COMPETITION ADVOCACY IN TIME OF RECESSION

THE UK COMPETITION COMMISSION'S APPROACH

Talk given by Peter Freeman[1]
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Why is competition advocacy important?

Competition advocacy means making the voice of competition heard outside the world of competition specialists. I want to talk today about why this is important, how it is done, and why it is doubly important in the current economic crisis. I suggest three reasons why competition advocacy is important: a general need, a particular need resulting from the establishment of independent competition agencies, and because we are faced with a serious economic recession.

A general voice

First, just as any other 'message', the benefits of competition for consumers, businesses and government need a voice both in any public debate and also within government, to ensure the message is considered when relevant decisions are taken.

A possible vacuum?

Second, we have seen the growth of independent competition agencies across more and more jurisdictions. This can mean that there is less direct interest in competition within the executive arm of government. In the UK, both the Office of Fair Trading (OFT) and the Competition Commission (CC) were recast as independent decision-making authorities between 1998 and 2002. As a result, there is less direct involvement by government in the day-to-day administration of the competition system. This means there is less familiarity with competition issues and despite the important work of the responsible department (Business, Enterprise and Regulatory Reform) the risk of less advocacy of competition within government. This has meant that the OFT and the CC have, in practice, increasingly taken on the role of advocates of competition.

Advocacy in recession

Third, there is the recession. There is always a danger that the benefits of competition are taken for granted. If the economy is doing well, then pointing out the benefits can seem superfluous. An economic crisis puts pressure on competition policy, as there is an expectation that the rigours of market forces will be softened to alleviate falling sales and profits.

Even before the recession, the consensus that openness, competition and access to markets are beneficial for consumers and the economy as a whole was coming under pressure from other policies—health, environment and social policy, to name a few. In time of financial and economic crises, the 'siren voices' advocating greater market intervention and trade protectionism are never far away. This makes it even more important to speak for competition, and to emphasize that competition is just as important in difficult economic times as it is in the good times.

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Competition advocacy in the UK

The work of the OFT

The UK institutional structure can be a little hard to understand. Let me begin with the OFT. The OFT is the principal 'front-line' UK competition authority, with extensive consumer protection powers also. It applies Articles 81 and 82 of the EC Treaty and their UK domestic equivalents. The OFT also assesses mergers and markets and decides if any further investigation by the CC is needed.

The OFT's advocacy role is crucial. It works generally and informally to raise public awareness of the benefits of competition and also has a formal role in making proposals or giving advice to government on current laws or proposed changes to the law. An example of this is its guidance on completion of the competition impact assessment in regulatory impact assessments (RIAs). (RIAs are prepared to provide information on the costs, benefits and risks of planned regulations and help policy makers to think through the consequence of proposals and encourage informed public debate.) The OFT's guidance is intended to ensure that the impact of any proposed policy on competition in affected markets is fully taken into account.

Other authorities

The sectoral regulators, most of whom have concurrent powers to enforce competition, are also advocates of competition. To some extent their advocacy role is internalized in the sense that in carrying out their statutory duties they will frequently have to consider what is the appropriate balance to strike between regulation and competition.

Better Regulation Executive

Regulation can sometimes limit the effectiveness of competition. The Better Regulation Executive (BRE) (part of the UK Department for Business, Enterprise and Regulatory Reform (BERR)) is concerned with the improvement of regulation and the simplification and modernization of existing regulation to lower burdens on businesses, especially SMEs. In doing so, it has regard to the principles of accountability, transparency, necessity, proportionality and consistency.

Other bodies

In a wider sense, there are also other advocates involved in the public debate on competition issues. These include academics, journalists, professional advisers and consumer organizations. Through public discussions and debates at conferences and roundtables, articles, studies and reports, they have an important role in contributing to the development of the competition agenda and arguing for the benefits of competition.

The Competition Commission

Then there is the CC itself, which unlike the OFT does not have a 'front-line' role but receives merger and markets cases on reference from the OFT and the sectoral regulators.

While the CC does not have an express statutory power in relation to proposed legislation, it also advocates competition in various ways: first, through market investigations. The UK has a specific market investigation regime which allows a comprehensive competitive assessment of entire sectors and industries. The CC can recommend the relaxation of regulatory barriers to competition as well as intervening directly to improve competition. At least three of its current or completed market investigations[2] have focused on the effect of government policy and the regulatory framework and the CC has made detailed suggestions on how things could be improved.

Secondly, the CC fully supports the OFT's efforts with more informal activities, such as speeches, organization and attendance of roundtable discussions and conferences. The CC's recent Roundtable on 'Competition in Recession' will be an important complement to the work of the OECD and others on this subject.

Problems arising from economic downturn

Let me now talk about why competition advocacy is so important now. Essentially this is to deal with the argument that competition is theoretical but job losses are real.

End of the 'competition honeymoon'

Until recently we have had a broad political and public consensus that competition policy is beneficial for economic efficiency and the best means for enhancing general welfare in a market economy. It was because of this consensus that the Government was willing to vest decision-making powers in the two independent competition authorities, the CC and the OFT. We also saw a largely bi-partisan approach to a major programme of privatizing utilities. Improvements in prices and consumer choice in services such as telecommunications and energy were taken for granted.

But even before the current economic crisis, some criticism of competition was evident. Expectations of instantly lower utility prices following privatization were not always fulfilled. Competition did not always deliver lower prices in the short run and this could be a difficult message to give to consumers. Deregulation and increased competition in utilities also had the effect, some would say, of too little investment in capacity.

Moreover, not everyone regards competition as the only solution to every problem; far from it. In recent years, for example, the CC has met concerns from consumers which have nothing to do with competition, except perhaps to complain about its effects. For example, in the CC's *Groceries* inquiry,[3] many of the submissions received were on other policy aspects, such as the impact of grocery development on the environment and on public health—destruction of town centres and excessive drinking.

It is unsurprising that these lurking doubts have been substantially fuelled by the current crisis. A new line of argument is opening up which focuses on 'market failure' as well as 'regulatory failure' in financial services, unfortunately without always clearly distinguishing between the two. We are faced with calls to dilute or even suspend competition policy not only in financial services but across a range of other industries which find themselves in serious distress.

Let me now turn to some of the dangers to which this situation may give rise.

Protectionism

The first danger is protectionism. Governments globally have moved with some speed to support 'at risk' industries. First and foremost, these are banks and financial services

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[2] *Rolling Stock Leasing market investigation*, April 2009; *The supply of groceries in the UK market investigation*, April 2008; *BAA Airports market investigation*, March 2009.
[3] *The supply of groceries in the UK market investigation*, 30 April 2008.

providers, but other industries such as the motor vehicle industry, newspapers and other sectors are queuing up for help.

This intervention in the face of unprecedented upheaval in the financial sector may be necessary and understandable. But we need to avoid a situation where governments, by supporting domestic firms and industries, undo the access to markets and free trade built up so laboriously over past decades. European state aid policy and its enforcement falls within the remit of the European Commission. But national competition authorities have an important role in pointing out the dangers of protectionism—namely that it distorts competition in the short run and is usually unsuccessful in the long run; that it keeps inefficient firms in business, holds back innovation so that consumers may pay higher prices and taxpayers may be left to foot the overall bill.

Politicization of competition enforcement

The next danger is politicization. The application of competition policy by independent agencies free of government interference is in most countries, certainly in the UK, a comparatively recent and possibly rather fragile creation.

So, again, independence from political interference should not be taken for granted. Such interference could take the form of calls for more direct intervention bringing instant results instead of trusting to the more long-term benefits of competition.

What kind of welfare?

The third danger is the threat to the consumer welfare based competition policy applied in many countries. This danger is linked to the issue of long-term versus short-term gains, and follows in part from the pressure for instant measures that I have already mentioned. There is a temptation to trade off competition benefits in the longer term (low prices and innovation) against what may be more appealing in the short term—keeping jobs ‘at home’ and creating ‘big players’ to survive the recession. It may be claimed that these measures are justified in terms of total welfare although it is more likely that they would take us away from any kind of welfare.

Random effects

There is also the problem of randomness. The pressure from recession may not necessarily hit inefficient firms the hardest. If credit markets no longer function as they should, this may have the effect that some firms, which happen to be due for financing earlier than others, fail not because they are unsuccessful in their business, but simply because they cannot raise sufficient capital from banks which no longer lend. This needs to be distinguished from situations where uncompetitive firms are forced under in a recession. Intervention may help consumers in the former case, but in the latter case will keep inefficient firms in business.

How advocacy can help

Faced with these dangers, we need a clear and convincing message. We are currently witnessing an intensive debate on what went wrong in the financial sector and if and how the regulatory system needs to be reformed to prevent a similar crisis. It is important that this debate does not draw the wrong conclusions, leading to the wrong solutions.

Too much competition?

Some say that the financial crisis and the resulting recession have been caused by ‘too much competition’ (together with greed and too many harmful incentives). This is in my view misconceived. It is possible to construct an argument equating the excessive taking of risk in financial sectors with some features of competition, but what has occurred looks much more like a failure of regulation than a failure of competition. What may have been shown to be wrong is the idea that markets will always be ‘self-correcting’. But complete faith in the self-correcting nature of unregulated markets was always unwise and with hindsight looks naive. To blame the freezing of credit to the wider economy and the drying up of demand on the operation of markets in themselves is not justified.

Neither markets nor competition should be discarded

We need to emphasize the need for competitive markets in the longer term. But we must also emphasize that competition is important during the crisis as well. While the market economy certainly has its shortcomings and drawbacks, it is still the best or ‘least worst’ means to conduct economic activity given our experience with previously unsuccessful other economic models. The inherent benefits of competition are not made any less just because of reduced demand in the economy.

What should the authorities do?

Credibility of competition enforcement must be maintained in the face of economic downturn. This is best achieved by a combination of soundly-reasoned, evidence-based decisions and fair process. The competition authorities must stand firm in the face of uncertainty. Of course, we will also want to ensure that we are pragmatic and flexible, when appropriate, and that our powers are applied in a way that fully recognizes the economic reality and context. More firms will be pleading a ‘failing firm’ defence to competition authorities. We should always examine these arguments carefully, without relaxing the relevant criteria. Similarly, with remedies such as divestment, we may have to accept more flexible time frames. But further than this we should not go.

Conclusion

Competition advocacy plays a key role in sending a clear message about the benefits and importance of competition as we face a serious economic downturn. The recession may be severe and extended—so we should be prepared for a long struggle. No-one can reliably predict how long this will take.

During this period, firms will have strong incentives to collude or to merge with their competitors. Governments will face strong calls to intervene to support ‘key’ (non-financial) sectors.

Overall the questioning of the market system will increase. People will refer to the end of capitalism and its associated policies, of which competition is one. Yet the alternatives, increased state control and ‘command’-type economies are not attractive and markets remain the ‘least worst’ way to generate wealth.

The debate about regulatory failure will continue. In the financial sector critics of the past regime are on strong ground but it is important not to eliminate competition and risk taking altogether in the search for control and safety. In the wider economy it may be necessary to restate the balance between state control and the market, but only extreme ‘neo-liberal’ adherents would aim to exclude the state from some significant role in setting the framework for economic activity.

And the questioning of competition policy will continue; it will be described as a luxury, or as 'theoretical' whereas meeting the short-term recessionary impact will be seen as a greater need. Some recognition of this will be needed but the essential longer-term benefits of competition must not be lost.

Finally, there must be a strategy for removing government from its new-found and somewhat uncomfortable role as effective owner of large parts of the financial system.

Speaking up for competition in the face of these issues has never been more necessary. It is the competition authorities' challenge, and we must rise to it.

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