



From the Minister

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
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The Rt Hon Norman Tebbit MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1 Victoria Street
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16 March 1984

COMPETITION POLICY

Thank you for your letter of 17 February about the Prime Minister's initiative on the promotion of competition. I attach a note which sets out our response to the questions annexed to your letter.

Where appropriate, the note touches on those food products whose marketing is subject to statutory measures. Particularly in the case of milk, for reasons that will be known to you, we are proceeding as agreed in Cabinet and therefore have regarded it as an issue to be pursued separately from, although in parallel with, this present exercise.

I shall be taking a close personal interest in the progress of the examination, but I suggest that Alex Fletcher should make contact with John MacGregor for further discussion. Mr Gordon Myers is the Under Secretary who is acting as focus here at official level.

Copies of this letter go to the Prime Minister, other members of Cabinet and to Sir Robert Armstrong.

MICHAEL JOPLING

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COMPETITION POLICY

FOOD AND DRINK PRODUCTS

Introduction

1. Articles 85 to 90 of the Treaty of Rome, which relate to rules on competition, apply to the production of and trade in agricultural products (defined as the products of the soil, of stock farming and of fisheries and products of first stage processing directly related to these products) only to the extent determined by the Council. The Council issued in 1962 Regulation 26 concerning the application of the rules on competition in agriculture. This Regulation provides that Articles 85 and 86 are not applicable to most agricultural agreements, namely agreements which form an essential part of a market organisation or concern the production and sale of agricultural products.

2. Although food and drink manufacturing and distribution in the UK are both relatively concentrated, they nevertheless constitute an area of intense competition. This is largely a consequence of the dominant position held in retail distribution by a few very large and highly efficient chains of multiple grocers who are competing vigorously with each other for market share and for the remaining available sites suitable for superstore expansion. However, volume is critical to the profitability of most food manufacturing enterprises; they are very dependent on maintaining the custom of two or three very large retailer buyers; and they are consequently subject to increasing pressure from those buyers. This has not yet developed to the point where manufacturers' margins are being subjected to intolerable pressures, but there does appear to be a growing imbalance.

3. The crucial issue for the next few years is therefore whether the continued fairly ruthless exercise of retailer power will undermine the ability of our food manufacturing

industry to compete effectively with overseas suppliers by depriving it of the necessary funds for investment in research and innovation, a particularly important consideration at a time of rapid technological change. This is an issue which the Minister of State for Trade is encouraging the Director General of Fair Trading to look into in consultation with the departments concerned and this paper does not pursue it further. But it seems likely to be the major threat to fair and effective competition in food manufacturing in the next five years.

4. Another important factor is the ease of entry into the UK food and drink market for overseas suppliers. Our highly efficient and centralised retail distribution system makes market penetration by imports into the UK probably easier than into any other Community country. This has the advantage from the competition point of view that it provides a strong spur towards greater efficiency for our manufacturing industry. But there are also elements of unfair competition underlying parts of this trade, for example anomalies in the operation of the Common Agricultural Policy (eg the unsatisfactory method of calculating monetary compensatory amounts on processed foods), which are not conducive to effective competition in the long run. The adverse trade movement since 1973 in some of the more highly processed foods such as sugar and chocolate confectionery and biscuits is one of the results. In terms of the benefits of competition outlined by the Prime Minister in her minute, there can be some short term gains for the consumer from such a development in terms of lower prices. But in the longer run the domestic industry will suffer, competition will decrease to the detriment of the consumer and our industry's products will be less able to hold their own on world markets, and these developments would be clearly contrary to the objectives outlined by the Prime Minister.

5. Against this background, the following are the answers to the specific questions posed in the Annex to the letter from the Secretary of State for Trade and Industry. It will be apparent that in seeking to identify ways to achieve more effective competition, we have in mind two main objectives - first, to increase competition, but, secondly, to achieve fairer competition.

Question 1

6. Last year the Government used the occasion of the revision of the Community regulations on exclusive purchasing agreements to seek and obtain an arrangement which will open up the longstanding brewery tie without undermining the economy of the public house system. Under the previous arrangements, tenants of public houses were severely limited in the range of drinks which they could sell and in the sources from whom they could buy. Under the new provisions, tenants can obtain a full range of drinks for which there is a reasonable demand and independent drink manufacturers and wholesalers will have greater opportunities to compete for sales to public houses.

7. The Government have recently reviewed the arrangements for market support of potatoes with the objective of promoting greater commercial competitiveness and giving further encouragement to better marketing in response to the requirements of processors and consumers. Changes in the financing of market support measures which were announced by the Government on 29 February will place greater responsibility on the Potato Marketing Board (and hence on producers) for meeting the cost of the Board's support buying operations. Since 1979 the UK potato market has been open to imports and British growers and processors are having to compete in terms of quality, variety and price with the imported product. Therefore, though potatoes are still a Government supported crop, the level of the guaranteed price and the value of Government support has been substantially eroded in real terms since 1979, so compelling producers to seek their returns increasingly through the more efficient marketing of the crop and in competition with imports.

8. So far as intra-Community trade is concerned, the Government have also made strenuous and continuing efforts to eliminate illegal national aids in the Community since these clearly inhibit competition. The previous Minister made a major issue of national aids during his Presidency of the Agriculture Council in 1982 although, since the initiative lies with the Commission, only limited progress was achieved. Similarly, we have supported measures in the Community to remove legislative barriers to intra-Community trade in foodstuffs. In particular we gave strong support to the labelling directive and were one of the few Member States fully to apply its provisions from the prescribed date. We have also, following the ruling of the European Court, opened up the UK market to competition from imports of UHT milk.

Questions 2 and 3

9. The major questions in the food and drink manufacturing and distribution sector are whether the concentration of retailer buying power will continue to increase, whether (either through abuse of a dominant position or otherwise) this will threaten to undermine the viability of food and drink manufacturers and whether consequently their ability to compete with overseas suppliers will be weakened. Preliminary investigation of this problem, and particularly of alleged abuses of buying strength, is being undertaken by the Office of Fair Trading.

10. Over the next three years it is hoped to make new Regulations on food labelling designed to provide improvements in information to the consumer, notably on nutritional aspects and on meat products. An informed consumer is obviously an essential element in effective competition.

11. The decision to open the market to imports of UHT milk has opened the way for the abolition of Government control of the maximum prices for liquid milk, which is no longer necessary now that consumers have available an alternative supply. The Minister of Agriculture has announced his intention of bringing these controls to an end by the end of 1985 at the latest and has opened

consultations with the interests concerned about the implementation of this decision. There has been considerable Ministerial discussion of the much wider question of whether any other changes are needed in our present system of milk marketing and the Minister of Agriculture has been invited in consultation with other Ministers concerned to examine future marketing arrangements for milk and to bring forward the results of the examination and recommendations for discussion by the summer or as soon as possible thereafter.

12. At the request of Ministers, the Sea Fish Industry Authority has prepared a fish market development plan which it is hoped to implement over the next five years. This will include a number of measures designed to improve competition in the fish market. In particular, consumer education should lead to greater consumer awareness in purchasing fish. Improved methods of rapid dissemination of market information should lead to more effective competition between ports and markets in the UK. The development of retail outlets for fish should lead to greater competition at the retail stage.

13. Where appropriate, the Ministry is continuing to pursue in negotiations in the Community the removal of artificial barriers to trade through harmonisation of food standards and to press for the removal of discriminatory taxation on alcoholic drinks, including prompt application of Court judgements, and for removal of illegal national aids.

14. The Ministry is examining jointly with the Department of Trade and the FCO the arrangements for imports of bananas to see whether there is scope for increasing competition without prejudice to our longstanding Treaty obligations to the Commonwealth Caribbean suppliers.

15. The Department of Trade and Industry are considering various aspects of competition in the professions. We are particularly concerned with the veterinary profession (which has reservations about the proposal to introduce advertising) and we have an interest in any proposals which are likely to affect that profession.

Question 4

16. Apart from the courses of action already referred to in answer to the preceding questions, there are various specific measures which could be taken to improve competition in the industry, although some would raise obvious difficulties.

17. The most striking would be to end the distortion of competition created by the retention of VAT on certain foods. This discrimination prevents, for example, producers of chocolate biscuits from competing effectively with producers of other biscuits, ice cream from competing with other desserts or soft drinks with fruit juices. The financial constraints and the problems in Brussels which make it difficult to make such a change are however recognised.

18. Another area where competition might be improved, but which would require legislation, is in sales of alcoholic drinks. There has been a marked switch in the pattern of consumption from pub to home as a result of the rapid growth in supermarket sales of alcoholic drinks. The constraints on competition by the public houses could be eased to some extent (without risk of increase in consumption, let alone misuse of alcoholic drinks, if experience in Scotland is any indication) by extending south of the border the flexible licensing hours which operate in Scotland, as was recently urged by the Food and Drink Manufacturing EDC. This would not entail any longer opening hours in total, but only the facility to adjust hours of opening to suit consumer needs. Different arrangements might be necessary to take account of differences between England and Wales.

19. We also need to take continuing action to redress the imbalance between the terms of competition under which imported alcoholic drinks are able to compete on our market and the obstacles with which ours have to contend in overseas markets both of third countries and the European Community. In the Community the Court provides some protection to our manufacturers but we have to contend with failure to comply with judgements, or compliance only after a long period. The legal and administrative devices adopted in other Member States make it impossible for our own industry successfully to combat these without help from Government.

Question 5

20. The agriculture and food industries are inevitably affected by the degree of competition in related sectors. The following are a few of the areas where action might prove beneficial:

- (a) Energy is frequently quoted by food and drink manufacturers as a sector in which freedom to compete would lower prices (although we of course recognise the counter-arguments). Manufacturers wishing to compete by generating their own electricity also complain particularly of the handicap of penal charges for the necessary standby arrangements with the national grid. The high charge fixed by a monopoly supplier ought to be reasonably based and not operate to discourage competition.
- (b) Companies which provide their own loading, unloading and handling facilities at the Port of London Authority docks complain that they nevertheless have to pay the full port charges. This discourages enterprise. Even more discouraging to competition is the lighterman's monopoly in the PLA which precludes companies from using their own vessels from Erith upstream. The fishing industry too suffers from distortions in competition from the operational inflexibility and higher costs in some of the larger fishing ports attributable to the Dock Labour Scheme.
- (c) The fruit and vegetable manufacturers complain that, in spite of the steel surplus, tin plate prices here are appreciably higher than overseas. Since cans account for half the cost of producing canned fruit and vegetables in the UK this inhibits their ability to compete effectively with overseas suppliers. It is not clear whether this price differential is due to the application of subsidies overseas or to exploitation by BSC of their semi monopoly position. Ministry officials have already suggested that this may be a subject worth further investigation.

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- (d) UK manufacturers are dependent on the UK monopoly supplier of hydrogen (since imports are impracticable) and prices in the UK are substantially higher than those on the Continent. This is again an area which might merit investigation.

21. It is of course equally important to prevent the adoption of new measures which will distort competition and impede efficiency. The current proposals by the Greater London Council for restricting access of lorries to London could have a profoundly adverse effect on the food manufacturing and distribution industry in both these respects.

Ministry of Agriculture Fisheries
and Food
9 March 1984