

Responses to the economic and financial crisis: whither competition ?

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Plan

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I) Measures adopted by governments in a period of crisis

Measures adopted by governments in a period of crisis

1) Measures aimed at restoring confidence in financial markets and ensuring the stability of financial markets.

- Injections of liquidity into financial markets by central banks;
- Issuances of short and medium-term debt to assist banks, credit institutions, pension funds or insurance companies to overcome a temporary liquidity shortage;
- Government guarantee of financial institutions' liabilities;
- Regulatory capital forbearance,
- Recapitalization of banks and insurance companies.
- Carving-out of insolvent banks' bad loan portfolios (usually accompanied by organizational restructuring of the banks);
- Restructuring of the banking and financial sector in order to increase the stability of these sectors.

Example: the Irish bank guarantee scheme

On 2 October 2008, following a crash in the value of bank stocks on the Irish stock exchange, the Irish Government decides to grant an **unlimited guarantee on all bank deposits at its six main banks for the next two years**, to maintain financial stability.

The Irish guarantee scheme does not underwrite the non-Irish banks which were competing with the Irish Banks, thus creating a potential domestic competition problem. It triggered a cross-border flow of cash from British businesses to Irish banks, making the British banks more fragile

The British Government denounced the discriminatory and anti-competitive nature of the Irish scheme.

The European Commission forced the Irish Government to amend its scheme and to provide coverage of banks with systemic relevance to the Irish economy (not just “Irish” banks⁵).

Example: the recapitalization of Northern Rock

In August 2007, the British Government announces various public support mechanisms to support Northern Rock Plc bank and the bank is taken into temporary public ownership (TPO) in February 2008.

The Office of Fair Trading points out that **in the personal current account, savings and investment product markets, consumers concerned about the stability of banks might choose Northern Rock because it was the only bank with a 100 per cent deposit guarantee**. The OFT also worries that Northern Rock might be able to take advantage of a **lower cost of capital in money markets** to offer lower rates on its mortgages. “This could lead to an adverse impact on competition that may in turn lead to consumer harm”.

The Northern Rock Restructuring Plan issued in March 2008 includes commitments by **Northern Rock** to minimise risk of competitive distortions. It **will not promote its offering on the basis of Government guarantee arrangements**, nor to sustain a prolonged market leadership in any product category and to maintain market shares at well below historic levels.

Example: the merger between Lloyds TSB and HBOS

In September 2008, the UK government engineers acquisition of HBOS Plc by Lloyds TSB.

The Office of Fair Trading reports that Lloyds TSB would then have a share of 33% on the market for personal accounts and 28% of the U.K. home-loan market and that the collective share of the big four UK banks would rise from 67 to 80%. It states that: “there is a realistic prospect that the anticipated merger will result in a substantial lessening of competition in relation to personal current accounts, banking services for small and medium sized enterprises and mortgages.”

On 24 October 2008, an amendment to the UK’s merger control rules introduced a new public interest consideration to be weighed against the consideration of effect on competition: “maintaining the stability of the UK financial system” and the merger is approved on 31 October 2008.

Example: sectoral aid to the financing of farm equipment and other machinery

In the farm-equipment sector **Deere & Co's** purchase of a thrift years ago qualified it in December 2008 for a government guarantee on \$2 billion of its debt through a **Federal Deposit Insurance Corp** program to help banks access debt markets.

But the FDIC **didn't cover competitors such as Caterpillar Inc. or smaller equipment providers**. So the Equipment Leasing and Finance Association, a trade group, lobbied the Fed to expand the TALF program to sales of farm equipment and other machinery. The Fed eventually expanded TALF to cover Deere, Caterpillar and other equipment makers but it seems that this result was due to the lobbying of the trade group and not to an intervention by US competition authorities. The Fed can finance only borrowers with top credit rating, which is hurting some smaller equipment-leasing firms that have to pay as much as four percentage points more than higher rated firms to borrow.

Conclusion I

Measures aimed at restoring confidence in financial markets and ensuring the stability of financial markets are often discriminatory and anticompetitive and they may also impact competition in the real sector (ex Farm Equipement in the US).

In some cases the NCA is not consulted (ex Irish Bank Guarantee Scheme, Farm Equipment in the US) ; in other cases the NCA is consulted either successfully (ex: Northern Rock bail out) or unsuccessfully (ex Lloyds Plc/ HBOS merger)

The EC Commission has some power to force Member States which take discriminatory or anticompetitive measures, but is powerless to intervene in some other cases (ex: the Lloyds Plc/ HBOS merger).

Measures adopted by governments in a period of crisis

2) Extending the reach of regulation in the financial sector

- Strengthening of prudential regulation of financial institutions**
- Regulation to limit the growth or the diversification of banks**
- Regulation of new players on financial markets (hedge funds , for example)**
- Regulation of new financial instruments (CDOs, for example)**
- Regulation of incentives for executives in the financial sector (bonuses, golden parachutes, stock options)**
- Regulation of Credit Rating Agencies**

G-20 communiqué of the London Summit

The G-20 member states agreed, among other things: “to extend regulation and oversight to all systemically important financial institutions, instruments and markets (including systemically important hedge funds), to endorse and implement (...) tough new principles on pay and compensation and to support sustainable compensation schemes and the corporate social responsibility of all firms”. They also agreed to: “prevent excessive leverage and require buffers of resources to be built up in good times” and “to call on the accounting standard setters to work urgently with supervisors and regulators to improve standards on valuation and provisioning and achieve a single set of high-quality global accounting standards” and “to extend regulatory oversight and registration to Credit Rating Agencies to ensure they meet the international code of good practice, particularly to prevent unacceptable conflicts of interest”.

Proposed regulatory changes in the US financial sector

On June 17, 2009 President Obama unveiled a series of sweeping proposals for regulatory changes in the US financial sector to promote “a system that works for business and consumers” one that will enhance “honest, vigorous competition” rather than reward gimmickry. Among the measures announced **all hedge funds advisers would have to register with the SEC ; regulators would have more authority to regulate derivatives, including credit default swaps; capital requirement would be increased for all financial institutions; companies that issue mortgages would be required to retain at least 5% on their books to discourage companies from marketing unsuitable loans;**

The US banking industry alleges that the proposed regulation of financial products offered to consumers **may stifle innovation and make loans more expensive.** Competition authorities do not seem to have been involved in the design of the proposals.

Example: regulatory proposal to limit the size of banks in Switzerland

On June 18, 2009 the vice-chairman of the Swiss National bank was reported to have said : “**There are advantages to size....[but] in the case of large international banks, the empirical evidence would seem to suggest that these institutions have long exceeded the size needed to make full use of these advantages**”. The Swiss authorities are examining the forced shrinkage of banking groups such as UBS and Credit Suisse unless global policy makers could come up with a new system to deal with large banks when they fail .

Possibilities included the **adoption of limits on the absolute size of balance sheets or discouraging growth into risky areas by raising capital requirements**. There is no sign that the Swiss Comco was involved in the discussion of solutions which could have an anticompetitive impact.

Example : proposals for regulation of the Credit Rating Agencies (CRAs)

Ensuring that CRAs give accurate assessments of the risk quality of assets is crucially important for investors, firms seeking financing, and regulated firms such as banks which are constrained as to the kind of risky assets they can hold and regulators who rely on CRAS assessments.

Reasons to doubt that competition is strong and that it will eliminate CRAs with poor quality credit rating (high concentration, necessity for regulated firms or other firms to get credit rated, leading to low price elasticity of demand, possible conflicts of interest when CRAs also sell other services, possible collusion between CRAs and clients).

Alternative solutions with different competitive impacts include self-regulation, transparency requirements and best practices, regulation, modification of regulatory agencies' reliance on assessments of the Big Three, creation of public rating agencies etc..

Conclusion II

Regulatory proposals for the financial sector can have serious implications for competition.

A large number of such proposals are being considered now, following the G-20 meetings.

Many of these proposals are drafted by financial authorities or regulators without input from competition authorities and it is far from sure that competition issues are even considered to be relevant by the drafters.

Measures adopted by governments in a period of crisis

3) Measures aimed at preventing the extension or the deepening of the economic crisis in the real sector.

Stimulus packages including:

- Direct aid to ailing business firms or small and medium size firms which are collateral victims of the credit crisis;**
- Subsidized interest rate for certain types of firms;**
- Sectoral aid designed to boost demand in specific sectors.**

Example: the introduction of discriminatory provision in the US stimulus package

The American Recovery and Reinvestment Act (ARRA) adopted in February 2009 included a provision which required the use of US produced steel, iron and manufactured goods in public works funded by the ARRA, subject to certain exceptions (public interest, non-availability or unreasonable cost). A second provision required the Department of Homeland Security to procure US manufactured textile and apparel goods.

Following President Obama's intervention, the ARRA requires that these provisions be applied in a manner consistent with US obligations under international agreements. Further, Congress has indicated that the "buy American" provision for iron, steel and manufactured goods is not intended to apply to LDCs.

However, US state and municipal governments will be able to impose restrictions on the origin of steel and manufactured goods in procurement markets.

Example: the introduction of discriminatory provision in the Chinese stimulus package

China also adopted a large stimulus package (worth US\$ 586 billion) at the end of November 2008.

A notice issued by several central state agencies, including the powerful National Development and Reform Commission, on May 26, 2009 asserted that purchasing by local governments had actually been biased in favor of foreign suppliers. The notice requires that in the future Chinese companies should receive contracts for government stimulus projects unless Chinese companies can't deliver certain technical goods at a reasonable price or time frame.

Ex : the auto bailout plan in France

A controversy erupted in February 2009 as to whether the French auto bailout plan was compatible with EU competition rules. On February 5, 2009, President Sarkozy had indicated that he wished that: “the movement toward relocating plants outside France be stopped and that, if possible, jobs be repatriated to France” He added: “If financial aid is given to the automobile sector for restructuring, it is on the condition that no new plant will be moved to the Czech Republic or elsewhere”. On February 10, 2009, the EC Competition Commissioner suggested that such aid would be illegal under EU competition rules. That same day, the EU presidency (exercised under the rotation system by the President of the Czech Republic) denounced the “protectionism” of the French Government. So did the German Government. On February 27, 2009 the Commission finally approved the aid measures.

Conclusion III

- Stimulus packages may have discriminatory and/or anticompetitive effects by design (cf Buy American Act);**
- It is often because governments fearing that (economic) leaks may benefit foreigners, insert discriminatory conditions into their fiscal programs to prevent such seepage when they consider using budgetary deficits as a means to support demand (ex French automobile industry bail out).**
- Adoption of discriminatory and anticompetitive rules leads to retorsions (cf China Buy Chinese Act).**
- International pressure is, in some cases, sufficient to eliminate some discriminatory and anticompetitive aspects of stimulus packages but not in other cases (see the difference between US and China)**

Measures adopted by governments in a period of crisis

4) Protectionist measures

- Direct protectionist border measures**
- Imposition of antidumping duties**
- Tariff increases**
- Non tariff barriers**

Direct protectionist border measures

The United States gave in to lobbying by the Teamsters Union and US trucking interests and, as part of the U.S. economic stimulus package, the U.S. Congress cancelled a 2007 demonstration project allowing importation of some Mexican trucks into the US, thus violating a provision of the 1994 North American Free Trade Agreement permitting Mexican trucks to carry goods to and from the U.S.

In response, Mexico is imposing tariff increases on 90 U.S. products, with a value of US\$2.4 billion.

Tariffs hikes in various developing countries

In January 2009, Ecuador raised its custom tariffs on 630 products (from cereals to cell phones and tennis shoes), accounting for 8.7% of its imports, for one year to restore its balance of payments.

Russia imposed temporary increases of import tariffs on a number of products such as cars, trucks, buses (up to 30%); some types of flat metals (up to 15%); some types of ferrous metal pipes (up to 15%-20%); butter and certain types of dairy products, milk and dairy cream (up to 20%); and rice and milling products.

In March 2009, Ukraine imposed import duty surcharges up to 13%, except for "critical imports", for a period of up to six months, with a view to restore its balance of payments.

Antidumping

A World Bank report states that during the first half of 2008 (1 January to 30 June 2008) there was a ‘surge in new anti-dumping measures’ of 39%, compared to the corresponding period of 2007. India was the biggest initiator of anti-dumping actions, accounting for 29 % of total initiations.

The US and the European Union imposed duties most frequently. According to the World Bank report, in December 2008 the EU imposed duties on preserved fruits from China as well as on imports of welded tubes and pipes of iron or non-alloy steel from Belarus, China and Russia.

The Report of the WTO Director General to the Trade Policy Review Body at the end of March 2009 notes that the trend toward more numerous antidumping actions at the national level had continued in 2009.

Creative protectionism

In February 2009, Argentina introduced reference prices covering around 1,000 imported products considered sensitive (such as auto parts, textiles, TV, toys, shoes, and leather goods) and further non-automatic import licensing requirements, covering products such as textiles, steel, metallurgical products, and tires.

That same month, Indonesia imposed new licensing, reporting, and pre-shipment inspection requirements on over 500 goods (food and beverages, toys, electronics, footwear, and garments). It restricted entry points for those products to six seaports and all international airports.

Malaysia is reported to have imposed a ban on the hiring of new foreign workers in key services and manufacturing sectors.

Conclusion IV

Protectionist measures are particularly worrisome as they tend to attract retaliation by affected countries (see the Mexican truck example);

A significant number of these measures do not constitute violations of the WTO rules (see, for example, increases in tariffs in a number of developing countries);

Progress in the WTO negotiations on the Doha Round could alleviate some of the problems by decreasing the ability of some countries to increase their tariffs, by strengthening the discipline on antidumping and countervailing measures, and by getting more countries to join the agreement on public procurement.

Conclusion IV

Because of the financial and economic crisis, governments will continue to be under intense political pressure to take varied measures to alleviate the economic disruptions due to the present crisis and to prevent the occurrence of future crises.

As long as stimulus packages are not coordinated governments will be tempted to introduce discriminatory and anticompetitive measures in them.

So macro economic coordination in policy responses is a necessity to prevent a resurgence of trade restrictive and anticompetitive policy response to the crisis.

Competition policy and the institutional design of competition authorities

In most cases (except the EU to a certain extent), competition authorities have not been consulted on most of the policy responses considered even though these measures have huge potential implications for competition and international trade.

This is partly due to the fact that in the recent past the emphasis has been on competition law enforcement, independence of competition authorities and competition advocacy rather than on an overall government approach to competition policy.

Regulatory reform, even if it is useful, is insufficient at a time of intense multiform government intervention to the extent that it is voluntary, not always transparent, limited to regulation and ex post. Ex ante mandatory independent comprehensive and transparent competition assessment is required for all measures considered as a response to the crisis.

Where to go from here ?

Having governments commit themselves to adopting a systematic ex ante independent and transparent competition assessment of all measures taken to remedy the crisis should be one of the main focuses of competition authorities' efforts in a period of crisis.

Individual competition authorities may not have sufficient weight with their national governments to be successful. However, they can find support at the international level or in other policy communities. They can express their opinions through numerous international channels (such as APEC, OECD, ICN, UNCTAD etc....) and they can also find support in the international trade community (at the regional level or at the WTO) which is fearful of a resurgence of protectionism and in the international aid community (World Bank).

Remember

Most of the policy responses to the crisis work like medical drugs.

No matter how effective, they may also have severe secondary effects or even be incompatible with other prescribed medical drugs.

If a doctor prescribed medicines without reading the instructions for use or without considering incompatibilities or side effects he would lose his license to practice.

The same should apply to policy makers. By unnecessarily weakening market incentives, creating barriers to entry, increasing concentration, discriminating etc... policy responses to the crisis may actually delay or prevent full recovery.

II) Competition Law Enforcement in a time of crisis

Competition law enforcement issues raised by the crisis

1) Changes in the competitive environment due to the crisis

- decrease in demand**
- decrease international trade (i.e., both in export opportunities and in potential competition)**
- failing firms (i.e., increase in market concentration)**
- scarcity of available funds for investment (decrease in potential competition)**

2) Possible threats to competition due to policy responses

- protectionist policies**
- discriminatory fiscal stimulus packages**
- strategic use of public procurement (risk for competition and of corruption)**
- temptation to establish price controls**

3) Competitive markets can benefit only « smart » consumers and penalize unsophisticated consumers

State Aid Control (in Europe)

1) State aid control as a **regulatory tool** in the banking sector

Objective of state aid control with respect to the banking sector:

- Not limited to ensuring that the banking sector goes back to the pre-crisis state
- Aimed to **reshape the banking sector so as to avoid the repetition of crisis.**

2) Issues

- State aid control instruments: **aren't banks prevented from competing with each other** (ex: caps on market shares of recipients of aid)?
- Legitimacy** of the EU DG Comp to regulate the banking sector?
- Legitimacy** of state aid control in other sectors?

Competition enforcement and economic crisis: interim measures

It is probable that a **larger share of referrals than in the past will come from struggling economic agents** and that these referrals will be accompanied by requests for provisional measures.

Competition authorities will be inclined to ask themselves whether they should change their benchmark for assessing the gravity or immediacy of the danger that a potentially anticompetitive practice poses to the referring parties, which are, in addition, weakened by unfavorable economic conditions.

Competition enforcement and economic crisis: Merger control

It is likely that in a larger number of mergers than in the past, the parties to the operation will argue that the operation should be authorised, invoking the failing firm defence.

Moreover, the fulfillment of structural conditions imposed to allow otherwise anticompetitive mergers, such as selling some assets in order to reduce the market share of the merged firms or to allow viable competitors to emerge, will be difficult if not impossible in a situation of scarce credit and reduced investment.

Competition enforcement and economic crisis: Cartels

The temptation of market sharing and price fixing is stronger in a period of significantly reduced demand, when each firm in the market is threatened by bankruptcy, than in a period of economic expansion when all can increase their turnover simultaneously.

Competition authorities may want to step up their efforts in this area and to diversify their investigations in order to maintain the probability of detecting and sanctioning cartels at a level comparable to that which prevailed before the crisis.

Competition enforcement and economic crisis: vertical restraints and abuse of dominance

The anticompetitive effects of exclusion through vertical restraints, or abuses of dominance by firms, are apt to be greater than in the past. In a time of economic and financial crisis, the credit market struggles to finance diversification projects – which have the potential to intensify competition – while lenders have a greater aversion to risk and less ability to predict what the future will bring. Likewise, the very significant fall in international trade is a factor undermining competition. We can therefore expect that the number of cases in which such practices are deemed anticompetitive will be higher than in the past.

Post-crisis antitrust issues

- Are the fines too high ? **Due process revisited**
- Are markets as rational as once thought ?(demanders and suppliers)

Behavioral economics revisited

Collusive equilibria may be due to satisfying strategies

Simulation models for mergers may be unreliable

Firms may adopt pricing strategies to take advantage of overconfident or underconfident consumers

- Can competition law enforcement deliver benefits to vulnerable consumers?
- Are market studies necessary tools to complement competition law enforcement ?
- What relationship between competition and consumer policies ?₃₈

**Thank you very much
for your attention**
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