Competition Policy & Food Supply Chains: Time for a rethink
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The introduction of competition across the Australian economy has generally yielded positive results through increased efficiencies, lower prices and new products and services for consumers. However, this success has not been replicated in every Australian market. The implementation and execution of Australia’s National Competition Policy (NCP) has failed to deliver the outcomes within food supply chains expected of a competitive market. This failure has hurt the weakest involved in these supply chains; farmers and consumers. Reform of competition provisions is required to address these issues.

With the introduction of the NCP, farmers were stripped of their bargaining power within domestic and international markets, with the disbanding of coordinated supply and marketing arrangements, on the basis that exposure to competitive domestic and international markets would produce best overall outcomes for the Australian economy. However, successive governments have failed to provide free and fair international trade for Australian producers, and regulators have not been willing to tackle the significant market power of domestic buyers, such as the large supermarkets and processors.

International agricultural markets are defined by protectionism. Dairy markets in the European Union, The United States, and Canada all have import quotas and significant direct and indirect subsidies for their dairy farmers. The international market is merely a dumping ground for excess supply, leaving Australian dairy farmers at the behest of a market that is defined by below cost production. The monopsony-like (buyer) power of the supermarkets and some food processors has been left unchecked by regulators and policymakers alike. The Australian grocery market is the most concentrated market in the world, yet this triggers very little policy or regulatory concern. This lack of competition has allowed those with power to extract unreasonable economic surplus from food supply chains, hollowed out these supply chains, and reduced investment in efficiency-enhancing measures and innovation. It has also put into question the viability of many types of farming, where farmers are often squeezed to the point where they have no choice but to offer goods at below cost.

In the long-term consumers will be left worse off, with less choice and product innovation as food supply chains are hollowed out. There will be shortages of products available to consumer, as we have seen with dairy and other consumer goods, and a subversion of price competition once power has been consolidated by the supermarkets.

Farmers are not rejecting the principle of competition; they are rejecting the lack of real competition in food supply chains. To this end, this discussion paper puts forward solutions to ensure that Australia has food supply chains that are defined by value creation that will be good for producers and consumers alike, not just the redistribution of margins to those who exercise coercive power.

James Jackson
President
NSW Farmers’ Association
About the NSW Farmers’ Association

The NSW Farmers’ Association is Australia’s largest State farming organisation representing the interests of its farmer members.

Farmers across New South Wales produce more than $15 billion worth of food and fibre every year, representing around one quarter of Australia’s total agricultural output. Our state’s unique geography means a wide variety of crops and livestock can be cultivated and nurtured. NSW Farmers is Australia’s only state-based farming organisation to represent the interests of farmers of all agricultural commodities – from avocados and tomatoes, apples, bananas and berries, through grains, pulses and lentils to oysters, cattle, dairy, goats, sheep, pigs and chickens.

Our focus is not just on issues affecting particular crops or animals – it extends to the environment, biosecurity, water, economics, trade and rural and regional affairs. We also have an eye on the future of agriculture; we are advocates for innovation in agriculture, striving to give our members access to the latest and greatest innovations in research, development and extension opportunities. Our industrial relations section provides highly specialised advice about labour and workplace matters.

Our regional branch network ensures local voices guide and shape our positions on issues which affect real people in real communities. Members are the final arbitrers of the policies of the Association – through our Annual Conference and elected forums such as Executive Council, members can lobby for the issues which matter to them and their community to become Association policy. Our issue- and commodity-specific Advisory Committees are elected by members to provide specialist, practical advice to decision makers on issues affecting the sector. We are proudly apolitical – we put our members’ needs first.
Competition Policy & Food Supply Chains: Time for a rethink

There is little doubt that the introduction of the National Competition Policy (NCP) in the 1990s has created significant efficiencies in the Australian market and provided benefits to consumers through lower prices for goods and services, new products, and innovation. However, the introduction and execution of competition policy has not produced positive outcomes in all Australian markets. It is now widely accepted that ‘competitive’ energy markets have failed to provide the expected consumer outcomes, with high prices and little innovation. This discussion paper contends that competition policy has also failed in providing a superior mechanism for value creation within food supply chains. The price for this failure is being paid by those with the least power within the supply chain, namely farmers, and ultimately consumers will be negatively impacted through less product choice and innovation, volatility in pricing, and intermittent supply shortages.

Executive Summary

The discussion paper makes several recommendations to address the shortcomings of the implementation of competition policy within food supply chains, with a particular focus on:

- reforming unconscionable conduct provisions to provide better avenues for small businesses and farmers to counter supply chain abuses;
- reviewing the principles of the NCP to include fairness in business dealings as a consideration; and
- resourcing regulators and policy makers to adequately undertake compliance and enforcement.

While the insights and findings of this paper are relevant to all types of farming and small business operations, the focus and examples provided are largely drawn from dairy supply chains, given the recent egregious behaviour of some dairy processors, and aggressive pricing of private label dairy products by supermarkets.
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Market factors leading to sub-optimal outcomes

The liberalisation of the agricultural sector was based on assumptions that never came to fruition. The introduction of competition reforms were predicated on access and exposure to free and fair international and domestic markets. The inability of Australian governments to provide the free trade for agricultural commodities in the global market, combined with the removal of agricultural commercial and marketing arrangements, has placed Australian producers at a significant competitive disadvantage.

Australian farmers are not only exposed to highly distorted international markets, but highly concentrated domestic markets, through their interactions with powerful supermarkets and processors. Having to deal with large organisation with significant market and bargaining power, has meant that the margins of farmers have been further squeezed, often below the cost of production. This discussion paper further contends that the behaviours exhibited by supermarkets, such as the introduction of private labels and exclusive supply chains, further entrench their power within the supply chain and reduces competitive tensions within the market.

Regulators have failed to curb this excessive power, creating significant detriment to less powerful suppliers (such as farmers), and hollowing out the supply chain. In the long-term consumers will be worse off through less choice and innovation in products and less supply chain investments in efficiency and productivity, and potential shortages of products. Any short-term ‘consumer benefit’ is likely through redistribution not value creation.

National competition policy failing farmers

Small business, particularly farmers, within food supply chains have been let down by competition policy in Australia. There has been a failure to address the significant and undue power of supermarkets, large intermediaries and processors. This is the result of gaps in the policy framework that unintentionally focus on short-term consumer benefit to the detriment of value creation, and gaps that fail to address monopsony-like power (monopoly-like power held by buyers) in supply chains.

This competition policy failure is also due to inadequate enforcement and compliance regimes (including regulator and third party enforcement) that fail to check the undue power of large organisations, and thereby fail to set the competitive culture and norms of behaviour within these markets and supply chains.

Specific policy framework, enforcement and compliance shortfalls include:

- the lack of fairness as a principle in Australian Consumer Law (ACL), combined with a myopic focus on short-term consumer benefit;
- the inability of competition provisions to deal with the undue power of a monopsony, with competition provisions couched in terms of suppliers taking advantage of buyers or consumers;
- unconscionable conduct provisions are poorly defined and notoriously difficult provision to prove;
- the lack of resources for the Australian Competition and Consumer Commission (ACCC) to provide adequate enforcement and compliance activities across the board; and
- the high cost of litigation, particularly the imposition of cost orders, stifling third party action.

Adverse impacts of current approach

There are endless examples of long-term value being destroyed in food supply chains due to the undue power of supermarkets, processors and other intermediaries. As an example, because of the power asymmetry between poultry farmers and processors, processors have unfettered access to the cost structure of the farmer, setting their farm-gate price slightly above the cost of the farmer. This has meant farmers have not invested in productivity improvements as this pricing system makes investment unviable. This can be seen in investments in energy resources. Poultry farms are energy intensive, yet have been laggards in investing in cost reducing energy resources, as any reduction in their cost will reduce their farm-gate price. The result of the undue power in poultry supply chains means that the cost of production is being kept higher than what would be expected in a competitive market.

Even the touted consumer benefits of lower grocery prices (ACCC 2018), as a result of supermarket competition, is questionable and short-term in nature. This discussion paper argues that any consumer benefit created by supermarkets has not been due to economies of scale and competitive tension, but a redistribution of surplus from less-powerful supply chain stakeholders.

In the long-term consumers will be left with less choice and product innovation. Food supply chains will be hollowed out further, and there will be intermittent shortages of consumer products, as we have seen recently with dairy products and pet food.

This failure to check power has adverse impacts to Australia’s regulatory mindset. The failure of regulators to take on the undue power of supermarkets, have led to the consolidation of the processing sector to counter this uneven bargaining power. This has left farmers at the behest of supply chains characterised by consolidation and concentration. Counterintuitively, regulators implicitly suggest the need for the farming sector to consolidate; resulting in less competitive tension across the entire food supply chain.
Solutions and recommendations

Limiting supermarket power: Review of unconscionable conduct provisions

A review of unconscionable conduct provisions is required to provide practical avenues to challenge the monopsony power of supermarkets and processors within food supply chains. The Harper Review into competition noted that a review was not required as the provisions were working as intended, highlighted by the successful prosecution of Coles by the ACCC. The subsequent Woolworths case casts doubt on the decision not to review the provisions.

A fair go for small business: The principle of fairness included in National Competition Policy

A review of the principles of the National Competition Policy is required, including exploring the incorporation of principles fairness within the framework. Other jurisdictions, such as the European Union, have specific fairness provisions that look at bargaining power and ensuring viable supply chains. The review should also explicitly determine the relative benefits of the focus on consumer benefit above and beyond ensuring the process of competition, and the creation of value across the economy.

Effective enforcement: Adequate resourcing of the ACCC

Without adequate enforcement and compliance, it is difficult to instil the healthy competitive norms and culture within markets. The lack of enforcement is of particular concern within food supply chains, where many farmers and suppliers are reluctant to come forward against powerful organisations for fear of being locked out of supply chains. This makes the investigative work of the ACCC, particularly via the ACCC Agriculture Unit, vital in uncovering any potential systemic breaches of competition provisions.

At a minimum, the NSW Farmers seek commitment from the Federal Government to fund and resource the ACCC Agriculture Unit over the forward estimates and beyond. NSW Farmers further seeks sufficient funding for the implementation and administration of the proposed mandatory code for the dairy industry.

Enabling 3rd party enforcement: Cost effective dispute resolution and access to justice

Access to justice for small businesses and farmers is essential for the functioning of Australia’s competition law. It is recommended that consideration be given to the introduction of:

- a no cost order mode of litigation for small businesses and farmers where a prima facie review demonstrates that the litigation is not frivolous or vexatious; and
- alternate low cost options for small business and farmers for competition related arbitration and dispute resolution processes.

Government support for a unified farming sector: Collective bargaining & ‘national champions’

Australia is in the bottom half of OECD countries with respect to investment in its food and agricultural sectors by government. While this paper is not suggesting wholesale introduction of farming subsidies, targeted investments will create a step-change in the agricultural sector.

Federal and state governments must provide significant investment in promoting and helping establish voluntary collective bargaining unions and ‘national champion organisations’ for primary producers to do their bidding in international markets and with other large and powerful organisations.

Challenging coercive power: Agriculture Commissioner & Dairy Advocate

The erosion of the farming sectors bargaining power must be redressed.

The NSW Farmers welcomes the NSW Government’s commitment in establishing the Agricultural Commissioner and the Dairy Advocate; key pillars of our advocacy agenda in 2018. The Commissioner and Advocate should be tasked with undertaking investigations into potential competition issues and breaches within NSW’s food supply chains, assist in the implementation and management of various food related codes, and make recommendations on competition policy issues to state and federal governments.
Market factors leading to sub-optimal outcomes

International markets

The agricultural sector has been significantly damaged by the development and application of National Competition Policy (NCP) in Australia. The NCP has been steadfast in removing many commercial frameworks, such as agricultural marketing arrangements, to expose agricultural producers to domestic and international competition, which in turn were meant to provide greater efficiencies in the sector. However, the Hilmer Report (1993) and Harper Review (2015) simply assumed that international markets are free and fair. This is clearly not the case, and removal of international agricultural marketing arrangements has exposed Australian producers to highly concentrated, distorted and volatile international markets; putting the viability and future capacity of the Australia’s agricultural sector into question.

The Hilmer Report (1993) was the watershed reform in transforming the economic structure of Australian industries, particularly in the agricultural sector. The Report espoused the need to remove any structure or activity that reduced exposure to ‘free markets’. With respect to agriculture, this meant the removal of agricultural marketing arrangements and any attempt by producers to manage or coordinate supply available to the market.

Clearly these price and supply controls had an adverse impact on the cost and choice of products available to Australian consumers, particularly when coupled with protectionist import tariffs. However, in dismantling these arrangements, the NCP and Australian governments removed a critical tool for Australian producers to wrestle back some parity in bargaining power from unfair, concentrated, and distorted international markets.

This lack of bargaining power, and exposure to distorted international markets have left Australian producers at the behest of volatile price fluctuations, below cost pricing, and quasi-dumping of surplus supply by international rivals. The recent tariff war between the United States and China demonstrates this point, with President Trump providing multi-billion dollar subsidies to farmers and commitment to find international markets for their commodities in response to Chinese agricultural tariffs (Swanson 2019).

The inability of Australian governments to provide the free trade of agricultural commodities in the global market, combined with the removal of agricultural commercial and marketing arrangements, has placed Australian producers at a significant competitive disadvantage. It is commonly held that international dairy trade liberalisation would benefit Australian producers to the determinant of European Union and Canadian producers (Vavra and Martini 2005). The removal of subsidies and import tariffs overseas would also likely increase the global prices for dairy commodities.

Unfair, concentrated and distorted international markets

International markets for agricultural commodities are neither free nor fair. In major dairy producing countries, markets are governed by significant import tariffs and production subsidies. Major markets including the European Union, the United States, China, and Canada all have strict dairy import quotas (Sumner, Balagtas and Findlay (2014)). Most jurisdictions provide their dairy farmers with direct or quasi subsidies, with Canadian farmers enjoying a generous regulated floor price for farm-gate milk, and EU farmers receiving over 25% of their revenues from direct subsidies, and close to half their revenue from direct and indirect subsidies, including subsidies related to tax and levy exemptions, land management and reforestation payments etc. (Helm 2017).
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Leading dairy producing regions 2017 – global
Source: Food and Agricultural Organisation United Nations (FAO 2018)

Global milk production (million tonnes)
Source: Food and Agricultural Organisation United Nations (FAO 2018)

The top-three dairy producing regions account for more than 60% of global production, and are all characterised by significant farm subsidies, import tariffs, and regulated prices.

In addition to international agricultural markets being heavily distorted, the primacy of international markets in setting the Australian farm-gate price for milk seems at odds with the total amount of global trade. Less than 10% of dairy production is traded on international markets. The link should be even more tenuous for fresh milk supply chains, where fresh milk cannot be readily exported.

New Zealand stands alone amongst Australia’s major dairy competitors in not providing subsidies for dairy production. However, it does not have a system that is characterised by competition. New Zealand has implicitly deemed the infrastructure supporting the dairy supply chain to be a natural monopoly, with the formation of Fonterra in 2001 through a merger of its major dairy cooperatives (McGiven 2016). To compete internationally it was deemed necessary to have a monopoly entity to organise the dairy supply chain and engage in international markets. Safeguards were put in place under the Dairy Industry Restructuring Act 2001 to stop Fonterra from potentially abusing its market power domestically.
Australian producers have been left in the cold with respect to their exposure to international markets. Import quotas and subsidies provided to our international competitors allows these producers to supply to international markets at below cost when necessary and still be viable, due to the ability to recoup costs through the provision of supply to their protected domestic markets. Unlike New Zealand, Australian producers cannot rely on a ‘national champion’ to provide access to international markets on a more even footing.

The Harper Review (2015) explicitly rejected the need for this national champion model:

“... it is less clear whether, and in what circumstances, suspending competition laws to allow the creation of national champions is desirable from either an economic or consumer perspective.”

The Harper Review is completely blind to the need to address unequal bargaining power of major players within international commodity markets, and mistakenly conceptualises the only benefits of a national champion to be the realisation of economies of scale.

**Domestic markets**

Australian farmers are not only exposed to highly distorted international markets, but highly concentrated domestic retail and processing markets. Having to deal with large organisation with significant market and bargaining power, has meant that the margins of farmers have been further squeezed, often below the cost of production. This will mean less money spent on capital investments and innovation, and will ultimately erode our food production capabilities.

The recent ACCC Dairy inquiry final report (2018) found significant competition issues with the market structure of dairy processing and resultant behaviours towards dairy farmers. Several recommendations were made in redressing these issues, including the introduction of the mandatory code for dairy. Given this significant policy redress, this paper commends the work of the ACCC and will not delve into issues with respect to the relationship between farmers and processors.

Unlike its findings with respect to processors, the ACCC exonerated the role of supermarkets in damaging the viability of the dairy supply chain. The tacit acceptance of high levels of market concentration and power in food supply chains by policymakers and regulators is yet another barrier to the viability of the farming sector. The NSW Farmers’ Association’s critique of the ACCC findings on supermarkets can be found at: [https://bit.ly/2Y5qH9z](https://bit.ly/2Y5qH9z).

The undue power of the supermarkets affects farmers in two ways:

- Producer surplus is appropriated by supermarkets from farmers who are direct suppliers; and
- Removing surplus from the food supply chain subsequently compels processors and manufacturers to squeeze the margins of farmers.

A superficial review of supermarket behaviour might suggest that this redistribution of economic surplus can be a positive consumer outcome, if it is shared with the consumer. This is only true if the appropriation of the surplus from the supply chain does not destroy short-term and long-term value creation (see section 4.2 for more information).

Trying to evaluate consumer outcome is also a highly subjective exercise, where accurately identifying short-term and long-term consumer impacts is an exercise in judgement. Unlike Australian regulators, regulators around the world tend to focus on preserving the process of competition (see section 4.2 for more information), which is more objective, than the consumer outcomes of competition.

**Retail markets**

Australia has the most concentrated supermarket sector in the world, with a 70% market share for the largest two chains (Coles and Woolworths – ‘the big two), and 90% market share in the hands of just four supermarkets. It is also one of the most concentrated sectors in the Australian economy (Grattan Institute 2017).
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Concentration of supermarket sector by country
Source: Adapted from Grattan Institute 2017

<table>
<thead>
<tr>
<th>Largest Firms 1st 2nd 3rd 4th</th>
<th>Population (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>323</td>
</tr>
<tr>
<td>Australia</td>
<td>25</td>
</tr>
<tr>
<td>UK</td>
<td>66</td>
</tr>
<tr>
<td>Italy</td>
<td>60</td>
</tr>
</tbody>
</table>

The market power of the big two supermarkets (Coles and Woolworths) are unsurpassed globally. Approximately 50% of fresh fruit and vegetable sales, fresh meat, and 60% of all dairy products sold to consumers are sold through the big two (Grattan 2017).

Fresh milk sales (retail)
Source: Dairy Australia (2018)

<table>
<thead>
<tr>
<th>Supermarket</th>
<th>Non-Supermarket</th>
</tr>
</thead>
<tbody>
<tr>
<td>71.40%</td>
<td>28.60%</td>
</tr>
</tbody>
</table>

Market concentration is not the only indicator of the undue power of the supermarkets, and market concentration alone should never be used to determine the competitiveness of a market. The following supermarket activities all have the intention or unintended impact of further consolidating power in food supply chains in the hands of supermarkets:

- The increased incidence and promotion of private label brands that aims to reduce the power and number of brands in supermarket supply chains;
- Increased integration and control of supply chain data in the hands of supermarkets further entrenches their superior bargaining power; and
- Supermarket specific ‘regulations’ that aim to create exclusionary supply chains, and increase the switching costs to competing supermarkets for suppliers.

Private label brands

Economic regulators tend to take a superficial view on private label products, generally heralding the introduction of private labels as positive in terms of consumer outcomes. The ACCC dairy Inquiry final report (ACCC 2018) highlighted that private label milk has reduced the price of milk for Australian consumers, and did not provide a concern from a competition perspective.

This paper is not suggesting that private labels should necessarily be stamped out, but the benign view of private label products must be challenged. The intention of private label products by supermarkets is to consolidate power and control within food supply chains (Sutton-Brady, Taylor and Kamvounias 2017). Ultimately private label brands tend to replicate existing brands and products, with the goal to reduce the number of brands within each product category, and reduce the bargaining power of existing brands. The ideal state for supermarkets would be to have categories dominated by the private label, with two or three other brands in each category (Dobson, Clarke, Davies, Waterson 2000).

Private label brands, on the most, imitate existing brands and do not provide innovation or new consumer options in the market. Supermarkets can forego the need to innovate, as their competitive advantage is unfettered access to prime shelf space. They also tend to push the cost structure of their category up, where incumbent brands only retaliatory option is to divert financial resources into aggressive and expensive marketing and promotional activities (Dobson and Chakraborty 2008). As reviews of retail energy markets have demonstrated, competitive activities that purely focus on marketing and advertising to gain and retain market share creates no overall consumer benefit, and through increased costs, destroys consumer value overall (Thwaites Review 2017).

Private label brands increase the cost of innovation and reduce the benefit of product innovation (Dobson and Chakraborty 2008). The threat of private label product imitation increases the incumbent brands’ reliance on costly legalistic intellectual property protections. The return on innovation is also lowered, making investment in innovation harder to justify for incumbent brands.
Manufacturers and processors who are faced with the challenge of private label brands will generally force these costs onto primary producers, instead of taking on the power of supermarkets. This means less money invested by farmers in capital equipment and innovations that will provide long-term efficiencies, and less investment in resilience to weather the high-risk of primary production including volatile international prices and fluctuating climatic conditions.

Furthermore, private label brands make retail markets more opaque and reduce consumers’ ability to compare the value proposition across supermarket chains (Dobson, Clarke, Davies, Waterson 2000). Consumers can easily compare the value offered across supermarket chains when focusing on incumbent brands, such as Tim Tams. Given the consistent quality, packaging and portion sizes of Tim Tams, consumers can easily discern value across supermarket chains by relying on price and convenience. In the world of private labels, the various Tim Tam imitators will have different extrinsic and intrinsic qualities and portion sizes, making the consumer assessment on value-for-money much more difficult.

While there might be short-term consumer benefits to private labels, in the form of lower prices, the long-term implications are uncertain. Increased marketing and innovation costs will likely increase the price of product categories in the long-term. Consumer choice may be reduced, with private labels reducing the number of incumbent brands, and remaining incumbent brands investing less in new products and offerings. Value will be destroyed across the food supply chains, where the methods in which private label brands have been introduced will reduce investment in capital, capacity and innovation amongst primary producers. With less competition from incumbent brands, private label brands will be less likely to share the surplus extracted from food supply chains with the consumer.

It is likely that economic regulators would have greater competition concerns about private label products, if the defined market for analysis was conceived differently. If the market for analysis was defined as the market for shelf space access, the behaviours of supermarkets in introducing private labels would likely contravene competition provisions.
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**Featured Case Study**

**Woolworths takes leadership on adverse supply chain impacts of private labels**

While regulators have shown little concern in addressing the adverse supply chain impacts of dollar-a-litre milk, Woolworths unilaterally moved to increase the price of private label milk, and share the price increase with farmers. This was in response to Woolworth’s engagement with the farming sector, who noted that the cost structure within the supply chain meant that many farmers were producing at below cost, and that supply was being affected; a bad outcome for consumers.

Belatedly, other major supermarkets have adjusted the price of private label milk in recognition of the adverse supply chain issues. Woolworths should be commended for taking leadership on the issues.

**Increased integration and control of food supply chain data**

The importance of consumer data rights has become a pivotal public policy debate in Australia (ACCC 2018a), noting the potential for consumer data sets to be exploited by large corporations and outweigh the consumer benefits they create. The adverse impacts of consumer data exploitation has been demonstrated by the activities of Facebook with respect to misuse of consumer data for the purposes of political activities.

These concerns are replicated in the interaction of small business and suppliers with supermarket chains, yet there has been very little policy attention in exploring some of the adverse outcomes of the increasing power of processors and supermarkets in obtaining and controlling supply chain data.

Already processor and supermarkets can obtain significant real-time access to producer data. Poultry farmers are subjected to significant scrutiny of their input costs by processors. This data is used to set the prices paid to producers, and extract any surplus gained by efficiencies created by the producer for the processor.

This has significantly reduced any incentive for poultry farmers in investing in efficiencies or innovation, as any benefit is extracted from them by processors. As an example, poultry farming is a laggard in the farming sector in terms of investing in energy management, despite having one of the highest exposures to electricity prices. The lack of investment stems from the fact that any investment that will reduce their energy costs will result in the lowering of the price paid by processors for their chickens, making the return on investment uneconomic.

Many companies, such as Map of Ag (see: https://mapof.ag/), have been set up to increase the visibility of real-time data across all farming production systems. The ostensible benefit of this data is to improve the efficiency of the sector; however, it is instructive that the main clients and investors in these companies are large corporations operating in retail grocery markets, manufacturing, banking and insurance.

**Supermarket specific regulations and the establishment of exclusionary food supply chains**

Supermarkets are increasingly integrating their supply chains with non-government ‘regulations’ and requirements on suppliers (Burch and Lawrence 2005). Such regulations were once the sole domain of government. The very fact that supermarkets can impose regulations on its supply chain demonstrates the extreme power of supermarkets in Australia, above and beyond what their market concentration would suggest.

The reason for supermarket regulation is diverse and could be due to genuine commercial reasons, corporate social responsibility, or other reputational issues. Supermarkets may impose a set of behaviours on their supply chain with respect to a myriad of issues including producers’ employment relationships, other third party contracts, and the handling of waste.

There are compliance costs for producers to adhere to these regulations, from a substantive and administrative perspective. Producers often are required to incur upfront costs in establishing processes to adhere to the supermarket specific regulation. These costs act as a barrier for producers to switch to a competitor supermarket chain.

To be clear, this discussion paper is not arguing against the need for industry wide and supply chain wide codes and guidelines that promote industry and public policy outcomes. Industry wide codes, as distinct from supermarket specific regulations, do not create exclusionary supply chains. What this discussion paper is suggesting is that supermarket specific regulations have the intended or unintended consequence of creating exclusionary supply chains, by increasing the switching costs for suppliers in moving to another supermarket chain. This further entrenches the power of the supermarkets (Burch and Lawrence 2005).
The NCP has provided significant benefits for the Australian economy and consumers. In general, it has created greater efficiencies within our industries and provided better value to consumers. However, the introduction of competition has not been uniformly beneficial in creating overall and consumer value. Most recently, regulators and subject matter experts have questioned whether the implementation of competition in all markets has created value; most notably in electricity markets (Thwaites Review 2017). The following section will demonstrate that the introduction and implementation of the NCP has not created overall value within the economy, nor optimised consumer outcomes in the long-term.

It should be noted that there has been positive reform in terms of the implementation of competition policy within food supply chains, including:

- ACCC’s investigative powers and market studies that provides avenues to discover and address systemic issues within industries and supply chains;
- The establishment of the ACCC agricultural unit that provides a direct point of engagement for farmers and the agricultural sector; and
- The various active and proposed mandatory codes governing the grocery sector and specific agricultural commodities.

Similarly, the NSW Government has recently committed to establishing the Agricultural Commissioner and the Dairy Advocate, to provide greater resourcing in identifying and addressing competition concerns within food supply chains.

Fairness not a principle in Australian Consumer Law

Fairness is not an implicit or explicit principle, or sought outcome of Australian Consumer Law (ACL). In fact it is very hard to discern explicit principles for the National Competition Framework. The Harper Review (2015) sets out outcomes sought from the NCP:

- “limiting anti-competitive conduct of firms;”
- reforming regulation which unjustifiably restricts competition;
- reforming the structure of public monopolies to facilitate competition;
- providing third-party access to certain facilities that are essential for competition;
- restraining monopoly pricing behaviour; and
- fostering ‘competitive neutrality’ between government and private businesses when they compete.”

The Review sets out a set of questions to guide their deliberations:

- “Does the law focus on enhancing consumer wellbeing over the long term?
- Does the law protect competition rather than individual competitors?
- Does the law strike the right balance between prohibiting anti-competitive conduct and not interfering with efficiency, innovation and entrepreneurship?
- Is the law as clear, simple and predictable as it can be?”
The concept of fairness only appears in the ACCC’s organisational mandate, where it states:

“The ACCC promotes competition and fair trade in markets to benefit consumers, businesses, and the community.”

This is at odds with the legislative and policy of the competition framework, and likely only an organisational aspiration rather than a legislative mandate. Similarly, the promotion of business and community welfare is not a concern of the competition framework, apart from some very specific carve outs. The primary concern of competition framework in Australia is consumer benefit.

The failure of ACL to ensure fairness has been acknowledged by policymakers, with amendments to ACL in 2009 to introduce a general regime to deal with unfair contracts, which was extended to small businesses in 2016. Indeed the amendments are seen by some as admission of the limits of unconscionability provisions (Webb 2015). The Federal Treasury and the ACCC have also initiated a review of unfair contract provision in late 2018.

It should be noted that these provisions are limited by the value of the contract, the size of the business, and is more concerned with procedural fairness than substantive fairness (Treasury 2018).

Other jurisdictions, particularly the European Union (Gerard 2018), regard fairness as a core principle of competition policy, and integral to business-to-business dealings. In 2016, the European Union established the Agricultural Markets Taskforce (2016) to review the economic outcomes of farmers in food supply chains. Unlike reviews in Australia, the EU review went beyond the narrow procedural scope of fairness, exploring options that would provide substantive outcomes for farmers in terms of a reasonable return for their endeavours.

A lack of substantive fairness is likely to destroy long-term value creation within an economy, robbing up-stream supply chain participants of any margin, reducing innovation and investment in efficiency measures, and impeding value creating relationships.

Focus on short-term consumer outcomes fails to deliver in the long-term

The focus of the ACL is consumer benefit, and as many decisions by regulators and the judicial system has demonstrated, consumer benefits tend to be defined very narrowly to only capture very short-term and direct consumer benefits.

While regulators and policymakers argue that their focus is on short and long term consumer benefits, in practice it is hard to define longer term consumer benefits. This is evident in the findings of the ACCC Dairy Inquiry (2018), where the practice of marketing dollar-a-litre milk by supermarkets were deemed to be consistent with competition outcomes because consumers benefited from lower prices for milk.

The Inquiry discounted arguments that such practices stripped the value of milk production from the supply chain, reducing the ability of supply chain participants to innovate or invest in long-term efficiency measures. It discounted the potential that this activity had the intended or unintended consequence of consolidating the number of dairy brands and products available to the consumers.

The ACCC discounted the potential that over time lower prices on dairy products would be clawed back from higher margins charges on a suite of products in a customer’s shopping trolley. The ACCC concluded that there was no evidence of higher margins on other products over the period where dollar-a-litre milk has been dominant in the market (ACCC 2018). This is a classic case of an anchoring cognitive bias. It assumes that the base case is historical supermarket margins, not a process where margins are eroded over time through vigorous competition.

The ACCC discounted the ‘sticky’ nature of dairy supply, where supply cannot be adjusted quickly in the short-term due to the fact that it relies on a biological process. In the long-term, supply is restricted by land-use planning provisions, where land from decommissioned dairy farms cannot revert back to dairy farming, and new supply being restricted by the same land use planning barriers. This could create temporary shortages of fresh drinking milk (which cannot be imported) in the long-term, which is clearly a detriment to consumers.

There is no overarching principle that seeks to maximise business or community outcomes, with little focus on value creation and increasing overall economic surplus.

Critics of the consumer benefit approach to competition policy argue that such an approach is fraught with danger. The characterisation and evaluation of consumer benefit is difficult and highly subjective, and can place the imperative of economic distribution over improving value creation. The primary concern of competition policy should be value creation, and the distribution of this value; not one or the other (Carlton 2007). Focussing on the process of competition is far less subjective and less likely to glorify fair distribution to the detriment of value creation.

While the ACCC is solely focussed on the consumer benefits approach, other Australian regulators have acted to curb value destruction within a market. This has been the case, even when such action will reduce short-term consumer benefit.
Competition Policy & Food Supply Chains: Time for a rethink

RBA fights market power of payment system providers despite short-term consumer detriment

In 2017 (RBA 2016), the Reserve Bank of Australia (RBA) set caps on the interchange fees payment system providers, such as American Express, charge to merchants. The RBA noted that some interchange fees charged were unreasonable, and that providers were using their market power to extract these unreasonable charges from merchants, such as small businesses. This is despite the fact that merchants have the right to refuse the use of credit card payments or a brand of credit card.

Despite the significant benefits for consumers, where interchange fees funded generous consumer loyalty reward programs, and kept fixed consumer credit charges lower, The RBA placed a cap on interchange fees in recognition of the undue power used to extract margin from merchants.

The lack of protections provided to small businesses and farmers by the ACL is a derogation of policymakers and regulators responsibilities to these vulnerable stakeholders. The free market approach to industry and economic policy was sold to small businesses and farmers on the premise that market power of big organisations would be checked, to ensure that smaller players could thrive in this new economic paradigm.

Many of the farming collective bargaining and marketing arrangements were dismantled on the understanding or hope that the monopsony power of downstream food supply chain players would be thwarted. It is open to debate as to whether regulators have been effective in thwarting this monopsony power, particularly in the processing and supermarket sectors.

Grocery market share by company (2018)
Source: Roy Morgan 2019

- Woolworths: 37.20%
- Coles: 30.30%
- Aldi: 15.90%
- Metcash: 9.20%
- Other: 15.90%

Competition provisions ineffective at dealing with monopsony power

Most provisions and guidelines for the ACL conceptualise competition issues in terms of a supplier acting in a manner that adversely impacts the buyer. The implicit assumption is that producers have power over buyers downstream in supply chains. That is farmers have power of processors, and processors have power over supermarkets. It does not provide examples, or use language, that would suggest that buyers may have undue power within markets and supply chains.

Guidelines for various parts of the Competition and Consumer Act 2010 (CCA) conceptualise provisions as adverse actions by suppliers perpetrated on downstream stakeholders and consumers. The ACCC Guidelines on the misuse of market power provisions (ACCC 2018b) can only envisage situations where supplier action damages competition downstream, not a situation where downstream stakeholders lessen competition upstream.

The concept of refusal to deal is conceptualised as the act of refusing to supply another firm/competitor with a key input that may hinder competition in downstream markets. No mention is made of competition in supplier markets being hindered by actions of downstream players.

Section 46 (3.2.b) of the CCA notes that restricting access to an essential input can contravene the misuse of market power provisions, yet is silent on restricting supplier access to downstream markets. Similarly, conceptions of margin squeeze and predatory pricing are actions of suppliers perpetrated on organisations and consumers downstream.

This is in contrast to recent developments in the European Union, where the focus has been squarely on addressing monopsony power; particularly those of the supermarkets within food supply chains (Agricultural Markets Taskforce 2016).
Compliance and enforcement failing small businesses

When Mr Rod Sims first became the ACCC Chair, he highlighted that his first priority was to seek the doubling of ACCC’s funding (CEDA 2019). Though this comment was tongue-in-cheek, Mr Sims noted the ever increasing demands placed on the ACCC not just from a compliance and enforcement perspective, but increasing investigative and market monitoring responsibilities, and oversight of new portfolios (such as energy).

The extra demands placed on the ACCC, has not been matched by resources for the ACCC to adequately undertake its duties. This has particularly impacted the ACCC’s compliance and enforcement activities, with the vast majority of cases focussing on deceptive and misleading conduct, which is far easier to prove, and hence less resource intensive to prosecute. Cases on misuse of market power (even with the introduction of the ‘effects test’), and unconscionable conduct are extremely rare (ACCC 2018c).

With respect to unconscionable conduct, there have only been three proceedings initiated by the ACCC on business-to-business unconscionability. In two cases the defendants admitted guilt, while in the third case, ACCC v Woolworths (2016), the ACCC failed to convince the Federal Court that Woolworths acted unconscionably. Yates J. specifically noted that the prosecution failed because the ACCC did to gather specific evidence on harm with respect to the unconscionable conduct. This presents a very patchy history on enforcement activities.

Specific concerns for the farming sector include the lack of ongoing funding for the ACCC Agriculture Unit, and the minimal allocation of funding for the implementation and administration of the proposed mandatory code for the dairy industry (Treasury 2019).

Third party enforcement activities

As previously highlighted, the cost of third party legal action and potential imposition of cost orders is an insurmountable barrier for most farmers and small businesses. The uneven power relationship and the prohibitive cost of legal action by third parties renders third party action unfeasible.

Successful litigation tends to require the demonstration of specific harm of a competitor, consumer or supplier, as highlighted by Yates J in ACCC v Woolworths. However, given the unequal power relationships, often impacted suppliers will not want to provide evidence. Anecdotal evidence suggests a strong fear by suppliers of being locked out of supply chains if they speak out against large supermarkets or processors. Sutton-Brady (2001) suggest that the unequal power dynamics present in many food supply chains leads to self-censoring by smaller suppliers, fearing that any underperformance will lead to retribution by those with the power in the relationship. Thus a ‘voluntary’ request by the likes of Coles and Woolworths is likely to be seen very differently by a smaller supplier with less power in the supply chain.

Unconscionable conduct inadequate shield against supply chain abuses

The aim of this discussion paper is not to provide a legal opinion on the application of unconscionable conduct provisions, but provide the public policy context for the efficacy of the provisions in achieving its intended outcomes from a competition and consumer perspective.

Unconscionable conduct provisions in ACL are one of the only avenues for farmers to challenge the monopsony-like power of supermarkets and processors within the food supply chains. Enforcing business-to-business unconscionable conduct provisions is an important function of the ACCC. However, unconscionable conduct is notoriously difficult to prosecute.

In reviewing the NCP, the Harper Review (2015) highlighted the Federal Court declarations that Coles engaged in unconscionable conduct in 2011 in its dealings with certain suppliers, noting that the successful outcome against Coles suggested that:

“current unconscionable conduct provisions are working as intended to meet their policy goals.”

However, subsequent business-to-business unconscionable conduct cases throw doubt as to whether the Coles decision could be used to conclude that the provisions are efficacious. The case of ACCC v Woolworths (2016) was a sobering decision, in demonstrating the difficulty of proving unconscionable conduct in the business-to-business context, and cast doubt as to whether unconscionable conduct would have been proven in the ACCC v Coles (2014) case if Coles had not admitted to the conduct.

The only other high-profile business-to-business unconscionable conduct case brought forward by the ACCC under section 21 provisions was the case against Murray-Goulburn in 2017, which Murray-Goulburn settled in 2018, leaving the efficacy of unconscionable conduct provisions untested in a court of law.

The events after the ACCC v Woolworths (2016) case suggests that the refusal to substantially review unconscionable conduct provision by the Harper Review were unjustified. Indeed, the Review acknowledged that:

“Active and ongoing review of these provisions should occur as other matters arise. If deficiencies in the operation of the provisions become evident, they should be remedied promptly.”
Impacts on farmers

Australian dairy farmers are some of the most efficient and productive dairy farmers in the world, employing best practice. Despite this, Australian dairy farmers struggle to remain viable due to the volatile nature of international prices, which often falls below cost, and the superior bargaining power of processors and supermarkets, who can extract most of the economic surplus within the supply chain.

The business model of dairy farms in Australia has undergone significant change, with the utilisation of economies of scale. The average dairy herd size has increased from 200 to 300 in less than two decades (Dairy Australia 2018). Only New Zealand has larger dairy herd sizes, with most competing countries having herd sizes well below 150. Australian dairy farmers are also early adopters of technologies that reduce input costs such as electricity; with world leading rates of adoption for distributed energy resources (Australian PV Institute 2017).

Despite these efforts, dairy farming is becoming increasingly unviable in all but a few regions in Victoria. There is a significant divorcing of farm input costs and the farm-gate price for dairy. This gap does not bode well for the long-term viability of dairy farming. While processors and manufacturers have negotiated cost adjustment provisions with supermarkets, dairy farmers rarely see the benefits of such arrangements.

Economic inputs and outputs for typical dairy farmer

While the international price for dairy commodities is often highlighted to justify low farm-gate prices, it is difficult to understand why these prices are not reflected in other major dairy producing regions. The graph below demonstrates that Australian dairy farmers are receiving farm-gate prices below that of other major dairy producing countries.

Farmgate prices 2004 – 2013

Source: Productivity Commission 2014

As the NSW Farmers highlighted in their submission to the ACCC dairy inquiry, persistently low farm-gate milk prices would reduce the financial resilience of farmers to produce during times of increased extreme weather conditions, and during business cycles where input costs, such as energy, water and feed, become extremely expensive. NSW Farmers warned that the erosion of this resilience would lead to poor long-term consumer outcomes, with potential shortages of dairy products, such as fresh milk (see section on ‘impacts on consumers’ for more detail).

Impact on policy and regulatory decision making

Australian regulators are caught in a self-reinforcing spiral in overseeing food supply chains that create little value. They have failed to guarantee competitive markets in various stages of the supply chain, most notably in retail markets, allowing market concentrations and corporate behaviour that is inconsistent with any conception of a competitive market. This concentration has required consolidation upstream, reducing competition up and down food supply chains.

The significant concentration of power and market share within retail grocery markets has necessitated the wholesale concentration of processors within dairy supply chains. Due to this consolidation dairy farmers have to deal with essentially monopsony processors, where there is only one processor in any given geography. Anti-competitive practices in the farmer-processor relationship has reached a point where the ACCC and the Federal Government have agreed on the need for a mandatory code of conduct for dairy.

Regulators argue that these market structures are competitive, pointing to lower grocery prices. It is an open question as to whether the reductions in grocery prices have come about from value creation through competitive tension and economies of scale, or simply redistribution of surplus within the supply chain due to the market power of primarily supermarkets.

The implicit solution of regulators has been to suggest that dairy farmers need to consolidate to benefit from ‘economies of scale’ (Wu 2018). It is unclear whether this consolidation is occurring due to economies of scale or as a response to the uneven bargaining power. Regulators have allowed for a significant reduction in competition across food supply chains due to their reluctance on checking supermarket power.
Competition Policy & Food Supply Chains: Time for a rethink

Featured Case Study

**Regulator fallacy: Organic concentration good, concentration through acquisition bad**

Regulators seem to hold very contradictory positions on market power, prohibiting the consolidation of power in markets via acquisition, but freely allow consolidation through organic growth (Wu 2018). If the Australian supermarket had three players with a combined current market share of Coles and Woolworths (68%), it is unlikely that the merger between two of them would be approved by regulators, yet this situation is allowed to occur through organic growth.

This regulatory hesitance to address organic consolidation is a global phenomenon, where this hesitance is justified in terms of avoiding dire sovereign risk. However, it was not in the too distant past that large companies in the United States were broken up on competition grounds (Microsoft), and this practice is still in play in the European Union (Wu 2018). Such action has not seen an exodus of capital from these markets, nor has it seen their risk profiles adjusted.

**Impacts on consumers**

The ACCC dairy inquiry found that consumers were benefitting from competition with the supermarket sector through lower prices for groceries. It is unclear whether this was determined by referencing historical prices, using global comparisons, or developing scenarios for grocery price movements to compare actual movements. Given general reductions in global agricultural commodity prices and new technologies that have significantly reduced the freight and logistics costs within food supply chains, it would be expected that grocery prices would have come down regardless of the introduction of the competition imperative.

The ACCC is seemingly content to provide supermarkets with the benefit of the doubt with respect to competition. In the ACCC dairy Inquiry, it was noted that private labels (such as dollar-a-litre milk) were beneficial for consumers as it provided them with lower prices. It is unclear whether the ACCC considered:

- the potential for supermarkets to recoup margin from private label brands through cross-subsidisation across the products found in consumers’ shopping trollies;
- the use of private labels to reduce number of products and consumer choice within each brand category (bad outcome for consumers) to erode supplier bargaining power; and
- the role of private labels in reducing comparability of value across supermarket chains.

Furthermore, NSW Farmers warned the ACCC that the short-term price benefits of private labels for consumers were coming at the expense of the long-term viability of the supply chain, warning that continued sharp practices in squeezing supply chain margins would lead to long-term product shortages for consumers - an adverse consumer outcome.
Competition Policy & Food Supply Chains: Time for a rethink

Featured Case Study

Consumers facing shortages

In April 2019, NSW consumers were facing dairy product shortages with supermarkets unable to provide supply of popular dairy products. Lion, one of the largest processors in Australia, noted that:

“Extreme weather conditions … with significant cost increases across water, feed and energy, have contributed to the challenges facing dairy production in Australia which has resulted in lower milk supply…” (SMH 12 April 2019)

Of most concern is that fact that shortages have impacted smaller retailers, such as IGA, with supply to large supermarkets (Coles and Woolworths) prioritised by processors (SMH 12 April 2019). This further demonstrates the market concentration in the retail sector, and further entrenches the big-two’s dominance.

Other supermarket suppliers have been threatened with delisting by the major supermarkets when seeking negotiations on price and terms. Smaller suppliers have had to comply, in fear of being delisted. This has led some major suppliers, such as Nestle, to refuse to supply the supermarkets until fair negotiation processes are established by the supermarkets. This has meant shortages of products on supermarket shelves, such as cereals and pet food (AFR 18 April 2019). These shortages are a terrible outcome for consumers.

In the NSW Farmers’ response to the ACCC Dairy Inquiry, it was highlighted that persistent low farm-gate milk prices will erode farmers financial resilience, removing the margin that would be used to sustain cash flow and operations during times of extreme weather and unfavourable cycles in input costs, and potentially create shortages of dairy products for consumers, a bad long-term consumer outcome. The ACCC inquiry dismissed these concerns.
A fair go for small business: Principle of fairness included in the NCP

The principles underpinning the NCP are failing to provide the outcomes communities and consumers expect. The myopic focus on short-term consumer benefit, as opposed to the creation of economic value, and the failure to refer to any notion of fairness, has short-changed the community at large, and not in the long-term interest of consumers.

Ad-hoc measures have been put in place to address this problem, such as the extension of unfair contract provisions to small business. However, these measures only provide limited procedural fairness via uniform and standard contractual terms. Substantive fairness still remains unaddressed.

A review of the principles of the National Competition Policy, including exploring the incorporation of principles fairness within the framework. Other jurisdictions, such as the European Union, have specific fairness provisions that look at bargaining power and ensuring viable supply chains. The review should also explicitly determine the relative benefits of the focus on consumer benefit above and beyond ensuring the process of competition, and the creation of value across the economy.

Effective enforcement: Adequate resourcing of the ACCC

Without adequate enforcement and compliance, it is difficult to instil the healthy competitive norms and culture within markets. The lack of enforcement is of particular concern within food supply chains, where many farmers and suppliers are reluctant to come forward against powerful organisations for fear of being locked out of supply chains. This makes the investigative work of the ACCC, particularly via the ACCC Agriculture Unit, vital in uncovering any potential systemic breaches of competition provisions.

At a minimum, the NSW Farmers seek commitment from the Federal Government to fund and resource the ACCC Agriculture Unit over the forward estimates and beyond. NSW Farmers further seeks that sufficient funding for the implementation and administration of the proposed mandatory code for the dairy industry is provided.
Enabling 3rd party enforcement: Cost effective dispute resolution and access to justice

The lack of enforcement and compliance activities with respect to competition law has been detrimental in establishing the behaviours and outcomes we expect from organisation governed by these laws. As previously mentioned, the ACCC’s remit is broad and its resourcing is in all likelihood not commensurate with this broad scope.

In the absence of a regulator equipped to relentlessly enforce the law, third party action can partially assist in ensuring adequate enforcement and compliance of competition provisions.

**Access to justice for small businesses and farmers** is essential for the functioning of Australia’s competition law. It is recommended that consideration be given to the introduction of:

- a no cost order mode of litigation for small businesses and farmers where a prima facie review demonstrates that the litigation is not frivolous or vexatious; and
- alternate low cost options for small business and farmers for competition related arbitration and dispute resolution processes.

Support for a unified farming sector: Collective bargaining & ‘national champions’

Various supply and marketing arrangements within agriculture industry were dismantled on the assumption that the Australian market will be opened up to free and fair international trade that will improve our competitiveness and efficiency. The assumption of free trade in international agricultural markets has not materialised, placing our producers at a significant competitive disadvantage.

Essentially the international market has become a dumping ground for large producing nations when domestic supply exceeds domestic demand. This also means that the international price will often fall below cost of production.

Australia is in the bottom quartile of OECD countries in terms of government investment in the agricultural and food sectors (OECD 2017). While this paper does not argue for wholesale farming subsidies, it does argue for greater investment in activities that improves the international competitiveness and bargaining power of our farmers.

Federal and state governments must promote and help establish voluntary collective bargaining unions for farmers, ‘national champion organisations’ to do the farmers bidding in international markets and to rectify the power balance in domestic food supply chains.

The work being undertaken by the European Union Agricultural Markets Taskforce can be instructive, who are investigating options to harness collective bargaining to improve the position of farmers in commercial negotiations.

Challenging systemic abuses: Agriculture Commissioner & Dairy Advocate

The NSW Farmers welcomes the NSW Government’s commitment in establishing the Agricultural Commissioner and the Dairy Advocate; key pillars of our advocacy agenda in 2018. The Commissioner and Advocate should be tasked with undertaking investigations into potential competition issues and breaches within NSW’s food supply chains, assist in the implementation and management of various food related codes, and make recommendations to government on whole-of-government policy issues that will have an impact on the agricultural sector, including competition policy issues. These activities can be self-initiated or at the request of the government.
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