

**IAS BRIEFING PAPER: USE OF
ALCOHOL AS A LOSS-LEADER**

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Summary

The heavy discounting of alcohol is a problem that has come under increased scrutiny by various parties. A recent meeting between the Prime Minister and interested parties discussed binge-drinking culture in the UK. The issue of loss leading with alcohol was discussed, demonstrating the importance of the issue. While the Competition Commission has been unable to rule against this practice, a future government review into pricing and alcohol may yield some further developments.

Loss-leading with alcohol

British supermarkets have increasingly been using alcoholic products as loss leaders in their stores. Such a practice has alarmed groups as diverse as the alcohol policy field, the Campaign for Real Ale (CAMRA), the Association of Convenience Stores (ACS), the media and others. This practice may also be referred to as deep-discounting or selling below cost.

*A loss leader is defined as: "A good which is priced low, possibly even below cost, to attract customers who are expected to buy other goods which yield a profit. The use of loss leaders can be profitable only if consumers are more conscious of the relative prices of some goods than of others. This may be so, if goods differ in how easily their quality is checked, and how frequently they are bought. Selling cheap goods about which customers are well informed may be used to attract custom for other goods on which they are less well informed, and can therefore be exploited."*¹

For many years large supermarket chains have used staples such as bread as loss-leaders, in the manner described above. The reason for recent worries concerning this practice stem from the fact that alcohol is unlike other products available for sale in the supermarket. Alcohol is an addictive good that when consumed excessively can cause harm to one's health and may be the cause of wider social harm. Therefore, **many claim that using alcohol as a loss-leader is an irresponsible practice.**

The response of supermarkets to allegations concerning loss-leading with alcohol tend to revolve around free competition and consumer choice. They claim that they have the right to price goods as they see fit and that any interference in this is anti-competitive and out of line with common practices in a free market. They also claim that consumers have the right to affordable goods and that their customers particularly enjoy the availability of cheap alcohol in their stores.

As a rebuttal to these claims, other groups claim that such practices risk putting smaller vendors out of business, as they can not compete with the larger chains on price. One could also debate the extent to which improved consumer choice is reflected by the high sales of alcohol in supermarkets when one realises this alcohol is being sold at a potential loss by the supermarket, thus blurring the lines of supply and demand usually used to determine price, and is heavily promoted in a way to encourage impulse buying.

With regards to the pricing of alcohol in supermarkets, Scottish and Newcastle find the typical cost of a standard alcohol unit within the UK on-trade to be £1.02, while the typical cost in a multiple outlet is 30p per unit². CAMRA found the price of lager in some major supermarkets to be only 5p more than a pint of water³.

The pre-loading phenomenon

The proliferation of cheap alcohol for sale off-trade has arguably led to a rise in pre-loading. This describes how many drinkers tend to purchase alcohol for home consumption before the commencement of an evening spent at on-trade premises. This can lead to drinkers consuming more alcohol than they may do otherwise, with the resulting health and social consequences that are to be expected. There is a definite need for future research to ascertain quantitatively the extent that below-cost selling of alcohol has led to the increase in pre-loading experienced.

Since 2005, a number of licensed premises have stopped offering so-called ‘happy hour’ promotions and deals such as ‘£20 for all you can drink.’ This was intended to reduce levels of binge drinking and the associated effects experienced in pubs and bars⁴. However, alongside the growing availability of cheap alcohol for home consumption this action may have led to some extent to the growth in pre-loading of alcohol. Potential binge drinkers seemingly choose to get intoxicated in the most cost effective way. While previously this may have resulted in visiting whatever bars were offering drinks at a discount, **the fashion has shifted somewhat towards high levels of initial home consumption**. For instance, a recent Scottish study noted that “It was also mentioned that as licensing hours are more varied now there was less of a rush to get to the on-sales premises, and also people were substituting pub attendance with front loading then going straight to nightclubs.”⁵

While drinkers continue to head to pubs to enjoy the social aspects of drinking, a combination of factors have meant that it has become a more affordable option to drink at home first before heading out. To combat this, one needs to look at the pricing practices of off-trade shops, as well as calling upon on-trade premises to enforce to the best of their abilities the rules concerning serving drunks and admitting already drunk patrons to their premises. Studies have found that many premises continue to serve alcohol to obviously intoxicated persons⁶.

A recent study found that drinkers who “reported drinking prior to attending nightlife reported significantly higher total alcohol; consumption over a night than those not drinking until reaching bars and nightclubs.”⁷ It was also found that individuals who drank before going out were more likely to report drinking over 20 units on a usual night out and were over twice as likely to have been engaged in a alcohol-related violence in the nightlife of a city in the last 12 months. The authors conclude that “continued disparities in pricing and policing of alcohol between on- and off-licensed premises may increase at-home drinking prior to nights out and alcohol-related problems in residential areas”^{IBID}.

The Competition Commission and the Groceries Market Inquiry

The Competition Commission has now published the Final Report of its Groceries Market Inquiry⁸. The conclusion was reached that a ban on the selling of alcohol as a loss-leader is not advisable. The Competition Commission does not consider health implications when assessing the issue, due to this being outside its sphere of interest.

In January 2007 the Competition Commission released *Emerging Thinking*, which set out their thoughts at that time on “competition in the supply of groceries by retailers in the UK on the basis of the evidence... analysed to date.”⁹ These thoughts were fully reflected in their Final Report.

In *Emerging Thinking*, the Commission draws attention to the main trends in the grocery market in recent years, including an increase in grocery sales, a fall in the real price of food and a growth in sales at both supermarkets and convenience stores. The report notes that sales at specialist convenience stores have grown at a much slower rate than elsewhere. The three areas that the Commission considers the most important to their investigation are “the behaviour of grocery retailers towards their suppliers; the conduct of grocery retailers and consumers as well as the structure of any local market for groceries; and land and planning issues.”¹⁰

With regards to alcohol, the Competition Commission admits that the social impact of low-priced alcohol sales has been brought to their attention. **The review found ten grocery retailers engaging in below-cost selling, which represent up to 3% of total revenue for these retailers. It was found that the two main product groups sold at below cost were alcohol and dry groceries.** Rather than focusing on the potential social costs due to the widespread use of alcohol as a loss leader the Commission looks at whether this practice may adversely affect smaller retailers who rely on the sales of alcohol as an important source of revenue. If the number of small retailers were to dwindle this would mean less choice for the consumer.

It was widely reported that the Competition Commission were going to reject a ban of selling alcohol below cost upon publication of the final report¹⁰. The Commission ruled that enforcing a ban on below-cost sales of alcohol would be difficult to enforce and would not be in the interests of consumers. The Commission published their provisional findings report on 31st October 2007 and again stated that “below cost selling (of alcohol) is not having significant unintended effects on convenience stores and specialist grocery retailers”¹¹

In an appendix to the provisional findings report, the Commission expand more fully upon their findings relating to below-cost selling. Alcohol was found to be among the main product groups that supermarkets sold at below cost, with 6 out of 7 of the main respondents doing so in the period between January 2005 and June 2006.¹²

The Commission looked at how extensive the practice of below-cost selling of alcohol was during the football World Cup of 2006. This was noted as a period of particular intensity for such activity. It was found that the “total sales value of below-cost alcohol sales during the World Cup by the five grocery retailers was approximately £38.6 million.”^{IBID}

Tesco explained to the Commission that this had occurred due to the intense competition between retailers at the time, the use of point of sale advertising related to the World Cup and due to World Cup-related promotions on the alcoholic products themselves.

The Commission says that “during this period of heavy promotion there was no increase in the number of products sold below cost, although there was an increase in sales.”^{IBID}

Response of relevant parties

Presented here are some of the varied views of groups who have an interest in the debate over loss-leading with alcohol.

“In our view, the Groceries Order is a highly inappropriate and disproportionate mechanism by which to seek to control alcohol consumption”¹³ Department of Enterprise, Trade and Employment (Ireland)

“By intensive ‘below cost selling’ in a particular product range, the specialist retailer, who only has that range and a little more to sell, is affected. If this carries on, the number of specialist stores, in this case off licences, will decline and the service to the public would be removed.”¹⁴ The Proudfoot Group, Response to Emerging Thinking.

“We look at what's good or bad for consumers in terms of their pockets rather than their livers”¹⁵ An inquiry source from the Competition Commission, quoted on the Observer website.

“Supermarkets should not sell alcohol below cost price and preventative measures should be introduced if necessary. The result of below-cost selling is likely to be a rise in consumption, leading to more alcohol-related disease, social disorder and other social problems. It is highly irresponsible for supermarkets to sell alcohol below cost or at a deep discount, knowing the likely consequences. If supermarkets wish to make a positive contribution to the health of the nation and be more socially responsible, they could switch to discounting healthy foods.”¹⁶ Royal College of Physicians, Evidence to Competition Commission Inquiry into Groceries Market

“The ridiculous practice of the major supermarkets selling below cost for alcohol to out-price each other is reckless, irresponsible and dangerous. To put it in perspective some bottled water in the supermarket costs 49p a pint and water is not subject to excise duty as alcohol is.”¹⁷ CAMRA Chief Executive Mike Benner responding to CAMRA’s finding that lager was for sale at the equivalent of 54p a pint.

“We price a small number of items below cost primarily because we do not wish to be beaten on price on those items by our competitors. For the avoidance of doubt, we do not set our prices with the intention of driving smaller retailers from the market.”¹⁸ Tesco submission to the Competition Commission, 30/03/2007

“We do not engage in this practice”¹⁹ Tesco response to a consumer’s claim that the company uses loss-leaders to compete

“This House believes that the substantial price differential between alcohol sold in pubs and that sold in the off-trade is exacerbating the problem of binge drinking; continues to support the pub trade's efforts to curb irresponsible drinking and promotions; and urges supermarkets and off-licences to follow the example of pubs and act to end irresponsible drinks promotions and agree not to use alcohol as a loss leader on their premises”²⁰ PRICE OF ALCOHOL IN SUPERMARKETS AND OFF-LICENCES: Early Day Motion (495), proposed by John Grogan, 13/12/06

“We strongly believe that the sale of alcoholic drinks at low cost, used primarily to drive ‘footfall’ into stores, is not consistent with the promotion of responsible drinking”²¹ Scottish and Newcastle UK submission to the Competition Commission, June 2006

“Our experience is that the competition between the various multiple retailers acts as a most efficient control mechanism on any attempt at predatory pricing”^{IBID} Thierry’s Wine Services submission to the Competition Commission, December 2006.

“Asda considers that persistent pricing below cost can be a necessary feature of competitive pricing for an individual grocery retailer: either because competition on various products is particularly intense and all retailers price below cost or because one retailer has a better cost price and another retailer considers it must match”²² Asda submission to the Competition Commission, August 2006.

“The tacit acceptance of such market distortions is having a knock-on effect in other markets, and is providing an apparent justification for dangerous consolidation”²³ The New Economics Foundation submission to the Competition Commission

Minimum pricing as a policy response

The enforcement of a minimum price regime for alcohol is one policy idea put forward to combat the sale of alcohol at below cost. While the concept seems wholly advisable from a public health perspective, there are numerous other important considerations that cannot be ignored. The situation with regards to the law remains ambiguous, but there have been examples of Local Authorities introducing minimum pricing.

Such a policy could take one of many forms. There could be the enforcement of a point-of-sale minimum price whereby shops and pubs are not allowed to sell alcoholic products below a price determined by the government. This price could be set in order to lower harm and yet not be set too low to be termed excessively regressive or an impingement on consumers' rights. Another method could be the introduction of a minimum profit mark-up. This would be more difficult to enforce as it would necessitate an open divulgence of profits and suchlike by the industry, supermarkets etc. The method would work by ensuring relevant parties in the alcohol industry make a minimum profit on the sale of alcoholic products, ruling out the sale of such products at a loss.

The law perspective

Minimum pricing is a policy intrinsically connected with competition law. In order to introduce minimum pricing one has to contend with national competition law and Europe-wide competition law. Under national competition law (UK Competition Act 1998), it is apparent that the introduction of minimum pricing by local authorities is legal, if a regulatory body has recommended it with no input from the trade. If the industry has been involved in any decision then the policy would be termed anti-competitive due to the resemblance of the situation to that of a cartel.²⁴

With regards to European competition law, of particular note are Articles 28 and 30²⁵. EU law is of great importance especially if the government, say, wishes to impose a national minimum price on alcohol²⁶. Article 28 of the EC Treaty covers quantitative restrictions on imports in countries in the EU. The promotion of free movement of goods across national boundaries is the motive behind such legislation, which would rule against minimum pricing unless it could be set in a way in which imports were not at as disadvantage competitively compared with national produced goods. This is one reason why an increase in taxation is easier to justify from a law perspective at it would not discriminate against in which country the alcoholic produce was made.

Article 30 provides a potential legal loophole regarding minimum pricing. It states that the provisions of Article 28 do not preclude considerations of public morality, public policy or the protection of health and the lives of humans. For this to stand one also has to show that a policy such as minimum pricing is proportionate to the objectives sought. One may also have to demonstrate that such objectives cannot be achieved in a less intrusive way. For this reason again, an increase in taxation on alcohol may be the more sensible option.

A recent Parliamentary Question set out the government's take on the issue²⁷ :

Minimum Pricing Scheme

Mr. Don Foster: To ask the Secretary of State for Culture, Media and Sport what advice she has received from the Office of Fair Trading regarding advice for local authorities on minimum pricing schemes in licensed premises; and if she will make a statement.
[196767]

Mr. Caborn: Advice was taken from the Office of Fair Trading (OFT) in the preparation of the guidance issued under section 182 of the Licensing Act 2003 to licensing authorities, which was published in July 2003. Their advice was reflected in paragraph 7.79 of the guidance (available at www.culture.gov.uk) and includes "The promotion of price fixing or the creation of cartels is unlawful, and there would also be serious risks of breaching competition law." We understand that the Prime Minister's Strategy Unit and the Home Office have also consulted the OFT about this issue in connection with the Alcohol Harm Reduction Strategy.

The economic perspective

From an economic perspective, minimum pricing is not the most advisable way to solve the problems caused by alcohol abuse. Economic theory illustrates that an overall rise in taxation would solve this problem more efficiently. The reasoning behind this is that by introducing a minimum price for alcohol, producers will be guaranteed a price floor over which they have to sell their product. This should indeed reduce demand for alcohol by consumers who will find that they have to pay a higher price for the product. However, producers would now find themselves guaranteed a price above what they were previously offering and so will increase production. Consumer demand will fall and producer supply will increase together this will lead to an excess supply of alcohol in the market. Thus, by interfering in the market clearance price of alcohol, the government would risk sending signals to the market that result in skewed levels of demand and supply. A tax could arguably be more closely set at the correct level at which it covers the harm caused by alcohol than the setting of a price floor. There is the possibility that the average price of alcohol will fall and dumping on overseas markets will also occur. Advertising and other promotional activity would be sure to increase.

The public health perspective

Minimum pricing is a sound idea from a public health viewpoint because it would help solve the problems of excessively cheap drinks. Such drinks are assumed to be favoured by the most chronic of drinkers who choose to consume their alcohol in the cheapest manner possible, so as to be able afford a greater amount of alcohol. While the introduction of minimum drinks pricing may be difficult due to issues discussed in relation to the law perspective and economists may not favour the technique, public health advocates may tend to emphasise that debate should focus on whether such a policy would have benefits for health.

The introduction of minimum pricing would stop the use by supermarkets of alcohol as a loss leader. While supermarkets claim that people spread their drinking out no matter how much alcohol they purchase at one time, others tend to dispute this. Drinkers who have access to a large supply of cheap alcohol are likely to drink both more regularly and to consume a greater amount of alcohol overall²⁸.

Case study: Taunton, Somerset

Taunton is useful as an illustration of the bureaucratic ambiguity relating to minimum drink pricing. Due to worries that incidents of violence as a result of alcohol consumption were having a detrimental effect on the town's reputation, Taunton Deane Borough Council introduced the "drink safe, be safe" scheme. Alongside measures to reduce binge drinking such as getting premises to agree to the provision of free drinking water, a voluntary minimum drink pricing policy was agreed upon along with a promise to engage in no irresponsible promotion of drinks.

The difficulties in getting a policy related to the minimum pricing of drinks were widely reported²⁹. The Office of Fair Trading (OFT) agreed initially with the proposals before reversing their decision due to the stipulations of the Competition Act. The OFT then directed the licensing manager for Taunton to the Home Office. The Home Office then referred him to the Department of Culture, Media and Sport, who sent the licensing manager back to the Home Office. The Home Office then instructed him that they were presently in consultation with the OFT. Eventually a minimum pricing policy for the area was indeed introduced, with the agreement of the licensees. From October 2004 the minimum prices for a pint of beer, a single spirit measure³⁰ and bottled beer or alcopops were £1.50, £1 and £1.25 respectively.

Office of Fair Trading's (OFT) advice to Local Authorities Coordinators of Regulatory Services (LACORS) regarding minimum drink pricing, 12/01/05

The following is an exact transcription of the advice given by the OFT to LACORS concerning minimum drink pricing.

1 I understand that LACORS (Local Authorities Coordinators of Regulatory Services) provides advice and guidance to help support local authority regulatory and related services.

2 You have asked for our views on the introduction of minimum drinks pricing schemes to curb excessive alcohol consumption. Accordingly, this note sets out our position on the introduction of these schemes by the police and licensing authorities and also ensures that you are aware of the legal considerations that apply.

3 The Office of Fair Trading's (OFT) goal is to make markets work well for consumers, by ensuring that constraints on open competition are removed. Thus, it has a duty to uproot and deter all forms of anti-competitive behaviour, including cartels and other anti-competitive agreements.

4 The OFT fully appreciates the efforts of the Home Office, the police and local authorities to arrest irresponsible drinking in city centres. However, agreements between licensees that stipulate minimum alcohol prices are likely to raise significant concerns under competition law.

5 Price is a key factor in competition, which is a process of rivalry between firms to win consumers' business, by achieving lower levels of costs and prices. Competition benefits consumers by driving down prices or exploiting a firm's particular advantages to meet customer need more effectively than its competitors. Agreements that restrict price curtail this rivalry, leading ultimately to loss of quality and choice for the consumer.

Competition Act 1998 ("the Act")

6. The OFT is charged with enforcing the Act. Its primary purpose is to ensure that businesses compete on a level footing. It does so by prohibiting all forms of anti-competitive behaviour, such as price fixing, cartels and the abuse of market power. The Act was amended by the Enterprise Act 2002, which came into effect in June 2004. It introduced among other things a cartel offence under which individuals, who dishonestly engage in cartel agreements, may be criminally prosecuted and disqualification orders for directors of such companies.

7. Chapter I of the Act specifically prohibits agreements, decisions by associations of undertakings and concerted practices which have as their object or effect the prevention, restriction or distortion of competition to an appreciable extent and which may affect trade within the UK. For a price fixing agreement to fall within the scope of the Act, there needs to be an agreement between undertakings. The term "undertaking" has been defined very broadly to include any natural or legal person, irrespective of their legal status capable of carrying on a commercial or economic activity relating to goods or services.

8. As the sale of alcohol is an economic activity, licensees and other retailers of alcohol are undertakings within the meaning of the Act. An agreement between them setting a minimum alcohol price is thus a price-fixing agreement between undertakings, which is prohibited by the Act. Moreover, rules established by their trade associations on minimum pricing would also constitute decisions by associations of undertakings, which are equally prohibited under the Act.

9. However, where minimum prices are imposed at the sole instigation of a public authority such as the police or a local authority (which may not in any event be considered as undertakings within the meaning of the Act in relation to agreements of this nature) there is unlikely to be an agreement between undertakings that can be the subject of a challenge under the Act. However, it is crucial to differentiate this from a situation in which licensees actively and jointly participate in the determination of minimum prices in a meeting or other joint forum, facilitated by the police or local authorities and licensing officials. This latter scenario is likely to fall within the Chapter I prohibition.

10. You will appreciate that in practice it is often difficult to distinguish between this situation and what is permissible under the Act described above. Accordingly, the OFT's approach to date has been to consider any allegation that licensees have agreed amongst themselves to fix prices, whether or not imposed or recommended by the police or any other body on a case by case basis. It is important to note, however, that, it is likely that the Chapter I prohibition would be engaged, triggering a formal investigation, where licensees are involved in discussions to set the level of the minimum price, or where they subsequently agree to a joint or collective price.

Exclusions

11. Paragraph 5, Schedule 3 of the Act excludes conduct that is required to comply with a legal requirement. A legal requirement for this purpose being one imposed by or under an enactment in force in the UK, such as licensing legislation. This exclusion could apply to exclude licensees from liability to penalties under the Act where they enter into an anti-competitive agreement to fix minimum prices in order to comply with a legal requirement.

12. Equally, licensees would also avoid acting in breach of the law if minimum prices were agreed subject to an order made by the Secretary of State excluding it from the Chapter I prohibition. The power to do this is provided at paragraph 7, Schedule 3 to the Act, which states that the Secretary of State may make an order to exclude the application of the Chapter I prohibition from an agreement or category of agreements, where there are "exceptional and compelling reasons of public policy" for doing so.

13. This provision has not been invoked since the inception of the Act; however, it is likely to be construed very strictly and may require clear evidence linking minimum pricing to lower alcohol consumption and reduction in violent crime and also evidence that minimum pricing is indispensable in achieving these aims.

The legal Exception regime

14. The Act provides that agreements which satisfy certain criteria set out in section 9(1) are not prohibited, no prior decision to that effect being required. However, price-fixing is considered to be a very serious infringement and is unlikely to fall into this category.

15. The criteria require that the agreement contributes to improving production or distribution or promoting technical or economic progress, while allowing consumers a fair share of the resulting benefits. Additionally, an agreement is unlikely to be exempted under the Act if the restriction of competition which it would entail is greater than is necessary to procure the benefit in question and if it substantially eliminates competition.

16. It is unlikely that a minimum pricing agreement would facilitate production or distribution or promote technical and economic progress. Moreover, it is unlikely to be of benefit to consumers as it may only serve to bolster the profits of publicans and shield inefficient operators from competition. It is also likely to result in an across board price increase for the majority of consumers who may not consume excessive amounts of alcohol.

17. Although there is an intuitive sense that lower prices encourage excessive consumption of alcohol, there is no evidence linking higher prices to reduced alcohol consumption and a reduction in alcohol related violent crime and disorder. Moreover, such an agreement is in effect an agreement between licensees to limit competition between them, which will ultimately result in a substantial elimination of competition in the on-trade.

18. Imposing blanket minimum prices does not appear to be a proportionate means of curbing excessive alcohol consumption, without first exhausting existing police powers to deal with the perpetrators of crime and disorder and current regulations which permit licensees to refuse to serve drunken customers.

19. Accordingly, the OFT is of the view that any measures taken need to be proportionate, targeted to particular localities and premises and consequently to particular types of promotions and taken by the right people.

Future Developments

The government has commissioned an independent review of the evidence base concerning the effects of promotion and pricing of alcohol on harmful drinking. The report will be published in August 2008. This will look at the effects of alcohol promotion and price levels before making recommendations regarding the policy options open to the government in relation to this issue. Researchers at Sheffield Univeristy will put together the rport for the health department.

The Competition Commission published the final report of the Groceries Market Inquiry in March 2008.

Conclusions and recommendations

Loss-leading with alcohol is an irresponsible act. While supermarkets may be claiming that they offer customers good value, alcohol is unlike other goods in that it is a psychoactive, dependence-inducing drug which inflicts a huge burden of harm on individuals and society.

The IAS believes that supermarkets should refrain from using alcohol as a loss-leader. If they wish to compete on price, it would be more ethical to compete with goods such as bread or fruit.

If supermarkets fail to stop selling alcohol at such an irresponsibly low price, the government should take action to force them to refrain. This could take the form of banning the sale of alcohol at below cost, a separate tax on alcohol purchased off-premise or pushing for self-regulation.

The proliferation of cheap alcohol in supermarkets affects the health of the public as well as threatening the business of on-trade premises.

Institute of Alcohol Studies
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