Regulation for competition
Real medicine for markets or life-extending elixir for regulatory quacks?

Kings College lunchtime lecture
8 May 2014

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ESRC Centre for Competition Policy
University of East Anglia
Two key themes

1. **Regulation for competition is not just a life-extending elixir:**
   There is a continuing role for *ex ante* regulation in competitive markets

   But...

2. **The regulators do need to avoid quackery:**
   Such regulation needs to be carried out with great care!
Straw man (?) arguments

- The regulators should get the hell out of competitive markets because:

  1. markets work well when left to themselves
Privatisation: The expected story

- **Privatisation**: To change managerial incentives (to profit-maximisation)
- **Regulation**: To ensure, in the absence of effective competition, that those incentives drove benefits for productivity and consumers
- **Competition**: The end-point, which could be left to work its magic for productivity and consumers alike, with regulation a thing of the past
Regulation: A changing focus

Retail price regulation
- Most water and sewerage services
- 2\textsuperscript{nd} class stamps
- Heathrow and Gatwick airports
- Regulated rail fares

Access price regulation, incl. margin squeeze
- Energy transmission and distribution
- BT infrastructure
- Water/sewerage wholesale
- Network Rail
- ‘Last mile’ postal services
  (Payment systems)

A regulatory framework for competition
- Financial services
- Telecoms retail
- Energy wholesale
- Energy retail (so far!)
- Water/sewerage services for large use customers
- Other postal services
- Other UK airports
- Other rail fares
The competitive process as a virtuous circle

Active consumers buy the products which offer them the best VFM

Suppliers compete vigorously to offer consumers the best VFM
...but it needs certain key elements!

Do consumers... 
- access
- assess
- act

...on relevant info?

Active consumers buy the products which offer them the best VFM

Are there...
- enough suppliers who compete without barriers

Suppliers compete vigorously to offer consumers the best VFM

...to win custom?
Ex post competition and consumer law are crucial tools.

Do consumers...
- access
- assess
- act
...on relevant info?

Are there...
- enough suppliers
- who compete
- without barriers
...to win custom?

WYSIWYG rules
Aggressive selling
Misleading selling
Unfair contract terms
Mergers policy
Explicit collusion
Anti-competitive Agreements
Exclusionary abuse
Straw man (?) arguments

- The regulators should get the hell out of competitive markets because:
  1. markets work well when left to themselves
  2. *ex post* competition and consumer law are sufficient to ensure that markets work well
The gap on the supply side...

Standard *ex post* competition law doesn’t deal well with:

- Mergers policy
- Explicit collusion
- Anti-competitive Agreements
- Exclusionary abuse

Are there enough suppliers who compete without barriers... to win custom?
The gap on the supply side...

Standard *ex post* competition law doesn’t deal well with:

- Existing structural issues
- Tacit collusion
- Collective exclusion
- Market manipulation

Mergers policy

Explicit collusion

Anti-competitive Agreements

Exclusionary abuse

Are there... *enough suppliers* who *compete* *without barriers*...to win custom?
...and on the demand side

Can consumers... access assess act ...on relevant info?

WYSIWIG rules Aggressive selling Misleading selling Unfair contract terms

Standard *ex post* consumer law doesn’t deal well with:
...and on the demand side

Can consumers...

access

assess

act

...on relevant info?

WYSIWIG rules
Aggressive selling
Misleading selling
Unfair contract terms

Standard ex post consumer law doesn’t deal well with:

Search costs
Poor info transparency
Divergence of incentives
Switching costs & ex post hold-up

Behavioural biases
Why can’t these ‘gap’ issues just be covered by *ex post* laws?

- *Ex post* laws rely heavily on the concept of deterrence:
  - Not all firms that breach the law are caught, but sanctions for those that are provide incentives for compliance

- But effective deterrence requires:
  - High fines/sanctions…
  - … which rightly require a high standard of proof, which in turn makes it harder, more costly, and a longer process to change behaviour…
  - … and which are only appropriate where firms do something clearly wrong, otherwise they risk deterring pro-competitive behaviour

- Key issue in the ‘gap’ is that firms often don’t really do anything ‘wrong’.
The regulators are increasingly active in this ‘gap’ – Examples

<table>
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<tr>
<th>Ofcom</th>
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| • Oct 2013: Protection against mid-contract price rises through **switching** and enhanced **transparency**<br>
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• Jan 2013: RDR – new rules on financial advisors to enhance **transparency** and reduce divergence of incentives.<br>
• Oct 2012: MMR – new rules to enhance **transparency** (by reducing disclosure!) and limit **behavioural biases** |
‘Gap’ issues also occur elsewhere
.... Selected CC inquiries

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<th>Date</th>
<th>Inquiry</th>
<th>Key findings</th>
</tr>
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<tbody>
<tr>
<td>2013</td>
<td>Aggregates, cement and RMX concrete</td>
<td>• Tacit coordination in GB cement market, including collective exclusion of imports</td>
</tr>
<tr>
<td>2013</td>
<td>Private healthcare</td>
<td>• Market power in hospital services markets</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Lack of transparency on performance by hospitals or consultants</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Divergent incentives between patients and consultants due to referral Incentive schemes</td>
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<tr>
<td>2013</td>
<td>Statutory audit services for large companies</td>
<td>• Lack of transparency about audit quality in advance, leading to barriers to switching</td>
</tr>
<tr>
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<td></td>
<td>• Divergence of incentives between shareholders and management</td>
</tr>
<tr>
<td>2009</td>
<td>BAA airports</td>
<td>• Structural issues identified, giving BAA excessive market power in Scotland and South-East.</td>
</tr>
<tr>
<td>2006</td>
<td>Domestic bulk LPG</td>
<td>• High switching costs, search costs and a lack of transparency</td>
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Straw man (?) arguments

- The regulators should get the hell out of competitive markets because:

  1. markets work well when left to themselves

  2. *ex post* competition and consumer law are sufficient to ensure that markets work well

  3. if *ex ante* intervention is needed in markets, the CMA can, would and should do it, not the regulators
## The CC and financial services

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<td>Ongoing (to 2015)</td>
<td>Payday lending</td>
<td>• Issues include <strong>transparency, search costs, switching costs</strong> and <strong>behavioural biases</strong> (as well as <strong>barriers to entry and expansion</strong>)</td>
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<td>Ongoing (to 2014)</td>
<td>Private motor insurance</td>
<td>• Issues include <strong>divergence of incentives, vertical integration</strong>, and <strong>switching costs</strong> (NB Careful recognition of ongoing FCA work!)</td>
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<tr>
<td>2009</td>
<td>PPI</td>
<td>• High <strong>search costs</strong> and lack of <strong>transparency</strong>, combined with <strong>switching costs</strong> and <strong>mis-selling</strong></td>
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<tr>
<td>2007</td>
<td>PCA services in NI</td>
<td>• Poor <strong>transparency, search costs</strong> and <strong>switching costs</strong></td>
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<td>2006</td>
<td>Store card credit services</td>
<td>• Poor <strong>transparency</strong>, lack of clear APR info to enable <strong>search</strong>, <strong>ex post hold-up</strong> through high penalty charges</td>
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<td>2006</td>
<td>Home credit</td>
<td>• <strong>Search costs, switching costs</strong> and lack of <strong>transparency</strong></td>
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So why not leave ‘gap’ issues to the CMA?

<table>
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<th>Pros</th>
<th>Cons</th>
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<tr>
<td>✤ CMA truly understands competition, and</td>
<td>✤ Not always good at spotting problems</td>
</tr>
<tr>
<td>how to analyse it empirically</td>
<td>✤ Overly long and burdensome process for small</td>
</tr>
<tr>
<td></td>
<td>issues/tweaks</td>
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<tr>
<td>✤ CMA has clearer focus on competition</td>
<td>✤ Short timetables and need for ‘one-look’ analysis</td>
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<tr>
<td>✤ It comes to issues with a clear mind</td>
<td>✤ Short timetables for remedy design</td>
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<tr>
<td>(sees wood for trees)</td>
<td>✤ Weak at ongoing monitoring of remedies (where</td>
</tr>
<tr>
<td>✤ It does not face ‘perimeter’ issues</td>
<td>needed)</td>
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<tr>
<td>✤ Legitimacy and a strong history of</td>
<td>✤ Lack of resources to cover the whole economy</td>
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<td>avoiding political intervention and</td>
<td></td>
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<td>regulatory capture</td>
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So where are we?

Regulation
or
competition
So where are we?

Regulation for competition
Straw man (?) arguments

The regulators should get the hell out of competitive markets because:

1. markets work well when left to themselves

2. ex post competition and consumer law are sufficient to ensure that markets work well

3. if ex ante intervention is needed in markets, the CMA can, would and should do it, not the regulators

4. Ex ante intervention can be costly, ineffective and can even do more than good.
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So what are the risks?

- Misdiagnosis of problem

‘Well-functioning markets’
So what are the risks?

- Misdiagnosis of problem
- Misdesign of remedy

‘Well-functioning markets’
So what are the risks?

- Misdiagnosis of problem
- Misdesign of remedy
- Conflicting objectives

‘Well-functioning markets’
The UK Competition Network
Statement of Intent (Dec 2013)

- The UKCN brings together the CMA with the CAA, FCA, Ofcom, Ofgem, Ofwat, ORR and the Utility Regulator of Northern Ireland. These sector regulators all have a duty to promote competition in the interests of consumers.

- The health-care regulator, Monitor, which has a statutory duty to prevent anti-competitive behaviour, will attend the Network with observer status.

- The mission of the UKCN will be to **promote competition** for the benefit of consumers and to prevent anti-competitive behaviour.

- both through facilitating use of competition powers

- and **development of pro-competitive regulatory frameworks**, as appropriate.
So what are the risks?

- Misdiagnosis of problem
- Conflicting objectives
- Misdesign of remedy
- Incomplete toolkit

‘Well-functioning markets’
So what are the risks?

- Misdiagnosis of problem
- Conflicting objectives
- Process too slow

Misdesign of remedy
Incomplete toolkit

‘Well-functioning markets’
So what are the risks?

- Misdiagnosis of problem
- Conflicting objectives
- Slow process

Strongly affected by the political backdrop

- Misdesign of remedy
- Incomplete toolkit

‘Well-functioning markets’
So what are the risks?

- Misdiagnosis of problem
- Conflicting objectives
- Slow process
  - Unintended consequences
    - High cost
    - Little benefit
    - Too slow
  - ‘Well-functioning markets

- Misdesign of remedy
- Incomplete toolkit
Regulation for competition
Real medicine for markets or life-extending elixir for regulatory quacks?

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8 May 2014

Professor Amelia Fletcher
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Should competition and consumer law be left to the CMA?

- Major plus of concurrency is that regulators have full toolkit - otherwise choice of tools may be distorted

- **Key question:** Where they have a choice (ie for problems which are potentially covered by *ex post* competition and consumer law), should regulators ever use *ex ante* regulatory powers in place of these *ex post* laws?

- **Bad reasons:** Skills/confidence, compromising competition for other objectives

- **Good reasons:**
  - Applicability of CA98 or consumer law unclear/likely to be very difficult
  - Precedent/deterrence benefits likely to be minimal
  - CA98 will not *promote* competition sufficiently
  - **Most difficult issue:** Ease/speed of action/process of redress often better for regulation, due to different legal regimes