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First do no harm: the regulatory test neglected in the grocery market study

Post-conference submission

Veronica Jacobsen, Kieran Murray

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About the Authors

Dr Veronica Jacobsen has extensive expertise in all aspects of public policy and wide experience at senior levels in government, including the Treasury, the Ministry of Business, Innovation and Employment and the Ministry of Justice. She is an economist and lawyer and brings a rigorous multidisciplinary lens to complex policy issues. Formerly an academic, she has also acted as a consultant to international organisations, industry associations and government departments.

Kieran Murray is a professional economist, working primarily in the fields of competition analysis, environmental and economic regulation, and public policy reform. He has served as an economic consultant on these matters in more than 15 countries over two decades. Kieran co-founded and jointly leads Sapere, one of the largest expert services firms in Australasia and a leader in providing independent economic, forensic accounting and public policy services.

His expertise as an economist is recognised in his appointment, by the Governor General of New Zealand, as an expert lay member of the New Zealand High Court, and his appointment by the Governor General of Papua New Guinea as an International Arbitrator for appeals from the PNG Independent Consumer and Competition Commission. Earlier in his career he served as an adviser to the New Zealand Minister of Finance, and began his career as a Treasury official with responsibility for advising on major policy reforms.

1. Introduction

The Commerce Commission's (the Commission) vision in preparing market studies is to make New Zealanders better off (Commerce Commission, 2020, para. 4). In this paper, we assess whether the approach taken by the Commission in its draft market study into the grocery sector is likely to achieve that vision; we conclude that the Commission is likely doing more harm than good and the harm the Commission is doing is avoidable.

The Commission, as with any regulatory body, proceeds with imperfect information. To make New Zealanders better off, the Commission must balance the costs of better information against the costs of error. We use decision theory to explain that the Commission's current approach will not achieve a balance that is to the long-term benefit of consumers.

Our paper proceeds as follows:

- Section 2 introduces decision theory, decision-making with imperfect information, and the risks of error.
- Section 3 assesses the approach taken by the Commission and sets out how this approach has unnecessarily increased regulatory uncertainty and has therefore unnecessarily harmed consumers.
- Section 4 concludes.

2. Decision-making with imperfect information and the cost of error

2.1 Decision theory

No policymaker can be sure its decisions are optimal; welfare-enhancing decisions are made at the margin based on good information and sound policy principles. However, obtaining and analysing information is costly and sometimes unobtainable, and therefore the information available to a regulator is always imperfect.

Because information is always imperfect, a regulator must balance the costs of obtaining information to inform its decision with the costs of making errors. The costs of obtaining information include gathering and analysing factual information and the costs to participants from engaging in the decision-making process. Costs of error result from decisions based on imperfect information. These costs include "false positives"—the cost of condemning an activity that does not harm welfare—and the costs of "false negatives"—failing to prevent an activity that harms consumers.

These error costs include the impact on investors who must make decisions based on their assessment of how the regulator will balance the cost of obtaining information and the cost of error in future decisions. That is, the cost of error in a market study by the Commission takes in not only the sector under study but the ripple effect though all industries potentially subject to a market study.[1]

As Posner (1973) reasoned nearly 50 years ago, a rational decision-maker would try to minimise the sum of both costs—the costs of information and the costs of error. This insight was later developed in competition analysis by Beckner & Salop, (1999), Popofsky (2008) Evans & Padilla, (2005) amongst others.

The development of decision theory in regulatory settings suggests the risk of false positives (a conclusion, or intervention, targeting a harm that does not exist or is overstated) is likely to have a much higher expected value in a study of the grocery sector in New Zealand than the risk of a false negative. The expected value of a risk is the product of the impact of the risk event and the probability of that event occurring.

There are three reasons why the risk of a false positive in the grocery market has a much higher cost than the risk the Commission might fail to curb an activity that harms consumers. We outline these three reasons—investment uncertainty, characteristics of retail grocery services, and limitations of a small economy—in turn below.

[1] See Beckner & Salop, (1999) for a discussion of the economic rationale for 'precedent' in judicial decision-making.

2.2 Investment, employment and consumer welfare are depressed by uncertainty

There is an extensive and growing literature on the impact of economic policy uncertainty on firms' decisions and behaviours (see for example Al-Thaqeb & Algharabali, 2019; Baker et al., 2016). Economic policy uncertainty[2] arises when the future path of government policy is unknown, unclear or unpredictable. Even moderate amounts of economic policy uncertainty can affect investment and employment (Rodrik, 1991). Market studies can be a particularly aggravating source of regulatory uncertainty, because the possibility of error impacts not only the sector under study but all industries potentially subject to a market study.

When firms invest in both tangible and intangible assets, they forgo present income to increase future income. Firms are willing to make this investment when they expect the benefit from the investment will exceed its costs. Expected benefits and costs are informed by the impact of regulatory actions, as well as the firm's analysis of future market conditions.

Increased uncertainty tends to both lower the level of investment and delay the timing of investment. Most major investments by firms are irreversible: the firm cannot disinvest, so the expenditure is a sunk cost; it cannot be used by another firm or industry (Pindyck, 1988). When regulatory processes increase uncertainty, holding off investment allows firms to gain more information about the possible future state (Dixit & Pindyck, 1994). The higher the uncertainty, the greater the value of delay, and the more cautious firms become (Bloom, 2009; Vural-Yavaş, 2020).

In addition to decision paralysis ("wait and see"), regulatory uncertainty leads to resource misallocation (Giertz & Feldman, 2012). With increased uncertainty, firms may favour holding liquid assets. As firms switch from productive investment to holding liquid assets, resources are misallocated (Duong et al., 2020). This misallocation, while a rational response by the firm, creates a "deadweight loss" to the economy—the unrealised gains to firms and consumers from reduced productivity (Bloom, 2009, p. 164).

Increased caution is reflected in employment decisions and access to capital. In periods of high uncertainty, firms hire less (Baker et al., 2016; Jurado et al., 2015). Firms may "wait and see" instead of engaging in activities, such as new job creation, that create sunk costs (job creation costs are not refundable). Banks are reluctant to lend when uncertainty is high; this might mean finance is harder to obtain or is more costly (Alessandri & Bottero, 2020; Bloom, 2014).

Reduced investment flows through to consumers through its impact on the availability, quality and price of goods and services. Where uncertainty induced by regulation delays the introduction of new services and service innovation, the loss to consumer welfare can be significant; in economic terms, equating to the whole area under the demand curve for that new service (Hausman et al., 1997).

[2] We use a broad definition of uncertainty that includes risk (something that is not certain to happen but for which it is possible to assign probabilities to the possible outcomes – the 'known unknowns') and uncertainty (the 'unknown unknowns').

Available New Zealand evidence is consistent with the international literature. Rice et al. (2018) explore the effect of general uncertainty on the New Zealand economy over the period 1997 to 2016. They find that both domestic and global uncertainty reduces output, consumption, and investment. The impact on investment is significantly larger than the impact on consumption, and global uncertainty has in the past been relatively more important than domestic uncertainty in driving the New Zealand business cycle. Ratcliffe and Tong (2021) identify the key drivers of business investment in New Zealand over the past two decades and find that uncertainty has a strong negative effect on investment, but it is not clear whether this involves a cancellation or a delay in investment.

Sense Partners (2020) develop an economic uncertainty index for New Zealand based on media articles related to uncertainty and examine its impact on investment. Their results mirror those in the literature: firms delay investment and hiring decisions until the outlook is clearer, and households reduce their spending. These impacts persist: the economy is much weaker several quarters after the uncertainty shock hits.

Ryan (2020a) examines the effects of policy uncertainty using measures derived from New Zealand's parliamentary record from 1975 to 2017. The results show that uncertainty has a large negative impact on output and share prices, consistent with declines in investment and consumption.

2.3 Characteristics of the grocery sector make it vulnerable to regulatory uncertainty

Researchers have identified the characteristics of industries especially vulnerable to behavioural uncertainty by regulators and to third party opportunism in regulatory processes (Spiller, 2010). These industry characteristics include:

- customer services utilising substantial fixed investment
- increasing returns to scale over elements of service
- services that are consumed by almost everyone.

Taken together, these characteristics make a service inherently political for three reasons (Spiller, 2010):

- Almost the entire population consumes the services and hence politicians and interest groups are sensitive to price and service levels.
- Large economies of scale mean a limited number of industry participants for some services.
- Significant sunk costs provide regulators, political stakeholders, and third parties considerable leeway to act opportunistically.

These industry characteristics—present in the retail grocery sector[3]—mean governments face strong incentives to adopt short-run policies that may harm their long-run policy objectives, including threatening (or carrying out) expropriation of private investment. Governmental opportunism,

[3] Though economies of scale may not be to the same extent as in the utility sector where this literature originated (Levy & Spiller, 1994).

however, does not have to be so drastic as a law altering contracts, organisational form, or pricing, but can be achieved via the subtle works of administrative process (Spiller, 2010).

Seminal studies by Levy and Spiller (among others) identified achieving regulatory commitment (sometimes referred to as policy credibility) as the single most important characteristic if regulation is to benefit consumers in the long term (Levy & Spiller, 1994). Absent credible and predictable policies, firms will invest less. To illustrate, a study across 147 countries over the period 1960 – 1994 finds that the higher the degree of regulatory commitment, the greater the investment by private firms (Henisz & Zelner, 2001).

2.4 Limitations of a small economy

Leading economists, including Nobel Laureate Michael Spence, have long recognised the effects of the small size of a domestic market on the economic characteristics and performance of markets. The fundamental structural traits of small economies are so pronounced they belong to a "different class of market economies" (Caves et al., 1980, p. 5).

There are three structural traits of small market economies like New Zealand that mean the relative costs of a false-positive error (overstating harm) are likely to be higher than the costs of false negatives (failing to prevent an activity that harms consumers).

First, small economies are characterised by high industrial concentration levels, high entry barriers, and suboptimal levels of production.[4] These features are explicitly recognised in the Regulatory Charter for New Zealand's competition system (MBIE, 2018, p. 7). These economic characteristics create a basic tension between productive efficiency and competitive conditions—if a given number of firms can operate efficiently in a market of a certain size, then productive efficiency requires the market contain only this number of firms.

This basic tension means market studies should give greater weight to long-term dynamic considerations and recognise that high market concentration is often necessary to achieve efficiency. However, these welfare benefits may also be impacted adversely by higher concentration levels. Finding the right balance in this trade-off inherently involves judgement and requires more complex analysis than needed in a large economy (where the decision-maker can assume the market is sufficiently large for a number of firms to achieve productively efficient size) (Gal, 2012). Complex decisions involving judgement have a higher probability of error.

Second, the relative price paid by a small economy for a false-positive error is higher than that paid by a large economy. This effect arises because in large economies the "invisible hand of the market"[5] has more corrective power, given the size of the market and the number of entities in the market (Gal, 2012).

[4] For an explanation of these characteristics and their implications for competition policy, see Gal (2006).

[5] The invisible hand is an economic concept that describes the social benefits and public good brought about by individuals acting in their own self-interests. The concept was first introduced by Adam Smith in The Theory of Moral Sentiments, written in 1759.

Third, in small economies, the interdependencies in the interests of various stakeholders are likely to be more significantly affected by a regulatory intervention. Hence, the "risk of costly interest-group-affected industrial policy in the guise of competition law becomes high" (Gal, 2006, p. 9).

This risk of rent-seeking behaviour increases with regulatory uncertainty (Giertz & Mortenson, 2014). When economic policies are uncertain, firms divert resources to lobbying politicians and regulators to obtain more clarity or more favourable policy. Rent-seeking is not confined to firms or industries that are threatened by policy uncertainty. Rent-seeking is used by firms, who see advantages from the change, to consolidate potentially beneficial policies.

At the extreme, the regulator can be "captured" by an industry or interest group, unintentionally acting in its interests, rather than of New Zealand as a whole, often because of problems of information asymmetry—the regulator relies on information provided by the industry or interest group, who knows much more about itself, its motivations, operating model and behaviour, than the regulator does. The issue becomes more acute with consultation on policy proposals or co-design of policies where the regulator relies on information provided by the industry or interest group.

2.5 New Zealand reformed its regulatory institutions to reduce uncertainty

Hence, a regulator acting in a manner that increases uncertainty, including failing to recognise that it is making decisions with imperfect information and therefore imposing the costs of error on the community, creates powerful incentives for firms to postpone or reduce investment and hiring. Investment that does occur will require higher rates of return to compensate for increased regulatory risk, or will be undertaken from entities well connected 'politically'.

Because of the high cost to society from regulatory uncertainty, reforms to New Zealand's institutions in recent decades sought to reduce erratic and unpredictable changes in policy by providing institutional constraints (L. Evans et al., 1996, p. 1862). Important examples include the Reserve Bank Act 1989, the Public Finance Act 1989, and the Fiscal Responsibility Act 1994 (Barker et al., 2008). Together, these reforms create constraints to "structure political, economic and social interaction" (North, 1991, p. 97) and thereby determine New Zealand's incentive structure for savings, investment, trade and production. These reforms to organisations were supported by policy work to define the attributes of best practice regulation laid out in Appendix A (The Treasury, 2015). A recent careful study concludes the reforms were successful in reducing uncertainty from institutional sources (Ryan, 2020b).

Viewed against the hard lessons from experience, which informed the design of regulatory institutions in New Zealand, the approach taken by the Commission to its market study falls well short of a welfare-enhancing decision made at the margin based on good information and sound policy principles. Rather, for the reasons we explain in the following sections, the Commission's approach represents a return to "erratic and unpredictable changes in policy".

3. Market report increases uncertainty

3.1 The Commission appears blind to the costs of policy uncertainty and error

A regulator advancing a vision to make New Zealanders better off would be sensitive that it is proceeding with imperfect information and that processes and decision-making might impact on regulatory uncertainty, and hence unintentionally add to the long-term costs to consumers. It would be particularly careful when conducting a Ministerial-directed market study because of the high likelihood it would be investigating a sector in which services were politicised. These concerns would be given greater weight when undertaking a study during a time of increased systemic risk, such as the Covid-19 pandemic, and when maintaining supply chains is critical to consumer welfare.

As the submissions illustrate, the Commission is conducting its market study in a manner that exacerbates rather than resolves regulatory uncertainty. We highlight six behaviours.

3.1.1 Not committing itself to rigorous, credible evaluation methods

The Guidelines the Commission prepared for itself describe the processes it follows in undertaking a market study (Commerce Commission, 2020). These Guidelines provide little, if any, statements of methodology.

A single firm proposing a merger can be confident of the method the Commission will take to analyse the competitive effects of that transaction because the Commission's analytical approach is explained in its "Mergers and Acquisitions Guidelines" (Commerce Commission, 2019). A firm supplying services in a sector in which there is little or no competition, and little likelihood of a substantial increase in competition, can understand the method by which the Commission will regulate its prices and service levels, as the Commission was required to detail its Input Methodologies. In each case, these methodologies will be recognisable to investors in countries with a similar regulatory regime (for example, Australia, the United Kingdom, Europe, and the United States, as well as many other countries), reducing the costs of learning for foreign firms looking to invest in New Zealand.

In contrast, an entire industry subject to a market study learns the methodology applied by the Commission when it publishes its draft decision; sectors that are yet to be subject to a market study, and potential new entrants, cannot be sure the Commission will assess them in the same way. By not committing to the approach it will adopt, the Commission leaves firms uncertain how it will evaluate sector performance; this uncertainty perpetuates after the market study is completed for other sectors that might be subject to a market study.

As its methods appear to be evolving, the Commission leaves itself exposed to claims that it may make methodological choices that favour particular conclusions. For example, Woolworths observed that the Commission adopted purchasing power parity techniques for international comparisons in its fuel market study but not for its grocery market study; had the Commission applied purchasing parity,

it would have found that grocery prices are lower than in 21 other countries in the OECD, rather than just the six it reported (Woolworths New Zealand, 2021a, p. 66).

A methodological guideline would also allow the Commission to explicitly address how it considers its own performance in relation to any competition issues it identifies. As the Commission is responsible for enforcing legislative prohibitions on certain actions that substantially reduce competition, a market study is to this extent investigating the Commission's performance in identifying and correcting prohibited behaviour. The Commission's Guidelines do not explain how it deals with this conflict, and the Commission has not addressed this issue explicitly in its market studies to date. A regulatory entity enhances its credibility as a regulator when it objectively and transparently assesses its own performance.

3.1.2 Proposing heavy-handed interventions before concluding on the problem

The draft report sets out the Commission's preliminary views. These preliminary findings, and the analysis underpinning those findings, are strongly contested in some submissions and supporting expert reports. If the Commission consults with an open mind, it may yet reach different conclusions as to the nature and extent of any competition issues.

Before reaching a concluded view as to the competition problems, the Commission has floated the prospect of heavy-handed regulatory intervention in the retail grocery sector (and consequently the prospect of similar interventions into any other sector that might be subject to a future market study). Heavy-handed regulation generally involves direct regulatory control over core pricing, output, or investment decisions by firms.[6] Options at the heavy-handed end of the regulatory spectrum proposed by the Commission include government funding or other measures to favour entry by competing retailers or wholesalers, regulated operational or structural separation of wholesale and retail businesses, and a requirement for existing retail store owners to sell stores to competitors.

By floating the prospect of heavy-handed regulation before it has concluded that there is a material competition problem and that its regulatory proposals would be welfare-enhancing, the Commission creates two regulatory problems.

First, it will be very difficult for the Commission to assess submissions with an open mind. Given the significance of its proposed interventions, the Commission would find it very difficult to now conclude that it misjudged the competition issues without damaging its public credibility; by making heavy-handed proposals on the basis of a draft view, the Commission creates strong incentives for it to entrench its preliminary view rather than assess submissions with an open mind.

Second, the greater the negative expected outcome associated with an option (the product of the likelihood it will occur and the size of the effect), the greater the likely impact on business decisions.

[6] For a discussion on the characteristics of light-handed compared to heavy-handed regulation, see the Australian Competition and Consumer Commission, *Submission to the Productivity Commission's inquiry into price regulation of airport services*, (2006).

The most interventionist options put forward by the Commission—operational separation, vertical separation and divestment—are therefore likely to induce the greatest impact on firm behaviour.

Both incumbent and potential new entrants are likely to be affected and to adopt a “wait and see” approach to big, irreversible investments until there is greater policy clarity. These effects can be expected to ripple through all industries potentially subject to a market study.

The possibility of operational separation and vertical separation is likely to be of concern to vertically-integrated potential entrants. A regulatory regime requiring vertical separation that applied to some entities and not to others would be difficult and costly to enforce as it could be circumvented by ownership structuring.[7] Potential new entrants are therefore likely to adopt a “wait and see” approach until the policy uncertainty has been resolved, reducing the possibility of increasing competition in the sector, at least in the short run. Independent retailers are also likely to delay or reduce irreversible investments, for example in developing their own supply chains, until there is more clarity about their ability to access wholesale supply under the proposed changes.

The potential impact on suppliers is less clear, but they too are likely to be reluctant to make big investments until the policy direction is clearer.

3.1.3 Creating uncertainty it cannot resolve

The market study is creating uncertainty it cannot itself resolve because the wide sweep of its proposals includes options that are outside of its hands to implement and that involve an assessment of costs and benefits which the Commission is ill-equipped to assess.

It is notable that the Commission’s proposals that result from an assessment of competitive behaviour and barriers to entry (aspects of analysis within its core competency as a competition agency) are supported by a broad cross-section of submitters. The options that fit within this category include measures to improve conditions for entry by making sites available through **changes to planning law** and the **removal of restrictive covenants**; the adoption of a grocery **code of conduct** to govern relations with suppliers and providing **information for consumers** to make better buying decisions. These options are supported in submissions from Woolworths New Zealand, Foodstuffs North Island, the Food and Grocery Council, and Consumer NZ (Foodstuffs North Island, 2021; NZ Food and Grocery Council & Consumer, 2021; Woolworths New Zealand, 2021a).

While the market report addresses changes to the Resource Management Act to improve access to suitable sites (Commerce Commission, 2021, para. 9.77), it does not address changes to the Overseas Investment Act to facilitate entry by overseas firms. These changes are outside the remit of the market study but arguably together constitute the baseline conditions that are crucial to the successful implementation of any of the other options. Without some certainty about these changes, the efficacy of the other policy proposals is moot.

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[7] New Zealand’s experience in implementing the ‘lines – energy’ separation in the electricity sector provides an illustration of the difficulties of designing organisational form by regulation; these provisions have been the subject of legislative amendment in 1998, 2001, 2008, and 2010.

It is not clear how the Commission plans to pursue the proposed changes to the Natural and Built Environments Bill, which will replace the Resource Management Act. The changes will require buy-in from relevant Ministers and further development with the Ministry for the Environment, which is responsible for the Bill, and it is not clear what priorities the proposed changes will have relative to the rest of the Bill. Timeframes for changes are tight: the draft Bill is currently at a fairly late stage of development at Select Committee, although there will be further consultation when the full Bill is introduced in 2022. So whether or not the changes to Natural and Built Environments Bill will incorporate any or all of the changes proposed in the market study is not known at this stage, and the Commission can provide no certainty in this regard.

Nor is there any suggestion that the Overseas Investment Act should be amended to facilitate entry by overseas firms into the grocery market. This is somewhat surprising because the options proposed to facilitate entry by wholesalers and retailers could require greater certainty under the Act. Not only is the market report silent on any changes, but even if they were suggested, the Commission could not guarantee that they would be made, because they would inevitably involve decisions at the Ministerial level trading off the government's stance on increased foreign investment against the economic gains of increased entry into the grocery market.

Any regulatory agency raising policy proposals to address a competition concern should do so with a clearly defined road-map that spells out how the uncertainty it creates will be resolved and eliminated. The market study does not do this.

3.1.4 Failing to embrace the principles of best practice regulation

The attributes of best practice regulation laid out in Appendix A should inform and guide the methodology of the market study in developing policy options (The Treasury, 2015). In short, the policy options should be:

- **growth compatible**, including recognising the need for firms to make long-term investment decisions
- **proportional** to the benefits that are expected to result
- **flexible and durable**, allowing firms to comply at least cost and with feedback loops to assess how the law is working
- **certain and predictable,** with clear processes and decision-making and consistent with other regulatory regimes
- **transparent and accountable**, with clear rules and justifiable decision-making.

Policy changes are generally made in the wider public interest, weighing up the potential benefits against the inevitable costs of change. A crucial part of the policy development process is identifying and quantifying the benefits and costs of policy options, and this is usually done by government departments in providing advice to Ministers. This policy development process allows Ministers to assess the potential costs and benefits of the options and to identify those options which warrant public consultation.

The Commission cannot gauge which options might be acceptable to Ministers without undermining its independence; it is questionable therefore whether the Commission is the appropriate body to be consulting on whether an industry should be subject to heavy-handed regulatory interventions.[8]

Nevertheless, if the Commission persists with recommendations, the options presented in the market study should at least identify their likely effectiveness, as well as the nature of the costs and benefits involved, their distribution, and indicate their likely magnitude. This would at least provide a broad indication of which options could be ruled out and which could be developed further.

Absent such an approach, all options remain live, creating policy uncertainty for firms until such time as the government makes policy decisions. Leaving expropriation in the form of separation or divestment on the table creates a chilling effect on firms' investment decisions and leads to harm to consumers.

3.1.5 Proposing underdeveloped interventions

Assessing the options set out by the Commission against basic policy questions illustrates how little thought the Commission appears to have given to its spectrum of options:

- The **parameters** of the option. What exactly each option will entail is not clear, for example: Will it apply to all firms or just incumbents? How will separation and divestment occur? What are the compensation arrangements?
- The **effectiveness** of each option at increasing competition. Have they been tried elsewhere? If so, how effective were they at increasing competition? How applicable are the lessons to the grocery sector and in the New Zealand context?
- The **priority** of each option. Which options are likely to be most effective in increasing competition?
- The **interdependencies** of the options. Are the options independent of one another or do they constitute interdependent "packages"? If they are interdependent, how crucial is each part to the overall success of the package?
- The **interplay** of the options and the Commerce Act is not clear, although the report notes that restrictive covenants and exclusivity covenants may breach sections 27 and/or 28 of the Act (Commerce Commission, 2021, para 6.90).[9]
- The **trigger** for implementing the option. What exactly will lead to the option being put into place? How will the pro-competition effectiveness of other, less interventionist policies be monitored? How transparent will this be?
- The **lead time** for other options to bed in. How much time will be allowed for other, less interventionist options to take effect before more extensive options such as separation or divestment are implemented?

[8] Whether regulation should be imposed is distinguishable from decisions on how to implement regulation (as occurred when the Commission developed the Input Methodologies following an amendment to the Commerce Act requiring it to develop the regulatory detail).

[9] Curiously, the Commission notes that compliance and enforcement actions can be protracted and expensive, suggesting it is mindful of its costs (Commerce Commission, 2021, para. 6.90).

As noted in section 2, even moderate policy uncertainty can disincentivise investment and employment. The expected impact arising from the uncertainty surrounding proposed options is likely to be increased by:

- The **magnitude** of the policy change. For example, divestment is likely to have a bigger expected impact than separation.
- The **timing** of the policy change. The longer the delay (often several years) between the publication of the initial draft market report and the eventual implementation of the policy, the greater the period of uncertainty and disruption to firms' investment decisions.
- The **durability** of the policy change. The more credible the policy change, the less the expected impact. But if there is doubt that the policy, if implemented, will stick and it is susceptible to being changed or reversed, then the uncertainty will continue.

3.1.6 Encouraging third-party opportunism

Well-designed regulatory processes intentionally limit avenues for third-party opportunism; that is, they limit avenues for entities to lobby or influence regulators or politicians to achieve outcomes that favour them but may not be in the public interest.

The grocery sector is inherently susceptible to political interest as described in section 2.3. Almost everyone buys groceries, so consumers and thus politicians are sensitive to price and service levels. There are only a few large firms and significant sunk costs in the industry.

This susceptibility, combined with a lack of certainty about the existence of the problem and the lack of clarity about the nature, efficacy, costs and benefits of the options proposed in the market study, creates space for lobbying by third parties. This space for opportunistic behaviour by third parties seeking to influence the outcome is expanded by the Commission's lack of detail and research into its proposals; third parties are emboldened to promote options that are equally undeveloped and likewise without consideration of the costs of their proposals.[10]

Rather than recognising the risk of third-party opportunism, the Commission invites suggestions from interested parties on additional options (Commerce Commission, 2021, para 9.3). Several submitters have responded by encouraging the Commerce Commission to develop its proposals calling for divestment of assets. The Commission also provided time at its conference for submitters to lobby for the assets they would like to see sold and to make the case that these assets be sold only to an approved list of vendors (that would exclude foreign investors and include themselves).[11] These submissions, and the Commission itself, seem blind to the harm being done to New Zealand consumers.

[10] For example, in response to the Commission's draft report, Consumer NZ and the Food and Grocery Council wrote an open letter to all Members of Parliament seeking enforced structural separation between wholesale and retail and/or compulsory divestment of a significant proportion of supermarkets to third parties, suggesting that these entities view the Commission's process as politicised (NZ Food and Grocery Council & Consumer, 2021).

[11] Transcript of Grocery Market Study Conference, day 5 and 6, available at: https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-retail-grocery-sector?target=documents&root=269950

4. Conclusion

The Commission does not appear to recognise, and does not attempt to minimise, the cost of its approach.

Its policy options are sketchy and underdeveloped, creating great uncertainty about their nature, scope, effectiveness and priority. This uncertainty is acute for the more interventionist options as the factors that would lead to their adoption are not clear.

The methodology of the market study itself creates uncertainty. The Guidelines prepared for market studies provide little, if any, statements of methodology. Nor is there necessarily consistency of methodology between market studies. An industry potentially subject to a market study cannot know beforehand how sector performance will be evaluated.

The market study is creating uncertainty the Commission cannot itself resolve because changes to legislation are out of its hands. This uncertainty is compounded as the market study does not lay out a clear roadmap for how its proposals would be implemented.

Policy uncertainty of this kind affects decision-making and behaviour of firms and influences both the level and timing of investment. The economic literature on the damage to investment incentives, and hence the long-term harm to consumers, from regulatory threats to investments is extensive and persuasive. Both incumbent and potential new entrants are likely to be affected and to adopt a "wait and see" approach to big, irreversible investments until there is greater policy clarity. Firms in other industries that may yet be subject to market studies are also likely to concerned, especially by the more interventionist proposals, which may factor into their investment decisions.

The Commission could reduce the harm it is causing by:

- providing a clear, consistent and predictable methodology in its market study guidelines, applicable to all market studies
- reaching a concluded view that sufficient competitive detriment exists to warrant policy intervention, before proposing options
- developing its policy proposals consistent with the principles of best practice regulation, including providing sufficient detail about each option to determine its benefits, costs and likely efficacy and being clear about what it considers to be the best options
- providing a roadmap of when, how, and in what circumstances each option would be taken forward
- constraining its recommendations to its areas of expertise, including competitive conduct and barriers to entry.

The Commission takes the view that the costs and benefits of the interventions it proposes are for others to assess. However, if market studies are to benefit consumers, the methodology employed should adhere to the regulatory version of the old Hippocratic oath; first do no harm.

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Appendix A Attributes and indicators of best practice regulation

Attribute	Principle	Indicators
Growth compatible	Economic objectives are given an appropriate weighting relative to other specified objectives, including other factors contributing to higher living standard	Identifying and justifying trade-offs between economic and other objectives – for example, the pursuit of other dimensions of living standards – is an explicit part of decision-making The need for firms to make long-term investment decisions is taken into account in regulatory regimes where appropriate Open and competitive domestic and international markets including minimising barriers to, and maximising net benefit from, cross-border flows are explicit objectives
Proportional	The burden of rules and their enforcement should be proportional to the benefits that are expected to result	A risk-based, cost-benefit framework is in place for both rule-making and enforcement There is an empirical foundation to regulatory judgements
Flexible, durable	Regulated entities have scope to adopt least cost and innovative approaches to meeting legal obligations The regulatory system has the capacity to evolve in response to changing circumstances	The underlying regulatory approach is principles- or performance-based, and policies and procedures are in place to ensure that it is administered flexibly Non-regulatory measures, including self-regulation, are used wherever possible Feedback systems are in place to assess how the law is working in practice including well-developed performance measurement and clear reporting The regulatory regime is up to date with technological and market change, and evolving societal expectations
Certain, predictable	Regulated entities have certainty as to their legal obligations, and the regulatory regime provides predictability over time	Safe harbours are available and/or regulated entities have access to authoritative advice Decision-making criteria are clear and provide certainty of process There is consistency between multiple regimes impacting on single regulated entities where appropriate

Attribute	Principle	Indicators
Transparent, accountable	Rules development, implementation and enforcement should be transparent	Regulators must be able to justify decisions and be subject to public scrutiny
Capable regulators	The regulator has the people and systems necessary to operate an efficient and effective regulatory regime	Capacity assessments are undertaken at regular intervals and subject to independent input and/or review Implementation of the regime is efficiently achieving its objectives, with compliance and enforcement practices that reflect the capability and incentives of regulated parties

Source: The Treasury (2015)

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For more information, please contact:

Kieran Murray

Phone: +64 4 9157592

Mobile: +64 212451061

Email: kmurray@thinkSapere.com

Sydney	Melbourne	Canberra	Wellington	Auckland
Level 18	Level 5	PO Box 252	Level 9	Level 8
135 King Street	171 Collins Street	Canberra City	1 Willeston Street	203 Queen Street
Sydney	Melbourne	ACT 2601	PO Box 587	PO Box 2475
NSW 2000	VIC 3000		Wellington 6140	Shortland Street
				Auckland 1140
P +61 2 9234 0200	P +61 3 9005 1454	P +61 2 6100 6363	P +64 4 915 7590	P +64 9 909 5810
F +61 2 9234 0201	F +61 2 9234 0201 (Syd)	F +61 2 9234 0201 (Syd)	F +64 4 915 7596	F +64 9 909 5828

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