

WAS THE GOVERNMENT RIGHT TO ABOLISH THE GROCERIES ORDER?

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The Groceries Order has been a source of bitter debate in Ireland for over fifty years. Jane Gibbons examines its details and then looks at its effect on competition, prices and industry structure. Finally she concedes that this controversial law has no place in the Irish economy.

Introduction

The purpose of the 1987 Restrictive Practices (Groceries) Order was to ban below invoice price selling with the objectives of reducing the concentration in the retail industry and preventing predatory pricing. The proponents of the Groceries Order (GO) have said that it should have been retained to maintain a large number of small retailers to increase competition. They argue that consumers have benefited from the investment in retail outlets since the ban and also argue that consumers do not have to travel to find a cheaper basket of goods. Those opposing the GO say that it makes it illegal for retailers to pass on substantial discounts to their customers and gives legitimacy to practices that would otherwise be illegal under competition law. They believe the GO is an anti-consumer regulation which adds to the problem of high food prices in Ireland. This essay proposes that the opposition to the GO are correct in their criticisms and that Minister Martin was correct to announce the abolition of the Order in 2005. This essay will provide proof that the claims of the supporters of the Order are implausible. I will do this by firstly examining the effects of the ban on the price of food in Ireland and secondly by examining the cases of Germany and the U.K.

The Groceries Order and its purpose

The original GO was introduced in 1956, but the GO that caused the controversy was the 1987 GO that remained in place until November 2005. This Restrictive Practices Order made below invoice price selling and 'hello

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money'¹ illegal on grocery goods for human consumption, excluding perishable goods, intoxicating liquor and household necessities (Department of Enterprise Trade & Employment 2005). Dail debates on the GO demonstrated that the Order would interfere with competition, but these points were ignored. Before its inception each of the Fair Trade Commission Reports of 1966, 1972, 1975 and 1980 either did not consider or decided against below invoice price selling. However, it was the Fair Trade Commission of 1987 which recommended the introduction of such a ban. Only four years later it recognised its mistake and recommended that the ban be repealed, however this was not complied with. In both 1993 and 1995 the Department of Enterprise, Trade and Employment recommended the ban should be repealed. The 2000 report of the Competition and Mergers Review Group also recommended the Order be revoked. However, a report in March 2005 by the Joint Oireachtas Committee on Enterprise and Small Business supported the retention of the ban. This is hardly a surprising conclusion given that many of the members of this Committee and their lobbyist support groups were the retailers who were benefiting from the gross profits being legally handed to them. The Government finally took heed of the 2005 government report by the Consumer Strategy Group which recommended that the Order be revoked in its entirety. The purpose of the ban on below invoice price selling was to reduce, or even to maintain the level of industry concentration in the base year 1987, and also to prevent predatory pricing. This essay will attempt to analyse whether the government was correct to abolish the ban given the bans success (or failure) in fulfilling the two original objectives.

Pros and Cons of the Groceries Order

The GO has been a central issue of Dáil debate since its inception in 1956 but this debate heightened since the introduction of the ban on below invoice price selling in 1987. As a result of the controversy, and a number of submissions made to the Government regarding this argument, there is a great variety of debate on the matter. This section will highlight the arguments cited by the Department of Enterprise Trade and Employment, the Competition Authority and the Competition and Mergers Review Group.

¹ 'Hello money' is money or gifts given by suppliers to retailers for their custom. Forfas Report 1999 (The Dynamics of the Retail Sector in Ireland), reported that foreign multiples have managed to escape sanctions by receiving their payments through a foreign subsidiary.

Firstly, supporters of the GO argued that because of the low population density multiples tend not to locate in rural areas so independents and symbols cater for both one-stop and convenience markets. They said that the removal of the GO would further restrict access to shopping facilities for low income families, forwarding that this is particularly true for low income families because they cannot afford the transport costs to multiple supermarkets. As a response to this the Department refuted that if the elderly and low income families cannot afford to, or are unable to travel to multiples, then they depend on the independent retailers thus creating a niche market for independent retailers. The proponents also argued that there would be increased travel costs and congestion resulting from commuting to multiples. This argument does not hold because most multiples are located on the edge of urban areas where there are little problems with congestion. Those supporting the Order argue that it should have been retained to maintain a large number of small retailers to increase competition in the retail industry, however, the reality of this situation is that the GO had eliminated competition in the industry. The government argues that it is more expensive to shop in symbols and independents. It therefore wants more multiples to move into rural areas to increase price competition, which is virtually non-existent among independents. This appears to be an argument in favour of removing the GO. The Competition Authority were very much against the GO and they made the following points;

- i) The GO makes it illegal for retailers to pass on substantial discounts to their customers and gives legitimacy to practices that would otherwise be illegal under competition law.
- ii) This anti-consumer regulation adds to the problem of high food prices in Ireland. Removing it would have saved Irish consumers up to €577m over the twelve months between June 2004 and June 2005 (€481 per household).
- iii) By protecting Irish suppliers with the GO it undermines the competitiveness of the Irish food industry and hinders employment. Providing a vibrant and competitive marketplace at home is the best way to ensure that Irish companies are in a position to compete internationally (Competition Authority 2000).

Those in support of the Order said that the level of food processing and employment in the retail sector has grown far more since the ban than before. However, this but it may be refuted by arguing that these high growth levels should be accredited to the economy wide growth in almost all sectors during the Celtic Tiger era and beyond. An argument the proponents of the Order made was that customers have benefited from more investment in retail outlets since the ban, they have an increased range of products,

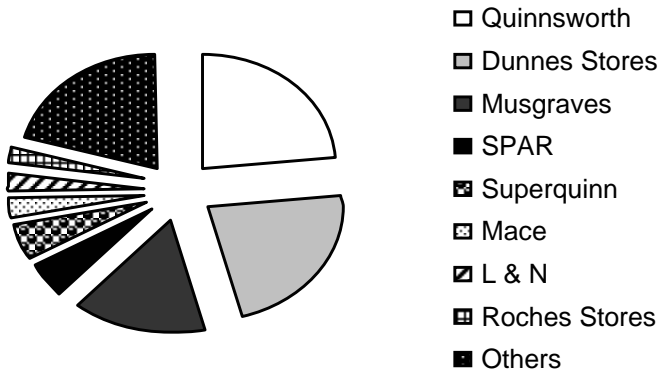
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longer opening hours, etc. They also said they have benefited because these stores are so price competitive that people do not have to travel to get a cheaper basket of goods. A reasonable explanation for this is price fixing among retailers has led to consumers not having the choice of receiving a lower price at another retail outlet. Consumers should not have to be grateful for extra services nor should retailers be protected for providing them, they should be expected. In fact the majority of the arguments made in favour of maintaining the GO are either not creditable or the problems that they emphasise will not, and have not, been solved by the retention of this ban.

The structure of the Irish grocery market

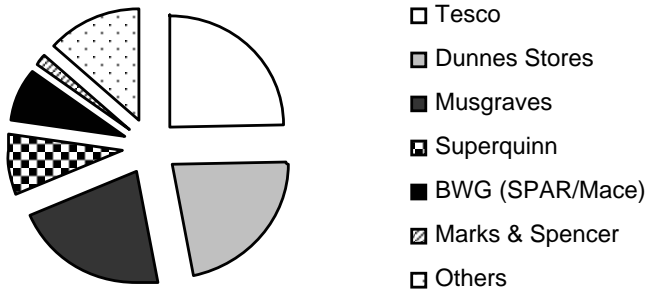
The structure of the Irish grocery market exhibits a high degree of concentration and a dualistic structure. Evidence has shown that this concentration has increased, rather than the hoped reduction, since the GO was introduced. In fact, Ireland and the UK exhibit similar levels of concentration despite the UK having no such ban. Pie chart one shows the market share in Ireland in 1990, just after the introduction of the GO. Pie chart two shows the concentration of the Irish grocery sector today and pie chart three shows the results for the UK in 2005. The most obvious changes have been the reduction in the number of independents by over 50% and also the loss of two multiples. Pie charts two and three also show how closely the UK and Irish markets are correlated.

Figure 1: Irish Retail Concentration 1990



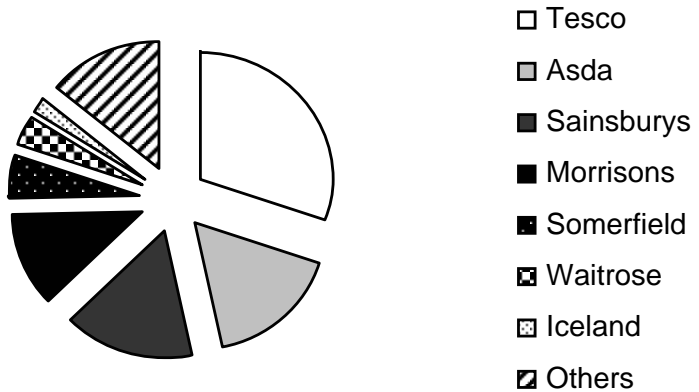
Source: 2005 Interim Report of Joint Oireachtas Committee

Figure 2: Irish Retail Concentration 2005



Source: 2005 Interim Report of Joint Oireachtas Committee

Figure 3: British Retail Concentration 2005



Source: TNS Till Roll Data June 2005

Competition and predatory pricing

As a result of the ban on below invoice price selling a supermarket price check in 2000 reported that the larger players in the industry have fixed their prices so closely that the current situation is seriously anti-competitive, and they strongly urged the Competition Authority to investigate (Department of Enterprise, Trade & Employment 2005). A lack of price competition has resulted in firms having to compete via non-price competition in areas such as convenience, product range, quality, cleanliness, friendly service, opening hours etc. Thus, it is the consumer, and in particular the marginal consumer, who loses out because they must spend a higher proportion of their income on groceries. To add to this the GO breached the Competition Acts in a number of ways: 'The Order seems to have as its primary objective the protection of competitors rather than competition. The ban on below invoice price selling could have the effect of applying dissimilar terms to equivalent transactions [due to the non-uniform application of discounts] something which is prohibited under sections 4 and 5 of the Competition Act.

'The Order may have the effect of mistaking legitimate competitive behaviour for predatory behaviour' (Competition Authority 2000: 8). Another item banned under the GO is predatory pricing. A predatory pricing strategy is a strategy that has the purposeful intent of damaging or eliminating competitors, mainly by selling items below cost (Department of Enterprise, Trade & Employment 2005). Irish Law states that it is not below cost selling but below invoice price selling that is illegal. This ignores the often quite substantial discounts from invoice prices that some retailers receive. Irish Law makes it illegal to pass these savings onto customers, this has resulted in prices among Irish multiples being almost indistinguishable.

A study by Walsh and Whelan (1999) says that "it is the ability of consumers to switch between alternative retail outlets that dominate pricing strategies" (Walsh & Whelan 1999:76). In reality most consumers tend only to have a high degree of "price awareness and a tendency to switch outlets on the basis of KVIs (known value items)" (Walsh & Whelan 1999:76). Thus, retailers, especially independents, tend to compete with respect to price on these KVIs and charge a higher mark-up on more price inelastic goods to maintain their rents. Walsh and Whelan cited the work of Bliss (1998) who indicated that assuming full consumer information and assuming all products to be KVIs, loss leading does not result in a competitive equilibrium. However, in reality consumers do not have perfect information and all products are not KVIs. Walsh and Whelan ran a model where there is imperfect information and they concluded that loss leading of multi-product retailers on a subset of products is an "equilibrium outcome used to protect market share which leaves retailer surplus, welfare, and the

structure of the market at full consumer information levels in the long run” (Walsh & Whelan 1999:84). Their second conclusion was that “compared with the laissez faire outcomes, the prohibition of below-cost selling in the pricing of multi-product retailers under imperfect consumer information and imperfect competition ensures that welfare declines to a third best outcome” (Walsh & Whelan 1999: 87) i.e. by intervening in the market and introducing the ban you end up distorting the market structure and long run welfare, that results in a third best outcome. If these results are realistic we should not worry so much about predatory pricing and hence there is argument in favour of abolishing the GO.

Effects of the GO on Food Price Inflation

This section will examine the effect of the groceries order on food and drink price inflation. The purpose of this will be to definitively prove whether the GO has resulted in higher prices to consumers. If it has resulted in higher prices then this puts further weight on the argument to abolish the GO. Table one shows that since June 2001 food items covered by the GO have increased 7.4% in price while food items not covered by the Order have decreased by 5.1%. The Department of Enterprise, Trade and Employment took 2001 as a reference year because it was that year that Aldi and Lidl joined the market and began to generate greater competition in the marketplace. They concluded that the GO has played an important part in affecting the level of competition on GO goods from 2001 onwards. An important statistic is the fact that over the period 1996-2005 Ireland’s rate of food inflation was virtually three times higher than that of the UK, where the rate is 8.3%. Also the Competition Authority, in its submission to the Department of Enterprise, Trade and Employment highlighted that although food prices rose between the period of 2000-2004 the prices of clothing footwear and household goods fell, which would mean retailers could not explain higher prices because of higher costs as these would appear in other industries’ costs also.

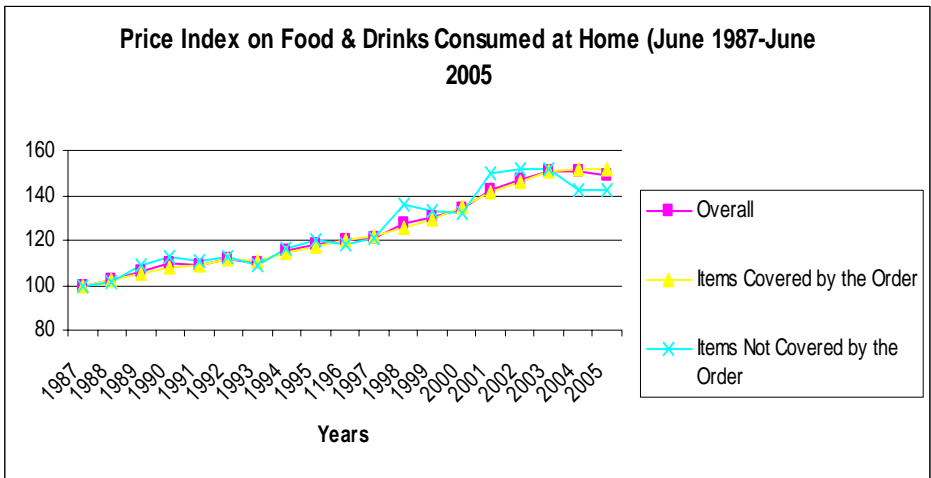
Food & non-alcoholic drink	+9.6%
Clothing & footwear	-15.9%
Housing durables	-3.9%

Source: Department of Enterprise, Trade & Employment 2005:118

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They also said that the introduction of Aldi and Lidl has stabilised prices but the prices of items under the GO continued to increase in price while those where competition was allowed fell.

Figure 4:



Source: Derived from CSO data

The experiences of other European countries

This section will briefly examine the positions of Germany and then it will give a detailed examination of the British case, as it offers a good comparison to the Irish market regarding structure. In Germany there is no general prohibition on selling below cost however, they do have a provision in law stating that a: “dominant retailer cannot abuse their position through below cost selling with a view to reducing competition in the marketplace, however, they are allowed to sell below cost to try increase market share, especially in emerging markets or new products” (Department of Enterprise, Trade & Employment 2005:140). This law seems to be successful as it was in Germany that Aldi and Lidl originated and they are the world’s biggest chains of low cost supermarkets. In the UK there is no prohibition on below cost selling but, under the Competition Act 1998, the abuse of a dominant position is prohibited (this includes unfair purchase or selling prices). Although British grocery prices are much lower

than Irish prices some say that this has been to the detriment of consumers. The Irish Co-Operative Organisation Society Ltd has called the phenomenon, of 42% of towns and villages in the UK having no grocery stores and price differences existing between rural and metropolitan areas, 'Ghost Town Britain'. Although these statements seem shocking at first the reality is not so dramatic and one must account for the fact that these statements came from groups who stand to gain from the rents available from the 1987 GO. A ban on below invoice price selling would not be the best solution to these problems. Other direct policy measures are required and could be targeted to help small businesses in rural areas gain business skills to help them run successful enterprises. Alternatively a minibus service a couple of times a week to a local multiple to would cater for those who lack transport.

Conclusion

The 1987 GO was brought in without suitable consideration. The Government ignored simple economic logic that would have told them that the introduction of competition to the market reduces prices and increases sales volumes. Numerous reports before and after its introduction have agreed conclusively that it was not a positive measure to be introduced and that it would not and did not address the issues for which it was proposed. Its purpose was to ban below invoice price selling with the aim of eliminating predatory pricing and thus protecting the independent retailers in the grocery sector. Throughout this essay, examples and statistics have shown that the GO has resulted in higher prices and lower competition. Specific country examples in Germany and the UK support the conclusion that even when problems existed a below invoice price selling ban was most definitely not the solution to their problems. In conclusion, the only people who have supported the retention of the GO have been the lobbyists who stood to gain rents from its retention. Those who were loosing for so many years were the consumers, adding an unnecessary €481 to their basket of goods each year (Competition Authority, 2000). Thus the government had little choice but to abolish the 1987 GO.

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