COMPETITION AUTHORITY

Submission on the Review of the floorspace cap on Retail Warehouses contained in the Retail Planning Guidelines (2000)

Submission No. **S/03/004**

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1. Introduction

This submission responds to the invitation from the Minister for the Environment and Local Government for comments on the floor-space cap on retail warehouses.[1]
Rather than address all the issues listed in the Department of Environment and Local Government's briefing paper[2], some of which are outside the Competition Authority's competence, this submission focuses on two sets of issues:

- where the current guidelines limit competition, and as such are directly and *explicitly* detrimental to the consumer; and
- where the current guidelines, in seeking to advance non-competition oriented policy objectives, (e.g. spatial strategy, urban renewal social inclusion) have a disproportionate, or *implicit*, adverse impact on consumers.

The Authority favours the removal of floor-space limits for retail warehouses, and would also favour the lifting of similar restrictions in other retail sectors. The Authority considers that the existing floor-space limit prevents the entry of new suppliers, domestic or foreign, and reduces the incentives on existing operators for efficiency and innovation. The availability of larger sized stores would give consumers the ability to exercise choice over a wider range of products at affordable prices. The present limit thus protects existing retailers at the expense of Irish consumers. Limiting floor-space means that Irish consumers experience less choice (for example, less inter-brand competition due to lack of shelving space) and, higher prices.

In coming to its conclusion in favour of removing floor-space limits, and in presenting this submission, the Authority reiterates various points made at the time the original regulations were established in 2000. Consequently, while focusing on the immediate issue of retail warehouses, the following comments also have a wider applicability.

[1] In making this submission the Competition Authority is fulfilling its advocacy responsibilities as set out in Section 30 of the Competition Action Act 2002.
[2] Review of the floorspace cap on Retail Warehouses contained in the Retail Planning Guidelines (2000). August 2003. The original objectives of the Guidelines and the Department's suggested questions are set out in Annex 1.

2. Explicit Impact on Consumers

2.1 Consumer Choice

The Authority considers that retention of size limits on retail warehouses would not be in the interests of consumers. The exclusion retail warehouses, in particular those larger than the current maximum limit of 6,000 square meters, deprives consumers of choice and reduces the scope for the downward effect on consumer prices that accompanies greater competition. The restriction on choice takes two forms. Firstly, the range of retail distributors is limited by the restriction on floor-space size. Secondly, floor-space restrictions limit shelf space capacity and thereby restrict the opportunities for innovation and improvements in product quality that result from competition, including inter-brand competition. In addition, the limited range of distribution channels hinders the scope for Irish exporters to test their products with Irish consumers.

2.2 Potential Harm to Consumers from Local Monopolies

The Authority is sceptical of the argument that floor-space restrictions prevent monopolies becoming established, and with them monopoly (i.e. high) prices, and therefore floor-space restrictions are beneficial to consumers. This argument was highlighted at the time of the guidelines originally being put in place. The argument is, however, weaker than it may at first appear.

Firstly, retailing is not necessarily a “zero-sum game” but rather can be a positive sum game whereby different types of retailer can co-exist. The case of aviation where new entry led to enormous market growth illustrates this point. A variety of airlines co-exist offering a range of choices for consumers.

Secondly, instances of new entrants managing to acquire monopoly positions are extremely rare. Such an outcome would require the product offering of the new entrant to be enormously more attractive to almost all consumers than the offering of existing suppliers. Furthermore, the removal of barriers to entry is in itself a protection against monopolisation. Even if an entrant did manage to acquire a position of dominance, it would always be vulnerable to further new entry, and consequently would always have to keep ahead in terms of pleasing consumers.

A third way in that the monopoly threat is overstated is by underestimating the impact of enforcement of competition law. The Competition Act 2002, does not regard monopoly as illegal *per se*, but rather regards as illegal the abuse of a dominant position in a market. The Act provides various remedies for such abuse. Therefore enforcement of competition law should be the first option when and if a there is a monopoly abuse, rather than pre-emptive restrictions designed to address a problem which may not materialise, but which create barriers to entry to the detriment of consumers.

2.3 Protecting Competition versus Protecting Competitors

It may be useful to elaborate further on the distinction the Authority makes between the protection of competition and protecting competitors. The Authority would place significant weight on the impact of new entrants on existing suppliers (i.e. competitors) only if an adverse impact on existing suppliers will necessarily impact adversely on consumers. This will be a special rather than a general case.

In the context of retail warehousing, the Authority does not consider the exclusion of potential new entrants protects consumers. Rather, as stated above, the Authority considers that the current restrictions adversely affect consumers by limiting choice and limiting the impact of competition on prices. Even the threat of entry can exert downward pressure on prices by existing suppliers. So the abolition of the guidelines, even if no new entry actually were to occur, could have a positive competitive impact if existing retailers, fearing entry, responded by cutting prices so that entry became less attractive.

2.4 Inflation

It can be expected that increased competition in retailing markets will, by virtue of increased supply, reduce prices to consumers and hence have a downward effect on inflation. In the longer term competition encourages innovation, which in turn encourages efficiencies. In a competitive retail market these should be passed on to consumers, thereby maintaining downward pressure on prices and hence reducing inflation.[3]

Combating inflation is not, however, a primary objective of competition policy. Competition analysis focuses on prices, and quality, of a given product or products at a given point of time. In contrast, inflation measures changes in the price levels over time. One implication from this is that inflation comparisons, either national or international, of general inflation or in specific sectors, do not provide a full picture of the extent of competition in a market. Consequently, the merits of increasing competition may be supplemented by, but do not depend on, a downward impact on inflation. For example, lower Irish inflation in particular sectors, compared to other countries would not, in itself, provide conclusive evidence of the state of competition, efficiency or productivity in any particular sector or industry.

3. Implicit Impact on Consumers

The second area of interest to the Authority concerns implicit, damage to consumers from the pursuit of sectoral or social policy objectives.

The Authority recognises government's prerogative to pursue a variety of sectoral and social objectives. Regulations that restrict competition may sometimes be necessary for the achievement of other public policy objectives. This is by no means always the case. In relation to implicit impact on consumers, a *proportionality* test should be applied, i.e. that restrictions on competition, and hence the restrictions on the benefits of competition, should be only be used where necessary, and only then should be the minimum necessary to advance the public policy objective in question.

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[3] See for example J.A Chevalier et al. "Why don't prices rise during periods of peak demand? Evidence from Scanner data", <u>American Economic Review</u>, March Vol. 93 (1) (2003) pp. 15 –37. They conclude that retail competition, including via loss leading, dampens the rise in prices that could otherwise be anticipated in a boom period such as during the second half of the 1990s in the US.

With specific reference to retail warehouses, it is not clear that competition should be restricted at all. Even in pursuit of broader policy objectives, other policy instruments, such as general improvements in planning generally, or the use of taxation to deal with negative externalities, would be more cost effective for the State. Restrictions on competition can have adverse consequences such as acting as a de facto tax, but with the important distinction that the revenues resulting from protection from competition, go to existing retailers, rather than the State. If higher prices are the desired policy outcome (to choke off undesirable demand), then taxation is a much superior instrument. Increasing prices by restricting competition, including by restricting retail warehouses, will reduce consumption but will be poorly targeted, i.e. will affect all prices and all commodities not just those deemed undesirable.

The following comments address various issues concerning the impact of restrictions on retail floor-space. Under each heading a case can be made for some form of restriction of competition. However, the merits of restrictions need to be balanced against the costs of adverse impacts on consumers. For each of the issues highlighted below, the Authority considers that restricting competition through a uniform limit on retail floor-space is an excessive (i.e. disproportionate) policy response and which has an unnecessarily high detrimental impact on consumers.

For each of the cases below there are two counteracting effects on consumer welfare from a relaxation or removal of the current restriction. Firstly, any closures of smaller retailers would reduce the range of retail choices for consumers. Secondly, however, stores remaining in the market will offer lower prices. The second effect is likely to be the more dominant, even more so for large or specialised items (including bulky items) that require some form of transport.

3.1 Transport Congestion

One argument made against retail warehouses is the adverse impact of congestion on roads, i.e. that customers travelling to and from large stores will cause traffic congestion. It is not obvious, however, that limiting the size of retail floor-space is the most proportionate response to problems of traffic congestion. The extent of congestion will be more fundamentally influenced by location and the quality of roads than by store size. It would seem reasonable to assume that the quality of the road network will improve over the next few years thereby alleviating potential problems of out of town or edge of town sites. In addition, out-of-town locations will likely ease present congestion in urban areas. Other options to reduce congestion include allowing longer trading hours, thereby spreading out over time the density of customers in any one area.

It could be argued that for a given volume of trade, providing a given amount of space in smaller units may reduce congestion caused by larger stores because of shorter travel times and the dispersal of stores. However, economies of scale in infrastructure would counter such arguments. In addition there is also the counter argument that people do not need to be protected from making longer journeys as they take into account of the higher costs, including the potential delays from congestion. To the extent that congestion from large stores is considered a problem, taxation of larger units would be more a more appropriate and straightforward approach, and indeed one that could be applied consistently to all planning matters. In addition, if the objective is to reduce the number of road trips people take, e.g. for environmental reasons, then a tax on petrol would seem a more appropriate policy than banning large stores.

3.2 Town Centres

It can be argued that the development of large stores, particularly those outside of town centres, has an adverse impact on the social role of town centres, e.g. through the detrimental impact on town centre traders. On this issue the Authority's comments in 2000 remain relevant, namely:

"The reduction in the viability of local stores is a competition issue. The Authority considers that any decision to restrict the size of superstores because of their effect on the viability of local stores is, in fact, a decision to restrict competition. The essence of competition is that those who are best at their job succeed, others fail. …. If consumers have the choice of a number of different types and size of stores, they will choose some more than others simply because they meet their needs better. Others, which do not attract custom, will fail. While the government may decide that certain services should be maintained in an area because of their social function, it could be argued that the costs of this should be funded in some other way than by individual customers paying higher prices."[4]

In other words, focusing on the last sentence above, the Authority doubts that restricting competition through a uniform restriction on floor-space is a proportionate response to the possible, but by no means inevitable, negative impact on town centres. Furthermore, to reiterate the points above, a reduction in congestion arising from a larger retail stores outside the town centre, could well have a positive impact on the vitality of a town centre, particularly in relation to large or bulky items which may not quickly or easily be transported within urban centres.

3.2 Social Exclusion

Retail warehouses are sometimes criticised on the grounds of social exclusion. For example, exclusion can occur when retail warehouses, or other large scale developments, are located such that some people do not have ready access to the site and hence are not able to exercise consumer choice. Not everyone has access to private transport to travel, and this will be a more severe issue for retail warehouses located outside of a town centre. However, one way to alleviate this concern would be through improved public transport networks, rather than limiting the range of retail options available to the whole population. Internet sales would also encourage the spread of low prices even to those who might not be able to physically access an out of town retail warehouse, i.e. assuming that internet sales prices do not discriminate between those with, and those without, physical access to a site, then the downward pressure on prices will be spread widely and will benefit all consumers, thereby reducing the harm from social exclusion.

It should not, however, be assumed that large retail warehouses would necessarily become established outside of urban areas, or away from public transport networks. Accordingly, it is not inevitable that social exclusion would necessarily increase with a relaxation of floor-space restrictions.

[4] Competition Authority presentation to the Joint Oireachtas Committee on Enterprise and Small Business. 6 April 2000

Another less obvious but highly significant aspect of social exclusion arises from the absence of retail warehouses, or other large scale operations. This exclusion is experienced by people, especially the elderly and people on low incomes, having to pay higher prices than would otherwise be the case. Competition from retail warehouses, aided where possibly by internet sales as described above, would put pressure on incumbent retailers to lower their prices and to maintain and improve quality. Ultimately, smaller shops may never match prices from larger outlets, but nevertheless the entry of additional suppliers (e.g. retail warehouses) would benefit all consumers, through lower prices across the range of retailers.

4. Conclusion

To conclude, the Authority supports the removal of retail floor-space restrictions. Firstly, on purely competition grounds, a blanket ban on retail warehouses cannot be justified. Exclusion of retail warehouses benefits existing suppliers but reduces consumers' range of choices and access to lower prices. Local monopolisation is extremely unlikely to be a concern. Even if it were, ex post competition enforcement against abuse of dominance would be a preferable instrument than banning new entry even before a would-be dominant firm has any market share at all.

Secondly, a proportionality test should be applied, i.e. that regulations to advance social or sectoral policy objectives are designed and implemented in a manner that minimises the cost to consumers. In this regard, a uniform, or blanket, limit on floor space is not the most proportionate policy response. Other policy instruments to achieve the desired objectives would be more effective. This would allow an opportunity for a careful consideration and weighing up of the benefits to consumers of such developments against any possible negative effects by the local representatives of the area concerned, who are best equipped to make a decision in the interests of their own local communities. Generally, more confidence should be placed in allowing markets to respond to consumer needs directly, rather than in the capacity of policy makers to second-guess consumer preferences.

Annex 1

Original Objectives of Retail Planning Guidelines

The Retail Planning Guidelines had a number of fundamental objectives:

- To ensure that in future all development plans incorporate clear policies and proposals for retail development;
- To facilitate a competitive and healthy environment for the retail industry of the future;
- To promote forms of development which are easily accessible – particularly by public transport – located in such a manner as to encourage multi-purpose shopping, business and leisure trips;
- To support the continuing role of town and district centres – particularly with a view to reinforcing the public and private investment in urban renewal which has already been made;
- To discourage large retail centres located adjacent or close to existing, new or planned national roads and motorways due to concerns regarding the inefficient use of costly major road infrastructure. Such infrastructure is primarily provided to serve long distance strategic transport requirements and should not act as a corridor for development, which encourages short, car based trips and congestion.

Suggested Questions

- Is there a need for a review of the manner in which the guidelines apply to retailing formats involving the distribution and sale of bulky goods?
- Is the cap on retail warehouses in the Retail Planning Guidelines inhibiting effective competition in relation to any particular retail sectors?
- Is the cap on retail warehouses in the Retail Planning Guidelines having a negative impact on consumer price inflation?
- Is the cap on retail warehouses hampering innovation in the retail sector in Ireland?
- Is the cap on retail warehouses contributing positively to the minimisation of traffic congestion and the efficient use of transport infrastructure? Would any change to the cap have a negative impact in this regard?
- Could any change to the cap on retail warehouses support the objectives of the National Spatial Strategy? For example, is it possible that permitting larger retail warehouse-type formats in the designated Gateway and Hub urban centres could effectively support balanced regional development by facilitating the growth of such centres and the consequent building up of “critical mass”?