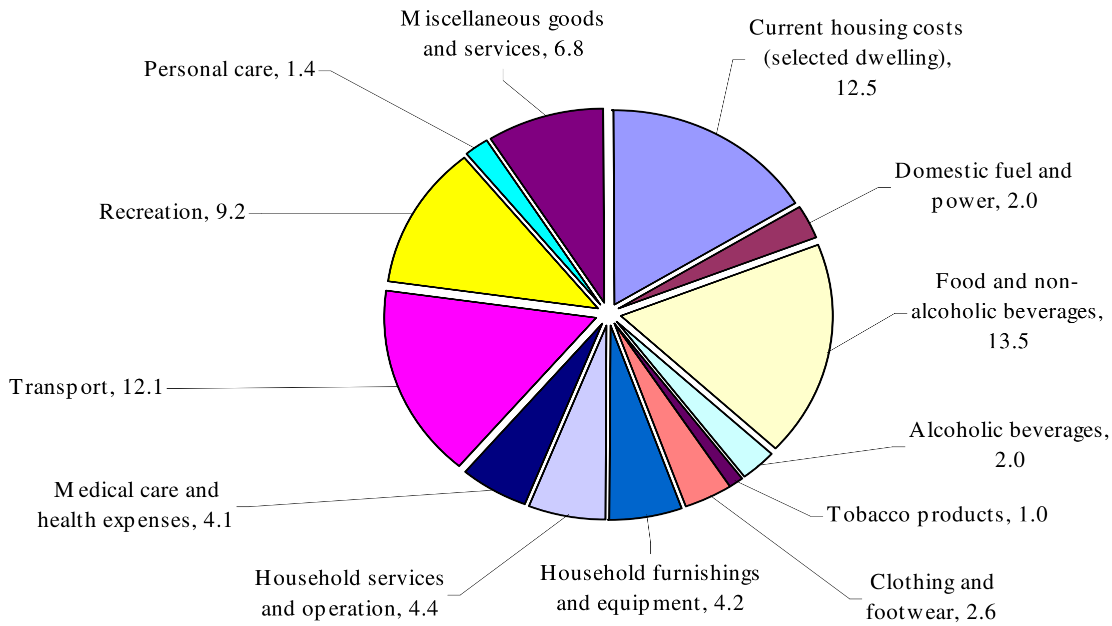
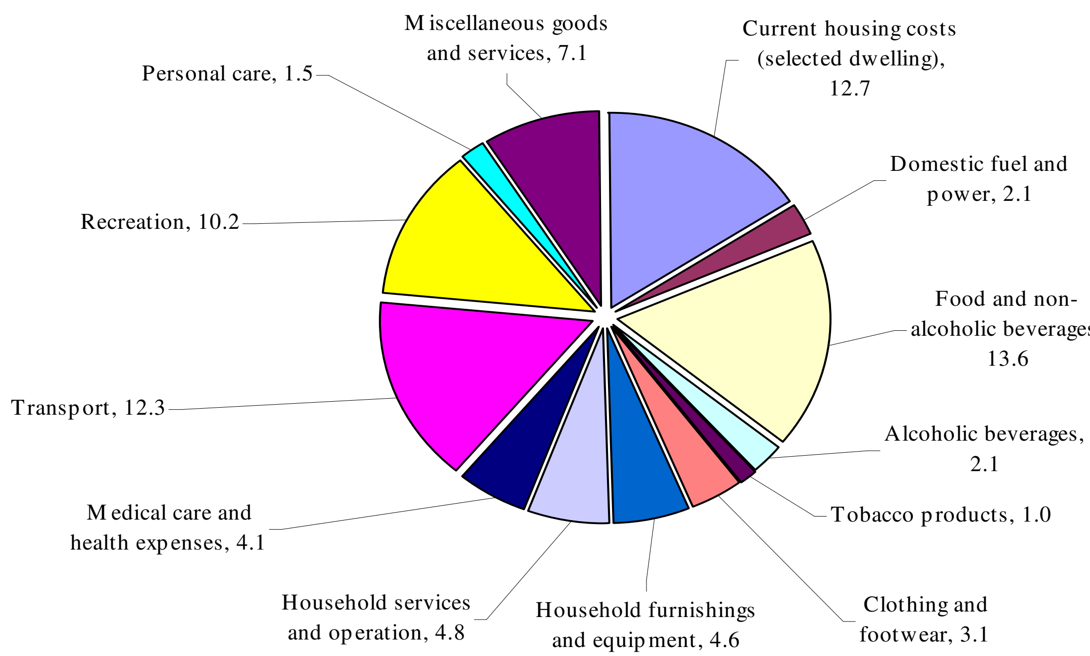
2006-07 Per cent of household spending



2003-04 Per cent of household spending



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