Identifying Regulatory Restraints of Competition in the Agricultural Sector

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Benefit from Australia's Experience – use competition to promote growth

OECD 2003:

•Australia's National Competition Policy reviewed about 1,800 laws and regulations for unnecessary restraints on competition

•The implementation of Australia's ambitious and comprehensive National Competition Policy over the past seven years has undoubtedly made a substantial contribution to the recent improvement in labour and multifactor productivity and economic growth. The Productivity Commission estimates that Australian households' annual incomes are on average around A$7 000 higher as a result of competition policy.

Benefit from Australia's Experience (2)

OECD 2006:
•Domestic product (GDP) growth since the millennium has averaged above 3% per annum

•Growth in real gross domestic income averaged over 4%, with terms of trade gains, among the best of OECD countries

•Unemployment rate has fallen to around 5%, its lowest level since the 1970s;

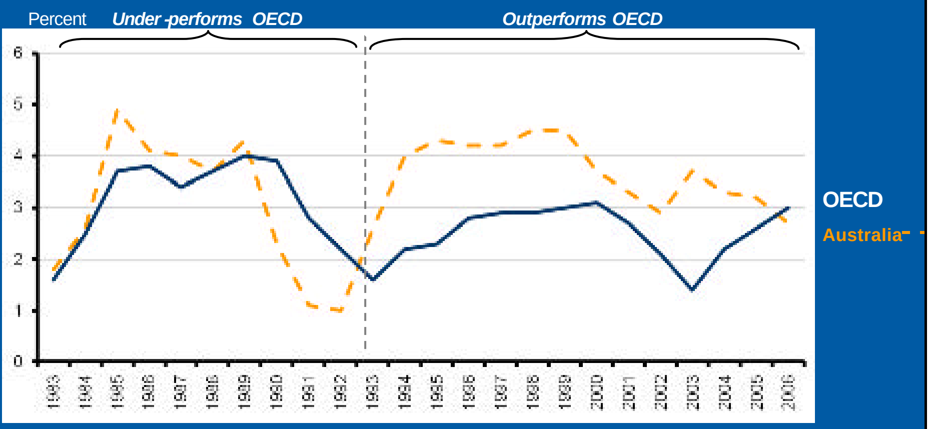
•Inflation within the target range

•A long stretch of fiscal surpluses, general government net debt eliminated.

•Living standards steadily improved since the beginning of the 1990s, now surpass all G7 countries except the United States.

•Wide-ranging reforms, particularly to promote competition, were instrumental.

Australia versus OECD—real GDP growth*



* 3-year moving average

Source: Fred Hilmer, University of New South Wales, OECD Stat Gross Domestic Product (output approach), Volume Index

OECD Competition Assessment Toolkit

- Designed to help evaluate whether a law or regulation unduly restricts competition.
- The goal is to identify ways to achieve the objectives of laws and regulations with the least harm to competition.
- Can be used in a process to streamline large numbers of existing laws and regulations, review proposed new ones.
- Can be used at national, regional and local levels

Competition Checklist

- Goal of checklist is to create a filter that can be applied by non-specialists to effectively identify whether a law or regulation raises competition issues requiring further analysis.
- Initial Review: Does the law or regulation:
  - Limit the number or range of suppliers?
  - Limit the ability of suppliers to compete?
  - Reduce the incentive of suppliers to compete vigorously?
- A <u>positive</u> answer to <u>any</u> of the items noted in the Competition Checklist will warrant a more detailed competition assessment of the law or regulation.
  - Level of detail as warranted by circumstances, to avoid unnecessary paper burden, and often minimal.

Limit the number or range of suppliers?

- This is likely to be the case if the law or regulation:
  - Grants exclusive rights for a supplier to provide a good or service
  - Establishes a license, permit or authorisation process as a requirement of operation
  - Limits the ability of some types of suppliers to provide a good or service
  - Significantly raises cost of entry or exit by a supplier
  - Creates a geographical barrier to the ability of companies to supply goods or services, invest capital or supply labour

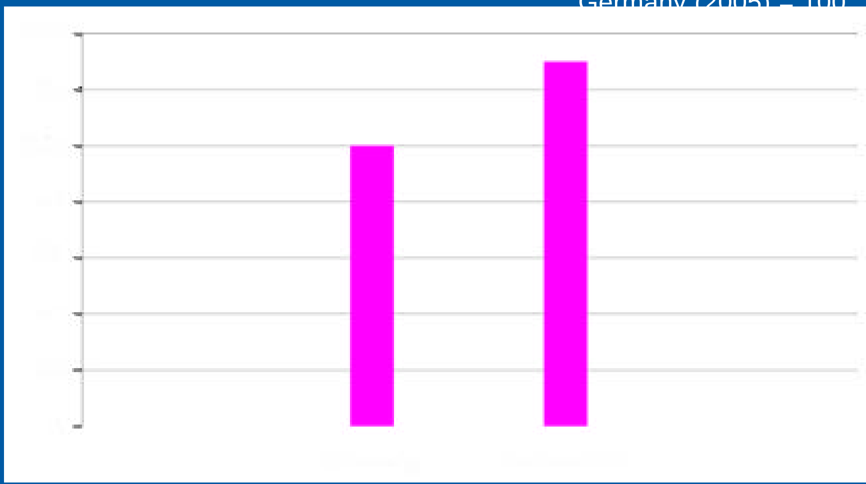
Example: import restrictions raised Swiss food prices

- Import restrictions on agricultural products reduced competition in the Swiss retail sector in 2005
- Due to the import restrictions, possibilities of entrants to sell cheaper imported agricultural products and thus undercut the prices was limited

  - Established retailers (Migros and Coop) occupied the most favorable points of sale
  - They had long-term relationships with suppliers or were partly vertically integrated with food processors (e.g. Migros with Micarna and Optigal, Coop with Bell)
- In Switzerland, food prices were estimated on average about 30% higher than, e.g. in Germany (source : Swiss Competition Authority, '05)

Example : import restrictions raised Swiss food prices (2)

Germany (2005) = 100



Limit the ability of suppliers to compete?

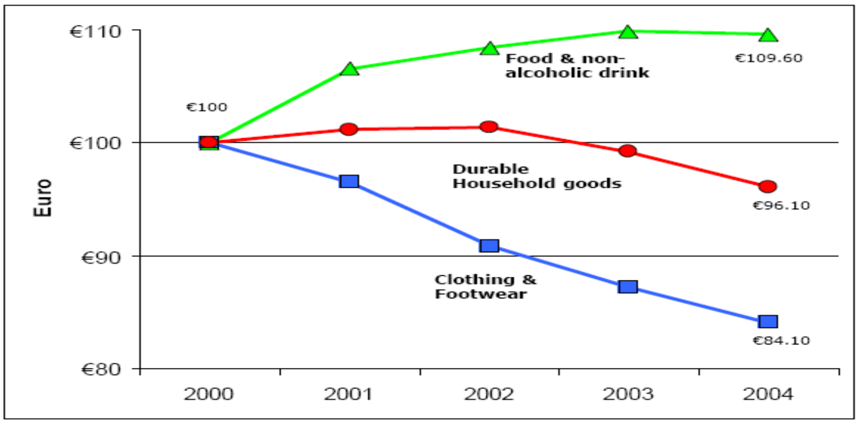
- This is likely to be the case if the law or regulation:
  - Controls or substantially influences the prices for goods or services
  - Limits freedom of suppliers to advertise or market their goods or services
  - Sets standards for product quality that provide an advantage to some suppliers over others or that are above the level that many well-informed customers would choose
  - Significantly raises costs of production for some suppliers relative to others (especially by treating incumbents differently from new entrants)

Example: Irish Grocery Order

- In Ireland, the Groceries Order, introduced in 1987, prevented retailers from selling certain grocery products below their invoice price
- The Irish Competition Authority examined pricing trends under the Order in 2005
- The Authority first compared price trends in food to those in durables and clothing
  - The comparison showed price increases in food were greater than those of durables and clothing

Example: Irish Grocery Order (2)

Figure 1: Irish food prices rise while clothing, footwear and household goods prices fall.



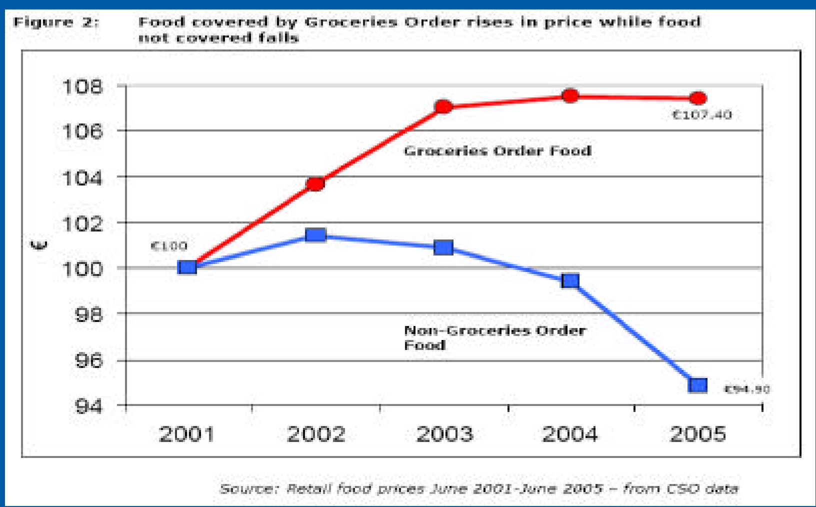
Source: Retail price levels 2000-2004 from CSO data

Example: Irish Grocery Order (3)

The Authority also found the prices for grocery items covered by the Order have been increasing, while the items not covered by the Order have been decreasing

On average, Irish families were paying 500 Euros more per year for the covered items because of the Order ? More damage to low-income families

Example: Irish Grocery Order (4)



Example: Australian Milk Price Regulation

- Prior to the year of 2000, farm gate prices for drinking milk were set by State Governments in Australia
- Australia eliminated the restrictions on dairy sector throughout the country on July 1, 2000
- The Australian Competition and Consumer Commission (ACCC) monitored consumer prices and profits of intermediaries in the period before and after the liberalization in milk industry

  - There were concerns that milk processors and retailers would be the main beneficiaries , while consumers would receive only marginal savings

Example: Australian Milk Price Regulation (2)

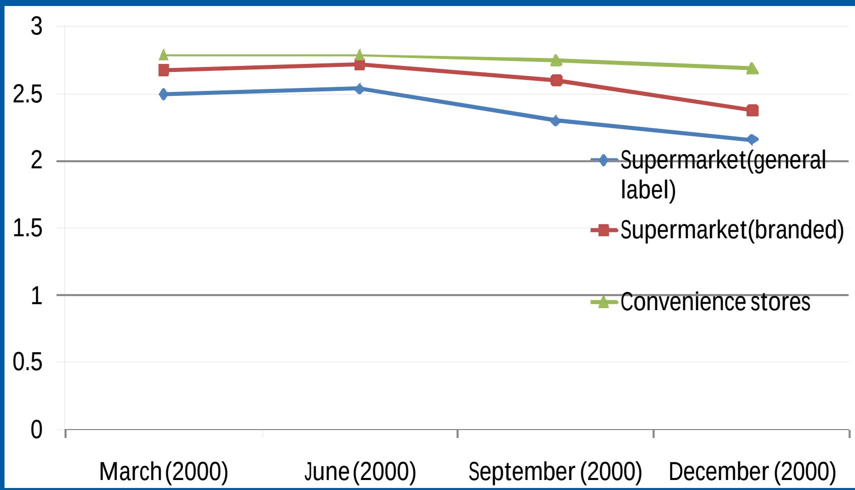
- One major national supermarket chain announced two year contract plan with processors after the reform

  - The opportunity to win these contracts triggered aggressive bidding between milk processors
  - The chain chose a national marketing strategy of setting low prices to drive more traffic to their store rather than to increase its revenue

- Supermarket prices for plain milk fell by a maximum of 34 cents per liter (2.72A$? 2.38A$) across all pack size and brands from June quarter to December quarter of 2000 (Prices for reduced-fat milk also fell, though to a lesser degree)
- Convenience stores also lowered their prices in response to lower supermarket prices (2.79A$ per liter ? 2.69A$ per liter)

Example: Australian Milk Price Regulation (3)

Milk price change



source : ACCC (2001) and ADC

Example: Australian Milk Price Regulation (4)

- While retail prices declined, retailers' margins also declined

  (source : ACCC (2001) and ADC)

  - Supermarkets : declined by 19 percent

  - Convenience stores : declined by 24 percent

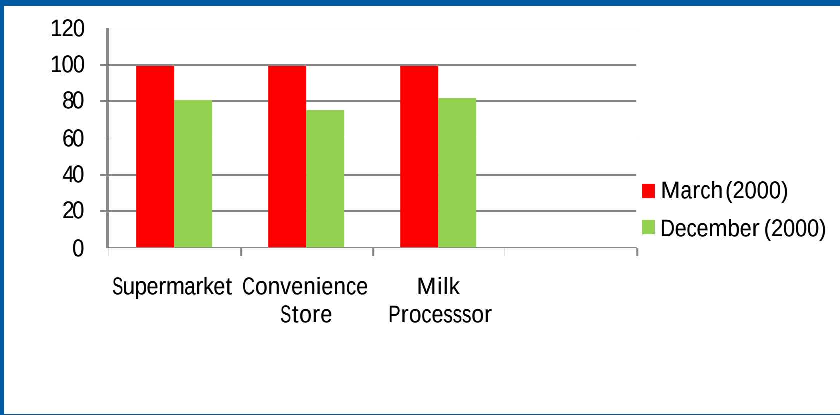
  - Milk processors : decreased by 12-18 percent

* Savings from sales of supermarket milk to Australian consumers were estimated to conservatively about **A$ 118 million** on a full year basis (source : ACCC (2001) and ADC)

Example: Australian Milk Price Regulation (5)

Drop in Milk margins

March 2000 = 100



Reduce the incentive of suppliers to compete vigorously?

- This may be the case if the law or regulation:
  - Creates a self-regulatory or co-regulatory regime
  - Requires or encourages information on company outputs, prices, sales or costs to be published
  - Exempts the activity of a particular industry or group of suppliers from the operation of general competition law
  - Reduces mobility of customers between suppliers of goods or services by increasing the explicit or implicit costs of changing suppliers

Example : Oranges from California and Arizona

- The Agricultural Marketing Act of 1937 permitted the majority of producers to form a marketing coalition
- Given antitrust immunity, the Navel and Valencia orange producers formed administrative committee to set the price, the timing of shipments to the domestic market for fresh oranges and the minimum size to be marketed
- The effect was to reduce the percentage of the fruit that went to market in season below the percentage that went out of season
- Although 85-90% of Navels and 65-80% of Valencias were of sufficient quality to be marketed in fresh form, fewer than 70% of Navels and 45% of Valencias typically reached the fresh market during 1960 – 1980. (Shepard, 1986)

Navel oranges : 20% were kept off the market

Valencia oranges : more than 30 % were kept off the market

Jurisdictions making progress with competition assessment

Jurisdictions	Progress
Australia	Adopted OECD competition assessment checklist for reviewing impact of new regulations
Canada	Competition authority is running a pilot of the OECD competition assessment methodology
Korea	Competition authority is reviewing select new regulations with the Competition Assessment Toolkit
Mexico	Started a large project to review and revise regulations with competitive impact
United Kingdom	Pioneered a formalized competition assessment process, applying the OECD checklist methodology
European Commission	Has included a call for competition assessment in its development of new regulations

How Competition Reform Promotes Productivity

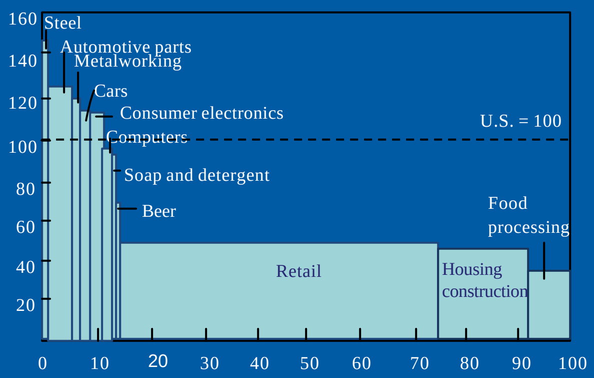
- Recent OECD papers explain how reforms to stimulate stronger market competition affect growth by
  - spurring efficiency and productivity growth by 4-10%
  - disciplining managers
  - increasing investment by removing barriers
  - increasing employment – the employment rate is up to 2.5-5.0% higher where in-depth reforms have been adopted
  - reinforcing incentives for innovation
  - speeding the adoption of new technology and process of adjustment to change

McKinsey links regulatory restrictions to economic performance

- McKinsey and Company compared productivity levels in Japan and the United States.
- In the sectors of the Japanese economy that were exposed to international competition – in steel, automotive parts, metal working, cars, consumer electronics and computers -- productivity levels were about the same or higher compared to productivity levels in the U.S.
- Where Japanese sectors were protected from competition – in the retail sector, housing construction and food processing -- the productivity levels were as much as 50% below those of the U.S.
- These differences can largely be explained by competition and regulation. In the underperforming sectors, competition is highly restricted, in large part because of regulation.

Competition and Productivity -- Japan's Dual Economy

Relative productivity levels
Index U.S. = 100



Employment
100% = 12.5 million employees

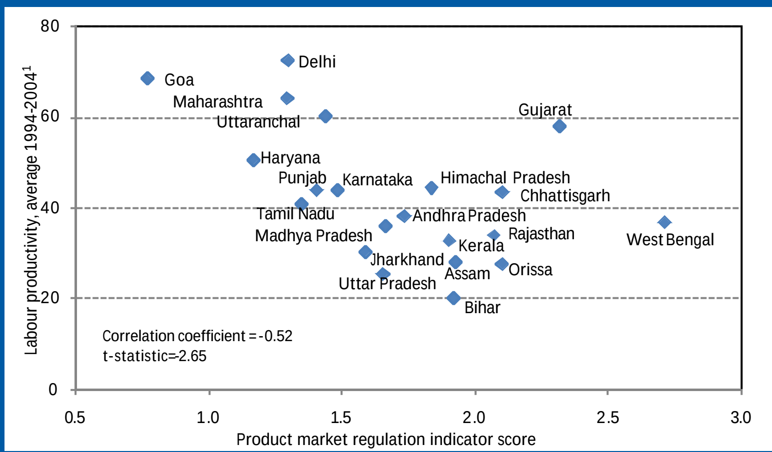
Source: McKinsey Global Institute

Fighting Poverty -- Impact of Reducing Burdensome Regulation in India

- Per capita income has been diverging in Indian states over recent decades – the rich states are becoming relatively richer.
- Since mid-90s, labor productivity growth has been the primary driver of growth in GDP per capita in the majority of Indian states
- "Differences in product market regulation, as captured by the OECD's PMR indicators, do appear to have a significant impact on productivity performance at the level of a aggregate state economies. Over the period of 1994 to 2004, there is a clear negative relationship between the restrictiveness of product market regulation and average labor productivity."

Source: Conway, Herd and Chalaux, March 2008, "Product Market Regulation and Economic Performance Across Indian States," OECD Economics Department Working Papers No. 600

Labour productivity higher in Indian states with fewer restraints on competition



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Promote and protect competition for India's growth!