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Draft Law on Domestic Trade: Replicated Effort to Intervene in Free Market Economy

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The draft law "On Domestic Trade", (No. 9443), aims to protect local markets from imports, secure competitive position of small traders as opposed to large retail chains and improve settlements between retail chains and their suppliers. Some provisions of the draft violate fundamental principles of market economy, hampering small size producers and traders, leading to monopolization of food industry and, consequently, to consumer price increase, thus jeopardize stabile supply of citizens. The results would be, thus, opposite to the declared objectives.

The Cabinet of Ministers of Ukraine on January 22, 2013, submitted a new draft law "On Domestic Trade" to the Parliament of Ukraine. Bringing the above mentioned objectives to the forefront has been positively accepted by relevant agri-food associations and NGOs, but the instruments to achieve them have been heavily criticized at the same groups.

The reason for this is, that the draft law replicates the effort of its predecessor – the draft law "On Domestic Trade" dated from 2011 – to introduce several regulations which would, in essence, violate the principles of market economy. Inadequacy of some of these regulations has already been addressed in the Policy Paper No. 36 of the German-Ukrainian Agricultural Policy Dialogue. Currently, the following provisions of the draft law are of concern:

1. Supermarkets, hypermarkets and other stores that have the area of more than 300 m^2 (hereinafter – retail chains) must be located at the distance of at least 5 km from cities:

Moving retail chains outside cities will affect not only retail chains, whose costs will drastically increase, but also face consumers with affordability of specific food items in the neighborhood. In addition, poor quality of roads inflicts significant transportation costs, so delivering of the products to remote areas might be rather expensive. In combination with price and mark-up limitations, this might lead to a situation when transporting the food from supply centers to distant areas might not be economically viable, so it will reduce supply of certain food products. Furthermore, consumers will be forced to spend additional sources to commute to suburb areas. This can be especially harmful for poor citizens and impact negatively to their balanced and healthy food supply.

2. Total supply chain mark-up (from producer to retailer) must not exceed 20% by the end of 2013 and 15% starting from 2014;

The proposed level of mark-up of 15% starting from 2014 is considerably low compared to other countries. For example, average mark-up for food products in the USA amounts to 81% (Dillivan, 2012). Average marketing margins in the EU Member States, according to the European Parliament, are as follows:

- In the milk and dairy products supply chains, producer-consumer price margins range from 28% to 62% for liquid milk, 25% to 60% for cheese and 42% to 82% for butter;
- In the meat and meat products supply chains, producer-consumer price margins are generally wider due to the number of different cuts and joints which have different consumer values. Price margins range from 12% to 92% for pork and from 7% to 74% for beef;
- In the fruit and vegetables supply chains, there is a wide variation in price margins by both product and EU Member State. Price margins for fruit (apples and pears) range from 26% to 74% and for all vegetables from 14% to 82%.

State mark-up controls may cause substantial structural changes at the upstream stages of the supply chain, i.e. among food manufacturers and agricultural producers. Producers will strive to regain some profits they lose via switching to more profitable products or reduction of product quality. Thus, not only food security but also food safety will be threatened.

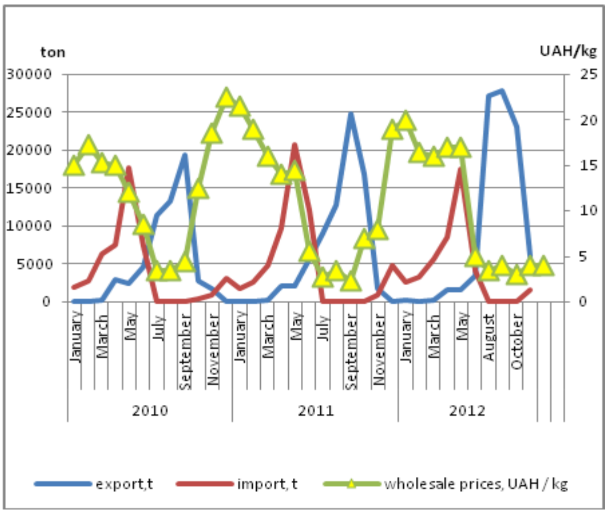
One of the main concerns with respect to mark-up controls is that inability of small and medium-size traders (and suppliers) to deal with squeezed margins will lead to market monopolization by large traders and, thus, potential price increase and losses for consumers. Restricted mark-ups will make export of food products more attractive, resulting in domestic product supply to fall further below equilibrium level.

3. Retail chains must guarantee that 80% of the assortment traded is locally produced:

First of all, the clause violates specific provisions of Article III National Treatment on Internal Taxation and Regulation of GATT of 1947. The applicable provisions of Article III caution that any measures should not be applied to imported products so as to afford protection to domestic production (Article III.1). Another requirement is that imported products cannot be treated less favorably than domestic products in respect to all rules relating to internal sale, transportation, distribution or use. These rules need to be accommodated.

Secondly, imports play important role in sustaining food security in the sectors with high seasonality of production, e.g. dairy, fruits and vegetables. For example, Ukrainian greenhouse tomatoes are about 1.5 times more expensive than those imported from Turkey at the end of February. Figure 1 demonstrates interrelation between imports and domestic wholesale prices for tomatoes in Ukraine.

Figure 1. Tomato foreign trade and domestic wholesale prices for tomatoes in Ukraine



Source: State Statistics Committee, wholesale market „Shuvar"

4. Payments of retail chains to their suppliers must be executed in max. 7 days:

In the EU, retailer payment periods vary from 14 to 60 days depending on the Member State and the product shelf life. Clear definition and differentiation between payment periods for products with different shelf lives would be a positive development in Ukraine too. It would improve mid-term planning at all stages of the supply chain and enable conditions for the development of small and medium-size businesses. In this regard, the second last edition of the draft law "On Domestic Trade" proposed the following payment periods:

- 10 business days for goods with the shelf life of less than 10 days;
- 30 business days for goods with the shelf life of 10-30 days; and
- 45 business days for goods with the shelf life of more than 30 days.

In general, this idea can be supported. However, the interests of retail chains have to be also considered in some specific cases. For example, the period of payment for the products with shelf life of more than forty-five days may not be limited as certain products such as macaroni products and canned food may have shelf life even more than six months.

Generally, the current draft lacks clear definitions e.g. "cities", "area of stores" etc., which provides an additional base for disputes, space for corruption and needs or court cases, which would hamper a sustainable development of food supply and trade chains according to western European experiences.

As a conclusion, experiences in developed economies show clearly the advantage of market forces. The current draft law neglects these advantages and will not improve Ukraine's economic environment. Competitive forces capable of improving market performance will be restricted by regulations and direct market interference of public authorities. Economic performance will be restricted by a lack of competition.

Direct interference in the planning of wholesale and retail sectors will hamper food security and food safety in the country. The current draft law puts focus on central planning approaches, which have shown to fail in the socialist past, thus will not lead to the declared objectives. It will increase bureaucracy and corruption instead.

Current edition of the draft law will not achieve its objectives and should therefore be dropped. Instead of restricting domestic trade by excessive regulation, competition is the key to better performing markets. Small and medium businesses should be supported through stimulating measures.