

IS A CODE OF PRACTICE NEEDED FOR THE GROCERY TRADE?

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The introduction of a Code governing grocery supplier/retailer relations, enforced by an Ombudsman, is favoured by the Department of Enterprise, Trade and Employment in its Consultation Paper, *Code of Practice for Grocery Goods Undertakings* (August 2009). A recent analysis of the issues[†] questions the need for a Code, and suggests that the issues which have prompted calls for such a Code would be better dealt with in the context of the government's "better regulation" agenda and the provisions of the Competition Act as amended in 2006.

The Code proposed in the Consultation Paper constrains the behaviour of the retailer with respect to certain practices that include those that shift risk from the retailer to the supplier as well as those that result in unexpected costs to suppliers. For example, a retailer shall not directly or indirectly require a supplier to make any payment or grant any allowance for the advertising or display of grocery goods. The rationale for the Code appears to be that devaluation of sterling, combined with the recession means that retailers are able to put increased pressure on local suppliers for lower prices, which in turn squeezes suppliers' margins. In other words, retailers can import grocery products either from the UK or elsewhere at lower prices than are available from suppliers and distributors in Ireland. This gives rise to an alleged imbalance in the relationship between retailers, on the one hand, and suppliers and distributors, on the other.

Governments normally intervene in markets where there are market failures relating to market power, externalities and information problems. These market failure rationales do not apply in the case of the Code. In reality the Code is a form of protectionism occasioned by the inflow of lower priced imports. The retailer is simply the channel through which these lower-priced imports reach consumers. The problem facing Irish suppliers is not the retailer, but the competition from imports. Local suppliers should adapt through developing better products and becoming more efficient, rather than seeking shelter from market forces. At the same time, macroeconomic policies are currently aiming to restore Ireland's competitive position.

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One of the objectives of the Code is to restore “balance” between retailer and suppliers. Viewed in this context the key objective of the Code is to restore the old equilibrium. The Code permits the restoration of the status quo by reducing the freedom of manoeuvre and discretion of the retailer through the adoption of explicit and transparent contracts and restricting the availability of certain discounting mechanisms. This is meant to increase the bargaining power of the supplier vis-à-vis the retailer and thus increase the return to suppliers. If the above characterisation is accepted as reasonably accurate, then grocery prices are very likely to be higher under the Code than without the Code.

It is argued that the Consultation Paper should be withdrawn and reissued, but in a manner consistent with the government’s better regulation agenda which is currently ignored. This agenda sets a framework within which regulation can be assessed prior to its introduction. The framework requires that the question of necessity be addressed. In other words, is the regulation necessary? The Consultation Paper sidesteps that question, focusing almost entirely on the details of how the Code would be specified and operated, with little attention given to the issue of whether a Code should be introduced.

Although the Consultation Paper discusses the need to enhance consumer welfare and ensure that there is no impediment to the passing-on of lower prices to consumers, there is no provision in the Code that ensures that these conditions are satisfied. This contrasts with the Competition (Amendment) Act 2006, which includes a competition test and also applies to the grocery sector. If a compelling case can be made that there are business practices that damage competition and consumers in the grocery sector, then such practices should be either prosecuted under the 2006 Act, or the Act should be amended to outlaw them.

The objectives of the Code are inherently contradictory. The Code’s stated purpose is to achieve balance between grocery undertakings, while at the same time increasing consumer welfare and ensuring that there is no impediment to lower prices being passed-on to the consumer. However, in achieving balance the Code proposes to constrain the behaviour of retailers in favour of suppliers so that the Code is likely to lead to a rise in prices for suppliers with no mechanisms or tests for considerations of consumer harm to be taken into account. Amending the 2006 Act where a compelling case can be made would be a better option.

[†]GORECKI, P.K., 2009. “A Code of Practice for Grocery Goods Undertakings and an Ombudsman: How to Do a Lot of Harm by Trying to Do a Little Good”, *The Economic and Social Review*, Vol. 40, No. 4, Winter 2009.