

Symposium **Reform Works**

19.02.2007

Seminar 2B: Retail Trade

Effects from liberalisation of goods trade

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Outline

- Introduction
- Regulatory framework for retail distribution
- Regulation, Costs and Prices
- Comparative Import Price Levels for retail goods
- EU-Integration Effects in Austria after 1995
- Potential price effects in Switzerland through liberalisation of goods trade

Introduction

- Report on liberalisation in the Swiss service sector (SECO)
- Conclusion for Retail Trade:
 - Regulation of distributive activities in Switzerland of about the same magnitude as in the EU on average
 - BUT:
Regulatory impact from other regulations in the Swiss retail Industry higher, primarily through import barriers
- Motivation for follow-up-study on Retail Trade:
 - What effects can be expected from free trade in the Swiss Retail industry?
 - What can we learn from trade-liberalisation in other countries?

Regulatory framework for retail distribution

- Data on Regulation of Retail Distribution
 - Survey from Copenhagen Economics (2005) on behalf of SECO
 - Focus on regulation of «distributive activities»

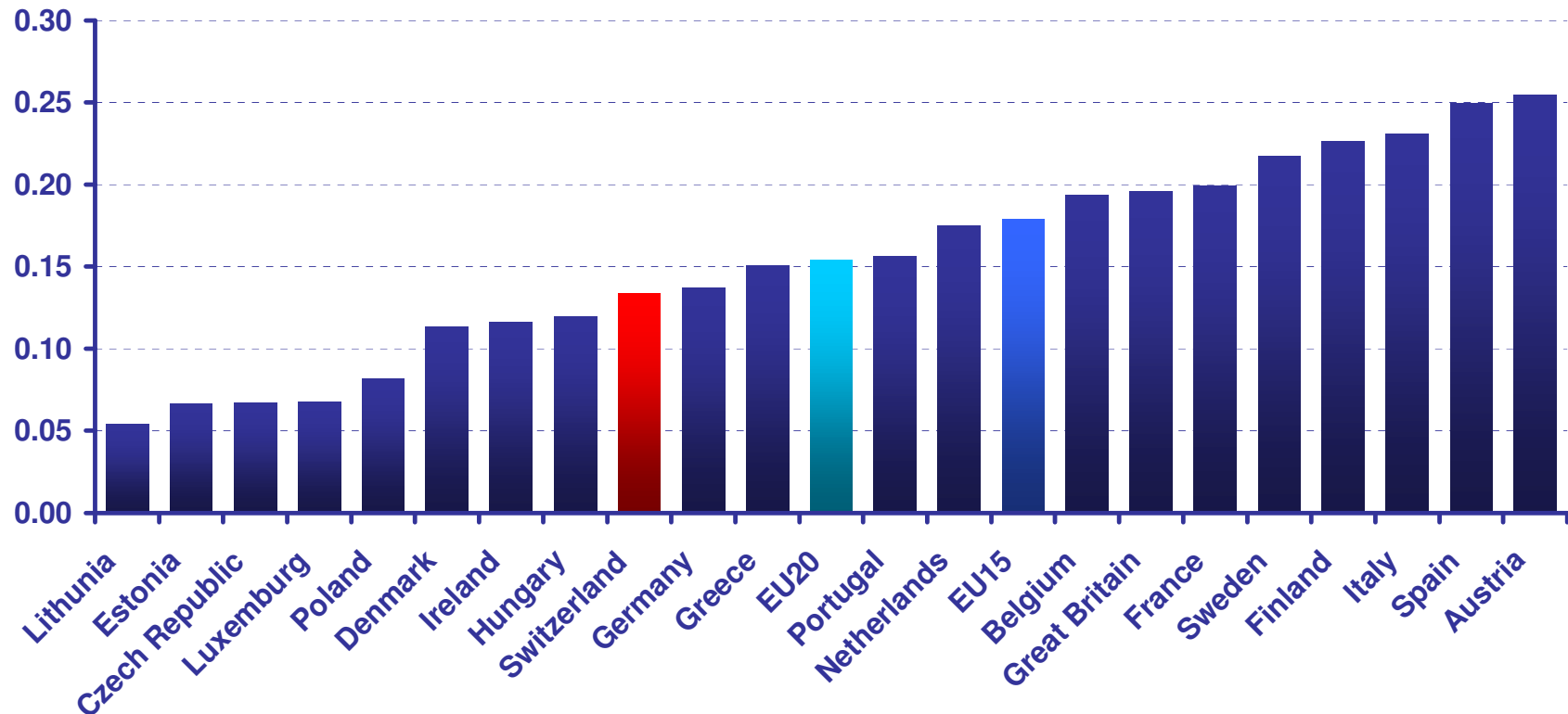
- Regulation of «distributive activities»
 - Market entrance (establishment)
 - Promotion
 - Distribution
 - Sales activities

- Additional regulatory factors with impact on retail trade
 - Zone-planning, barriers in the context of building applications
 - General regulation of product and labour markets
 - Import barriers

Regulatory framework for retail distribution

Regulation of establishment, promotion, distribution and sales activities

Index [0-1], the higher the index value, the more restrictive the regulatory framework is

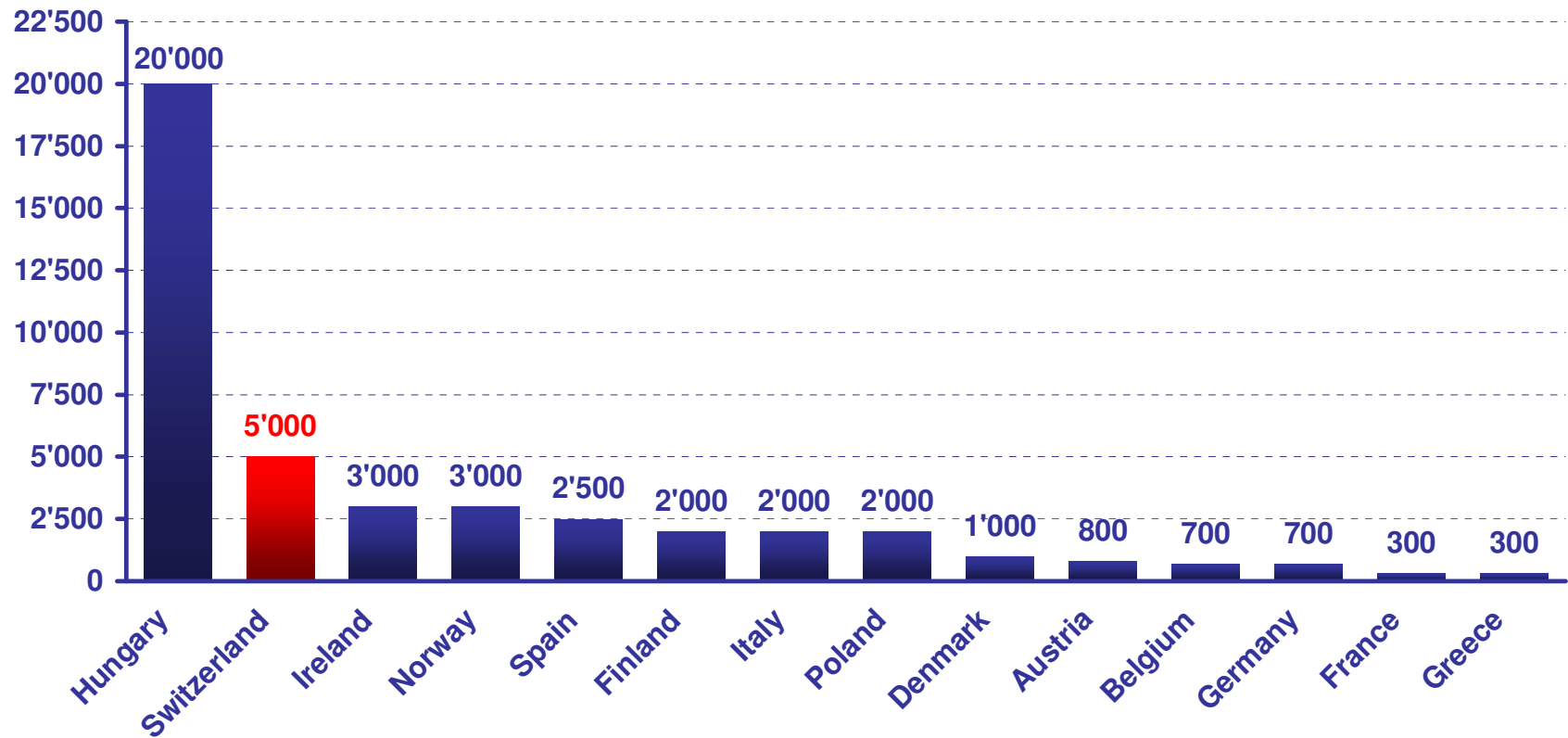


Source: Copenhagen Economics

Regulatory framework for retail distribution

Regulation of large outlets

Threshold surface limit at which regulation of large outlets applies (2003)



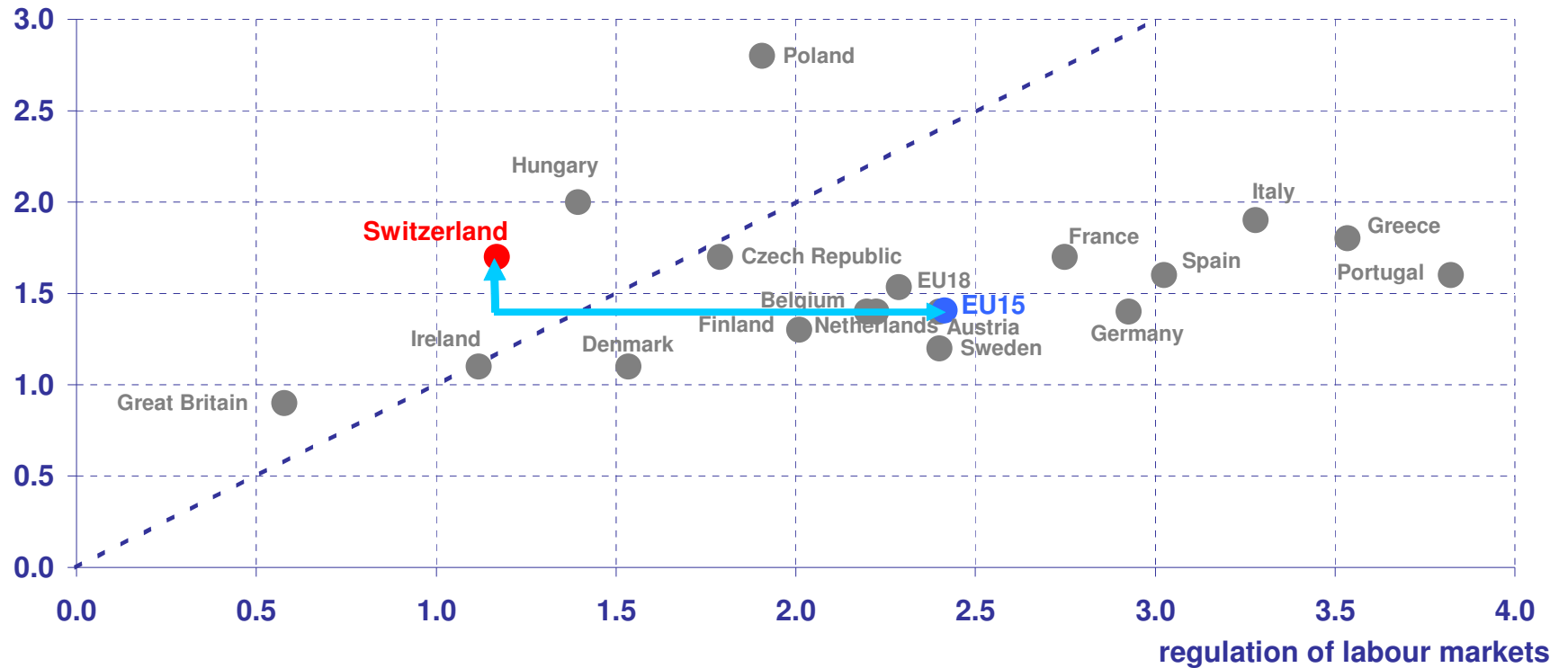
Source: OECD

Regulatory framework for retail distribution

General regulation of product and labour markets

Index [0;6], the higher the index value, the more restrictive the regulatory framework is

regulation of product markets



Source: OECD, Fraser

Regulatory framework for retail distribution

Import barriers

- Tariffs

- Non-Tariff-barriers
 - Technical trade barriers
 - Patents

- Competition regulation
 - limited power of national competition commission in case of cross border vertical collusion

Regulation, Costs and Prices

- Excess regulation leads to inefficiencies and higher production costs
- Relative costs can provide insight into the question of the (relative) magnitude of regulatory impacts in the retail industry
- Relevance of Cost disadvantage as an indication for the relevance of negative regulation impact

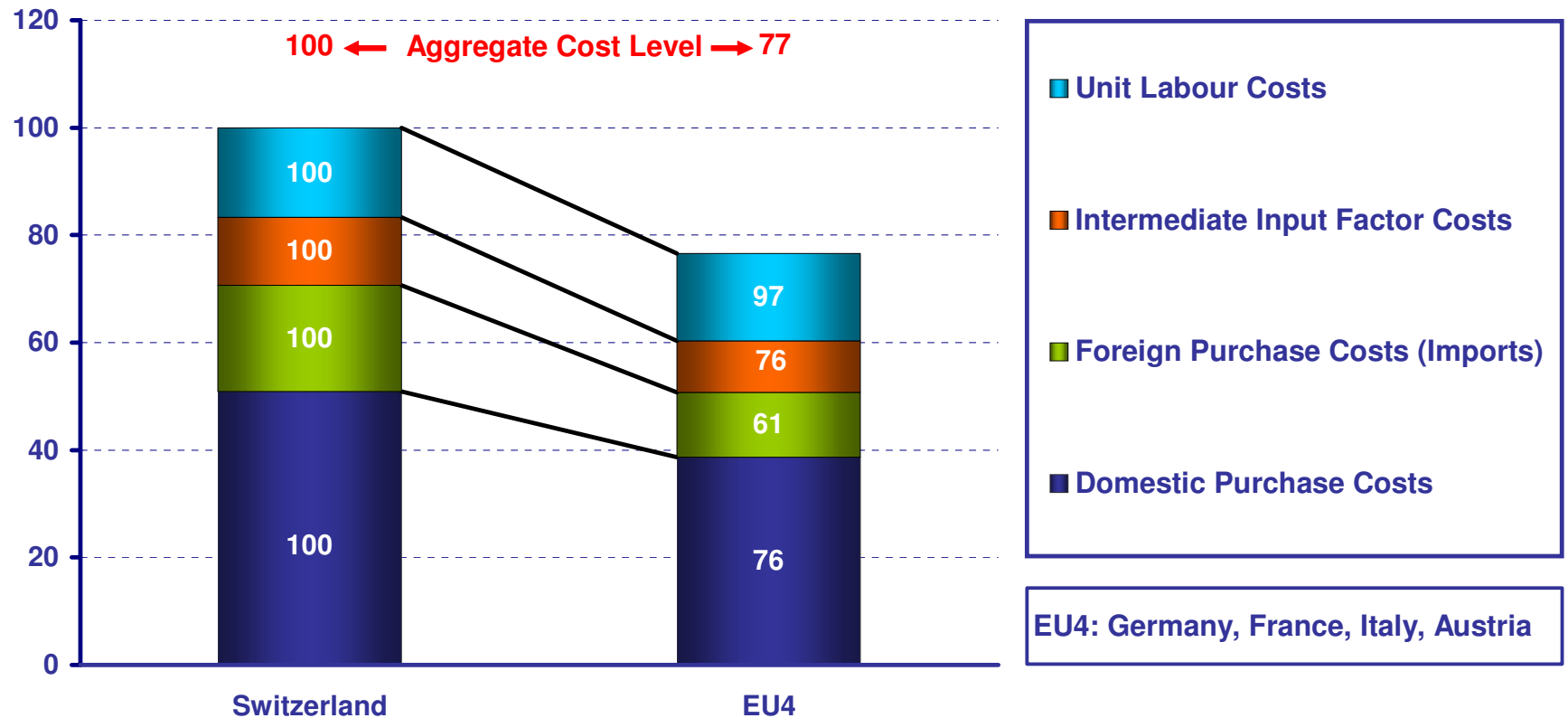
Results on Cost and Price comparisons are taken from

BAK Basel Economics (2006): «International Comparison of Costs and Prices and their determinants in the retail trade industry », study on behalf of IG DHS

Regulation, Costs and Prices

International Comparison of Costs in the retail trade industry

Comparative Cost Levels, Index, Switzerland=100



Source: BAK Basel Economics

Regulation, Costs and Prices

International Comparison of Costs in the retail trade industry

- For the retail industry in Germany, France, Austria and Italy main production costs are on average about 23 percent lower than for the Swiss Retail Industry.
- Mainly due to lower VAT, the consumer price difference is lower than the cost differential and amounts to 15%
- Among the main cost categories the cost disadvantage of the Swiss retail industry is the highest with respect to import costs. The import cost advantage of the EU4 amounts to 30 percent.
- The cost disadvantage with respect to import of goods accounts for about 8 percentage points of the total consumer price differential between the Swiss and the EU4-Retail industry
- About 15 percentage points of the consumer price difference can be attributed to higher domestic purchase and intermediate input costs, which is mainly the result of excess regulation in other domestic markets (energy, agriculture, etc.)

Comparative Import Price Levels

Potential causes for higher Swiss import prices

- Tariffs
 - Cost-disadvantage of the Swiss retail industry relative to EU-counterparts
 - Administrative and transaction costs of tariffs

- Non-Tariff-barriers
 - Technical trade barriers
 - legal prescriptions on the physical characteristics of the product
 - technical regulation of the package, labelling, product permission
 - Patents: national (CH) vs. regional (intra-EU) exhaustion of patent rights

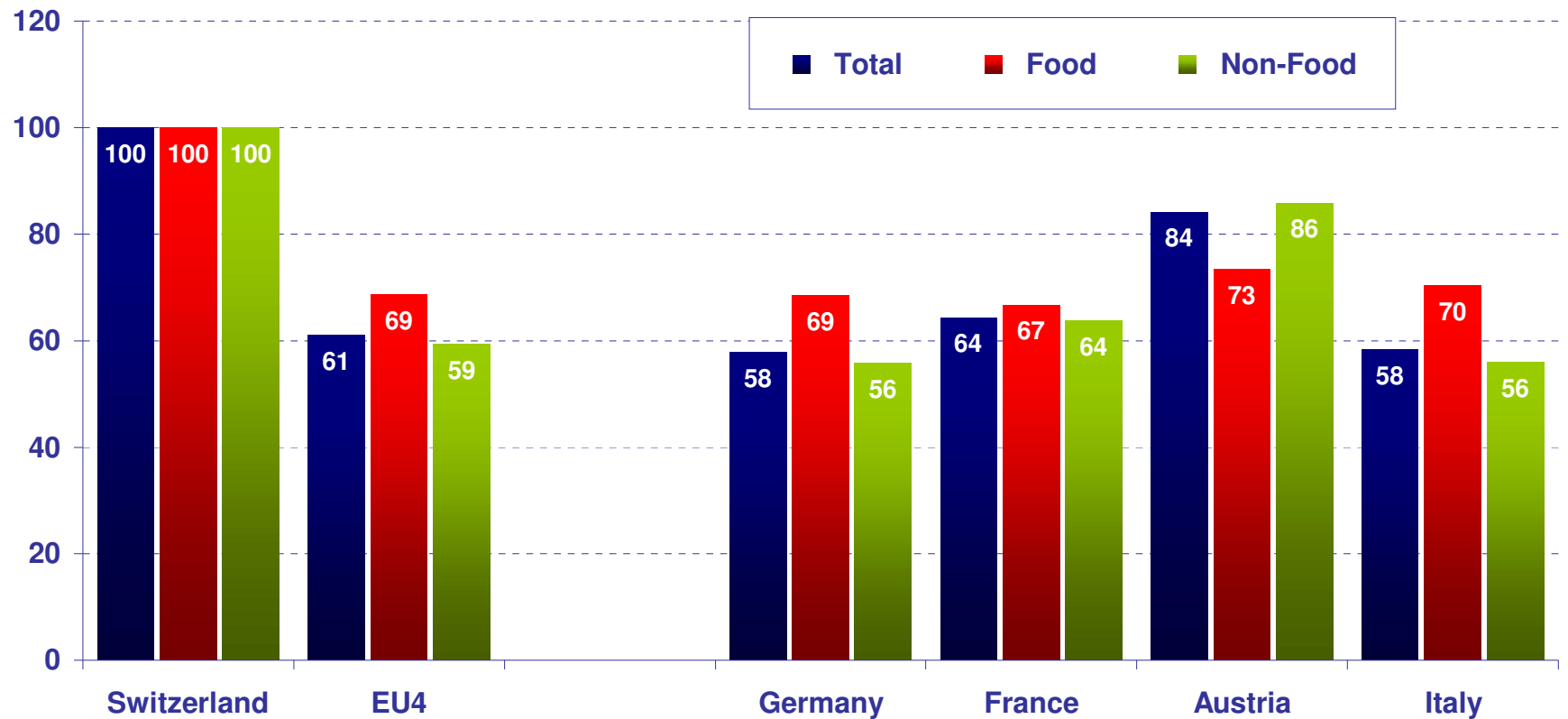
- Further reasons for higher Swiss import prices
 - Collusion
 - Economies of scale

- Interdependencies (technical barriers, patents, collusion)

Comparative Import Price Levels

International Comparison of Import Costs in the retail trade industry

Comparative Import Price Levels, Index, Switzerland=100



Source: BAK Basel Economics

Comparative Import Price Levels

International Comparison of Import Costs in the retail trade industry

- Import Price differences are much higher for Non-Food-products
- Similar import conditions in the 3 big countries Germany, France and Italy
- Huge import price differential between Austria and these 3 countries, especially in the Non-Food-Sector
- This indicates that
 - ⇔.. Economies of Scale play an important role
 - ⇔.. the «Single Market EU» is not perfectly realized so far
- E.o.S. cannot explain the whole picture:
 - ⇔ The combination of technical import barriers, the patent right regime and vertical collusion play an important role

EU-Integration Effects in Austria after 1995

- Trade creation and trade diversion
- Import prices
- Consumer prices

EU-Integration Effects in Austria after 1995

Trade creation and trade diversion

- Trade creation

⇔ Increasing trade volume after 1995 ?

- Trade diversion

⇔ Increasing share of imports from EU-countries ?

- Measurement issues

- $M=P*V \Rightarrow P(-) \Rightarrow V(+) \Rightarrow M(?) \Rightarrow$ Use (real) Volume Index to analyze volume effects
- Very different conditions in Food/Non-Food-sector 1995 \Rightarrow Sector-specific analysis
- Economic Cycle effects \Rightarrow Additional information d(Import/Consumption)

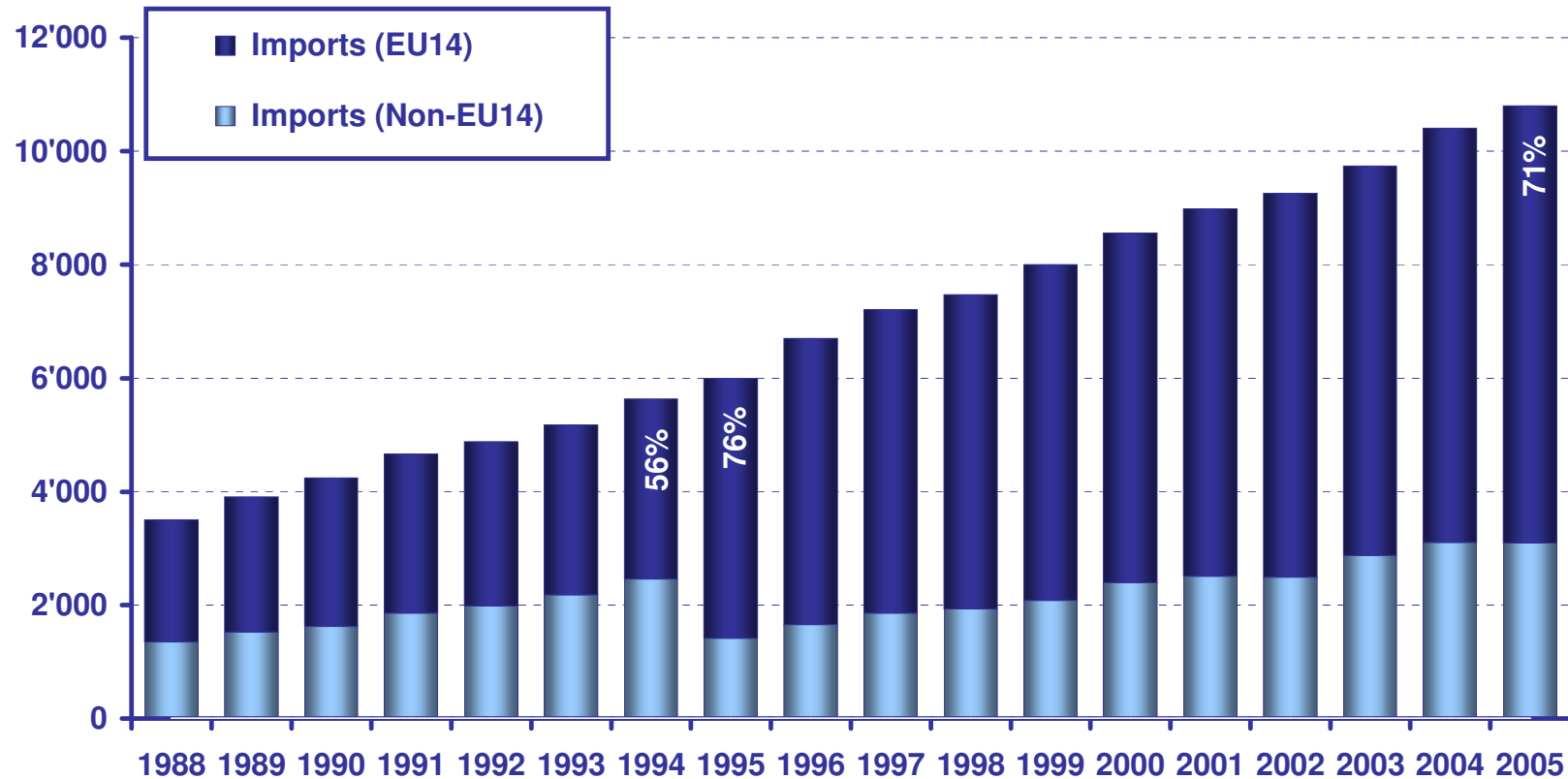
EU-Integration Effects in Austria after 1995

Trade creation and trade diversion

Trade creation ?

Trade diversion ✓

Imports (left scale) of retail goods in current prices



Source: Eurostat, BAK Basel Economics

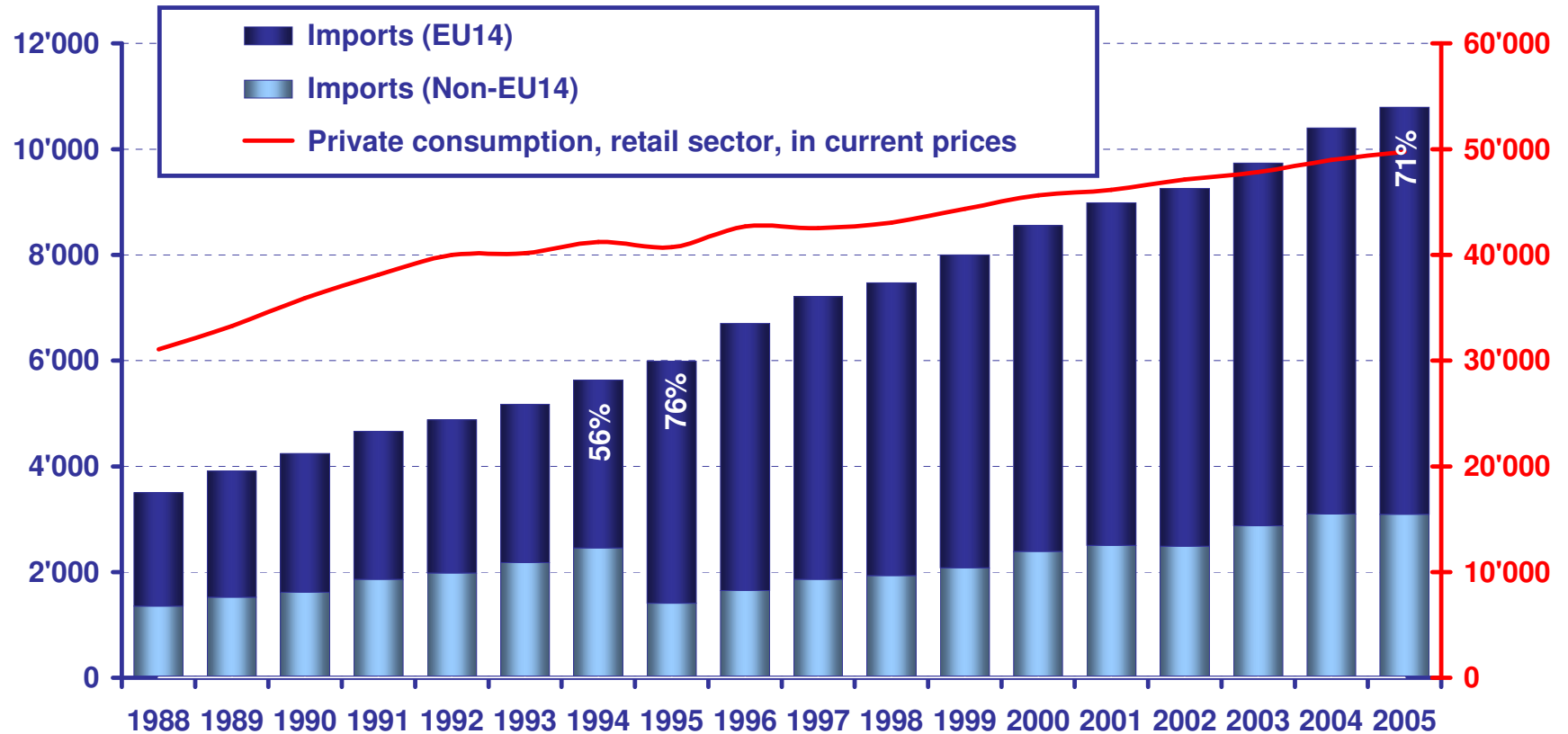
EU-Integration Effects in Austria after 1995

Trade creation ✓

Trade creation and trade diversion

Trade diversion ✓

Imports (left scale) and **private consumption** (right scale) of retail goods in current prices



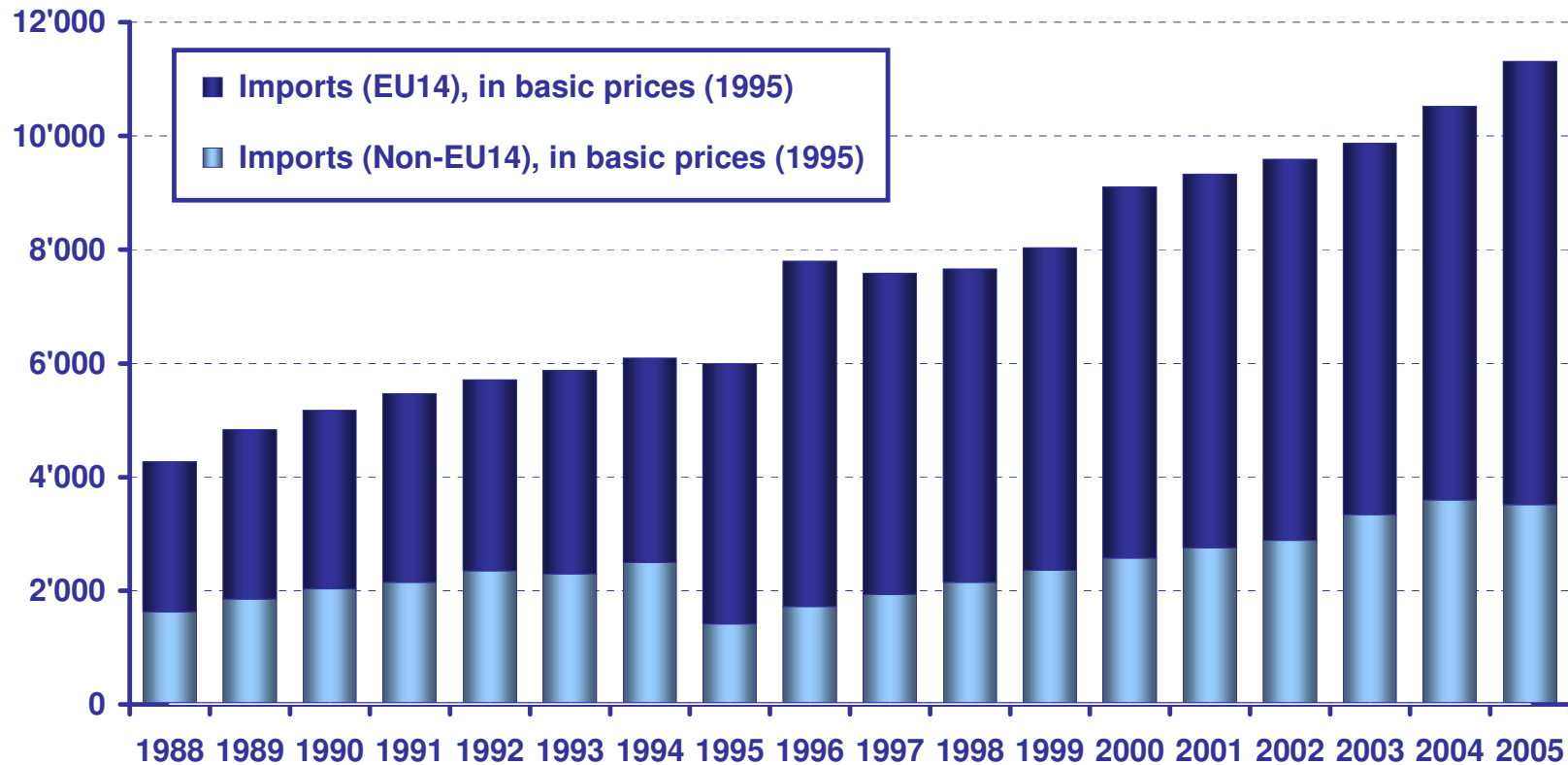
Source: Eurostat, BAK Basel Economics

EU-Integration Effects in Austria after 1995

Trade creation and trade diversion

Trade creation ✓
Trade diversion ✓

Real Imports (left scale) of the retail goods in basic prices (1995)



Source: Eurostat, BAK Basel Economics

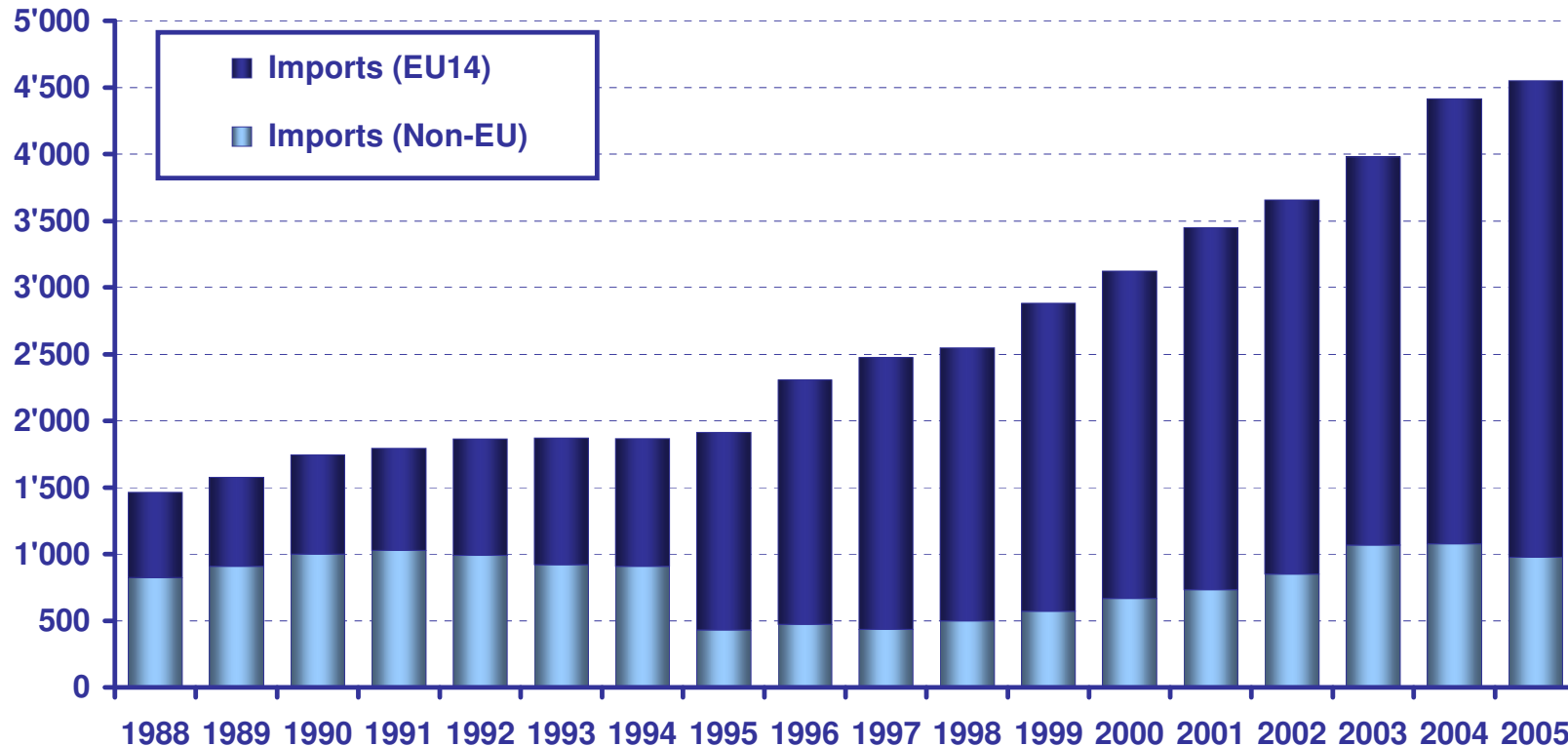
EU-Integration Effects in Austria after 1995

Trade creation and trade diversion

Trade creation ✓

Trade diversion ✓

Real Imports of retail goods, **Food-sector**, in basic prices (1995)



Source: Eurostat, BAK Basel Economics

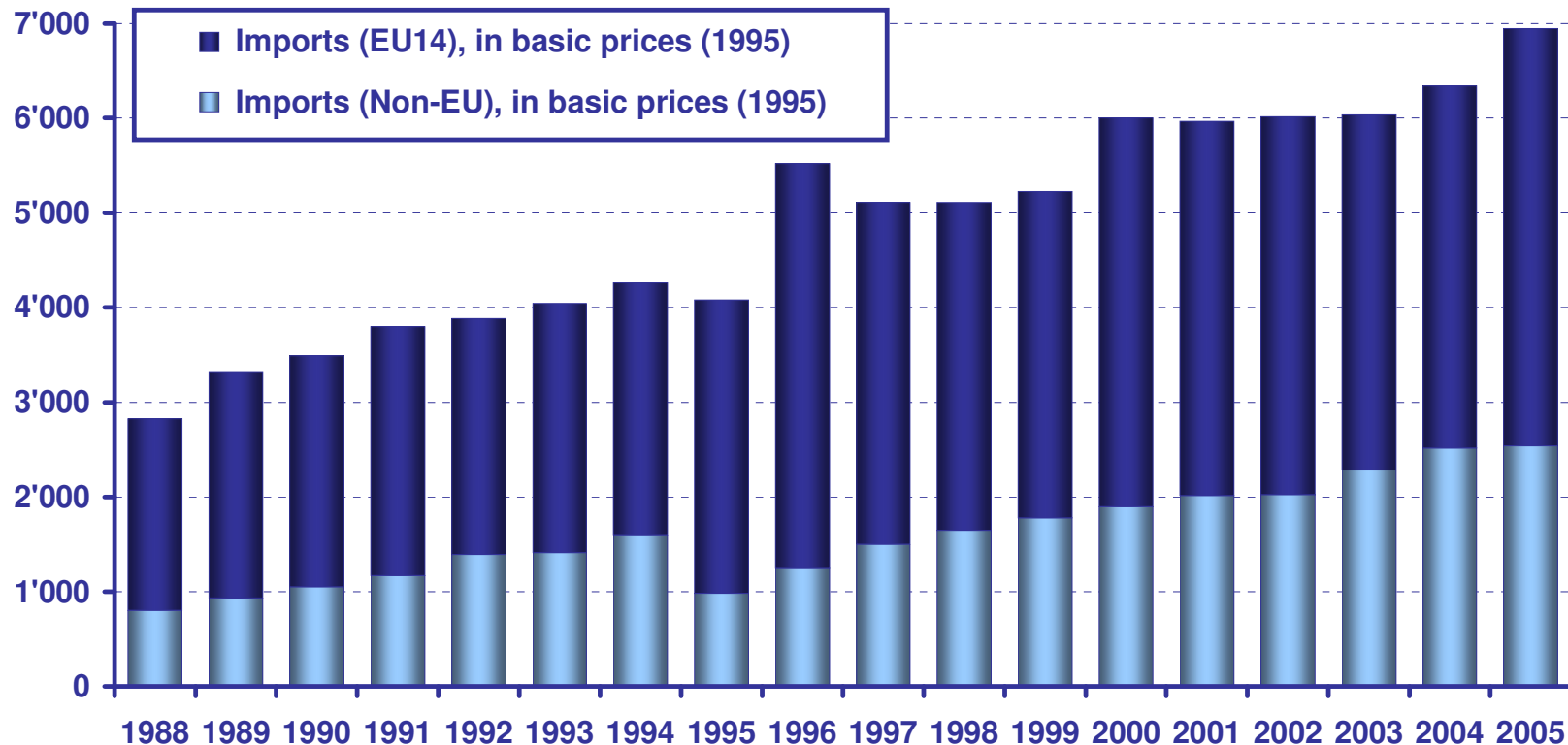
EU-Integration Effects in Austria after 1995

Trade creation ✓

Trade creation and trade diversion

Trade diversion (✓)

Real Imports of retail goods, **Non-Food-sector**, in basic prices (1995)



Source: Eurostat, BAK Basel Economics

EU-Integration Effects in Austria after 1995

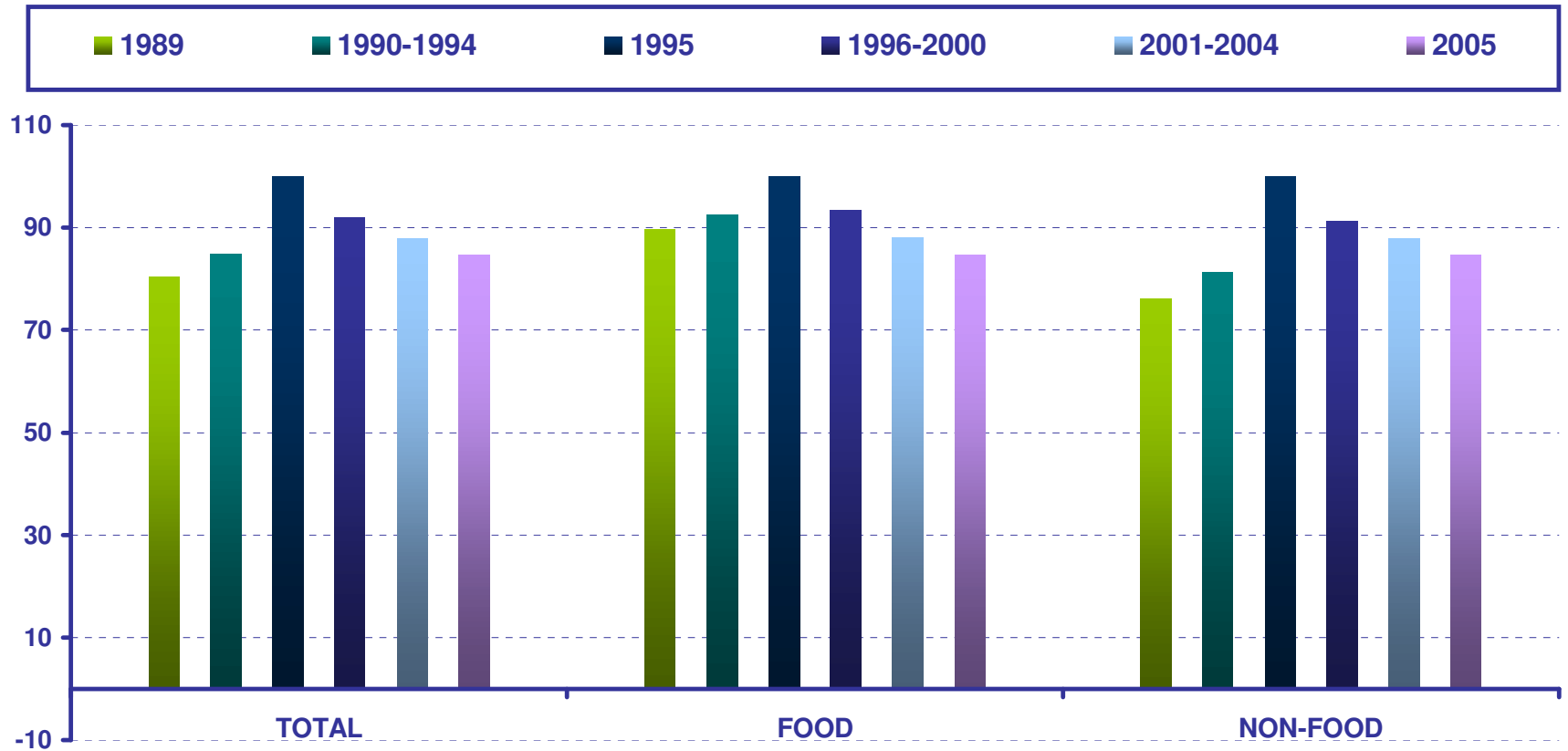
Trade creation and trade diversion

- EU-Integration has led to
 - .. an increase of imports (level and share of consumption) ⇔ trade creation
 - .. an increasing importance of imports from EU-countries ⇔ trade diversion
- Trade effects mainly in the food sector, where trade barriers played a more prominent role

EU-Integration Effects in Austria after 1995

Import prices

Import Price Index, Retail Goods

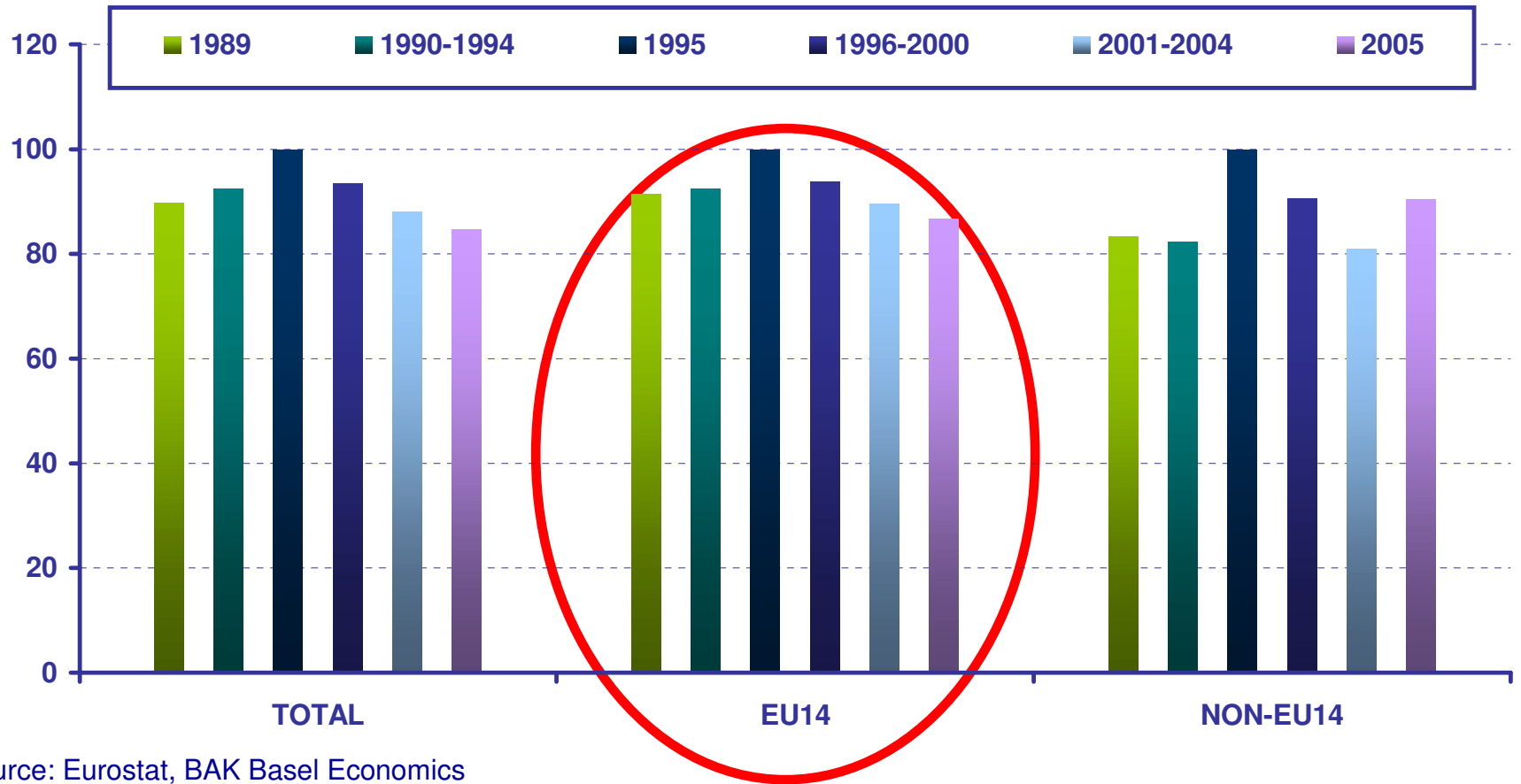


Source: Eurostat, BAK Basel Economics

EU-Integration Effects in Austria after 1995

Import prices

Import Price Index, Retail Goods, **Food-Sector**

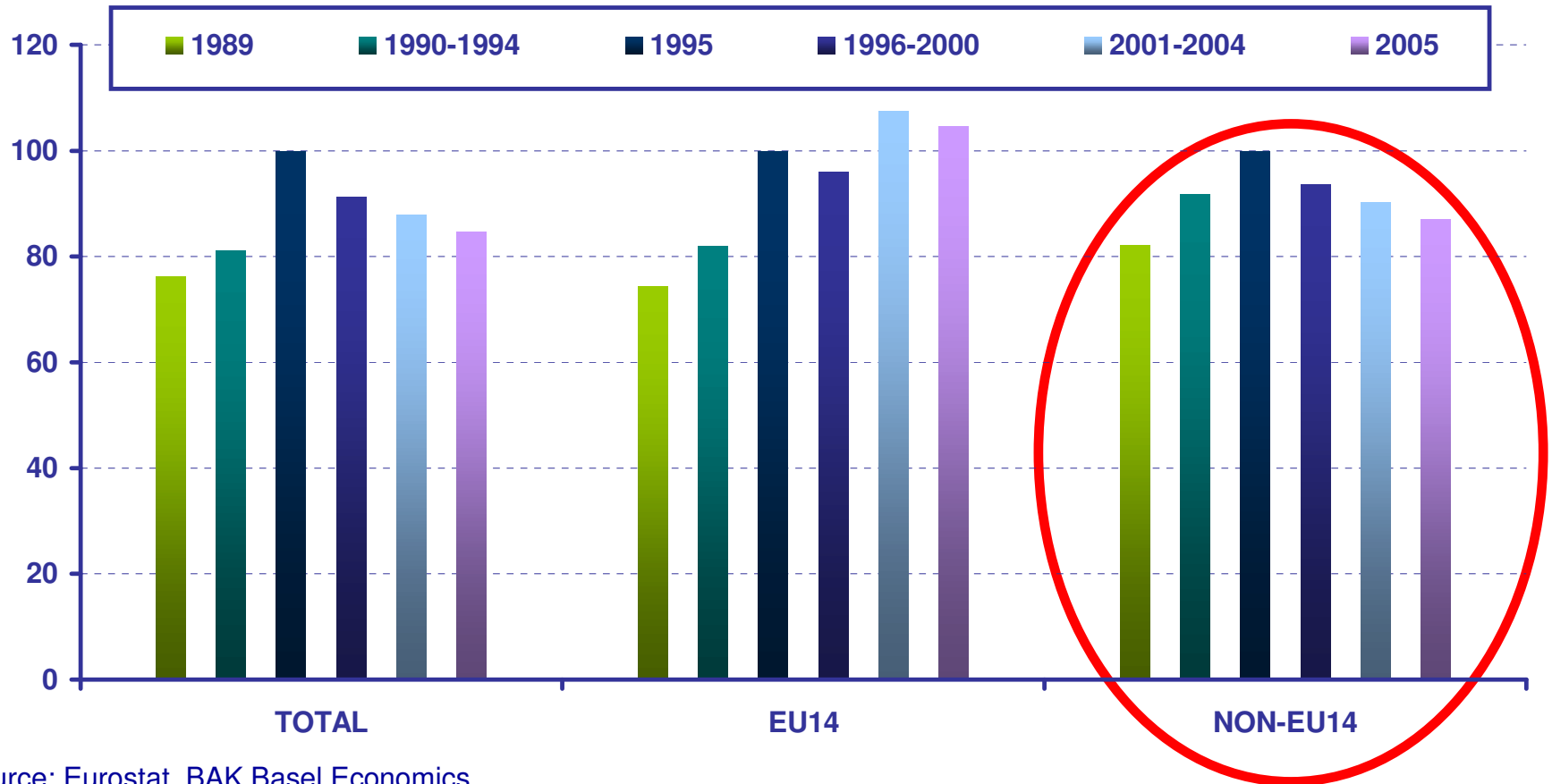


Source: Eurostat, BAK Basel Economics

EU-Integration Effects in Austria after 1995

Import prices

Import Price Index, Retail Goods, **Non-Food-Sector**



Source: Eurostat, BAK Basel Economics

EU-Integration Effects in Austria after 1995

Import prices

- Measurement issue
 - «Structural break» in statistical data in 1995?

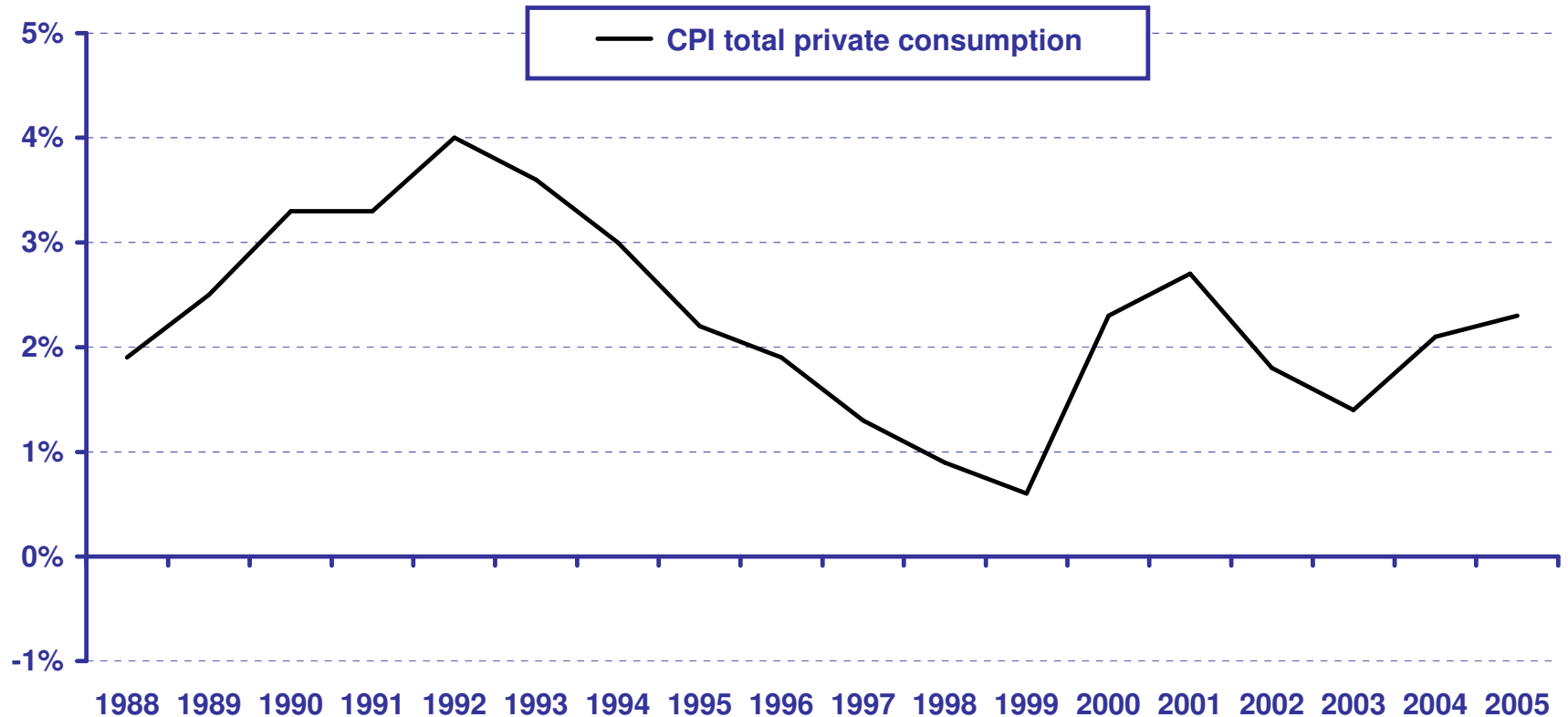
- EU-Integration has led to decreasing import prices / import price inflation

- Strong structural/regional aspects
 - Food import prices decline from Intra-EU-imports (-13% from 1995-2005)
⇔ EU-Integration Effect
 - Non-Food import price decline from Out-of-EU-imports (-13% from 1995-2005)
⇔ Globalisation

EU-Integration Effects in Austria after 1995

Consumer prices

Consumer Price Index, annual growth rates

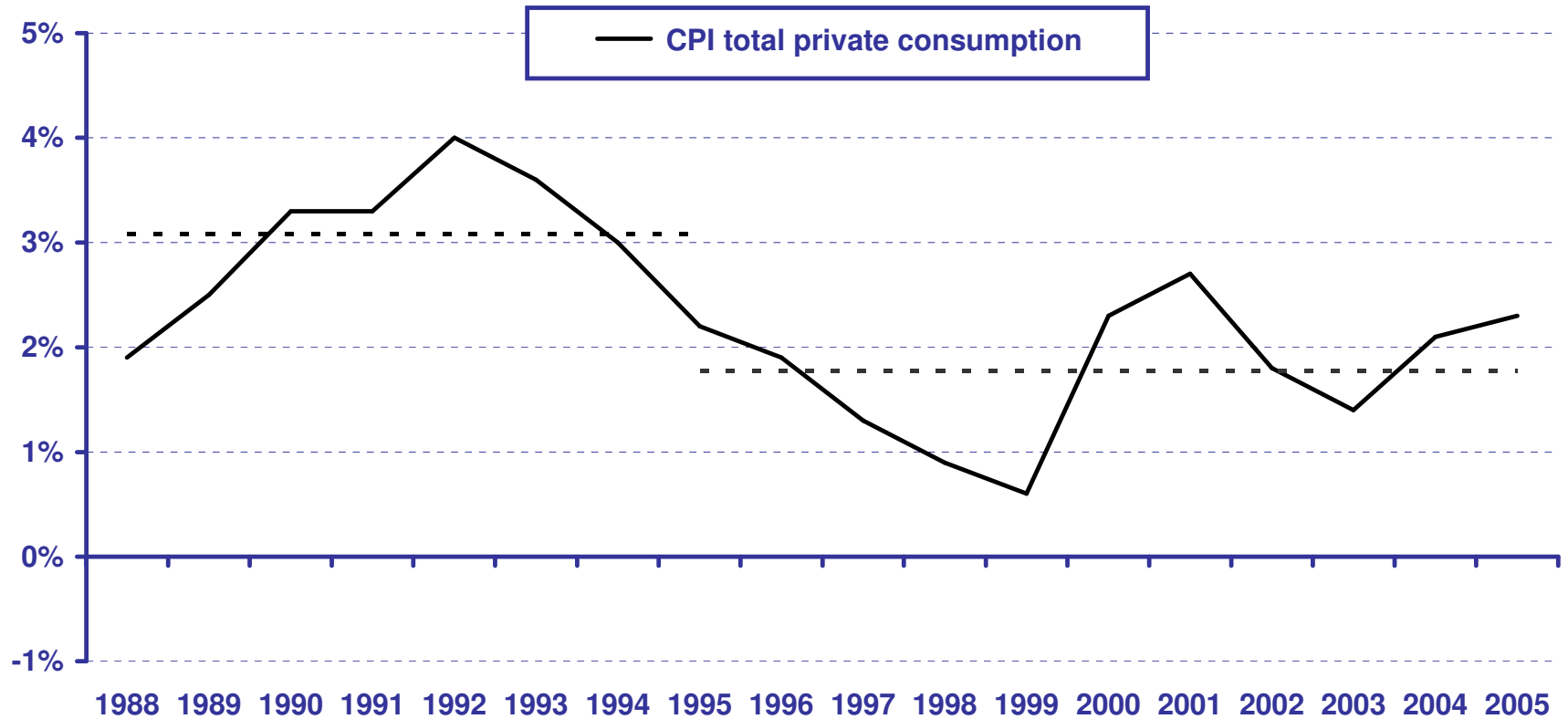


Source: Eurostat, Statistik Austria

EU-Integration Effects in Austria after 1995

Consumer prices

Consumer Price Index, annual growth rates

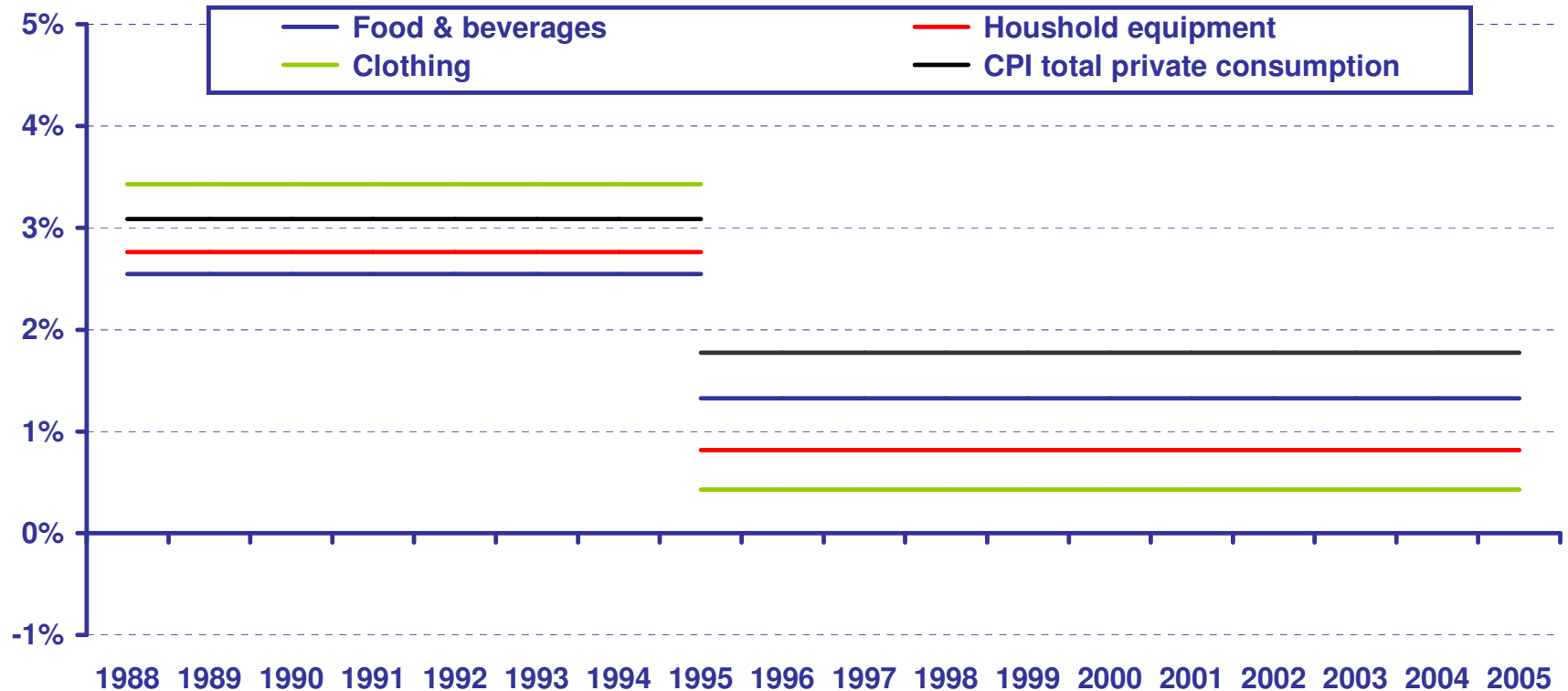


Source: Eurostat, Statistik Austria

EU-Integration Effects in Austria after 1995

Consumer prices

Consumer Price Index, annual growth rates

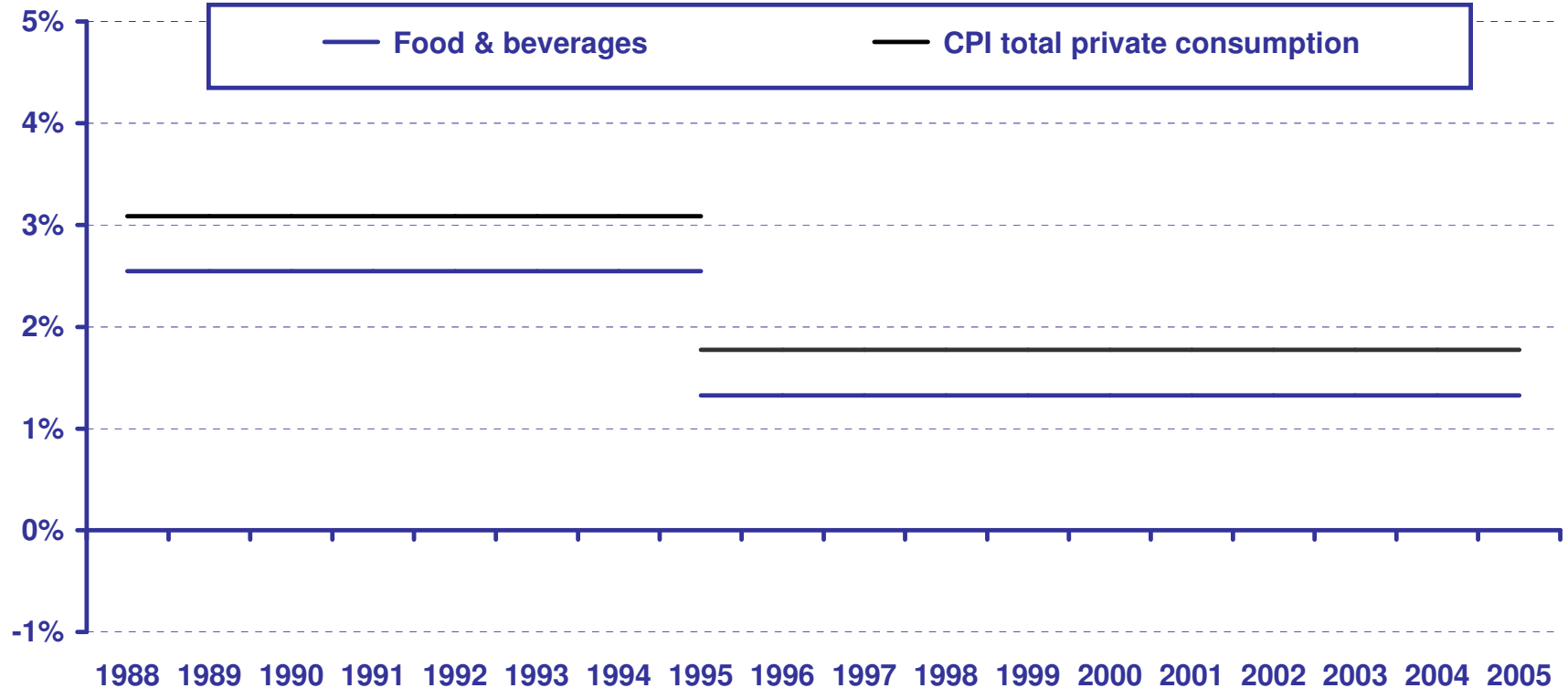


Source: Eurostat, Statistik Austria

EU-Integration Effects in Austria after 1995

Consumer prices

Consumer Price Index, annual growth rates

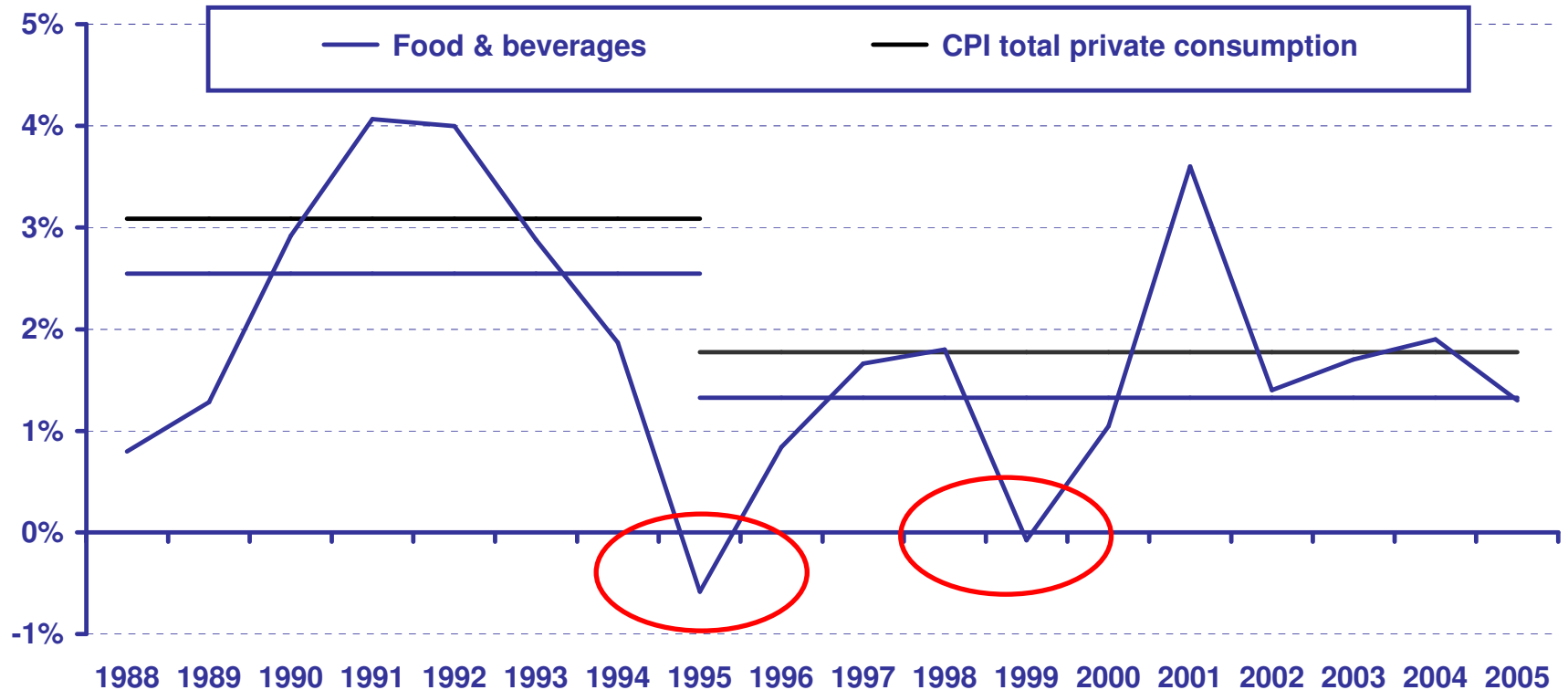


Source: Eurostat, Statistik Austria

EU-Integration Effects in Austria after 1995

Consumer prices

Consumer Price Index, annual growth rates



Source: Eurostat, Statistik Austria

EU-Integration Effects in Austria after 1995

Consumer prices

- EU-Integration has led to a substantial decrease in consumer price inflation
 - Higher competition
 - Lower costs

- Cost savings through lower import price (inflation) as expected
 - BUT: cost savings not completely put through to the consumer

- Food-prices show no level effect, only lower growth of prices
 - ⇔ Other EU-wide factors (BSE, etc.)

- Relative to the EU-average food prices declined by 6% between 1995-2004
 - ⇔ With increasing competition, cost savings have been put through to the consumer

Potential price effects in Switzerland through liberalisation of goods trade

Scenario «FREE TRADE» : liberalisation of goods trade

Assumptions scenario « FREE TRADE » :

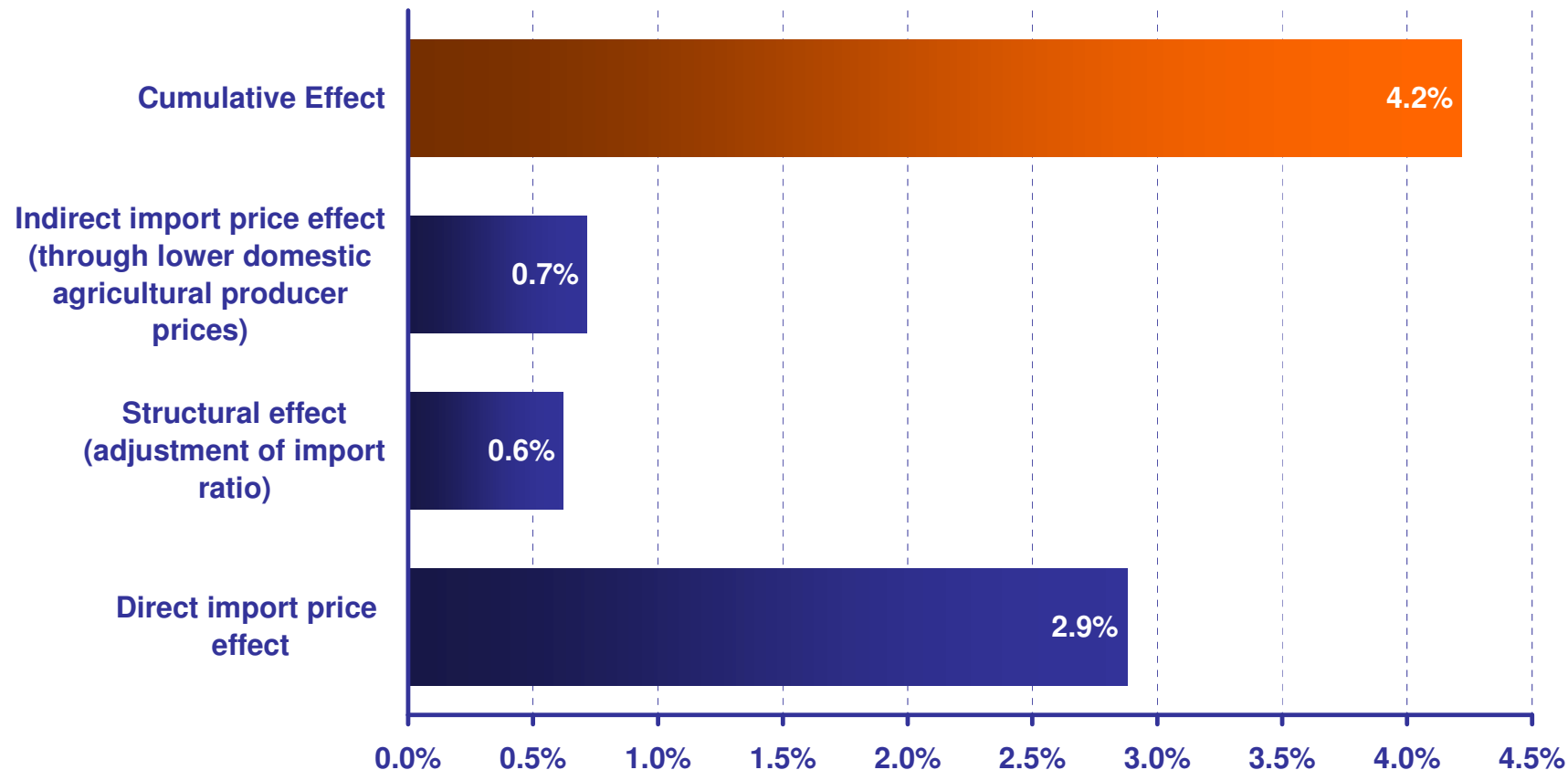
- No more import price differences due to Tariffs or Non-tariff barriers
 - Import price differential shrinks to its «structural» component (e.o.s.)
 - «Structural» component is comparable to Austria's relative position
- Import ratio adjusts to new price relations
 - Austrian import ratios

Model

- Comparative static analysis
- No feedback effects
- Key Variables: Price Levels relative to EU4 (Germany, France, Austria, Italy)

Potential price effects in Switzerland through liberalisation of goods trade

Scenario «FREE TRADE »: Cost effects



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Potential price effects in Switzerland through liberalisation of goods trade

Scenario «FREE TRADE ++» : additional liberalisation of product markets

Additional assumptions scenario « FREE TRADE ++ » :

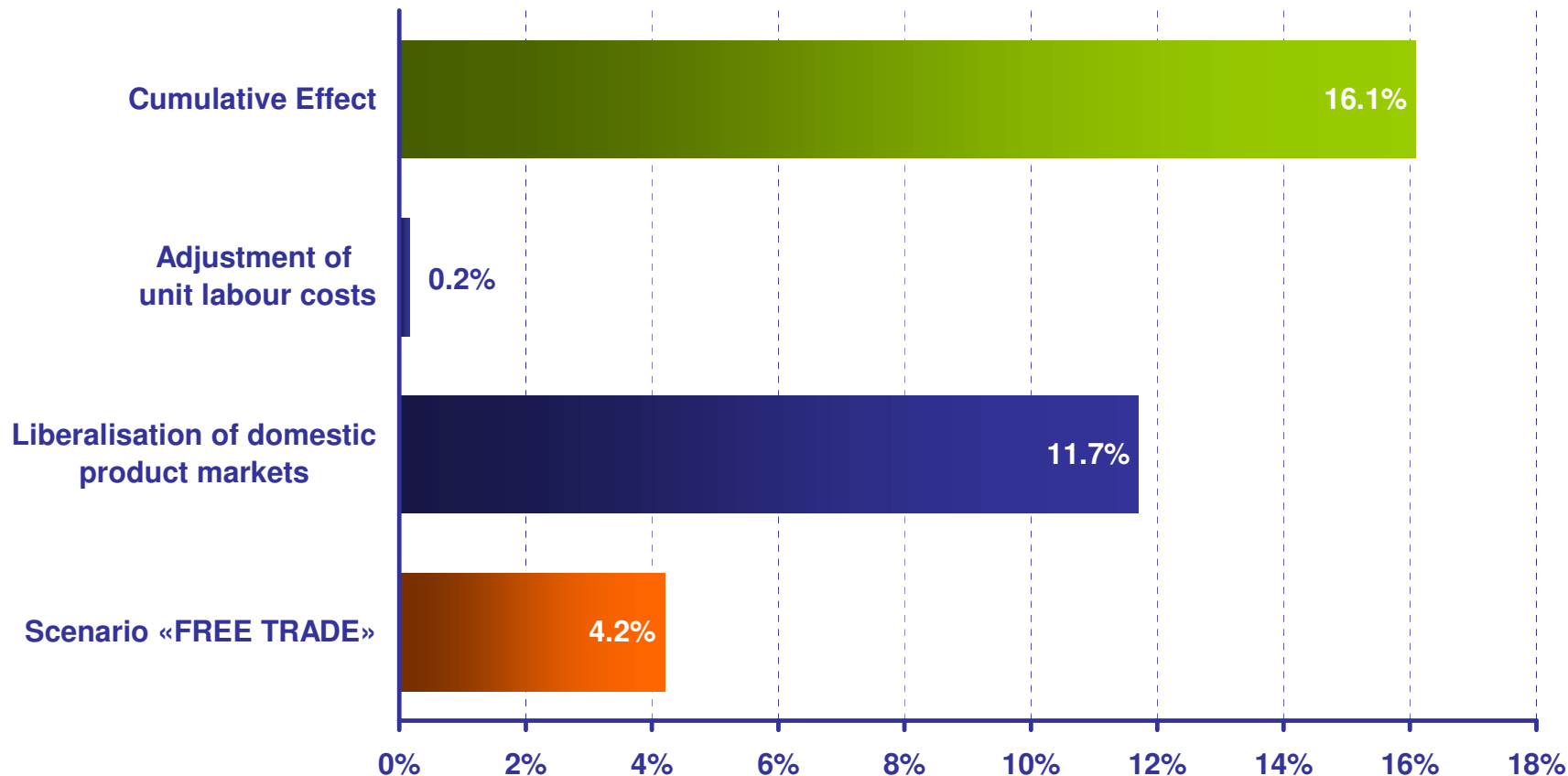
- No more higher domestic producer prices (energy, agriculture, etc.) due to regulation
 - Producer price differential shrinks to its «structural» component
 - «Structural» component is comparable to Austria's relative position
- « Production Process » adjusts to new price relations
 - Austrian input structure

Model

- Comparative static analysis
- No feedback effects
- Key Variables: Price Levels relative to EU4 (Germany, France, Austria, Italy)

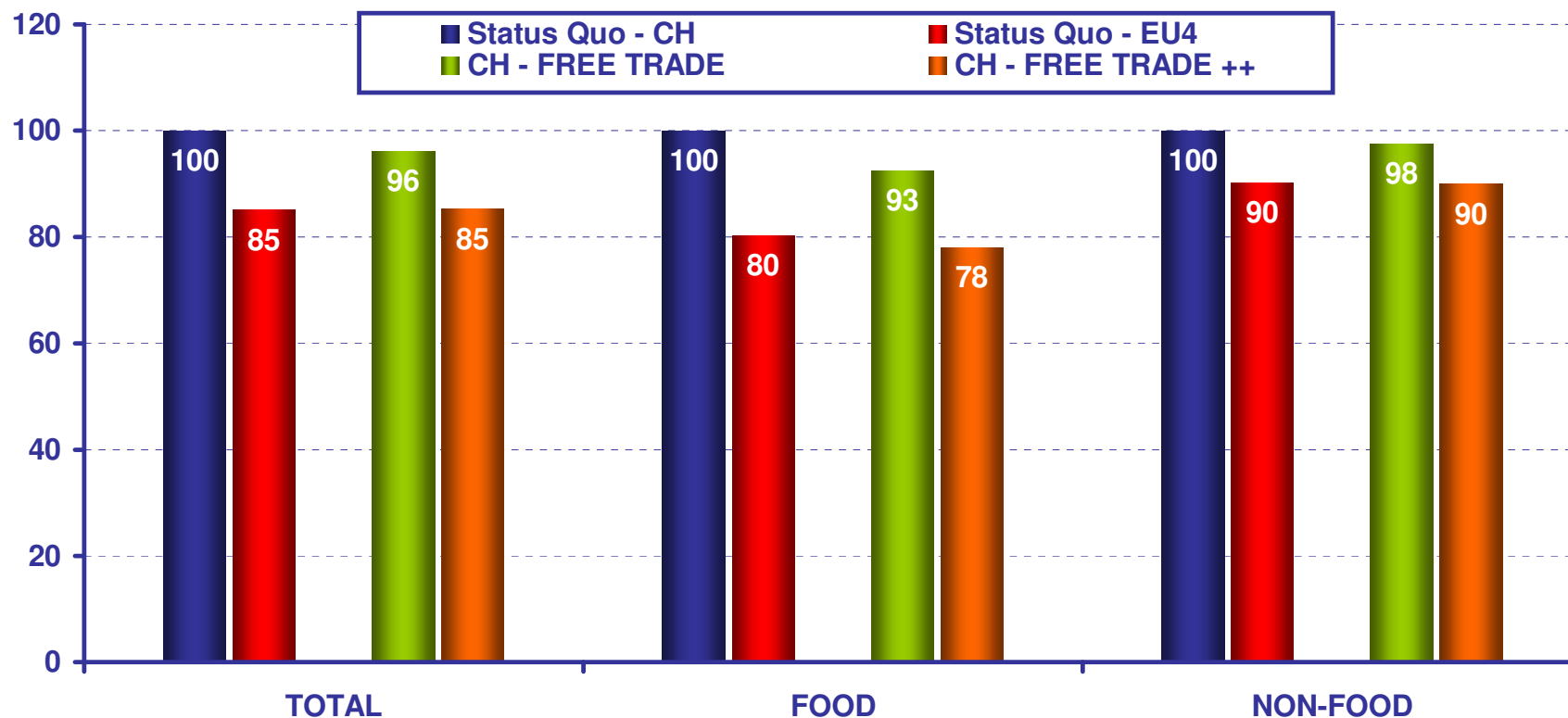
Potential price effects in Switzerland through liberalisation of goods trade

Scenario «FREE TRADE ++»: Cost effects



Potential price effects in Switzerland through liberalisation of goods trade

Scenario analysis: price effects



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Potential price effects in Switzerland through liberalisation of goods trade

- Scenario results imply significant price effects in the case of a liberalisation of goods trade (Scenario FREE TRADE)
- Potential Price decline is about 4%
 - Food-sector: 7%
 - Non-Food-sector: 2%
- Still substantial higher consumer prices compared to EU4
- General deregulation of domestic industries leads to a distinctive additional price effect (Scenario FREE TRADE ++)
 - Still higher Costs in Switzerland (due to structural effects)
 - Prices on EU4-average-level with current VAT-rate-relations

Summary (1)

- Regulation

- Regulation of distributive activities in Switzerland of about the same magnitude as in the EU on average
- Regulatory impact from other regulations in the Swiss Retail Industry higher, primarily through import barriers

- Regulation and Costs

- Large cost disadvantage of the Swiss Retail Industry with respect to import prices
- About 8 %-pts of the price differential to the EU4 (15%) can be attributed to higher import prices
- Higher import prices can be explained with
 - Import barriers
 - Economies of Scale

Summary (2)

- EU-Integration Effects in Austria after 1995
 - Trade creation and Trade diversion:
 - Increasing relevance of imports for procurement in the retail industry
 - Increasing relevance of the EU- (Food-) Market
 - Import and consumption prices
 - Substantial decline in import prices
 - Food-prices show no level effect, only lower inflation rate
 - With increasing competition, cost savings have been put through to the consumer

Summary (3)

- Scenario-Analysis:

- Scenario results imply significant price effects in the case of free trade
- Potential Price decline is about 4% (Food: 7%, Non-Food: 2%)
- Still substantial higher consumer prices compared to EU4
- General deregulation of domestic industries leads to a distinctive additional price effect

- Policy Implications

- Positive free trade effects in the retail industry (lower costs, higher competition)
- Maximal erosion of higher price level only with general product market deregulation