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THE RECESSION, BUDGETS, COMPETITION, AND REGULATION: SHOULD THE STATE SUPPLY BESPOKE PROTECTION?

*Paul K. Gorecki**

1. Introduction

Recessions are harsh. Demand declines. Firms shed labour, reduce output or file for bankruptcy. Pressure mounts to reduce prices and increase productivity. Returns decline; margins are squeezed; dividends are suspended. Unemployment increases. Firms seek to delay payments to suppliers, while simultaneously demanding suppliers reduce input prices and extend credit. Carefully assembled workforce teams are broken up. New products and innovations are put on hold. Competition is characterised as cut-throat, destructive and excessive. Faith in markets begins to be questioned.

As a result some producers, often with the support of organised labour, demand protection or shelter from market forces in a recession. The demand for what will be referred to as bespoke protection takes many forms from legislative to budgetary. The state is asked to provide free insurance against the impact of the recession, usually to well organised and articulate groups. Of course, the state already provides protection against the effects of the recession through universal programmes: for individuals, unemployment benefits, medical cards and, in exceptional cases, mortgage

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assistance; and, for firms, bankruptcy and limited liability laws. This paper focuses on bespoke protection, rather than universal programmes.

A superficially plausible case can be made for responding to these demands by providing bespoke protection. Unprecedented times demand, it is argued, radical solutions. Government, many believe, should preserve jobs to the maximum extent possible. The banking crisis and light touch regulation demonstrates liberal capitalism has failed. There is a need to tame the market. Too much competition, or what has been referred to as 'overcompetition,' leads to destructive and cut-throat competition driving firms, employees and their families into penury. The intervention need only be temporary. Thus, there will be no long-term adverse impact on growth and productivity. This paper considers the validity of such arguments.

There are three inter-related issues that need to be addressed by the state in considering the demand for bespoke protection:

- On what criteria or grounds should the state supply such free insurance to particular groups in recessionary times? In other words, why should the state intervene?
- How and in what form should the state provide the protection? The state has a number of instruments that it can use to supply the protection demanded, from budgetary to regulatory; and
- What are the consequences of providing bespoke protection, in terms, for example, of productivity and growth? What can be learnt from previous examples of protection provided in similar circumstances? Will bespoke protection impede the rapid recovery scenario from the current recession as set out in Bergin *et al.* (2009, Figure 2, p. 11)?

In answering these three questions two alternative approaches are used: public choice and welfare economics. Public choice is about explaining the actions of public representatives based on the assumption that politicians make choices that they think will get them re-elected. In contrast, welfare economics focuses on the overall welfare of society. It is more about what politicians *should* do and about working out the consequences of sub-optimal decisions by politicians.

The paper is divided into five sections including the Introduction. Section 2 considers the alternative instruments that governments can employ to provide bespoke protection and the merits, from a public choice perspective, in a tight budgetary situation of favouring off-budget instruments such as regulation and competition. Section 3 presents some actual or proposed recent examples of the provision of bespoke protection – restrictive regulatory and competition interventions. In each case a public choice and welfare economics approach is considered. Attention turns in Section 4 to the costs and benefits of providing bespoke protection, drawing both on the Irish and international experience. A bleak picture emerges of the economic costs of acceding to the demand for bespoke protection, while some of the benefits are transitory. Section 5 compares the answers to the three questions set out above using the public choice and welfare economics frameworks. The answers are not the same. The public choice model results in granting bespoke protection which is not justified using welfare economics criteria. This suggests that welfare can be improved if

mechanisms can be put in place that result in political decisions closer to those favoured by welfare economics.

**2.
Some
Preliminary
Observations:
Instrument
and Public
Choice**

INTRODUCTION

The purpose of this section is to provide a thumbnail sketch of how the public choice mechanism can influence government intervention. Attention is also devoted to how the predictions derived from public choice with respect to instrument choice are reinforced by the current recession. A particular Irish twist that solves two of the problems inherent in public choice is discussed next. The section concludes with a brief discussion of whether or not welfare economics and public choice are likely to respond to demands for bespoke protection in a similar manner.

INSTRUMENT CHOICE

Governments can intervene to supply relief from market forces. Governments have a rich menu of instruments of intervention from which to choose. These can be divided into three broad categories:¹

- Budgetary, such as subsidies (e.g. overpayment for goods and services, award contracts on non-competitive basis, modernisation and R&D grants and so on) and tax expenditures (e.g. tax relief for investing in selected activities such as multi-storey car parks and holiday camps);
- Regulatory, such as restricting entry by placing a cap on the number of participants in a regulated activity and/or mandating price reductions in a regulated activity; and
- Competition, such as partial or complete exemption of certain markets or professions or other groups from competition law and/or budget reductions/reorganisations of the competition agency that lessen operational effectiveness.

These instruments are substitutes in many policy contexts in that each can be used to achieve the same policy objective.

An example illustrates the point. After the decline in the value of sterling at the end of 2008 due to the UK recession, Irish shoppers increasingly turned to Northern Ireland for their groceries.² Retailers in Ireland eventually reacted by reducing some prices, evidenced by Tesco's announcement on 5 May 2009 (Tesco, 2009). This in turn put pressure on food processor margins and farm gate prices. Demands for bespoke protection from the impact of these pressures could be met in various ways:

¹ There are, of course, other instruments that the state could employ. For example, Trebilcock *et al.* (1982) consider public inquiries and public enterprise, but do not consider competition policy. In part this reflects the different contexts within which choice of instrument is considered. In this paper the context is the recession, while for Trebilcock *et al.* (1982) the context was part of a larger study of regulation.

² For further discussion of these developments see Revenue Commissioners/Central Statistics Office (2009).

- Budgetary assistance through a tax on food which would be redistributed to food processors and farmers, and/or grants to enhance productivity of processors and farmers and/or provision of an export credit scheme with a state-backed guarantee;³
- Regulatory assistance through the creation of a Retail Ombudsman to make sure that processors and farmers are paid sufficiently to ensure “equity and fairness in the food supply chain” and/or government instructions to the independent regulator, the Commission for Energy Regulation (CER), to reduce electricity prices,⁴ and,
- Competition assistance through the exemption of food processors and farmers in dealing with retailers from the Competition Act 2002 (the Competition Act), so that producers can combine to offset the alleged buyer power of the supermarkets.

Of course, it is possible that these instruments can be used in a complementary manner, with one reinforcing the other.

If the state is to intervene to provide bespoke protection, the issue arises of what form the intervention might take. In other words, which of the three instruments are likely to be selected? In an era of budgetary restraint in Ireland consequent on the worldwide recession, exacerbated considerably by domestic policy failures, there are severe constraints on the extent to which these demands for protection can be met through *increased* budgetary measures.⁵ Instead the relative attractiveness of the two off-budget balance sheet instruments identified above – regulation and competition policy – is likely to increase. These off-budget instruments have minimal public expenditure implications, while delivering the desired benefits to the group demanding protection. Vigorous competition policy and independent regulation designed to promote entry and competition for the benefit of consumers thus may be seen as unaffordable luxuries in a period of economic crisis, if the state decides to supply protection demanded by particular groups.

It should be noted that budgetary measures may be used to complement restrictive regulation and competition policies in times of recession if they involve a *reduction*, rather than an increase, in public expenditure. For example, the effectiveness of regulatory and competition agencies can be weakened through budgetary reductions and/or reorganisations. This weakening will lead to less vigorous enforcement of competition law, with the result that private arrangements to mitigate the impact of the recession,

³ Apart from the tax on food, this response was favoured by food processors. For details see FDII (2009a; 2009b). In this connection it might be noted that the government announced in 2006 a €50 million investment grant package to beef and sheepmeat processors. For details see Department of Agriculture and Food (2006).

⁴ The Retail Ombudsman is favoured by the farmers (IFA, 2009a) and FDII (2009a; 2009b), while the FDII also called for lower electricity prices in meeting the challenge posed by Tesco’s price cuts. The quotation in the text is from IFA (2009a).

⁵ For details of the budgetary situation see Barrett *et al.* (2009). The General Government Deficit is forecast to be 12 per cent of GDP in 2009, 11.5 per cent in 2010. While public net current expenditure will decline in nominal terms, in volume terms it will remain essentially constant over this period.

such as a cartel, are less likely to be detected and prosecuted. This, therefore, facilitates private, albeit illegal, market restrictions.⁶

PUBLIC CHOICE

Public choice is about explaining choices made by politicians.⁷ A number of different assumptions have been made as to what politicians are maximising, what they are trying to achieve, what motivates and guides their selection of policies or other actions as public representatives. Trebilcock *et al.* (1982, p.11), for example, assume that proximate aim of politicians is ...*maximizing the likelihood of their election or re-election*. In this respect politicians are competing for the marginal voters, since these voters are most likely to switch compared to infra-marginal voters. Friedman (1990, p. 546), in contrast, assumes that the ...*politician is seeking to maximize his long-run income (plus non pecuniary benefits, one of which maybe 'national welfare')*... subject only to the constraint that they need to get re-elected.

Public choice theory sees politicians as operating in a market in which they supply (say) bespoke protection during a recession, in return for actions which contribute positively towards their aim or objective such as re-election. These actions might, for example, include campaign and other contributions to party coffers. Certain propositions have been developed using this framework which can assist in predicting the conditions under which politicians supply bespoke protection and the likely characteristics of the instrument selected.

A number of propositions have been developed in the public choice literature, which are particularly relevant in respect of instrument choice. Two are considered here, following the terminology adopted in Friedman (1990, pp. 545-548):⁸

- protection will favour concentrated not dispersed groups; and
- politicians will prefer transfers for which the information cost of determining what is going on is as high as possible for the victims –

⁶ There is some evidence that cartels are more likely to occur in a recession. For example, Stephan (2009) finds, contrary to expectations, that many of the cartel infringements in the past 10 years ...*indicate that many collusive agreements may be formed as a consequence of an economic downturn*. (p. 5). In Ireland the formation of a beef cartel was encouraged by the government in order to reduce overcapacity. The Competition Authority took a case under the Competition Act. Although the Competition Authority lost at the High Court, the case was appealed and aspects of the case were referred to the European Court of Justice (“ECJ”) by the Supreme Court. The ECJ ruled that the beef capacity reduction arrangements were an infringement of competition law. The Supreme Court has still to decide whether despite being an illegal agreement there are offsetting advantages, which would mean that on balance the arrangements were consistent with competition law. The Supreme Court held the hearing on 25-26 May 2009. Judgment is awaited.

⁷ It is, of course, the case that the discussion could be extended, as the literature shows, to include other important actors such as public servants. However, it could be argued in a country such as Ireland with a much smaller public sector – in absolute size – and thus a smaller span of control within a government department, compared to many other larger countries, that politicians are able to exert an unusually high degree of influence over decisions and hence it is appropriate to concentrate attention on politicians in this paper. See Trebilcock *et al.* (1982) for consideration of other actors besides politicians.

⁸ A third is that more efficient transfers will be preferred to less efficient transfers. For a discussion see Friedman (1990).

consumers and taxpayers – and as low as possible for the beneficiaries – small well organised groups.

The prediction that protection will typically be awarded to small concentrated groups rather than larger dispersed groups reflects a number of factors. *First*, there is a greater incentive to belong to a concentrated group than a dispersed group. This reflects the differing pay-offs or benefits. Let us assume that the bespoke protection is equivalent to €20 million that benefits 20 firms €1 million each per year, while the cost is borne by consumers through a small increase in price, equivalent €10 per household per year. The firm has a much greater incentive to belong to a group since the pay-off is substantial whereas for the household the cost is trivial. *Second*, there is an information problem. Members of a concentrated group are much more likely to be aware of the value of the benefit afforded by the protection and have an incentive – given its expected size – to estimate its magnitude. In contrast, a dispersed group is much less likely to be aware of the cost to them of the restriction and may not be in a position to estimate its magnitude. Furthermore, even if they were, given that the likely magnitude is small they may decide to remain what Friedman (1990, p. 547) and others call “rationally ignorant.”⁹

Third, it is easier to overcome the free-rider problem for a concentrated than a dispersed group. Each group – whether it is the concentrated or dispersed – is providing a benefit that takes on the characteristics of a public good.¹⁰ In other words, if the concentrated group is successful in securing protection (or the dispersed group successful in preventing the protection), then a firm (or member of the dispersed group) is likely to benefit irrespective of whether or not it contributed to funding, organising and participating in the group. Hence, if the firm (or member of a dispersed group) does not contribute to the group it still benefits and thus is referred to as a free rider. If there are too many free riders the group will not be formed, since insufficient subscriptions will be collected to fund the lobbying effort. Overcoming the free rider problem is much easier for the concentrated group since moral persuasion and social sanctions can be applied, which are much more difficult to apply to a dispersed group. There is, of course, the added problem of identifying members of the group, which is likely to be more difficult for the dispersed group. Thus, it is easier to free ride in the dispersed than the concentrated group. *Fourth*, the transaction costs of running a concentrated group are much more likely to be small compared to a dispersed group, especially given the above factors.

The second prediction is that politicians will prefer transfers for which the information cost of figuring out what is going on is as high as possible for the victims – consumers and taxpayers – and as low as possible for the beneficiaries – small well organised groups. This point is fairly obvious. Politicians have no desire for consumers and taxpayers to become aware that each of them is paying a small increase in price in order that income can be

⁹ See Peltzman (1989, p.6).

¹⁰ These are a very special class of goods which cannot practically be withheld from one individual consumer without withholding them from all (the *non excludability criterion*) and for which the marginal cost of an additional person consuming them, once they have been produced, is zero (the *non rivalrous consumption criterion*). Paul M. Johnson, “A Glossary of Political Economy Terms,” http://www.auburn.edu/~johnspm/gloss/public_goods. (Accessed on 15 May 2009).

transferred to a concentrated group, particularly if that group is perceived to be well off and in some sense privileged. Hence, the provision of bespoke regulation is likely to be justified on grounds other than a transfer or quasi tax on a large group to benefit a small group. In the example cited above concerning assistance to food processors and farmers the bespoke regulation could be justified, for example, on grounds of ensuring equity and fairness in the food chain.¹¹

It might, of course, be argued in some sense that the various special interest groups would cancel each other out. In other words, there would be some sort of balance that would neutralise the impact of these special interest groups.¹² However, there can be no assurance that this will occur in the context of this paper, in examining whether or not bespoke protection should be offered in a recession. Indeed, it is unlikely to be the case. It is often the case that these special interest groups combine to argue for protection, rather than oppose one another.¹³

There are a number of criticisms that could be made of the public choice explanation of when bespoke protection will be provided.¹⁴ These criticisms are not so much that the discussion above is incorrect, but rather that it needs to be extended. It is not clear, from a public choice perspective, when the state will say ‘yes’ and when it will say ‘no’ to demands for bespoke protection.¹⁵ There appear to be no bright lines that can be used to exclude demands from certain groups or activities, but not others. Equally, there are

¹¹ On 11 August 2009, the Minister for Enterprise, Trade and Employment issued a consultation document on proposals to establish an Ombudsman to enforce a code of practice for grocery good undertakings (Department of Enterprise, Trade and Employment, 2009). The consultation document referred to *...the need to achieve balance in the relationships between grocery undertakings, taking into account the need for a fair return to both suppliers and retailers, the need to enhance consumer welfare...*(p. 2). The proposals were welcomed by food processors (IBEC, 2009c) and farmers (IFA, 2009b), while retailers have, as yet, to take a position. In their initial reaction retailers talked about the necessity of ensuring, *...that no obstacles are put in the way of retailers securing the best value from their suppliers and, in turn, delivering the most competitive price to consumers* (IBEC, 2009b).

¹² There are instances where the interests of differing groups might to some extent offset each other. For example, in international trade negotiations there may be groups opposed to further liberalisation such as farmers and other groups such as exporters that are in favour of greater liberalisation and openness.

¹³ A good example is the Voluntary Restraint Agreements (“VRAs”) that between 1981 and 1985 artificially restrained the volume of car exports from Japan to the US. These were in reaction to the file jointly submitted by the Ford Motor Company and the United Auto Workers to the US International Trade Commission for relief from imports. Although it was unsuccessful it led to the VRAs. It has been estimated that in 1984-1985 the VRAs imposed the equivalent of an 11 per cent tariff on cars, with a benefit to producers of \$2.6 billion, about a quarter of industry profits, but of course, there was also a positive impact on employment and wages. For details see Hufbauer (1991, pp. 121-125).

¹⁴ There are, of course, more fundamental criticisms of the public choice approach. Trebilcock (2005, pp. 436-438), for example, points out how the move towards deregulation and vigorous competition policy are examples of policies that by and large benefit dispersed rather than concentrated groups. However, in Ireland these policies have not been followed with the same degree of vigour as in other countries. Attempts to reform the regulation in urban buses was a failure, while several of the examples of deregulation in Ireland – taxis and pharmacies – have come about because of judicial intervention, rather than public policy. Furthermore, as reported below, recent policy action by the state appears to signal a downgrading of competition policy.

¹⁵ Becker (1983) presents a model where interest groups compete for rents that tries to resolve this issue.

many well informed groups demanding bespoke protection. Hence, while there may be information asymmetries between the concentrated group that receives such protection and the dispersed group that pays the cost, such asymmetries may not obtain with other concentrated groups, particularly in adjacent areas of economic activity. This poses a problem for the politician in that in giving bespoke protection to one concentrated group but not another it may alienate the latter group. In the discussion of social partnership below one possible method of resolving this is presented.

IMPLICATIONS FOR INSTRUMENT CHOICE

The second prediction has an implication for instrument choice. Restrictive regulation and relaxing competition policy are much more opaque methods of providing bespoke regulation than budgetary measures such as a tax increase. In the example cited earlier concerning the impact of price reductions on food processors and farmers, the government could impose a tax on groceries and then redistribute the revenue to the processors and farmers or it could set up a Retail Ombudsman to make sure that processors and farmers are paid sufficient to ensure “equity and fairness in the food supply chain.” Both instruments of intervention have the same outcome in terms of redistributing income to farmers and processors, but in the latter case the transfer is cloaked in language designed to justify higher consumer prices that may well be acceptable, while a tax on food would probably result in howls of outrage, especially given that poor consumers spend a disproportionate percentage of their income on food. Perhaps it is for this reason that an ombudsman has recently been proposed by government.¹⁶

AN IRISH TWIST: SOCIAL PARTNERSHIP¹⁷

While these predictions are general, in the case of Ireland, a specific institutional structure, social partnership, has been put in place that is conducive to facilitating the introduction of bespoke protection. Although partnership is primarily concerned with pay bargaining, since its inception in 1987 its remit has gradually been extended so that now it *...is difficult to think of a policy issue that is not now the subject of some social partnership working group or another...* (Hardiman, 2006, p. 362). Social partnership is a corporatist arrangement whereby, primarily, representatives of organised labour and business, together with the government taking the role of chairman, reach multi-year agreements on important aspects of economic and social policy. For example, the partnership framework for 2006 to 2015 is 140 pages in length – not including a separate 11 page document on agriculture – and covers everything from the Irish abroad to better regulation.¹⁸

Partnership is essentially an interest or pressure group model of decision making. As noted above, it is typically the well organised groups representing labour and business which do a deal, with the blessing of

¹⁶ See footnote 11 above for details.

¹⁷ For a further discussion of partnership see for example, Boyle *et al.* (2004), Hardiman (2000, 2006), Roche (2009) and references cited below.

¹⁸ For details see Department of the Taoiseach (2006). At the present time there are ongoing discussions to reach a new a partnership agreement between the social partners in view of the changed economic circumstances. It appears that reaching an agreement is proving challenging.

government.¹⁹ There are no groups representing consumers. The advantages of any partnership agreement reached, even if it contains bespoke protection, is likely to be stressed by the parties to the agreement. It is very difficult for the outsider to unpick the deal, as the negotiating process and the various trade-offs reached are conducted in secret, with very little involvement of the legislature.

Social partnership helps resolve the co-ordination problems identified above with respect to the public choice approach as to when bespoke protection will be provided. The partnership process involves many if not all of the concentrated groups that are likely to demand bespoke protection. It thus provides a forum in which these groups can reach an accommodation as to which demands should be met.

This is not to deny that there may be benefits flowing from social partnership (Hardiman, 2000; 2006). The process may lead, for example, to a shared understanding of the problems facing the Irish economy and thus make resolution easier to formulate and implement. However, these benefits should not be exaggerated. For example, the OECD (2001, p. 26), based on Fitz Gerald (1999), questions whether partnership led to an outcome for wages that was any different from what market forces would have led to. As Fitz Gerald (1999, p. 162) states, *While helping to bring about a more orderly labour market, with fewer industrial disputes than in the 1970s, the partnership approach served more to validate the results which market forces had made inevitable.*

In view of subsequent developments in social partnership this conclusion arguably needs to be modified, perhaps even rejected. In particular, public sector pay rises awarded in 2003 and thereafter were based on a comparison of *equivalent positions in the private sector* (Kelly *et al.*, 2009, p. 342). The outcome of this benchmarking process was that the public sector pay differential with the private sector *...increased from less than 10 per cent in 2003 to almost 22 per cent in 2006, controlling for human capital and other relevant pay determining characteristics...* (Kelly *et al.*, 2009, p. 364).²⁰ In other words, it does not appear that there were any objective economic grounds for the increase in public sector pay compared to the private sector.^{21,22} Such significant widening of the public/private sector pay differential is likely to have adverse macro-economic effects: competitiveness will suffer due to wage inflation in the private sector, the tax burden is increased and any downward adjustment in public sector wages in the current recession is likely to be difficult, raising the possibility of strikes and other forms of industrial action.

¹⁹ While it is true that a third pillar, the community and voluntary sector, was added in 1997 (Hardiman, 2000, p. 293), *...the core economic actors – unions and employers – inevitably have a privileged status over the community and voluntary sector* (Hardiman, 2006, p. 348).

²⁰ This is likely to understate the differential since no account is taken of the fact that public servants have defined benefit, rather than defined contribution, pension schemes, that there is greater pension coverage in the public sector and there is much greater job security in the public compared to the private sector. Kelly *et al.* (2009, p. 365) estimate that the impact of the greater pension coverage in the public sector is to raise the pay differential in 2003 from 9.7 per cent to 12.9 per cent.

²¹ The result is consistent with the hypothesis put forward by Boyle *et al.* (2004, p. 22) that partnership *conferred greater bargaining power than they [public sector unions] would otherwise have had.*

²² The basis on which the increased differential was recommended was not made public and appears inconsistent with other evidence such as that on vacancies. For further details see O'Leary (2002).

ECONOMIC EFFICIENCY, INSTRUMENT CHOICE AND INTERVENTION

The rationale for intervention and the instrument selected using the public choice approach is unlikely to coincide with that provided by welfare economics, as illustrated in Table 1. Typically in the welfare economics approach the first question to be asked is: What is the rationale for intervention? In terms of the grounds for intervention, the relevant question is whether or not there is a market failure that merits intervention. The market failure might be a misallocation of resources due to the existence of a monopoly, the presence of negative externalities due to environmental pollution and so on. Given that there is a sound rationale for intervention, the next question is: What is the most appropriate instrument? The instrument selected is designed to be the most cost effective, with a preference for transparent instruments that increase accountability. There can be no guarantee that it will be off-budget rather than budgetary. Furthermore, before deciding whether to actually intervene there is a need to compare the cost of intervention with the benefits. The third set of issues is the economic and other consequences of intervention guided by welfare economics and public choice considerations. A priori it seems likely that interventions guided by welfare economics will improve the welfare of society whereas it is not at all clear that this will hold for interventions based on public choice. In the next two sections this latter issue will be discussed in more detail.

Table 1: Public Choice and Welfare Economics Models: Answers to Three Questions

Public Choice Model	Welfare Economics Model
Q1 Why? Political benefits > political costs	Q1 Why? Market failure
Q2 Which instrument? Regulation/competition; not budgetary	Q2 Which instrument? Preference for more transparent
Q3 Consequences? Concentrated groups will benefit at the expense of widely dispersed groups	Q3 Consequences? Increase in societal welfare

Source: See text.

3. Demand and Supply of Bespoke Protection: Some Recent Illustrative Examples

INTRODUCTION

There are already signs that the recession has resulted in increased demands for bespoke protection. In some cases the protection has been granted, in others the outcome is not yet certain as events unfold on a daily basis. The purpose of this section is to provide illustrative examples of the way in which regulation and competition may be used to provide bespoke protection in the current economic climate. In each case reference is made to whether or not from a welfare economics point of view there is a market failure that merits bespoke protection. The list is not exhaustive; it is meant

to be illustrative only.²³

REGULATION

There are a number of ways in which regulation can provide protection to those adversely affected by the recession. As noted above these ways include restrictive regulation and influencing regulatory decisions.

Restrictive Regulation:²⁴ Proposed Cap on Taxi Licences

Prior to 2000 entry into the taxi market had been restricted dating back to 1978.²⁵ Taxi licences acquired a substantial value.²⁶ Liberalisation occurred in 2000 as a result of a High Court ruling which found that the Minister of Transport could not impose limits on the number of taxi licences.²⁷ The number of taxi licences more than tripled between 2000 and 2004 (Goodbody, 2009, Table 4.3, p. 32). In the latter year a Taxi Regulator was established which presaged reforms such as a national fare structure and other changes. The number of taxi licences continued to climb, so that by 2008 the level was 50 per cent above 2004 and five times the level in 2000. Demand also increased. In Dublin, for example, there were 22 million trips in 1997, 27 million just after liberalisation and in 2008, 40 million (Goodbody, 2009, Figure 3.3, p. 18). Waiting times were reduced drastically: in Dublin, for example, 58.3 per cent of taxi users waited 10 minutes or less in 1997, by 2008 the corresponding percentage was 85.7 per cent (Goodbody, 2009, Table 6.3, p. 49).

In more recent times the gross earnings of taxi drivers has fallen – by 5 per cent between 2005 and 2008 in Dublin (Goodbody, 2009, p. 43) – and hours of work increased – by 8 per cent between 2005 and 2008 in Dublin (Goodbody, 2009, Table 5.8, p. 45). There are indications that as national unemployment grows and overall economic activity declines that the number of new taxi licences issued is declining, while the exit rate has increased.²⁸ Furthermore, it appears that there is some discounting of taxi fares, since the Taxi Regulator only sets maximum fares.²⁹ Terenure Taxis, which operates in south Dublin, for example, offers a 10 per cent discount off metered fares.³⁰ In other words, there is nothing unusual in the way in which the taxi market is functioning that might merit government intervention.

²³ It could, of course, be argued that the selection may be biased in that the most successful examples of bespoke protection will pass with little comment in the media. However, the author was a member of the Competition Authority between 2000 and 2008 and so would have been aware of attempts to supply bespoke protection through competition and regulation, since in both cases the Competition Authority would have been involved either directly or indirectly in making comments and presentations.

²⁴ Other examples include the Retail Ombudsman mentioned earlier in the paper.

²⁵ For details see Barrett (2006).

²⁶ See Table 2 below for details.

²⁷ *Humphrey v. Minister for Environment and Local Government* [2000] IEHC 149; [2001] 1 ILRM 241 (13 October, 2000). The judgment may be accessed at: <http://www.bailii.org/ic/cases/IEHC/2000/149.html>. Accessed on 19 May 2009.

²⁸ Goodbody (2009, Table 9.1, p. 78; Figure 9.1, p. 78).

²⁹ Goodbody (2009, p. 77).

³⁰ Based on an advertisement by Terenure Taxis in the free sheet *Town & Village* June 2009 issue on the front page. The free sheet is distributed to various places in south Dublin and claims a circulation of 20,000.

Under these conditions it is not surprising that taxi owners have organised to seek protection from the impact of the recession that has exacerbated a decline in income, a lengthening of the working week and pressure on prices. These demands continue despite the March 2009 report by Goodbody for the Taxi Regulator. The report rejected the call for a moratorium on the issuing of new licences, for which taxi organisations had called. Goodbody (2009, pp. 83-84) could identify no market failure which would justify such a policy move. Indeed, it pointed out the adverse effects on consumer welfare of such a moratorium. This has not stopped the clamour for government to provide bespoke protection to taxi owners.

SIPTU, which represents a number of taxi drivers,³¹ for example, states:

We totally reject the notion that people should be expected to work longer, harder and for less pay ad infinitum.

There is also an important question for us of having an appeals system in place to protect our members' rights, not to mention the health and safety implications of the Goodbody approach, for the travelling public and our members (SIPTU, 2009).

Protests by taxi drivers have continued in support of these demands. Traffic is disrupted; consumers and others are inconvenienced.

Some elected representatives have lent more than a sympathetic ear to the plight of the taxi owners. The Chairman of the Joint Oireachtas Committee on Transport, Frank Fahey, criticised the methodology in Goodbody by stating that:

*... it is like reading the front of **The Beano**. Mr Feeney [from Goodbody] has no idea about drivers' incomes. The driver of any cab into which one gets will tell you that he or she is earning below the minimum wage. They cannot all be fooling us. I have been in five or six cabs in recent weeks, the drivers of which tell me that they earned €50 over eight or nine hours. The report's finding is ludicrous and every cab driver in this city [Dublin] and throughout the country is hopping mad about it. (Joint Oireachtas Committee on Transport, 25 March 2009, p. 8).*

In the latter respect the Deputy preferred to rely on the information gleaned from taking five or six cabs as opposed to the representative sample included in Goodbody.

The Labour Party wants to introduce not only a moratorium on new licences, which it argues is consistent with Deputy Fahey's proposals in a new bill the Taxi Regulator Amendment Bill 2009, but also that before issuing new licences the regulator would be required to consider...*taking capacity and the demand-supply balance into account...* (Labour Party, 2009, p. 22). It is not clear why administrative intervention, rather than the market, is needed to make such decisions. Thus although the Minister has up until now

³¹ The vast majority of drivers own and operate their cabs. Only a small minority of drivers are renting as opposed to owning a licenced vehicle. (Goodbody, 2009, p. 23). Thus SIPTU in this context is representing the self-employed rather than the employed.

rejected calls for a cap on the number of licences, the pressure continues for a moratorium on issuing new licences.

There seem to be three different concerns expressed with the regulatory regime. *First*, there is a concern that standards are not appropriate and that there are insufficient resources to enforce the existing rules. The solution to these problems is setting the correct standards and ensuring that there are adequate resources so that they can be enforced. *Second*, there is a concern that taxi drivers' earnings are in some sense too low. Restricting entry is the answer of the taxi organisations supported by some elected representatives. However, it is not clear what market failure would be addressed by a putting a cap on numbers. If the return is too low in this market then taxi drivers will exit and/or not enter in as large numbers. Indeed, as noted above this is the record of recent developments in the taxi market. Furthermore as Goodbody (2009, p. 84) points out there is no guarantee that a cap will raise incomes of existing taxi owners unless other restrictive rules are also introduced. *Third*, it is sometimes argued that it is necessary to restrict entry in order to ensure that proper standards are adhered to by the taxis. However, it is not at all clear why if enforcement of existing standards is adequate, that there is any linkage between the two. Indeed, in pharmacy where entry restrictions were introduced in 1996 in part on the grounds of improving quality, there is no evidence of any improvement, but pharmacy incomes increased substantially (Gorecki, 2009b). Finally, there is no evidence that when entry controls on the number of taxis were in place prior to 2000 that there were not problems with the quality of taxi services; on the contrary there was widespread dissatisfaction because of a shortage of taxis at certain times (Barrett, 2006, p. 4).

Influencing Regulatory Decisions: Electricity Prices

The Commission for Energy Regulation (CER) is an independent regulator of the energy sector, including electricity prices. It has processes and procedures concerning the conduct of its affairs and cycles for the review of key issues such as price and investment reviews. Adhering to those processes and procedures is important in terms of creating regulatory certainty and predictability. The greater the uncertainty and unpredictability the greater the regulatory risk, which translates into, for example, higher cost of capital with consequent adverse effects on price and investment for consumers.

Ireland's industrial electricity prices are high by EU standards. The National Competitiveness Council (NCC) regularly draws attention to this situation. (NCC, 2009, Figure 3.37, p. 65). IBEC (2009a) raised the question of high energy costs during the 2009 partnership talks, including at several meetings with the Minister for Communications, Energy and Natural Resources and the CER. It appears that in part as a result of these exchanges the Minister asked the CER to undertake a review of electricity prices to determine if prices could be reduced. More specifically the Minister stated:

We have a robust regulatory energy framework in Ireland which is transparent and encourages competition. It is right that we maintain the role of the CER as the decision-maker in terms of pricing. To this end, I am asking the energy regulator to undertake an immediate review of options to bring forward a reduction in electricity prices. Based on current trends I expect a double-digit decrease in electricity and gas prices this year. (DCENR, 2009a, p. 1).

In response to the Minister's request the CER issued a proposed decision paper (CER, 2009a) and subsequently issued the decision (CER, 2009b). The CER complied with the Minister's request by:

...re-profiling network charges, bringing forward reductions now and repaying them next year, there can be a reduction in the short term. The advantages of this approach are that it is non-distortionary and benefits all electricity users regardless of their supplier. (CER, 2009a, p. 21).

In other words, prices will be a little lower in the short term and a little higher in the medium term, compared to what they otherwise would be.

The action of the Minister clearly undercuts the perceived independence of a major regulator and thus increases regulatory risk for a very short term gain. The CER (2009a, p. 4) drew attention to this in its proposed decision: *[T]he re-profiling is not without risk, as it deviates from established regulatory process creating market uncertainty and introducing unpredictability into regulatory decisions.* In the CER's final decision, which summarised the various submissions received, several firms expressed concerns as to the impact of the re-profiling on regulatory risk and predictability.³²

A number of observations can be made on the Minister's actions. *First*, if the aim of policy is to reduce energy prices, then there are a number of regulatory alternatives that can be considered. Some of these, for example, envisage reform in market structure. One change which has attracted considerable support is that Eirgrid, the transmission system operator, should own the transmission network, rather than the former vertically integrated monopolist in the electricity market, ESB.³³ However, the Minister decided to defer in March 2008 decision on this issue pending yet another report (DCENR, 2008). The promised senior independent chairman responsible for overseeing the process leading to the report was not appointed until 15 months later at the end of June 2009.³⁴ *Second*, it is not clear that any analysis was carried out concerning the economic rationale for the Minister's intervention. Is there a market failure? What are the benefits and costs of a small reduction today in prices compared to a slightly higher offsetting price later in 2009? Surely, if there are systematic problems with the regulatory regime they should be addressed directly rather than through ad hoc policy interventions. In other words, is it a sufficient rationale for

³² For example, CER (2009b, p. 23) report that: *ESB Networks raised their concern that the re-profiling option significantly distorts the whole framework of unbundling and price regulation that has been developed over the last decade. Further to this it introduces significant additional risk and is likely to increase the perceived Regulatory risk in Irish network infrastructure assets and consequentially increase the cost of capital.*

³³ See, for example, Fitz Gerald *et al.* (2005), Competition Authority (2004a), OECD (2001), and Prasifka (2009).

³⁴ For details of the statement by the Minister see DCENR (2008) in which reference is made to appointing shortly a senior independent chair who in turn would *...appoint independent consultants to carry out the technical and economic analysis.* However, the Chair was not appointed until 29 June 2009. In the news release making the announcement, reference is made to an assessment of the costs and benefits and the regulatory impacts, for which input will be sought from *...all the direct key stakeholders: ESB and EirGrid managements, ESB and EirGrid unions and ESB Employee Share Ownership Trust* (DCENR, 2009b). No reference is made to consumers or other agencies such as the CER, the Competition Authority or others with a broader consumer/economic welfare perspective.

public intervention that one of the social partners is concerned enough that it raises the matter with the Minister?

COMPETITION

Competition policy has been strengthened considerably in terms of legislation and resources since 2000. The Competition Act 2002 (the Competition Act) modernised competition law in Ireland. Mergers were assigned to the Competition Authority and were to be assessed on a competition test, instead of a broad public interest test. Sanctions against criminal cartels were raised and the Competition Authority was given better and more effective investigative tools. The restrictive Groceries Order 1987, which criminalised reducing price below the invoice cost for certain grocery products, was abolished in 2006. The budget of the Competition Authority was raised substantially during the early part of the decade. However, with the onset of the recession the future for competition policy is not as favourable, as a number of measures have been proposed or implemented which have the effect either directly or indirectly of weakening competition law and enforcement in furtherance of the supply of bespoke protection.

In terms of the administration of competition policy a decision was made in October 2008 to merge the Competition Authority with the National Consumer Agency (NCA).³⁵ Ongoing discussions are taking place to implement this merger with legislation expected in late 2009/early 2010. Subsequently, it was announced on 18 June 2009 that the Consumer Directorate in the Financial Regulator will be incorporated into the NCA.³⁶ Finally, the Special Group on Public Service Numbers and Expenditure Programmes (2009), headed by Colm McCarthy, recommended in its July 2009 report that the Irish Takeover Panel be merged with the Competition Authority.³⁷ These organisational changes are likely, in the short run at least, to reduce enforcement efforts of competition law.³⁸

Two sets of activities have or are scheduled to be made partially exempt from the Competition Act:

³⁵ See Department of Enterprise, Trade and Employment (2008a; 2008b). For an analysis of the merger see Gorecki (2009a) which suggests little consideration was given to the problems and mechanics of the merger prior to the decision being made.

³⁶ See Department of Finance (2009).

³⁷ It is not clear on what basis this merger is being proposed. No cost savings are expected. It is not at all clear how the duties of the Irish Takeover Panel dovetail with the consumer and competition remit of the new Competition/NCA/Consumer Directorate in the Financial Regulator. A reading of *Special Group on Public Service Numbers and Expenditure Programmes* (2009, Volume 1, pp. 18-19; p. 27) does not fill this gap.

³⁸ This reflects: *first*, resources will have to be diverted from enforcement to address issues surrounding the merger of the Competition Authority and the NCA; *second*, there appear to be some differences in the way that the NCA and the Competition Authority view price fixing agreements. The two representative organisations of the publicans, the Vintners Federation of Ireland (“VFI”) and the Licensed Vintners Association (LVA), announced a price freeze on behalf of their over 5,500 members from 1 December 2008 (VFI/LVA, 2008). The NCA broadly welcomed the announcement, but would have preferred that the emphasis was on reducing prices (Michael and Cullen, 2008). In contrast, the Competition Authority, which sees its role as promoting consumer welfare, saw the behaviour as a breach of competition law and successfully instituted legal proceedings against the two representative organisations, after unsuccessfully asking them to cease and desist (Competition Authority, 2009a; 2009b).

- trade associations representing medical professions in negotiating with the Minister for Health and Children are able under the Financial Emergency Measures in the Public Interest Act, 2009, to consult on the outcome of any such negotiation without contravening section 4 of the Competition Act;³⁹ and,
- voice-over actors, freelance journalists and session musicians are to be made exempt from section 4 of the Competition Act when engaging in collective negotiations.

In addition, under the Credit Institutions (Financial Support) Act 2008 the application of merger control is removed from the Competition Authority and transferred to the Department of Finance for certain classes of credit institution mergers. It should be noted, however, that the state cannot exempt firms in Ireland from EU competition law. Thus trade associations will still be subject to Articles 81 and 82 of the Treaty, while if mergers reach the European Union merger control financial and other thresholds they will be subject to assessment by the European Commission, not the Member State.⁴⁰

*Exemptions: Voice-over Actors, Freelance Journalists and Session Musicians*⁴¹

As a result of an Competition Authority investigation into possible price-fixing between self-employed actors and advertising agencies for voice-over services, the union representing the actors, Irish Actors' Equity SIPTU, and the trade association representing the advertising agencies, Institute of Advertising Practitioners in Ireland, agreed in 2004 not to enter into or implement any agreement that fixes fees for voice-overs (Competition Authority, 2004b). Subsequently, Equity tried unsuccessfully to persuade the Competition Authority that the former impugned agreements between it and the advertising agencies benefited from the exemptions set out in section 4(5) of the Competition Act and/or Article 81(3) of the Treaty.⁴²

Broadly speaking section 4(5) of the Competition Act sets up a series of criteria whereby an agreement that would otherwise damage consumer

³⁹ For further discussion on this exemption see Gorecki (2009a) and *Competition* (2009). There is some question as to whether or not this is an exemption. It could be argued that consultation is not prohibited under the Competition Act, based on Judge Findlay-Geoghegan's recent decision in the pharmacists case (*Hickey and others vs HSE* (2007) 180 COM), and that all this amendment does is clarifies the position based on this judgment. It should be noted that in the past that some medical groups have employed boycotts to gain higher fees and/or preserve the status quo that resulted in the Competition Authority commencing proceedings under the Competition Act.

⁴⁰ It is, of course, the case that under certain conditions parts of a merger relevant to a particular Member State can be referred by the Commission to a Member State to assess. This occurred in 2008 when Heineken's proposed acquisition of Beamish and Crawford was referred back to Ireland to be dealt with under the relevant section of the Competition Act.

⁴¹ This discussion draws heavily on Gorecki (2009a).

⁴² The author was the member of the Competition Authority responsible for reviewing the arguments put forward by the representatives of voice-over actors and with other members of the Competition Authority deciding that, in its view, the section 4(5) criteria were not met.

welfare is permitted.⁴³ These criteria, which include that the agreement promotes technical or economic progress, improves the production or distribution of goods, while allowing consumers a fair share of the benefits, are cumulative. Thus, the legislation strikes a balance whereby the damage caused by the price fixing is compared to the benefits and a judgment made. In other words, this is very much like a cost-benefit analysis that would be undertaken as part of the welfare economics approach used to award bespoke protection.

However, despite the fact that the Competition Authority considered that the agreement did not pass the tests set out in section 4(5), part of the text of the partnership agreement of September 17, 2008 reads as follows:

The Government is committed to introducing amending legislation in 2009 to exclude voice-over actors, freelance journalists and session musicians, being categories of workers formerly or currently covered by collective agreements, when engaged in collective bargaining, from the provisions of Section 4 of the Competition Act, 2002 taking into account, inter alia, that there would be negligible negative impacts on the economy or on the level of competition, and having regard to the specific attributes and nature of the work involved subject to consistency with EU competition rules. (Dobbins, 2008).

It is well established that the Competition Act does apply to workers when they are self-employed, but not when they are employees. While agreements among voice-over actors etc. as to price may have only a negligible impact on the economy, it is nevertheless likely to raise prices in the affected markets. Indeed, in a recent recruiting drive, trade unions claimed that they raise the price of labour.⁴⁴

*Trading Places: Credit Crisis, Banks, Takeovers, and Mergers*⁴⁵

Since 1 January 2003, under the Competition Act, the Competition Authority has had responsibility for merger control in Ireland. All mergers above a certain turnover threshold have to be notified to the Competition Authority. This requires a thorough investigation to see whether the merger leads to a substantial lessening of competition (SLC) and if it does whether there are any remedies that might fix the competitive problems created by the merger. The Competition Authority is a specialist body with expertise in applying the SLC test to several hundred mergers since 2003.

This changed in 2008 with respect to banking where under certain conditions the Department of Finance administers the SLC test. To maintain the stability of the financial system guarantee arrangements to safeguard all deposits with respect to six Irish banks was introduced effective on midnight on September 29 2008 for two years. Coverage was subsequently extended to five banking subsidiaries with significant

⁴³ For further discussion see Whish (2009, pp. 148-164). Section 4(5) provides a legal exception to the prohibition in section 4(1) concerning agreements that prevent, restrict or distort competition, by, for example, price fixing, sharing/allocating markets and/or limiting production, by providing that it may be declared that section 4(1) is inapplicable if certain conditions – specified in section 4(5) – are satisfied.

⁴⁴ See <http://www.ictu.ie/joinaunion/>.

⁴⁵ This discussion draws heavily on Gorecki (2009a).

operations in Ireland.⁴⁶ However, the emergency legislation also amends the Competition Act to give the Minister for Finance control of merger review involving financial institutions.

For such mergers, if the Minister for Finance considers that the proposed one is necessary to maintain the stability of the financial system, then the Minister may approve the merger even if it will result in SLC. Under the legislation, the responsibility for determining whether the merger will lead to an SLC lies with the Minister for Finance, not the Competition Authority. Furthermore, although the Minister for Finance may as he/she sees fit consult the Competition Authority, the Minister may appoint a competition advisor other than the Competition Authority to assist in arriving at a view about SLC.

It is readily acknowledged that maintaining the stability of the financial system is vital for the functioning of markets. In an emergency, mergers may have to be approved rapidly. However, other jurisdictions have combined the flexibility of quick approval but still allowed a key role for the national competition authority in analysing the competitive effects of the merger.

The United Kingdom has one such system. Although the Secretary of State makes the final decision as does the Minister for Finance in Ireland, nevertheless the Office of Fair Trading (OFT) provides an analysis of the competition effects of the proposed merger. This has occurred with the anticipated takeover of Lloyds TSB plc of HBOS plc in which the OFT had from September 25 to October 24, 2008 to make a report to the Secretary of State.⁴⁷

The Competition Authority could have been given a bigger role, especially as the Competition Authority's merger control function generally gets good marks in surveys.⁴⁸ There is ample evidence that competition problems are likely to arise in any merger situation involving banking in Ireland. In 2003, for example, the two leading banks accounted for between 65-75 per cent of the value of personal current accounts. Although there has been some entry since then, the market share of these two banks is unlikely to have declined significantly. As the Competition Authority has conducted an extensive analysis of the banking sector, it has expertise in the area.⁴⁹

CONCLUSIONS

Two conclusions can be drawn from this discussion of recent examples of bespoke protection. *First*, the public choice model of awarding bespoke protection is unlikely to deliver outcomes consistent with welfare economics unless new or revised rules and/or policies are introduced, a subject dealt with in Section 5 below. While from a welfare economics viewpoint there are no grounds for either exempting voice-over actors from the Competition Act or imposing a moratorium on the issuance of new taxi licences, the public choice model would predict that both are candidates for bespoke

⁴⁶ More details may be found at the Department of Finance website, <http://www.finance.gov.ie/>.

⁴⁷ More details may be found on the Office of Fair Trading's website at http://www.offt.gov.uk/advice_and_resources/resource_base/Mergers_home/comment/.

⁴⁸ Based on a survey of stakeholders undertaken independently in preparation for the three-year strategy of the Competition Authority, covering 2009-2011.

⁴⁹ Competition Authority (2005).

protection. *Second*, promoting competition as a policy objective – judged by government policy – has been accorded less weight since the onset of the recession.

4. The Costs and Benefits of Restrictive Regulatory and Competition Policy

INTRODUCTION

Just because these regulatory and competition interventions are off budget and relatively costless to implement in budgetary terms does not necessarily mean that such intervention is not costless. Indeed, the precise opposite is the case. Arguably restrictive regulation and competition costs are higher than budgetary measures designed to achieve the same objective. The latter are more transparent, easier to understand and quantify and thus more difficult to hide from the public. They are thus more likely to be subject to critical scrutiny. Furthermore, in recessionary times budgetary expenditure is less likely to be used to supply bespoke protection through, for example, subsidies. In this section the costs of bespoke protection are presented, together with the benefits.

THE COSTS

There are a number of costs associated with the granting of bespoke protection. These can be divided into four main categories:

- Lower consumer welfare as a result of higher prices and reduced quality of service;
- Misallocation of resources due to dissipation of resources in rent seeking behaviour and X-inefficiency;
- A less flexible economy that will underperform when the world economy recovers ; and,
- Dynamic losses that increase over time.

In each case the nature of the cost will be specified and evidence of the costs will be presented. In general the evidence refers to Ireland. However, the adverse impact of bespoke protection on the ability of Ireland to take advantage of the recovery in the world economy is based on evidence drawn from the US for the 1930s and Japan for the 1990s.

Lower Consumer Welfare: Higher Prices and Reduced Quality of Service

Bespoke protection of the sort discussed above reduces the scope for market forces to allocate resources. Typically in well functioning markets if prices are raised then entry takes place and/or existing firms expand output, thus moderating any price increase. However, with bespoke protection there is much less opportunity for these mechanisms to operate. Entry, for example, may be prohibited. The market becomes less competitive; prices are higher than they otherwise would be and the quality of service may decline. Consumers are worst off and the beneficiaries of bespoke protection are – initially at least – better off, an issue that will be discussed further below.

In many instances the future stream of benefits from bespoke protection are capitalised in the value of the right to engage in the economic activity

that has been restricted. In the case of taxis, for example, it is the taxi licence, in the case of a pub it is also the licence. Table 2 presents estimates of the value of these licences for specific years expressed in 1999/2000 €. In some cases, as noted in the ‘Comments’ column, the bespoke protection has subsequently been abolished, an issue discussed further below. These licence values suggest a non-trivial transfer of resources from a dispersed group – consumers – to the concentrated group receiving the protection. In the case of taxis the evidence suggests that these licence values are high by international standards (Barret, 2006, p. 5).

Table 2: Impact of Restrictive Entry Regulation, Licence Value, Selected Activities, Various Years, Ireland

Regulated Activity	Year Licence Value Estimated	Value of Licence (€1999/2000)	Comment
Pharmacy	2002	Increased value of pharmacy by circa 40%	The restrictive regulations were revoked by the Minister due to a case brought in the High Court.
Pubs	2000	140,000	Geographical mobility of licence, 2000
Road freight	1980	40,000	Dail deregulated, 1986
Taxis	1999	101,000	High Court abolished controls, 2000

Source: OECD (2001, pps. 31, 32, 36) and Purcell (2004, pp. 51-52).

There is less evidence available on the impact of restrictive regulation on prices in Ireland, but the impact of restrictive regulation on airline routes was to raise prices by 18-33 per cent.⁵⁰ Weakening competition policy by exemptions and various administrative measures means that anti-competitive activity, such as cartels, is less likely to be investigated and prosecuted. A large worldwide survey of the impact of cartels on prices concluded that the median impact of a cartel was to raise prices by 25 per cent (Werden, 2008, p. 10).

With competitive pressure being less onerous the quality of service may decline. As noted above, waiting times for taxis decreased once entry controls were abolished. Similarly, with the liberalisation of entry into the airlines the number of destinations served from Dublin increased dramatically and consumers were given a choice of types of service – full service compared to no frills. Although referring to the UK, evidence suggested that where there was more competition among pharmacists service quality improved. For example, *...when a pharmacy faced no other pharmacy within 5km, it was less likely to offer home delivery...* (OFT, 2003, p. 44).

In some cases entry control is geographical thus leading to under-served populations. For example, the people of Knock, Co. Mayo were denied a pharmacy – until the relevant regulations were revoked by the Minister in 2002 due to a case brought in the High Court – despite the fact that Knock had 1.5 million tourists and pilgrims a year because the local health board determined that there was not a market for such a facility despite two

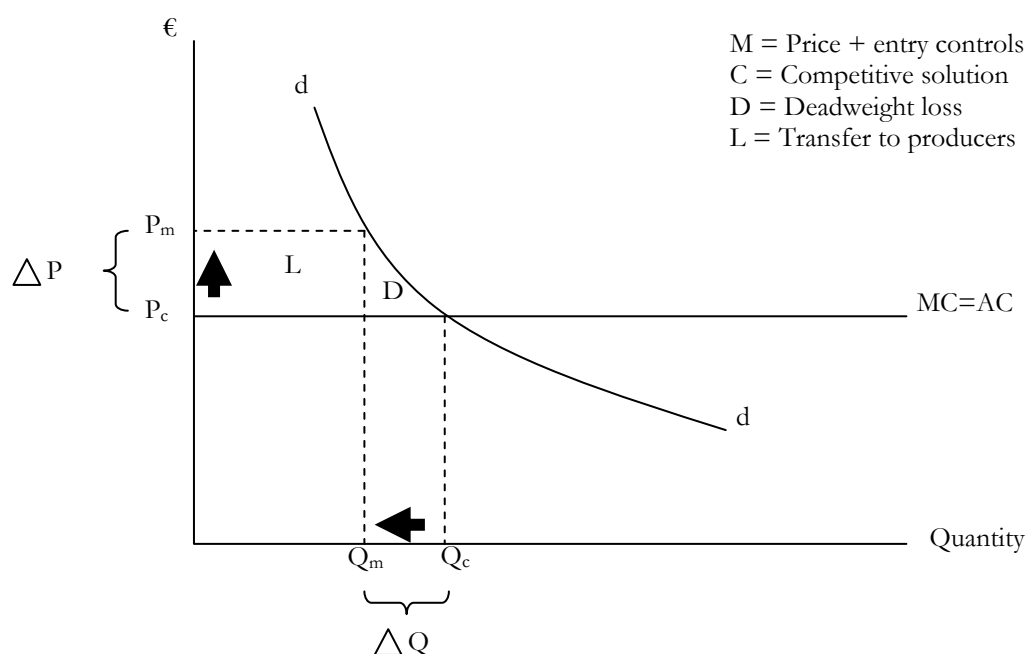
⁵⁰ Real decline in Dublin-London price 1985-1995 was 25 per cent; US airline deregulation 15 per cent price decline. In 1985 the Irish government announced that it had decided to deregulate air transport. For details see OECD (2001, p. 33).

applications to set up a pharmacy in Knock (Competition Authority, 2001b, pp. 12-13). A similar situation existed with respect to pubs where Dublin was considerably 'under-pubbed.' (Competition Authority, 1998, pp. 36-50).

Rent Seeking: Rectangles and Triangles

It could, of course, be argued that the above discussion has overestimated the costs of bespoke regulation, since what is being measured is the rectangle L in Figure 1 which represents a transfer from dispersed groups such as consumers to concentrated groups such as producers. Economists should be neutral on distributional issues. Instead attention should be confined to the deadweight loss of consumer welfare, represented by the triangle D. This is the so-called Harberger (1954) triangle, named after the economist that was among the first to estimate its magnitude due to monopoly, concluding that it was quite small, slightly more than 0.01 per cent of national income. However, this argument does not stand up to critical scrutiny.

Figure 1: Bespoke Protection, Prices and Output



Source: See text.

First, the redistribution of income has not been achieved in an open and transparent manner, compared to a tax increase. Considerable concern has been expressed about so-called stealth taxes; bespoke protection is only one remove from such stealth taxes.⁵¹ *Second*, rent seeking behaviour in the form of lobbying for bespoke protection consumes resources. Such activities are concerned with wealth redistribution rather than wealth creation. Not all requests for protection can be granted. In the political marketplace it is difficult to set out criteria for accepting the demands of group A as opposed

⁵¹ For example, restrictions on entry into taxi services not only redistributes income from consumers to producers, but also prevents the unemployed, for example, from supplying such services.

to group B. Firms and other organised groups will thus lobby for protection. Equally, in some cases, those who oppose bespoke protection will also organise and lobby. The use of resources for these purposes is considered unproductive and therefore a waste. Tullock (1967), Krueger (1974), and Posner (1975) have argued that resources devoted to demanding bespoke protection will be equal to the rectangle L. *Third*, once bespoke protection is awarded then the group that is in receipt of such protection may have to devote resources to retaining that protection as entrants may wish to share in the rents that are being generated. *Fourth*, the rents represented by L in Figure 1 may be dissipated by those in receipt of these rents in a variety of ways. Production may become less efficient as competitive pressure eases; X-inefficiency will become important. As a result cost curves will tend to drift upwards, with the result that the observed L and D based on actual cost data will understate the magnitude of both L and D. In sum, some or all of the rectangle L as well as the triangle D should be considered as the cost of supplying bespoke protection.

Thwarting the Road to Recovery

A recent ESRI recovery scenario for Ireland from the current recession envisages the possibility of a rapid recovery once the world economy starts to pick up (Bergin, 2009, Figure 2, p. 11). A critical implicit assumption is that resources will be able to flow from activities where demand is unlikely to expand such as construction to those where demand is likely to be more buoyant such as electronics and financial services. This in turn implies that there will be no artificial barriers that impede the flow of resources between markets. However, bespoke protection, by raising returns in the protected sector is likely to not only impede the flow resources but also slow adjustment and adaptation.

A number of recent papers have examined the impact of granting bespoke protection to markets in economies suffering a recession. In the US under Roosevelt's New Deal policies certain sectors were made exempt from antitrust laws and cartels were allowed to be formed provided that wages were raised. Cole and Ohanian (2004) in a careful study of the effects of these policies conclude that *New Deal cartelization policies are an important factor in accounting for the failure of the economy to recover back to trend* (p. 779). Equally, in Japan certain sectors were shielded from competition using a variety of instruments including *...weak antitrust enforcement, legalized cartels, subsidies, protection and cooperative R&D* (Porter *et al.*, 2000, p. 117). The evidence suggests that these sectors did not fare well in, for example, export markets. As a result Porter and Sakakibara (2004, p. 47) conclude that unless the *...serious impediments and distortions...* that developed in the 1990s are addressed then *...the period of Japanese economic stagnation will be unnecessarily protracted.*

Dynamic Losses: Bespoke Protection is Not Just for Christmas

The discussion above is largely in terms of static welfare losses. However, as the discussion of how bespoke protection can thwart the recovery from the current recession makes clear, there are ongoing losses which may increase over time. Hence, the dynamic effects of bespoke protection also need to be considered.

Dynamic effects can be divided into two broad groups. *First*, dynamic competition usually refers to innovation through new products and processes. Entrants are often the source of such competition, as they apply a

technology from another market or a person leaves an existing firm to establish a new firm. Bespoke protection frequently restricts entry which removes this source of competition. Furthermore, this leads to less competitive pressure on incumbents who as a result are less likely to innovate. Thus bespoke regulation is likely to harm dynamic competition. As such it is inconsistent with the recently announced government policy of the promotion of the smart economy, which is based on innovation (Department of the Taoiseach, 2008).

Second, dynamic effects occur through the impact of the bespoke protection increasing as the constraints become more binding. The number of licences might be fixed or expand at a rate well below the increase in demand. The result is that each licence holder will experience an increase in demand. Since entry is restricted price is likely to increase and the value of the licence increase. This is clearly observable in the case of taxis where the licence value increased by almost 26 (in nominal terms) and almost 10 (in real terms) fold between 1980, two years after the introduction of bespoke protection to 2000, when it was terminated due to a High Court judgment. (See Table 3 for details).

Table 3: Taxi Licence Value, Dublin, Selected Years, 1980-2000

Year	Value (€) Nominal	Value (€) Real*
1980	4,400	4,400
1985	9,100	5,100
1990	54,600	26,000
1995	89,000	37,400
2000	114,000	42,300

* Deflated using CPI.

Source: Barrett (2006, Table 3, p. 6).

Dynamic costs associated with bespoke regulation will, other things being equal, increase with time. In this respect there are good grounds for arguing that once granted bespoke protection is difficult to reverse. Indeed, there is an inbuilt mechanism to ensure that the regulation becomes more restrictive and binding. The beneficiaries of bespoke protection will defend their turf and their lifestyle. They will adjust to their newfound wealth. In this context it is important to distinguish between the initial and subsequent beneficiaries of bespoke protection. While the initial beneficiary of bespoke regulation earns a rent represented by the capitalised value of the future returns in the licence, the new owner will only earn a normal rate of return and will have an incentive to realise unanticipated further gains. On the other hand, if the bespoke protection is withdrawn then the firms subject to the protection will experience large losses and hence are likely to vigorously resist change and reform.⁵² Tullock (1975) has referred to this as the transitional gains trap. Thus bespoke regulation is likely to be long lived, not temporary.

The evidence presented in Table 4 is broadly consistent with this view, with protection lasting almost a century in the case of pubs. However, it is

⁵² Of course, expectations about the stability of the regulatory regime will be incorporated into the price of a licence. If liberalisation is anticipated then a high discount rate will be used to evaluate future benefits. However, if no liberalisation is anticipated a lower discount rate will be used.

also true that in some cases that the bespoke protection was much shorter – six years in the case of pharmacies. In this case it was revoked by the Minister due to a case brought in the High Court. Efforts were made by both the government and the pharmacists’ representative body to find a way of reintroducing the restrictive entry regulation but to no avail (Purcell, 2004, pp. 48-49).

Table 4: Restrictive Entry Regulation, Duration, Selected Activities, Ireland

Regulated Activity	Start	Reformed/ Abolished	Duration	Comment
Airlines	1932	1986	54 yrs	Abolished. Administrative act
Bus – Dublin	1932	No Reform	77 yrs +	Very restrictive licensing regime
Bus – Inter City	1932	No Reform	77 yrs +	Restrictive licensing regime
Cement	1933	2000	67 yrs	1 licence issued
Supermarkets	2001	No reform	8 yrs +	Restriction on store size of supermarkets, with a lower cap for discounters such as Aldi & Lidl
Pharmacies	1996	2002	6 yrs	Revoked by the Minister due to a case brought in the High Court
Pubs	1902	Partial reform, 2000	98 yrs+	Partial reform; geographical mobility of licence between country and Dublin
Road freight	1932	1986	54 yrs	Dail deregulated
Taxis	1978	2000	22 yrs	High Court abolished entry controls

Source: Barrett (2006); Competition Authority (1998, 2001a, 2008); Massey (2007); OECD (2001, pps. 31, 32, 33, 36).

CONCLUSION

None of the four sets of costs is likely to be readily apparent to the victims – consumers. The costs in terms of lower productivity are in the future and may take sometime to emerge. Linking bespoke protection to slowing the recovery from the current recession may be a difficult stretch for people to accept. Quantification of the impact of bespoke protection requires careful measurement and quantification. This can take considerable time and effort, thus delaying the necessary debate as to the appropriateness of bespoke protection. Nevertheless, in some cases consumers can make the connection between bespoke protection and low quality service, such as the long waiting times for a taxi because of restriction on numbers.

BENEFITS

The benefits and beneficiaries of bespoke protection appear, at first glance, a mirror image of the costs outlined above. The concentrated group, whether it is taxi drivers or pharmacists, receive rents, while the politicians receive support, in return for supplying bespoke protection, in various forms. However, this is somewhat misleading as has already been alluded to earlier in the paper. While it is the case that the firms engaged in the activity

granted bespoke protection are in receipt of rents when the protection is first introduced, when the right is subsequently sold then some or all of the stream of future rents are capitalised in the value of the licence and subsequent participants are likely to earn a normal rate of return – with little or zero rent.

THE BANK GUARANTEE: A COUNTER-EXAMPLE?

It could be argued that one of the largest recent examples of bespoke protection, the two year bank guarantee provided in September 2008, referred to in Section 3 above, is an exception to the picture presented in this and earlier sections, that bespoke protection has little if any merit. It is not clear whether such protection was actively sought by bankers. Intervention to protect the banking system from collapsing is likely to be welfare enhancing, given the undoubted negative externalities in terms of the seizing up of credit markets and loss of faith in this vital sector of the economy. Hence, supplying bespoke protection in the form of the guarantee would, it could be argued, improve welfare and cure a market failure. However, is such a conclusion warranted?

There is an alternative version of events that is consistent with the view that the guarantee is an example of bespoke protection that is needlessly costly to consumers and taxpayers. It appears that the guarantee was supplied in response to the difficulties of one bank – supposedly Anglo-Irish – that was *...unable to roll-over its foreign borrowings and had effectively run out of collateral to refinance at the European Central Bank* (Honohan, 2009, p. 220). Other banks did not face a comparable situation. Hence an alternative course of action to the guarantee, given the insolvency of one bank, would have been to nationalise it and effect an orderly wind down, while at the same time introducing measures to provide more limited assistance to other banks should there be a risk of contagion.⁵³ Such measures might have included *...specific state guarantees for new borrowings or injections of preference shares* (Honohan, 2009, p. 220). Such intervention would not have provided protection to the shareholders of the bank at risk – unless the government overpaid – while the assistance to the other banks would have been limited and appropriately priced. This, of course, did not happen. Hence the fact that the protection provided through the bank guarantee was far more than necessary, suggests that the awarding of the guarantee is indeed an example of bespoke protection consistent with the thrust of the paper.⁵⁴

It should be remembered, however, that the events surrounding the introduction of the bank guarantee and the information available is not all in the public domain so that any conclusion must, of necessity, be tentative.

CONCLUSION

Bespoke protection inflicts large enduring costs on both consumers and the wider economy, while the benefits are ephemeral. As such bespoke protection should be avoided.

⁵³ See Honohan (2009) and Fitz Gerald (2008). The latter suggests that this was the position of the Department of Finance.

⁵⁴ Honohan (2009) and Fitz Gerald (2008) list some of the negative economic consequences of the guarantee.

5. Towards a Solution

INTRODUCTION

In this section of the paper the threads of the discussion are brought together and the policy implications developed. The three questions raised in Section 1 are answered with respect to the demand and supply of bespoke protection. Next, attention turns to policies that should enhance welfare in deciding whether or not to grant bespoke protection. These policies include: the provision of better information; a regulatory budget; and, screens that should be applied before granting such protection.

TWO MODELS AND THREE QUESTIONS

Section 1 of the paper posed three questions with respect to bespoke protection: ‘Why?’; ‘Which Instrument?’; and, ‘What are the Consequences?’ These questions were answered within a public choice and welfare economics framework in Section 2, with the results summarised in Table 1. Sections 3 and 4 of the paper examined the record of bespoke protection in Ireland, enabling Table 1 to be amended to take into account the consequences of bespoke protection, with the results presented in Table 5. The burden of the paper is that the welfare economics model compared to the public choice model is based on a different rationale for supplying bespoke protection, favours using different instruments to provide the protection and has quite different consequences. The public choice model damages consumer welfare; the welfare economics model enhances consumer welfare.

Table 5: Public Choice and Welfare Economics Models: Answers to Three Questions: A Reprise

Public Choice Model	Welfare Economics Model
Q1 Why? Political benefits > political costs	Q1 Why? Market failure
Q2 Which instrument? Regulation/competition; not budgetary	Q2 Which instrument? Preference for more transparency
Q3 Consequences? Stalled recovery, lower consumer welfare, ephemeral benefits	Q3 Consequences? No slowdown in recovery, no long term consumer harm

Source: See text.

This naturally leads to the policy question of can policies or mechanisms be developed that will move policy outcomes closer to the welfare economics model than the public choice model. It may be objected that this is not feasible; that politicians would not agree to such a change. However, this is incorrect. Politicians often make commitments or tie their hands so as to limit their discretion in such a way that welfare is enhanced. For example, Ireland and other countries through GATT and then the WTO have committed through successive international rounds of cutting tariffs and reducing non-tariff barriers where the major beneficiaries are consumers and narrow concentrated groups often are the losers.⁵⁵ A similar argument could be made with respect to Ireland’s membership of the European Union, where the state aid rules have, for example, limited the ability of the Irish

⁵⁵ This is not to deny that concentrated groups of exporters gain from such free trade agreements.

government to provide financial assistance to Aer Lingus after 9/11 as well as to Waterford Crystal. Finally, many countries have assigned control of monetary policy to an independent central bank such as the Bank of England or the European Central Bank.

REDUCING INFORMATION ASYMMETRIES: THE EMPEROR HAS NO CLOTHES

As noted in Section 2 it is much easier to supply bespoke protection where there is information asymmetry. In other words, the concentrated group is well aware of the impact of the bespoke protection, but the dispersed group, usually consumers, is unaware of the cost and may even be under the mistaken impression that the bespoke regulation improves their welfare. Furthermore, for reasons set out above it is rational for the members of a dispersed group not to invest in determining the impact of the bespoke regulation on their welfare – they remain rationally ignorant.

One solution is thus to remove the information asymmetry by supplying an evaluation of the impact of a proposed bespoke protection so that members of dispersed groups are in a position to evaluate the impact of the protection. One of the case studies discussed in Section 3 above concerned whether or not there should be a moratorium on the issuance of new taxi licences. In this case the Taxi Regulator commissioned and issued a report that addressed the question of a moratorium on issuing new taxi licences, firmly rejecting the idea. The availability of such information makes it more difficult for concentrated groups to argue successfully in favour of bespoke protection since there is more likely to be a perception that such protection is likely to have an adverse effect on consumer welfare.

Nevertheless, the provision of additional information is only the first step. As noted above concentrated groups can overcome the free rider problem, whereas dispersed groups find it harder if not impossible to overcome this problem. Thus, some thought needs to be given to how the voice of the dispersed groups can be articulated and thus command attention in the policymaking process. There are already a number of agencies that fulfil this role at the moment. Such bodies are also responsible for the generation of information to make dispersed groups aware of the issues.

The Competition Authority has a specific role under the Competition Act to comment on the *...implications for competition in the market for goods and services of proposals for legislation (including any instruments to be made under any enactment)*. It has taken this role with respect to, for example, taxis. Similarly, the National Consumer Agency has also made representations concerning bespoke protection in the taxi market. Individual regulatory agencies, to the extent that they are mandated to promote consumer welfare, may also play a similar role, albeit confined to a single sector. The role of the Taxi Regulator and the CER has already been alluded to in this respect. The regulatory impact analysis procedure discussed below is another mechanism with respect to new regulatory legislation. Finally, the Department of Finance might play a stronger role.⁵⁶ It is concerned with the overall efficiency and growth of the economy and research cited above shows how damaging bespoke protection can be to the economy and it would seem that this Department would have

⁵⁶ See, for example, Cowen (2007).

a major interest in promoting mechanisms and policies that limit such protection. Without such effective mechanisms and policies ongoing structural change will be more difficult to achieve.

REGULATORY BUDGET: A TAX IS A TAX IS A TAX

Bespoke protection is essentially taxation by regulation and relaxing competition policy. By supplying such protection the concentrated group is able to impose a small per unit quasi tax on purchasers of the group's good or service. However, as discussed above the cost is more than just the initial price hike; there is also likely to be a reduction in quality, while, over time, dynamic costs such as lower levels of innovation, will occur. Since all of these quasi tax increases are off-budget the result is that there is likely to be little if any discussion concerning the burdens imposed by the bespoke protection.

One option to redress this imbalance is the introduction of a regulatory budget.⁵⁷ Such a budget would quantify the quasi taxes imposed by any bespoke protection that is being proposed. Furthermore, the revenue generated by these quasi taxes would be allocated to the relevant government department; the Department of Transport in the case of a cap on taxis; the Department of Communications, Energy and Natural Resources for the increased regulatory risk because of the Minister's intervention in the determination of electricity prices.

It is, of course, recognised that estimation of the quasi tax imposed by bespoke protection will not always be easy. There can be genuine differences about the magnitude of the quasi tax. There may be considerable administrative costs in the provision of the budget in terms of collecting the necessary information. It is perhaps for reasons such as these that although the idea of a regulatory budget has been discussed for around 30 years, it is only recently been introduced in the UK: a trial run in 2009 before full implementation in 2010.

However, to a considerable degree, while discussions over the practicality of a regulatory budget are of obvious importance, such objections miss the point of introducing a regulatory budget. The purpose is not to present precise estimates and generate large volumes of consultants' reports. Rather the purpose is to get policymakers to realise that bespoke protection imposes costs which should be explicitly taken into account in any decision making process.⁵⁸

⁵⁷ For a discussion of the concept of a regulatory budget see, for example, DeMuth (1980), Doern (2009) and Thompson (1998). Doern reviews the developments in the UK referred to below in the text.

⁵⁸ It could be argued that tax expenditures are similar to bespoke protection in that they are less than transparent. In this respect it should be noted that the Department of Finance does publish estimates of such tax breaks and has undertaken a major review of said tax breaks. (For details see the Department of Finance's website: <http://www.finance.gov.ie/ViewDoc.asp?fn=/home.asp>). There seems no reason in principle this could not be extended to bespoke protection.

EXEMPTIONS AND REGULATORY IMPACT ANALYSIS

An important part of policymaking is necessarily evaluation. Policies should be adopted where the benefits outweigh the costs and thus society as a whole is better off. To inform such decisions analysis and study are required. However, this can be a time consuming exercise and as a result screening devices are introduced so that only the most important instances of government intervention are analysed. For example, policy interventions that are likely to impose costs above a certain minimum threshold or the likelihood that significant competition problems will occur would be subject to extensive analysis. These issues are considered first with respect to exemptions from competition law and then the introduction of restrictive regulation.

Exemptions from the Competition Act

The Competition Act is a law of general application that covers all sectors of the economy. It does not prohibit all forms of cooperation between businesses. An agreement that does not have as its object or effect the restriction of competition is not an offence under the Competition Act; equally a merger that does not substantially lessen competition would not be prohibited. The Competition Act only applies to undertakings – persons or organisations – involved in the sale of goods or the supply of services for gain. Hence, certain thresholds need to be met before the Competition Act comes into play. Even when the Competition Act is breached, in the first instance, there are mechanisms within the Competition Act that may mean an otherwise anti-competitive conduct is still permitted. A dominant firm that is apparently abusing its dominant position may have an objective justification; an anti-competitive agreement that apparently raises prices may improve economic progress, reduce costs and benefit consumers; and, a merger that apparently leads to SLC may be permitted if it leads to efficiencies that result in lower overall prices to consumers. Thus competition law contains within it a system of checks and balances designed to improve consumer welfare even for otherwise anti-competitive conduct. Thus if government is going to exempt the activity of a certain group from the Competition Act, it should first determine whether or not it can satisfy the relevant conditions as set out above. If it does not – as appears to be the case in voice-over actors, discussed above – then the government should be required to provide compelling public interest reasons for such a policy move. In the case of voice-over actors this has not been forthcoming, setting an unsettling precedent.

Screens and Full Regulatory Impact Analysis

Ireland has recently developed a system of reviewing proposals for regulation.⁵⁹ It is a two-part regulatory impact analysis (“RIA”) procedure: first, a Screening RIA for selecting those regulations that should be subject to further analysis;⁶⁰ and second, a Full RIA, an evaluation of the proposed regulation that may lead to a full cost-benefit framework. This is clearly a

⁵⁹ For details of the programme see the better regulation website at: <http://www.betterregulation.ie/eng/>. Accessed 17 June 2009.

⁶⁰ On screening filters see, for example, Lyons (2005/6); and Lyons and O’Toole (2006). A Screening RIA results in significant regulations being selected for a Full RIA. Significant means initial costs of at least €10 million or cumulative costs over 10 years of at least €50 million. For further details see Department of the Taoiseach (n.d.).

move in the right direction. In order to ensure that a healthy debate occurs it is important that RIAs are published which is the intention of government. RIA is clearly a promising development in ensuring that the costs and benefits of bespoke protection are taken into account in decision making. However, it is too early to come to a judgment as to its effectiveness.

It may seem a bit odd, perhaps even out of place, to present a paper on the supply and demand for bespoke protection at a conference on budgetary perspectives. However, that would be too narrow a perspective. A little like the drunk who, on losing his keys at night, only looks under the street lamp where the light shines. The rigor and transparency of the budget process leads to a substitution effect as organised groups use alternative instruments to achieve effects comparable to a tax increase. It is, therefore, important to examine these effects and to the extent possible ensure that the use of these alternative instruments is subject to the same rigor and transparency as taxes are subject to through the budgetary process.

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