

Submission

By

**THE
NEW ZEALAND
INITIATIVE**

to the Commerce Commission

on

*Issues raised at the Consultation Conference on the Commission's Market study into the retail
grocery sector draft report*

18 November 2021

Prepared by:
Eric Crampton, Chief Economist
The New Zealand Initiative
PO Box 10147
Wellington 6143
eric.crampton@nzinitiative.org.nz

1 INTRODUCTION AND SUMMARY

- 1.0 This submission in response to the Commerce Commission's (**Commission**) Consultation Conference subsequent the *Market study into the retail grocery sector draft report*,ⁱ is made by The New Zealand Initiative (the **Initiative**), a think tank supported primarily by major New Zealand businesses. In combination, our members employ more than 150,000 people.
- 1.1 The Initiative undertakes research that contributes to the development of sound public policies in New Zealand and the creation of a competitive, open and dynamic economy and a free, prosperous, fair and cohesive society.
- 1.2 The Initiative's members include two New Zealand supermarket operators, Woolworths New Zealand and Foodstuffs North Island. However, the views expressed in this submission are the views of the authors, not those of our members.
- 1.3 In summary, we submit:
 - (a) The Commission's Market Study process affords it a unique opportunity to address the root causes of any potential failures in competition. It is not limited to more traditional narrow questions. The Commission should make the most of this opportunity and set a precedent for future inquiries.
 - (b) The Commission's focus on divestment options, structural or operational separation, and facilitation of new entry through subsidisation risks wasting a very real and unique opportunity to address regulatory and legislative barriers to entry in the grocery market. It risks being accused of protecting specific potential competitors rather than encouraging competition.
 - (c) Where legislative barriers to entry are material, solutions focused on divestment, separation, or subsidisation of potential competitors will do far less good than the Commission may intend. Indeed, they may do no good at all or result in serious harm to consumers. Note that KiwiBuild failed because it did not address underlying problems of restrictive zoning and difficulties in infrastructure financing. Divestment would simply create a third competitor to join the existing two large supermarkets, with no new potential for further entry. If the Commission views the current environment as a duopoly, turning it into an oligopoly of three players may be rather less helpful than abolishing legislated barriers to entry to ensure the grocery market is workable competitive.
 - (d) The Commission should disregard rent-seeking pleadings from would-be competitors for subsidisation or for forced transfers of stores from existing supermarkets. The Commission should take the opportunity to delve deeply into legislative and regulatory barriers to entry and tell the Government what changes need to be made to Overseas Investment regimes and zoning and land use planning to enable real competitive entry. On the back of those changes, the Commission should actively solicit entry by large international grocery retailers who may have written off New Zealand as being far from worth the regulatory hassles – by informing them that New Zealand is now open for business.
 - (e) We believe further investigation is warranted into the materiality of zoning and consenting constraints, infrastructure supply, and the Overseas Investment Office. We strongly suggest working with Councils and the OIO here, and asking Aldi why they decided not to enter the New Zealand market six years ago.

- (f) As we noted in our initial submission, the Commission should focus, in the first instance, on easing barriers to entry so that the threat of entry and the potential for actual entry might provide stronger market discipline. In the short term, this requires:
- a. The voiding of any title encumbrances that have an anticompetitive effect; and
 - b. Urging the Overseas Investment Office to view any entry into grocery retail as being presumptively in the national interest and subject to automatic approval.

In the longer term, this requires:

- a. Including competition as an aim in council spatial planning by including it in the Spatial Planning Act, currently in development;
- b. Setting a role for the Commerce Commission in providing input into spatial planning processes regarding the pro- or anti-competitive effects of proposed spatial plans. Ideally, the Commission would be able to veto spatial plans that have an anticompetitive effect.

This would require the Commission to look closely at and be involved in the current Resource Management Act reform process. It would have beneficial effects far beyond this current supermarket inquiry. The underlying barriers may be a source of weak competition in areas beyond grocery retail. Setting a market study process that seriously investigates regulatory and policy barriers to entry is important. Often, the agencies responsible for those regulatory or policy areas will never have considered the detrimental effects of their regimes on competition.

2 THE COMMISSION NEEDS TO INVESTIGATE ACTUAL ENTRY BARRIERS

- 2.0 We strongly suspect that regulatory and legislated entry barriers are material. Our initial submission discussed these barriers in section 3, while commending the Commission's work in Chapter 6 of the draft report.
- 2.1 If legislated barriers to entry are the fundamental cause of the problems that the Commission identifies, policy interventions around operational and structural separation, or forced divestment, would fail to yield desired results and could invite a legal challenge.
- 2.2 The work to establish the materiality of these constraints would not be onerous but has not been undertaken.
- 2.3 As a first step, council zoning maps would establish how many sites are available in different cities and towns for use in grocery retail. Of those sites allowed to operate in grocery retail, what proportion are already supermarkets? How many are encumbered by exclusivity arrangements or covenants preventing their use as supermarkets, even if zoned appropriately?
- 2.4 We also note complexities like Ashburton's Plan Change 4, formally adopted 30 June 2021, which prohibited additional retailers from taking up premises in new retail developments that competed with downtown businesses.ⁱⁱ The plan change came in after developers set new premises to lease to retailers but were then prohibited by Council from taking on tenants – because Council considered that the competition would be harmful to downtown premises. The plan change seems entirely anticompetitive in intention and effect. How many similar rules are in place across other towns? Even if no grocer had planned on taking up premises in this development, the prohibition on entry affects potential competition. And, again, consider the position of a potential international entrant. If small councils are in the habit of using plan changes to frustrate new entry, is it *safe* to invest here? Would it be unreasonable for a potential international entrant to conclude that cartels of existing connected property owners

collude with councils to set anticompetitive zoning rules to frustrate entry and that the Commerce Commission ignores such activity?

- 2.5 The Commission may be reluctant to undertake this work because it believes that collating the necessary District Plans and searching for all of the bits that might curtail where supermarkets might be located across dozens of councils' plans would be onerous. In that case, the Commission might consider that this fact alone is a barrier to entry for an international entrant. Simply having to think about this mess is a barrier to entry.
- 2.6 Next, the Commission would want to establish whether an entrant's resource consent application in sites zoned for grocery retail, unencumbered by existing covenants or exclusivity arrangements, would be successful. In some cases, underlying infrastructure might be considered inadequate. Councils in those cases sometimes seek to load substantial costs onto developers of new sites, and discerning what portion is the incremental cost of the new development and what portion is making up for decades of underinvestment in pipe maintenance is not always straightforward.
- 2.7 In discussions with Council planners, the Commission might wish to canvass views on the 39-page economic impact report on the proposed opening of a New World store in Auckland.ⁱⁱⁱ The Commission seems to be of the view that more grocery stores are in the national interest. Nevertheless, in March 2021, Foodstuffs New Zealand seemed to believe that it needed to produce a substantial retail impact assessment to be allowed to put a New World on Dominion Road. The Report sought to demonstrate that the business activity is necessary to provide for the community's social and economic needs and that it would not be too detrimental for existing competitors. Why is this needed at all? Can this kind of requirement have other than harshly anticompetitive effects?
- 2.8 The Commerce Commission might usefully spend some time dwelling on the report cited in 2.7. Why would a supermarket see the need to commission consultancy reports like this? What does it say about the nature of restrictions on competition in grocery retail? In this particular case, the report was needed for fast-track consent through special Covid legislation. But that the developer chose this route strongly suggests that existing status-quo Council processes are *even more restrictive*. Commissioning a 39-page economic consultancy report as part of a process to be allowed the privilege of opening a supermarket was considered *easier* than what Auckland Council otherwise requires. And, in any case, the report shows a substantial shortfall in grocery retail in the area. Look carefully at the report. It seeks to prove that the store would have no more than small effects on local competition. Large effects on competition would be expected to have effects on amenities that could see the consent declined. New Zealand has a planning system that treats competition as a harm to be mitigated rather than a boon to be encouraged.
- 2.9 In all cases, liquor licenses might be expected to be opposed by local medical officers of health, police, community groups, or all three. Council officials, or the local liquor licensing inspector, may provide a view about whether zoned sites are particularly likely to draw opposition. If the only places allowed to be grocery stores are near existing off-licences, opposition to the new entrant might be expected.
- 2.10 Finally, the Commission should check whether the Overseas Investment Office would consider the land to be sensitive for each of those sites. Land bordering on reserves and streams can be deemed sensitive. Land with any residential zoning can be deemed sensitive. Land bordering on a recreational reserve can be sensitive. Land adjoining a marine or coastal area or a lake can be sensitive. Some bits of land become sensitive depending on the scale of the proposed development. A 2000 square metre store would be considered sensitive in some cases; a 4000 square metre store would be considered sensitive in more cases. These restrictions can serve to limit the entry of full-scale grocery options.

- 2.11 Entry at scale by an international player may be impossible, given this set of constraints. If not impossible, it may be utterly impracticable for anyone who does not have deep existing experience in dealing with the particularities of each of the councils in which consents might be sought. A potential entrant might expect, not unreasonably, that many of the gains of entry would be eroded by consultancy fees necessary for getting through the hurdles that councils, the Overseas Investment Office, and District Licensing Authorities have established. They are putting hundreds of millions of capital at risk to enter at scale with a network of stores and suitable distribution logistics while waiting on OIO and Council consenting determinations that may dribble through over several years may not be particularly attractive. Building a distribution network adequate for the full set of stores could mean earning losses while waiting for months or years for some of those stores to be consented.
- 2.12 If it is *possible or even likely* that it is *actually impossible* for a large full-service international grocer to enter at scale because of the combination of zoning, consenting, and OIO approval, or that those barriers raise entry costs sufficiently to make entry unviable, surely this should be the *primary* focus of a market study into competition in grocery retail. Questions of which exchange rates to use in making international price comparisons, or the mechanics of operational separation of integrated grocery operations, seem trivial relative to figuring out whether the government has effectively banned new entry – if the Commission is actually interested in competition.
- 2.13 If these legislative and regulatory barriers are material, and the Commission decides to accede to a potential entrant like Tex Edwards' wish that the Commission force existing supermarkets to sell stores to him while effectively banning anyone else from bidding against him for them, what good is done? If the Commission believes that grocery retail is a duopoly, is it that much better to turn it into an oligopoly of three players where real entry for any fourth player remains effectively banned? Would doing so enhance any reasonable measure of workable competition? Or could it set a regulatory environment that further discourages entry by international competitors by making property rights fundamentally insecure?
- 2.14 Suppose these legislative and regulatory barriers are material, the Commission decides to accede to Supie's request and encourages the government to set some new KiwiEquity fund to provide Supie with starting capital, would any other entrant be able to come into that market? OIO constraints on other sources of capital would remain. Is "The government will subsidise new entry" a sustainable source of competition? Or might it possibly make sense to remove restrictions against international capital backing new entry while easing the regulatory hurdles that make entry less viable?
- 2.15 The market study process provides an incredible opportunity. The Commission is not limited to more traditional narrow questions. The Commission can look widely. It took the opportunity to do so in Chapter 6, but questions raised in Chapter 6 were almost entirely ignored during the consultation conference. They seem fundamentally important if the Commerce Commission wishes to encourage workable competition in grocery retailing. They should not be glossed over or shunted to the side because they require action by other parts or levels of government.
- 2.16 We also encourage the Commission to get in touch with Aldi to ask them what they viewed as the main constraints against their entry when they decided not to enter the New Zealand market six years ago. They may identify additional barriers that could be considered.

3 A PATH TO COMPETITION IN GROCERY RETAIL

- 3.0 The Commission should begin by determining just how substantial a barrier the combination of zoning, consenting, and OIO approval proves, as described in part 2 above.
- 3.1 The Commission should then inform relevant government agencies about the very real effects of their decisions on competition.
- 3.2 The Commission could tell the Overseas Investment Office that the Commission has determined a new entrant to be in the national interest and ask them what they think. Seek a joint statement making very clear to all potential entrants that the OIO poses no barrier at all to buying or optioning land for new grocery retail. Set a very broad waiver. If Aldi, or another entrant, wishes to purchase a site for grocery retail at ground level and an apartment tower above the store, no OIO constraint should apply. Both increased housing and increased grocery retail competition are in the national interest.
- 3.3 The Commission could tell Minister Parker and Associate Minister Twyford about the materiality of zoning and consenting constraints in grocery retail competition. Parliament is currently considering legislation requiring councils to allow the development of up to three homes of up to three stories on every site. That legislation could be amended to allow supermarkets everywhere as well. The Initiative's submission on that legislation recommended such a broadening and urged the Government to consider allowing not only up to three houses of three stories on a property but also a supermarket.^{iv} It could be helpful if the Commission endorsed that recommendation if the Commission wishes to enable stronger competition.
- 3.4 In the draft report, the Commission avoided weighing in on Resource Management Act reform. The Commission could instead seek a role in ensuring that regional plans do not embed anticompetitive outcomes. The Commission could promote minimum standards for regional plans. New regional plans should provide sufficient mixed use retail zoning that grocery retail could happen in most parts of towns and cities. Whether a site is commercially feasible in grocery retail should determine entry, not whether a council planner views the provision of grocery retail to be adequate.
- 3.5 The Commission could consider holding consultations with local and regional councils about the best ways of applying competition law to council zoning decisions. Consent applicants could have recourse to the Commission if zoning or consenting processes are being used to anticompetitive effect. If regional plans and council planners do not weigh the benefits of competition highly enough, the Commission could.
- 3.6 When the regulatory barriers stymying entry are dealt with, the Commission should inform every potential international entrant that New Zealand is, at long last, actually open for business. I had suggested this at the hearing. I will write it here as well. Recommend the Government make it possible for the Commerce Commission to send this letter to Aldi, to Lidl, to Kroger, to Sobeys, to Loblaws, to Trader Joe's – and other potential entrants.

Hello [international grocer],

New Zealand may not have featured in any plans you may have had for international expansion. Small markets at the far end of the world beset by regulatory impossibilities that make it hard for new entrants to set up shop are not the most enticing proposition.

We at the NZ Commerce Commission are writing you today to ask that you reconsider New Zealand, or to think about us for the first time.

Our market study into grocery retail concluded that a new entrant would be in the national interest. Consequently, the Government has instructed the Overseas Investment Office that no application for OIO approval is necessary for overseas persons purchasing land for grocery stores. This waiver is broad. If a new-entrant grocer proposes an apartment or commercial tower above their new supermarket, that is also allowed.

We have also instructed councils that they must issue zoning variations and consents for new grocers, and that grocers have recourse to the Commerce Commission if zoning or consenting processes are hindering the establishment of a new entrant in grocery retail.

New Zealand is open for business. For too long, regulatory impediments stood in the way of new entry. Those impediments are now gone. Please consider New Zealand in any plans for future expansion.”

4 CONCLUSION

- 4.1 We thank the Commission for the opportunity to provide further comment on its draft report and its two weeks of hearings. The barriers to entry identified in Chapter 6 appear material and in need of remedy. The fundamental underlying cause of those barriers is zoning restrictions that sharply reduce the number of sites allowed for use in large-footprint grocery retail. Any effective remedy must deal directly with the source of the underlying problem if greater competition in grocery retail is desired. Other options will do little good and risk doing much harm.

-
- ⁱ https://comcom.govt.nz/__data/assets/pdf_file/0025/260377/Market-study-into-the-retail-grocery-sector-Draft-report-29-July-2021.pdf
- ⁱⁱ Burns, Adam. 2021. “Ashburton developers disappointed at consent decision.” 21 October. Stuff.co.nz. <https://www.stuff.co.nz/national/politics/local-democracy-reporting/300435509/ashburton-developers-disappointed-at-consent-decision> . When Councils are doing things like this, it is hard to comprehend how the Commission could spend two weeks interrogating grocery CEOs rather than spending any time investigating council behaviour.
- ⁱⁱⁱ See https://www.epa.govt.nz/assets/Uploads/Documents/Fast-track-consenting/Dominion-Rd/Application-documents/App_21_Retail_Impact_Assessment.pdf
- ^{iv} Crampton, Eric. 2021. “Submission: Resource Management (Enabling Housing Supply and other matters) Amendment Bill”. *The New Zealand Initiative*. Available at <https://www.nzinitiative.org.nz/reports-and-media/submissions/submission-14/>