

**Key Findings  
of  
A Study Looking At  
Minimum Markup Laws  
and  
Sales-Below-Cost Laws:**

*Effects on Market Structure and  
Employment*

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## Study Shows That Fair Marketing Laws Are Good for Consumers, Good for States That Adopt Them

A growing number of research projects show that Fair Marketing Laws, particularly sales-below-cost laws and minimum markup laws (SBC/MM), benefit consumers.<sup>1</sup> These studies provide compelling evidence showing that states that adopt SBC/MM laws see lower retail prices over time compared to states that do not or have repealed such laws.

**The reason is clear:** Fair marketing laws create a more competitive retail structure in terms of the number of competitors, greater employment in those outlets and lower wholesale prices brought on by this enhanced competitive structure resulting in lower retail prices and markups vis-à-vis the increased number of competitors vying for market share. Opponents need not fear that SBC laws protect inefficient gasoline resellers. In fact, for small firms to survive, they must be efficient in order to compete in the ever-changing gasoline market.

### SBC laws lead to more establishments, increased employment and lower prices:

- After five years, the number of retail establishments increased by about 3.2%.
- This created about a 2.4 % increase in employment.
- SBC/MM laws, though not directly correlated with wholesale prices, still have a significant negative direct effect on prices (about 0.5 cents).
- In total, the direct effect on prices, and the indirect effect of lower wholesale and retail prices generated from having more retail establishments, results in a nearly 1 cent per gallon decrease in retail prices after five years.
- Evidence shows that one way SBC/MM laws lower prices is through an increased number of establishments.
- SBC/MM laws increase the number of small and medium- to large-size establishments (4.1% for medium to large establishments, 5 or more employees, and 2.9% for small establishments, 1-4 employees).
- SBC laws cause a slower rate of decline in the number of outlets in recent years.

**Table 1: Comparison of Average End-user Price, 1983-2003**

	Years When SBC Law Is in Effect	Years When SBC Law is Not in Effect
<b>Retail Price (in cents)</b>	81.73	84.06

**Table 1 Summary:** Initial evaluation of the possible effects of SBC/MM laws shows a simple comparison of retail prices for all states during the years 1983-2003.

**Result:** Average monthly inflation-adjusted prices net of taxes are more than 2 cents per gallon lower in states/years where the law was in effect relative to those states/years in which there was no law.

## **SBC/MM Laws Foster Competition and Maintain Low Gasoline Prices**

- SBC laws foster competition by preventing large, high-volume firms from posing a predatory threat to smaller and/or independent retailers.
- In the absence of SBC/MM laws, larger firms can lower prices below cost, drive out smaller firms and, by gaining increased market share, raise prices since no competition exists.

In the broadest sense, supporters of minimum markup and sales-below-cost laws (SBC/MM) in general, and gasoline-specific laws in particular, contend that such laws protect the competitive structure of the retail gasoline market in one of two ways:

1. SBC laws foster competition by preventing large, high-volume firms from posing a predatory threat to smaller and/or independent retailers. Without such laws, larger firms could drive out smaller firms by lowering prices below cost. Once the smaller competitors close their doors, the larger, high-volume firms gain an increased market share, ultimately leading to higher prices due to lack of a competitive environment.

“If the victim has limited financial resources to fight a predatory price war, as often occurs with new entrants, the predator may successfully be able to force it to exit. Future entry will be deterred by the same fate ... With just a small amount of uncertainty in an entrant’s mind about whether the incumbent will respond to entry aggressively, a dominant firm can deter future entrants by establishing a reputation for behaving aggressively.”<sup>2</sup>

“In short, there is some reason to believe that predatory actions can and do occur, and that they often work to preserve monopoly power.”<sup>3</sup>

2. In the absence of predatory pricing, proponents maintain that SBC/MM laws reduce market concentration by maintaining the number of competitors in the market or reducing market share held by the largest firms. The end result of leveling the playing field is a more price-competitive market.<sup>4</sup>

### **The Benefit/Harm of Reduced Market Concentration**

- Critics argue that decreased market concentration is a detriment to consumers, arguing that inefficient retailers are protected. If true, these same critics would need evidence that such laws actually protect the smallest firms to the detriment of consumers. Research shows just the opposite to be true.
- Proponents argue that consumers are the beneficiaries due to enhanced local competition.
- SBC/MM laws reduce the retail price and markup.
- SBC/MM laws affect retail prices indirectly by preserving a strong independent retailing sector.

One of the main criticisms that opponents cite against enactment of SBC/MM laws is that they protect small and/or inefficient sellers. Available research examining this issue shows just the opposite to be true:

- Inefficient grocery retailers fared no better or worse in states with or without SBC/MM laws.<sup>4</sup>
- SBC/MM laws had no impact on determining the viability of small resellers (in this case, retailers) in an absolute or relative sense, nor did SBC/MM laws play a significant role in minimizing bankruptcies.<sup>5</sup>
- SBC/MM laws do not enhance or diminish the viability of the smallest gasoline retailers.<sup>6</sup>
- Although SBC/MM laws help to preserve the number of retail gasoline outlets, no statistical difference was found regarding the preservation of the smallest gasoline retailers.<sup>7</sup>
- SBC/MM laws reduce the retail price and markup; the market concentration and power literature provides a basis for positing that SBC/MM laws affect retail prices indirectly by preserving a strong retailing sector.<sup>7</sup>

## **Gasoline Market Factors Also Play a Role in Pricing**

### **Price Uniformity and Price Volatility**

- Tacit collusive behavior is more likely to be found in markets where mergers have taken place and, as a consequence, has raised market concentration.<sup>8</sup>
- Prices were higher as the distance between competitors increased.<sup>8</sup>

### **Importance of the Independent Retail Sector**

- Preserving the independent retail sector decreases local retail gasoline prices through increased price competition.<sup>9</sup>
- A stronger independent retailer sector leads to lower gasoline prices.<sup>9</sup>
- A decrease in market share of larger, branded firms was greater in magnitude than that associated with a higher share for independent retailers, contributing to lower overall prices.

### **Additional Studies on Market Concentration, Market Power and Price**

There is overwhelming evidence that, in many industries, increased market concentration places power in the hands of a reduced set of competitors, which often leads to higher prices. In varying degrees, recent gasoline pricing studies all highlighted the importance of maintaining a balance of competitors.<sup>10</sup> Another study found that an increase in station density decreased price.<sup>11</sup> It is also noted that competition authorities in European countries have shown that integrated firms utilize collusive agreements to restrict price competition, particularly in locales with a limited set of competitors.<sup>12</sup>

In California, two recent studies, one for the California Program on Workable Energy Regulation, concluded that the primary reason California has gasoline prices far above the national average is the weak independent sector at both the refining and retail levels.<sup>13</sup>

## **Fair Marketing Laws Impact Industry Concentration**

- The number of outlets appears to be higher in states with gasoline-specific SBC/MM laws.<sup>14</sup>
- The presence of a motor-fuel SBC/MM law is associated with a slower rate of decline in outlets.<sup>6</sup>
- The conclusion: SBC/MM laws protect the competitive nature of the gasoline market.<sup>6</sup>
- SBC/MM laws lower prices by about 1 cent per gallon after 5 years. The primary route by which SBC/MM laws affect prices and markups is through increasing the number of establishments.<sup>1</sup>

It is contended that SBC/MM laws place firms with different financial resources on a more equal footing.<sup>4</sup> As a consequence, an equally efficient but less powerful firm can compete more effectively in markets with SBC/MM laws.

Two studies from the “anti-SBC/MM” literature show that SBC/MM laws have a direct and positive impact on maintaining a more extensive and competitive market. A 1999 study indicated that the “presence of a motor-fuel SBC law is associated with a slower rate of decline in outlets.”<sup>6</sup> Specifically, a study of the impact of SBS/MM laws on gasoline prices notes that “the number of outlets also appears to be somewhat higher” in states that have gasoline-specific SBC/MM laws and that “the presence of a motor-fuel SBC/MM law is associated with a slower rate of decline in outlets.”<sup>14</sup> The study concluded that “it is possible that these laws have helped to maintain a stronger independent retailing sector” since such laws protect the competitive nature of the gasoline market.<sup>14</sup>

In 2005, updated information was utilized to again examine the relationship between the presence or absence of SBC/MM laws and the number of retail gasoline outlets.<sup>7</sup> Again the conclusion was the total number of outlets was greater in the presence of the law.<sup>14</sup>

## **Conclusion**

The complete study, detailed under separate cover, was performed by Dr. Jimmy Peltier, the Irvin L. Young Professor of Entrepreneurship and Professor of Marketing, and Dr. Mark Skidmore, Department Chair, Professor of Public, Labor and Urban Economics, Fiscal and Economic Research Center, both of the University of Wisconsin-Whitewater. They examined the impact of gasoline SBC/MM laws on consumers to better understand why these laws do, in fact, lower the prices and markups consumers pay for gasoline.

The study conclusively identified that one main benefit of SBC laws is that they protect the competitive structure of the market, where equally efficient, though less powerful, retailers are given the opportunity to compete. This finding, coupled with the results found in general and gasoline-specific market concentration studies, suggests that

enhanced competition resulting from SBC/MM laws is the likely driver of lower gasoline prices in those states that have adopted fair marketing laws.

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**Comment [jb1]:** Unsure of first and last name here. The order should be first name last name