

**'We are here in a very melancholy Situation'
Financial crisis and competition policy**

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3 November 2009

Summary

In this speech to the David Hume Institute in Edinburgh, delivered on the day that the EU measures affecting RBS and Lloyds were announced, Peter Freeman discussed various aspects of competition policy during a recession. Taking as his starting point David Hume's reference to, and Adam Smith's description of, the Ayr Bank collapse in 1772, he referred to the recent Lloyds/HBoS case and its aftermath. Whilst acknowledging that the banking sector had special features which meant that competition policy had to be applied to it with particular care, he emphasized that there was no case for exempting the sector from competition altogether. The recent EU measures were helpful, but did not remove the need for more competition in banking, once the immediate risk of instability had passed. He noted the recent remarks of the Governor of the Bank of England on this point.

On the wider economy, the application of competition policy would take careful account of market realities, but, again, there was no case for relaxing the principles. In setting priorities, the authorities would take care, whilst protecting consumers from short-term harm whenever possible, not to neglect longer-term market effects in key sectors whose performance would boost the economy as a whole. The US experience in the Great Depression suggested strongly that suspending competition law would not 'help the economy to recover'.

The UK competition authorities would carry on despite the difficult times, aware that, in David Hume's words, the credit crunch might 'introduce frugality among the Merchants and Manufacturers', if not among bankers.

¹Chairman, Competition Commission (CC). All views expressed are personal. The help of Dr Ingrid Nitsche and Dr Alison Oldale of the CC staff in the preparation of this talk is gratefully acknowledged.

Introduction—1772–2009

Ladies and Gentlemen, it is a pleasure to be invited again to address the David Hume Institute on a subject related to competition. I must congratulate the organizers of this lecture for their sense of timing. I last spoke here on 3 May 2007, election night for Scotland. Since then much has happened on the political scene and also on the economic scene. Today it has been announced that two major Scottish banks will be subject to considerable divestment requirements.² It is against this background that I want to review recent developments, and their effect on competition policy and competition enforcement. Looking back on what I said more than two years ago, the message was a fairly optimistic one—indeed I said that we were ‘highly optimistic’ about what competition policy can achieve. I remain optimistic, but this is tempered by a sober realization that the arguments for competition have to be made clearly and repeatedly and are by no means to be taken for granted.

In looking for sober realism there is no better place to start than David Hume himself.

On 17 June 1772, David Hume wrote to his friend Adam Smith, in Kirkcaldy, in the following terms:³ ‘We are here in a very melancholy Situation: Continual Bankruptcies, Universal Loss of Credit, and endless Suspicions. There are but two standing Houses in this Place’.

He then listed the various banks in difficulty, and observed that ‘The Case is little better in London ... even the Bank of England is not entirely free from Suspicion’. Hume referred further to the misfortune of the Adam brothers who were engaged in the costly and risky Adelphi development scheme next to Somerset House in London and wondered how they would fare. In the event they sold lottery tickets to stave off bankruptcy. The development itself was a failure, albeit a brave one.

David Hume’s cryptic observations on events around him are always worth careful note, but in this letter he also posed a direct question to Adam Smith, then engaged in writing the *Wealth of Nations*: ‘Do these events any-wise effect your Theory? Or will it occasion the Revisal of any Chapters?’

That question, I submit, is exactly the question which faces us today with banks and famous names seemingly falling around our ears. Put in modern terms, do the credit crunch, the resulting financial crisis and more general recession ‘any-wise affect’ competition policy and enforcement?

Adam Smith’s reply to Hume’s letter, if made, does not appear to have survived. But the events which gave rise to the ‘melancholy Situation’ are referred to in some detail in the *Wealth of Nations*, first published in 1776. The facts are fairly well known. Douglas, Heron & Co, better known as the Ayr Bank, had been established in 1769. Its principal purpose was to support schemes for land improvement at a time when capital was in short supply. In Smith’s words, though, ‘The design was generous; but the execution was imprudent, and the nature and causes of the distress which it meant to relieve were not, perhaps, well understood. This bank was more liberal than any other had ever been, both in granting cash accounts and in discounting bills of exchange’.⁴ The start of the bank was accompanied by a developing economic crisis in Scotland with falling commodity prices and a tightening of credit (other than from the Ayr Bank itself). The bank’s failure occurred in June 1772, the

²BBC Online News, *RBS and Lloyds in major shake-up*, 3 November 2009; Financial Times: *Lloyds and RBS in new round of fundraising*, 3 November 2009.

³The Letters of David Hume ed JYT Greig II, p263, reproduced in *Well Tempered Eloquence*, Ingrid A Merikoski DHI 1996, p63. See also *The Correspondence of Adam Smith*, Mossner & Ross ed 2nd Edition, Clarendon Press, Oxford, 1987, p161.

⁴*Wealth of Nations* II ii.73. See Penguin Classics ed Andrew Skinner 1999, p412.

month of Hume's letter—indeed the bank suspended payments just two days before, on 25 June; so certainly it would have been fresh in the mind.⁵

Adam Smith's judgement on these events was severe. 'The operations of this bank ..., seem to have produced effects quite opposite to those which were intended by the particular persons who planned and directed it ... (and) increased the real distress of the country which it meant to relieve'.⁶

So, while there may have been some 'revisal' of Smith's chapters, there was no obvious alteration to the theory underlying the *Wealth of Nations*.

Relevance to today

You may ask, how is this relevant to today's situation? Surely in a global, interrelated economy, where the lessons of much more recent history than Scotland in the 1770s have been well digested, Hume and Smith have little to tell us? Well, in one sense that is true; the facts of economic life have changed very greatly; in particular in the scope and complexity of financial instruments, the interrelation between hitherto isolated national economies and the enormous increase in the role of Government in the management of the economy. But in another sense the consequences of excessive lending, exuberant trading and the resulting 'Universal Loss of Credit' seem to pass the test of relevance to today's situation. And I take comfort from the fact that the Governor of the Bank of England, in his speech two weeks ago here in Edinburgh, made exactly the same point.⁷

Failing banks

As I said, in May 2007 all this was still to come. There was little talk or thought of crisis in the financial services sector and economies around the world appeared to have found a new way of providing growth and prosperity for all, based on the infinite fragmentation of risk.

The story of how things went wrong has been told fully and eloquently by many leading commentators. I single out two. One is the March 2009 'Turner Review', the Chairman of the Financial Services Authority's (FSA) prescription for the global banking crisis.⁸ The other is an article in December 2008 by Sir John Vickers called, rather modestly, 'The Financial Crisis and Competition Policy: Some Economics'.⁹

These describe the expansion of the balance sheets of banks relative to their own capital, resulting from huge global imbalances—in essence Asian saving and Western borrowing to spend—combined with a very benign overall environment and 'light touch' financial regulation. The fall in asset values, particularly US housing loans, led to massive and unpredicted, destabilization. In this country the *Northern Rock* failure in August/September 2007 was the first time there had been a run on a bank for half a century, but, as John Vickers says, Northern Rock's failure stemmed from the seizing up of short-term funding from institutional investors rather than the default of borrowers. Nonetheless, Northern Rock was taken into public ownership¹⁰ and we have now seen it is to be split up at the behest of

⁵Ibid, pp414&415.

⁶It reopened on 28 September 1772 but closed again in August 1773 after trading unsuccessfully for the best part of a year.

⁷Speech by Mervyn King, Governor of the Bank of England to Scottish business organizations in Edinburgh, 20 October 2009, which quotes Sir Walter Scott's comments on the Ayr Bank failure.

⁸*The Turner Review: a regulatory response to the global banking crisis*, FSA 003289, March 2009.

⁹GCP Release One, December 2008, *Competition Policy International*.

¹⁰The OFT reported in March 2009 on the impact of public support for *Northern Rock* on competition, [Northern Rock: The impact of public support on competition](#). The European Commission has recently approved a restructuring package for Northern Rock, see EU Commission press release IP/09/1600 of 28 October 2009.

the EU. Banks, in effect, had stopped trusting each other and ceased to act as banks. At the same time there was a collapse of confidence by depositors in the banks themselves.

There followed a year of often frantic worldwide activity with a succession of institutional crises and failures, culminating in the collapse of Lehman Brothers in September 2008. And, of course, around the same time there arose major problems for important UK banks, including the two principal Scottish banks, Halifax Bank of Scotland (HBoS) and Royal Bank of Scotland (RBS).

A year ago, when the UK Government with its bank recapitalization scheme undertook major recapitalization of leading banks by injecting substantial sums into among others, RBS and Lloyds/TSB, we saw a recognition that the crisis had moved from one of lack of confidence to one of undercapitalization, and we have been living with the consequences of that recognition ever since, although the hope is that we are now looking towards the stage of restructuring and possible 'exit'.

The Lloyds/HBoS case

So that is the last two years, in a nutshell as it were. Where is competition policy in all this? The most direct example we have of the impact of the financial crisis on competition policy is the acquisition of HBoS by Lloyds/TSB, which took place in the autumn of 2008.

Before examining this case, let me say a word about the competition system in the UK. The CC and Office of Fair Trading (OFT) are competition authorities, required to identify and act on competition problems. The CC does not choose its cases but can only act on a reference from OFT or a sector regulator. For mergers, the OFT conducts an initial review and can decide there is either no problem, or the problem can be solved by measures volunteered by the merging parties. If the OFT decides the problem is more serious, it sends the case to the CC which can clear, or prohibit, as it sees fit. Ministers are not involved. A similar system operates for markets and market investigations. But if there is a specified public interest consideration, the Minister can serve an intervention notice; this makes the OFT's (and CC's) role advisory, with the final decision made by the Minister.

Against that background, the sequence of events was essentially this. A possible merger between these two banks had often been considered, but hitherto ruled out mainly on competition grounds, particularly after the CC's prohibition of the Lloyds/Abbey merger in 2001.¹¹ On 18 September 2008, however, a possible merger was announced. At the same time Ministers stated that a new public interest ground of preserving financial stability would be introduced into UK merger control.¹² The Secretary of State subsequently issued an intervention notice on the basis of this consideration, which had the effect of rendering the OFT's role advisory rather than decisive. The OFT undertook a speedy but comprehensive competition assessment, concluding on 24 October that the merger did raise competition issues, particularly in relation to personal current accounts, SME banking services and mortgages, including important aspects in Scotland, which required investigation by the CC.¹³ The Secretary of State considered that advice, along with advice on financial stability from the Bank of England, the FSA and HM Treasury, and on 28 October 2008¹⁴ decided not to refer the merger to the CC.

On 28 November the Merger Action Group (MAG), a group of individuals whose members were based in Scotland, applied to the Competition Appeal Tribunal (CAT) for judicial review

¹¹ *Lloyds/TSB Group plc and Abbey National plc: A report on the proposed merger*, July 2001.

¹² Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2008 (SI 2008/2645, 10 October 2008).

¹³ OFT Report to Secretary of State, 24 October 2008.

¹⁴ Decision under [section 45](#) of the Enterprise Act.

of the Secretary of State's decision. Judgment was given for the Secretary of State on 10 December 2008 and the merger was subsequently completed.

The first point to note on this case is that as it never came before the CC, we can express no view on the merits of the decision, particularly on the extent to which we, the CC, would have been able to take into account some of the financial stability issues in our assessment. It simply didn't happen and we have no view on the substance of the case.

However, as regards procedure, the sequence of events around this case demonstrates that UK merger control procedures were in practice flexible enough to deal with a highly sensitive case of this kind. In providing a statutory mechanism for balancing competition against financial stability, albeit at ministerial level, and an opportunity for judicial review, the UK showed up better than those jurisdictions that simply disappplied merger control altogether from bank mergers as an emergency measure.

Third, as I will come back to when I discuss merger control generally, it is best to see this case as an isolated incident, a product of the acute factual situation prevailing a year ago. It is easy to be wise after the event. But the merger was first mooted at a time when the over-riding issue appeared to be lack of confidence and a merger with Lloyds/TSB was seen as a strong reassurance for HBoS depositors; but, as we have seen, the situation changed rapidly to one of under-capitalization, in which a merger was less relevant, as injection of state capital could have been made to HBoS either on its own or, as it transpired, as part of a merged group. And the state support provided to RBS took place without any merger situation.

The question arises, with competition considerations having been over-ridden in this case, whether that is the end of the matter. Clearly not; there are several ways in which further action may be taken.

First there is action at the EU level. Although the Lloyds/HBoS merger did not fall under European merger control, the subsequent injections of state funding require approval under EU State Aid rules. This process, which has received a certain amount of publicity, is now in its final or 'restructuring' phase. This is when DG Comp considers, and the European Commission decides, what adjustments to the assets of the banks concerned are appropriate in order to secure approval for their continued receipt of state support. The overall objective is to prevent the banks in question from having an unfair competitive advantage by virtue of their having received, or continuing to receive, state assistance. Today's announcements in relation to Lloyds and RBS, coming on top of the recent moves by DG Comp to break up ING and to approve the splitting up of Northern Rock are evidence that this process is having some real impact.

Second the fact that a particular merger has been allowed does not remove the competition issue. In its own representations to the OFT on *Lloyds/HBoS*,¹⁵ HM Treasury stressed the overall conformity of the bank recapitalization scheme with EU State Aid rules and the Government's interest in ensuring that arrangements under that scheme were not anti-competitive. HM Treasury also stated that the OFT had been invited to continue to monitor competition in the banking sector and that if problems were found, 'appropriate action' would be taken. The announcements today are very much in line with this position.

In July 2009, the Conservative Party announced that, were it to be elected, it would seek to have the banking sector investigated by the OFT and the CC.¹⁶ This was repeated by George Osborne MP two weeks ago; there are reports in the press from time to time

¹⁵HM Treasury representations, redacted version set out in OFT Advice Annexe 2, particularly paragraphs 26–30 on competition.

¹⁶From *Crisis to Confidence: Plan For Sound Banking*, p48.

expressing similar concerns.¹⁷ So the competition issue for the banking sector, particularly retail banking, remains in play.

In the meantime, we are all digesting the lessons of what has happened. Lessons are there both for the financial sector, and more widely.

Competition in the financial sector

What lessons can we draw so far in relation to the financial sector and competition?

Special features?

First of all, I believe that we have to accept that banks are to some degree 'special' and competition in banking has also to be regarded in some respects as 'special'; mainly because of the imbalance of product information between customer and supplier and the systemic effect of a major bank failure. But it would be a serious error to exempt the banking sector from the competition regime altogether or to ascribe these recent disastrous events to an excess of competition. This has not yet been said explicitly on a wide scale—you will not find it in the Turner Review, for example—but it is a short step from calling these events a 'failure of the market' to blaming them on 'too much competition'.

There are two strands to this: whether competitive pressure led, for example, HBoS to overreach itself in domestic mortgages—lending far beyond the value of its security; or, whether competition enforcement—seeking to lower bank charges, encourage switching, etc—took attention off the needs of safety in the financial system—the danger of one bank failure triggering a general collapse. I suggest the answer in both cases is 'no'. The competitive instinct to expand and gain customers and market share is entirely sound; but the special features of banking—imbalance of information and systemic risk—put the focus on careful regulation. Similarly for competitive intervention; it seems odd that one cannot have both a proper customer offering (appropriately regulated) and also maintain proper respect for the dangers of systemic collapse.

Competitive activity

The second lesson to draw is that it is necessary to improve regulation in financial services whilst at the same time preserving competition. Finding an acceptable regulatory settlement will not be easy, and it will take time. The focus should be on identifying genuine concerns about the adverse effects of particular competitive activity, whilst still being aware that competition generally brings benefits.¹⁸ It is interesting that recent press comment indicates that lack of competition in post-crisis financial services markets may be one factor behind high fees and high bonuses.¹⁹

Competitive structures

Third and related to this point, whilst there must be an increased emphasis on safety and stability, it is also important to maintain competitive market structures. The lessons from encouraging bank mergers, in the interests of stability, are at best ambiguous and a merged bank that is 'too big to be allowed to fail' creates its own set of problems, in addition to any adverse effect on competition. We are clearly not talking about reversing mergers that have taken place. But it would be good if the overall policy approach did not favour consolidation

¹⁷See, for example 'RBS and Lloyds "too dominant"', *The Herald*, 24 September 2009, p32.

¹⁸See for example the tighter criteria for mortgage lending announced by the FSA on 20 October 2009.

¹⁹*Financial Times* Leader, 28 October 2009 'Competition Rules'.

as an automatic solution and for future mergers to be considered, in the normal way, that is whether allowing a particular merger to proceed is more or less competitive than letting the merging business fail.

There has as yet been no attempt to repeat a banking merger in the UK on the scale of *Lloyds/HBoS*. Nevertheless, sooner or later, one feels, the competition authorities will have to address the issue of whether the post-crisis banking market structure, with more concentration and a tighter regulatory framework, is harming consumers. It is likely that all concerned will wish first to be satisfied that the risk of financial instability has receded. It is interesting, to put it no higher, that the Governor of the Bank of England, in the speech to which I referred earlier, states that 'by international standards UK banking is highly concentrated. There are four large banking groups I hope greater competition will produce less rigidity in the top four'.²⁰ I agree.

Moral hazard

This leads directly to the final lesson, which is the issue of so-called 'moral hazard' (that is the danger of insulating parties from the consequences of their actions). Joseph Schumpeter famously argued that the essence of capitalism was creative destruction. Two economists argued in the *Financial Times* earlier this year that if things were to move forward, we should start restoring 'a little orderly creative destruction'.²¹ This would ensure that at least some of the risk associated with financial services is re-privatized and, as a result, creditors, not the public, bear the risk of non-systemic banks becoming insolvent. Otherwise, we leave banks with no incentives to behave more responsibly in the future.

This is by no means a trivial issue; a market in which major—or even minor—financial institutions know that however imprudent they may be, they will be rescued by state intervention, is unlikely to work well for consumers, and arguably not for taxpayers either. This point was also made with considerable emphasis by the Governor of the Bank of England in the speech to which I have referred.

Competition in the wider economy

Let us then consider what lessons can be learned for the wider economy, to which the financial crisis rapidly spread and which is still weighed down by recession, despite the frequent claims that 'green shoots' of recovery have been spotted. I offer some general observations and then I will look at specific issues.

The first general point is that most industries do not have the financial sector's special features. In particular the dangers of systemic collapse and contagion between competing suppliers are generally absent. In the wider economy the collapse of a competitor is normally good news; in banking it is a cause for concern. That is not to understate the effect on, for example, component suppliers if a car manufacturer collapses, or indeed the serious social and employment consequences of any business collapse. But some businesses do fail from time to time, and that is a fact of economic life.

Second, the recession has reminded us that economic activity is, after all, cyclical, and that combating difficult conditions in a downturn is one way in which efficient firms are distinguished from the less efficient. This may sound harsh, and there will often be a case for limited and targeted state assistance to address the social costs, particularly as the denial of credit to businesses in the present financial crisis appears to apply randomly to efficient or inefficient businesses, depending more on their refinancing timetable than on any economic

²⁰Speech of 20 October referred to earlier; the Governor drew an analogy with the Premier League.

²¹Matthew Richardson and Noriel Roubini, 'Insolvent banks should feel market discipline', *Financial Times*, 6 May 2009.

consideration. But seeking to counter the effects of recession by generalized state support of firms or industries is not the answer, as this simply trades the preservation of present jobs against the future.

Third, unlike the financial services sector, there is no requirement for tighter regulation to preserve stability or impose prudence. As the CBI Director-General Richard Lambert wrote recently,²² government should not stand in the way of entrepreneurs' seeking to use the recession to acquire distressed assets, drive up productivity and generate wealth.

Let us now turn to specific issues.

Anti-cartel enforcement

I will not say a great deal about this as the OFT rather than the CC applies anti-cartel enforcement in the UK. But it has been well demonstrated that an economy in which price fixing, or customer or market allocation are prevalent is likely to be inefficient, uncompetitive and to cause harm to consumers through higher prices, less choice, poorer service, less innovation or probably all four of these. The OFT has carried forward a number of cartel cases recently—the most significant being in the construction industry.²³ I see no sign of this activity being relaxed; and the public statements of senior OFT officials bear this out.²⁴

Merger control

In merger control, with the isolated exception of *Lloyds/HBoS*, normal competition rules have applied. Recession affects merger activity in several ways—for example, failing firms may be more easily acquired, in whole or in part, by competitors; firms may merge for defensive reasons, to rationalize capacity and save costs; and private venture capital organizations may wish to divest assets or businesses as cash dries up. The general principle adopted by both the OFT and the CC is that the rules are unchanged, but the facts to which they are applied may be altered, and this may affect the analysis and, possibly, the outcome. This may take the form of acceptance that the assets of a failing firm are likely to leave the market and that this is a less competitive outcome than its acquisition by a competitor. The OFT cleared HMV's acquisition of 15 stores of a direct competitor, Zavvi, on this basis.²⁵

In relation to merger remedies, the ability to divest all or part of an acquired business may well be affected by prevailing economic conditions. This could affect the ability to find an acceptable buyer but it is noticeable that this has not so far proved a problem for the CC as divestment remedies, where needed, have been successfully applied.²⁶

In terms of the merger regime, there has, so far been no further attempt to introduce any further public interest considerations to cope with the effects of the recession. And in one sectoral example, the OFT was asked to consider whether the regime for local and regional media mergers should be relaxed to assist undertakings in difficulty and took the view that no relaxation was needed.²⁷

²²Richard Lambert—personal view, *Daily Telegraph*, 6 October 2009.

²³The OFT has imposed fines totalling £129.5 million on 103 construction firms in England which it has found had colluded with competitors on building contracts; see OFT press release [114/09](#) of 22 September 2009.

²⁴See, for example, Philip Collins's keynote address to the British Institute of International and Comparative Law Ninth Annual Trans-Atlantic Antitrust Dialogue, *Preserving and Restoring Trust and Confidence in Markets*, 11 May 2009.

²⁵Decision of 28 April 2009.

²⁶See, for example, CC report, *Capita and IBS. A report on the completed acquisition by Capita Group plc of IBS OPENSystems plc*, 4 June 2009.

²⁷OFT, *Review of the local and regional media merger regime*, Final Report, June 2009.

Nor has there been any serious call to go back to the pre-Enterprise Act merger control regime. In particular, the *Lloyds/HBoS* experience does not in any way signal, far less justify, a return to the previous policy of mergers being assessed against a wider range of public interest criteria. The financial stability consideration now in the statute is quite specific and the process of balancing this against competition is closely controlled. This is a far cry from the 1982 case relating to the bids by *Standard Chartered* and *HSBC* for *Royal Bank of Scotland*.²⁸ Although neither bid restricted competition, by a majority of four to two, the CC's predecessor body, the Monopolies and Mergers Commission (MMC), concluded that each of these mergers would operate against the UK public interest because they could be 'seen as part of a process of economic centralisation' that could be 'seriously damaging to Scotland'. The MMC went on to express concern about the 'likely deterioration in the quality and importance of decisions made in Scotland, reinforcing the impression of a branch economy'. There is much more in the report which, read today and with the benefit of hindsight, has elements of irony.²⁹ Whatever the merits of the decision, the concern is that the test that was applied, whilst having an obvious emotional appeal, would be very hard to apply reliably and predictably over time.³⁰ Competition is a more reliable test and when exceptions need to be made it is probably better for them to be made on clearly defined grounds applied by government.

Markets

The UK's system for investigating markets has also been in full operation during the past two years of financial and economic difficulty. The CC has concluded investigations in four major cases—*Groceries*,³¹ *ROSCOs*,³² *Payment Protection Insurance*³³ (PPI) and *BAA Airports*.³⁴ In each case the changes in economic activity have affected the analysis and, arguably, the outcome, but in no case has it seriously been suggested that such an investigation is inappropriate during a recession.

For example, in *Groceries*, the CC had to look closely at retail competition—the way in which retailers large and small compete with each other—and the supply chain, the way retailers treated their suppliers. In relation to retail competition we heard a lot of talk about how price competition no longer mattered and how affluent consumers were more concerned over whether their tomatoes had been fully dried in the sun or whether their cured ham was truly from Parma. Those attitudes have changed with the recession and our view that consumers attached considerable importance to the price of food has been proved right. And in relation to suppliers, the way in which some retailers have unexpectedly required their suppliers to subsidize their retail price reductions has reinforced the case for a strengthened supply code of practice (as we have enacted) with an effective enforcement mechanism (as we have recommended to the Government).

In relation to *PPI*, where two of the major banks have recently succeeded in having one of our principal remedies set aside by the CAT,³⁵ the CC was very clear that the case for intervention to protect consumers was stronger, rather than weaker, in a recession.

²⁸Cmnd 8472 MMC Report, January 1982: see in particular [Chapter 12](#).

²⁹See in particular paragraph 12.40 'If we had thought that Royal Bank Group needed better management or additional capital which could be obtained only by merger, or that it had poor long term prospects as an independent concern, we might well have been persuaded (otherwise)'.

³⁰The MMC itself made clear that its decision did not mean that all acquisitions of Scottish-based banks would be against the public interest.

³¹CC report, [The supply of groceries in the UK market investigation](#), 30 April 2008.

³²CC report, [Rolling Stock Leasing market investigation](#), 7 April 2009.

³³CC report, [Market investigation into payment protection insurance](#), 29 January 2009.

³⁴CC report, [BAA airports market investigation. A report on the supply of airport services by BAA in the UK](#), 19 March 2009.

³⁵*Barclays Bank PLC vs Competition Commission*, Judgment of 16 October 2009, [2009] CAT 27.

As for *BAA Airports*, I am aware of the significance of our report for Scotland's principal airports, but BAA has appealed against our decision and the matter is *sub judice* and it would not be appropriate for me to comment on the issues before the CAT. What I can say, however, is that our substantive conclusion (which has not been the subject of appeal) that, on the whole, customers and passengers would be better off if there were more competition does not strike me as particularly surprising.

As with mergers, we shall of course continue to be cautious and pragmatic in the choice and application of remedies to ensure we take full account of the realities of the economic situation and do not act in an unreasonable or disproportionate manner.

Wider issues

So in all these areas, the evidence is that the UK competition system is alive and well and being applied in a rigorous but realistic manner. And that is how it should be. Nor is this a blind reaffirmation of dogma, but instead it is a carefully considered position. Earlier this year, the CC held a Roundtable of its members and some distinguished outsiders to consider precisely this topic. The papers are on our website.³⁶ And the conclusions were very much in line with the position I have set out in this talk. My proposition, therefore, is that outside the financial services sector, where special features justify a degree of special consideration under tightly specified conditions, there is no case for relaxing, far less for suspending, the rules of competition because of economic difficulty in a recessionary period.

There is, however, the question of prioritization. This is less a concern for the CC, which does not choose which cases it must handle, but very much an issue for the OFT. Recession increases the pressure to concentrate on alleviation of short-term damage—stopping cartels, restricting excessive charges to consumers, indeed generally concentrating on consumer-facing sectors. There is nothing wrong with this and it serves to reassure consumers that they are not being asked to pay for suppliers' problems. But it is important not to neglect longer-term effects in the economy as a whole and to pay attention to those market sectors, whether it is financial services, communications or an R&D-focused sector like pharmaceuticals, where competition and innovation will stimulate productivity and economic performance longer term.

These issues of choosing the correct priority all presuppose the continuation of an effective competition policy. To be fair, no-one has seriously called for the abandonment of competition policy altogether. Instead the talk is more of 'market based solutions' being inappropriate in the post-recessionary era, and the lesson having been learnt that capitalism has failed, markets are not self-correcting and are not to be trusted to deliver good economic outcomes. Quite what the alternative is not clearly stated but the implication is clear—cartels may not be so bad after all, monopolies can be a good thing, more state involvement in the economy is not only necessary but desirable and suppliers rather than consumers are the best judge of how markets should work.

Part of this stems from a perfectly legitimate concern, which I agree with, that the relationship of competition policy to other policies needs to be much better defined and much more clearly articulated. A pure competition 'answer' will not always be best—other policy objectives in transport, environmental, health or social policy areas may need to be weighed in the balance and may even prevail in some situations. As we made clear in *Groceries*, the planning system, whilst in a sense obviously anti-competitive, can hardly be done away with in the interests of unrestricted retail development. And where there is justified concern over excessive consumption of alcohol this may legitimately be addressed as a health policy

³⁶Competition in Recession: A Members' Roundtable Meeting held at the Competition Commission 30 March 2009, www.competition-commission.org.uk/our_role/speeches/competition_in_recession.htm.

issue but not by suspending anti-cartel law to allow minimum price agreements. All that is very much on the right lines although it does expose the need for a proper transparent administrative framework by which such trade-off decisions can be made—such decisions being properly the task of government.

But none of this makes any kind of case for suspending competition rules ‘to enable the economy to recover’. It is my firm belief that if anything it would have the opposite effect. And I call on history in support of this view.

Historical lessons

We have, of course, been here before. Those who call for the bypassing or suspension of competition laws would do well to heed the lessons of the US experience. It is argued on good authority that the suspension of competition policy in the 1930s in the USA added to the duration of the Great Depression.³⁷

Although obviously not the sole cause of the troubles, the ‘New Deal’ industrial organization policies of the 1933 Roosevelt administration inconsistently encouraged competitors to collude by adopting so-called ‘industrial codes’, driving up prices, whilst later allowing aggressive antitrust enforcement to attack the very same cartels in order to drive prices down. The encouragement came from the NIRA (National Industrial Recovery Act), which promoted the industrial codes. This lasted from June 1933 until May 1935, when it was struck down as unconstitutional by the Supreme Court³⁸ (on the grounds that it gave too much discretion to the President); at its height there were nearly 500 codes with price provisions and some 30 industries had restrictions on productive capacity. Insult was added to injury by requiring the Federal Trade Commission, one of the two antitrust authorities, to police them. The attack came from about 1937 onwards, when the Department of Justice was seeking to prosecute cartels in the aluminium, steel and oil industries, among others, with the defendants pleading compliance with NIRA and with the ‘New Deal’.

The contradictory effects of these policies have been much discussed.³⁹ Some commentators point to a reduction in US GNP of 27 per cent and the Great Depression being lengthened by seven years. The lessons are frankly stark, and strongly suggest that the answer to our present problems does not lie in suspending competition.

Conclusion

So, to conclude, I have tried to put our present difficulties into some sort of historical context. We may be living through the worst financial crisis since the 1930s but it does no harm at all to remind ourselves that in 1772 there were only two Edinburgh banks surviving and that in London the Adam brothers had to resort to selling lottery tickets to avoid the collapse of their Adelphi project. The history of the Great Depression also reminds us that much of what we are currently experiencing has happened before and the lessons of that time need to be heeded.

It is also salutary to remember that in May 2007, when I was last in this building, there was precious little hint or warning of the calamities to come. That we can still contemplate, two years on, a financial system, an economy and even a competition system that all appear still to be functioning is a testimony to the fact that some of the lessons from the 1930s have

³⁷‘Lessons from the Great Depression’ by John D Harkrider, published in the ABA Journal *Antitrust* Vol 23 No 2 Spring 2009, pp6–11 and see also John Fingleton, *Competition policy in troubled times*, 20 January 2009, available on www.of.gov.uk, at p4.

³⁸*Schechter Poultry Group v US* 295 US 495, May 1935.

³⁹See, for example, Christina Romer ‘Why Did Prices Rise in the 1930s?’, 59 J Econ Hist 167, 197 (1999) (cited in Harkrider op cit).

indeed been learned and that the very considerable amount of state intervention, coordinated internationally, has had a beneficial effect, at least for now.

As to what happens next, the CC's Roundtable in March concluded that, as a competition authority, we should do best to carry on, conscious of the difficulties around us, but carry on nonetheless. How we extricate ourselves from the Situation we are now in, melancholy or otherwise, is a matter on which reasonable men and women may reasonably speculate. And in this they may again be helped by David Hume, who concluded his 17 June 1772 letter to Adam Smith in these terms:

On the whole, I believe, the Check given to our exorbitant and ill grounded Credit will prove of Advantage in the long run as it will reduce people to more solid and less sanguine Projects, and at the same time introduce Frugality among the Merchants and Manufacturers. What say you? Here is food for your Speculation.

But I wonder what Hume would have said about bonuses to bankers?

Thank you.