Written submission by the Competition and Markets Authority (PEG0315)

Overview

1. The CMA is an independent non-Ministerial government department and is the UK's lead competition and consumer authority. Its mission is to make markets work well in the interests of consumers, businesses and the economy.

2. The recession, recovery and adaptation of the economy to COVID-19 are likely to have significant consequences for markets. These effects, and how they are managed, will matter for consumers, for the post-pandemic recovery, and in particular for long-term productivity and economic resilience.

3. The recession and the economic adjustment to the pandemic create a number of risks to competition, including:

   - *Business failures and consolidation:* businesses are likely to fail at a higher rate as the economy goes through a recession and adjusts to a new normal in which consumer preferences may have changed, and in which public health measures require businesses to operate differently. These same pressures may also prompt more businesses to merge, or to be acquired by stronger competitors. Business failures need not always be harmful to competition – the process of productive assets being reallocated to more efficient firms can assist the economic recovery. But of greater concern are anti-competitive mergers, or otherwise viable firms leaving the market in response to a short-term demand shock, both of which could harm competition, leading to higher prices, less choice or weaker innovation.

   - *Stronger digital platforms:* the shift to online shopping[1] is likely to strengthen the position of online retail platforms. It may also benefit Google and Facebook, owing to their strength in the digital advertising market. Among other things, this could further restrict the ability of rivals to enter the market and compete on equal terms, thereby inhibiting innovation and the development of new, valuable services for consumers.[2]

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[1] Internet sales as a proportion of total retail sales rose from 19% in February 2020 to 31% in June.

Recent developments reinforce the need for a pro-competitive regulatory regime for online platforms, as recommended in the final report of the CMA's Online platforms and digital advertising market study. The CMA-led Digital Markets Taskforce – announced in Budget 2020 – will provide further advice to government on the potential design and implementation of such a regime.

- *Reduced international trade:* world trade tends to fall more than world GDP during global downturns.[3] In the current context, a contraction of trade may also be driven by policy measures intended to promote greater resilience in supply chains and domestic self-sufficiency in goods deemed to be essential. Other things equal, a reduction in imports will reduce the competitive pressure on UK firms to keep prices low, to sustain quality, and to innovate.

4. As well as a potential weakening in competitive forces, the recovery from and adjustment to COVID-19 could lead to higher levels of household debt, lower incomes and rises in unemployment. This could leave more consumers at higher risk of getting poor deals, or falling victim to exploitation. This is problematic in itself. But by damaging public confidence in market competition generally, and consumer confidence in specific markets, it also has the potential to weaken the competitive process, which requires not only suppliers to compete vigorously, but also confident and engaged consumers, who make choices that reflect their needs.

5. There are a number of things that Government can do – and avoid doing – to reduce the risks of weaker competition and mitigate consumer vulnerability. In responding to the Committee's questions below, we outline some of the factors that should inform a pro-competitive, pro-consumer recovery package, and explain why these matter to the strength and sustainability of the recovery.

What core/guiding principles should the Government adopt/prioritise in its recovery package, and why?

6. Policy measures to support the economic recovery should, wherever possible, preserve and promote well-functioning, competitive markets. This includes maintaining incentives for firms to compete vigorously, and ensuring that consumers are protected from unfair practices and contracts.

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[2] The effects of weak competition in online advertising markets are examined in the Final Report of the CMA's Online platforms and digital advertising market study (July 2020)

[3] See, for instance, Economics Observatory (2020) What happens to trade during global downturns? and World Bank, Global Economic Prospects, June 2020

7. The competitive process benefits consumers. It provides incentives for firms to keep prices down and to keep quality and service standards up: in short, to win business by making the best offer they can. In turn, this serves the wider economy, contributing to economic growth and productivity.[4] The firms that serve their customers most effectively, and are most efficient in terms of how they run their business, can be rewarded through winning market share from their competitors.

8. From this general point follow a number of principles that are relevant to any recovery package:

- *Identify and address consumer vulnerability.* As set out above, the recovery from and adjustment to COVID-19 may lead to consumer vulnerability becoming more prevalent. The crisis has also opened up new means and opportunities for unfair practices and anticompetitive conduct: the CMA's COVID-19 Taskforce has received large numbers of complaints about price gouging of essential items, and failures to respect consumers' refund rights when travel bookings, events and other services are cancelled.[5] The harmful effects of these practices are likely to be felt particularly acutely by vulnerable consumers, who are less able to afford the higher prices and are less likely to be able to go to a different shop, or to go online, to get a better deal. Equally, vulnerable consumers may find it harder to exercise their rights to refunds for services cancelled as a result of the pandemic and associated public health measures. Over the longer term, if more economic activity takes place online, it will add to the vulnerability already faced by those who do not have internet access, or who are unable easily to shop around online. And as the CMA has set out elsewhere, stronger consumer protection law – including the introduction of fines for infringements – would help to prevent and address more effectively some of the harmful practices that might arise as the economy recovers and adapts.

- *Retain openness to trade and investment.* The economic case for openness is well known. From the perspective of consumers, international trade and investment can provide an important competitive constraint on domestic firms, particularly in markets where there are a small number of domestic suppliers, thereby contributing to lower prices, higher quality and stronger innovation.[6]

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[4] For a summary of the evidence, see, for instance, CMA (2015) Productivity and competition; Productivity Insights Network (2019), Product market concentration and productivity in the UK

[5] The CMA has published regular analyses of the complaints received and its response to them. The latest can be found here.

[6] See, for instance, Besley et al (2020), *Antitrust policies and profitability in non-tradable sectors*, which finds that for tradable goods, exposure to import competition serves as a disciplining mechanism for firms,

- *Assist viable firms to weather the storm; allow unviable firms to exit the market.* Where assistance is provided to firms that are likely to struggle in the future, it should be conditional on a restructuring that places them on a path to viability, taking account of long-term structural changes, including the transition to a low-carbon economy. Sheltering firms that are unlikely to be viable in the long term – for example through subsidies or recapitalisations – could prevent a necessary adjustment and reallocation of resources towards those businesses that are able to thrive.

- *Ensure procurement is competitive.* Competition in procurement helps secure value for money for service users and taxpayers. Competitive procurement need not imply a focus on price variables alone – for example, fixed price tenders have been used to drive competition on quality in healthcare. However, it is important to bear in mind that procurement exercises that prioritise factors extraneous to price and quality (e.g. the location of bidders, in order to stimulate local economies) may mean that taxpayers or consumers end up paying over the odds.

- *Assess and monitor the impact of emergency interventions on competition and consumers*. The government's interventions to date – including exclusion orders, and cross-economy and firm-specific financial assistance, and regulatory forbearance – have provided important short-term support to the economy during the crisis. Looking ahead, the effects of these measures on the effective functioning of markets will need to be closely monitored by the government to identify and address any long-term distortions and constraints to competition they may create. Equally, as set out below, where the Government intervenes in markets to meet wider policy objectives (including in any revised Industrial Strategy), there is merit in early and careful consideration of the implications for competition and consumers.

Should the Government prioritise certain sectors within its recovery package, and if so, what criteria should it use when making such decisions? What conditions, if any, should it attach to future support?

9. In general, horizontal (i.e. cross-economy) support is likely to be more pro-competitive than support based on the location or sector in which a firm operates. However, given the asymmetric effects of the pandemic on different industries, there may be good reasons to provide targeted support to particular sectors. In designing such support, there is merit in assessing and mitigating potential distortionary effects. In particular:

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leading to lower profit margins.

- investment may be diverted from more productive firms (that sit outside the supported sector) to less productive firms (that sit inside the supported sector); and as a result the economy may end up producing products less efficiently, or producing products that are not favoured by customers;

- recipients of support may have weaker incentives to become more efficient, potentially weakening their prospects of competing with overseas rivals;

- support may create barriers to entry and innovation. Innovation in fields such as e-commerce, nanotechnology and robotics have the potential to re-draw sector boundaries, as firms with expertise in these emerging technologies transfer their expertise to other product and service markets. Policies that provide support to a narrowly defined sector risk ossifying markets, slowing entry, and slowing the emergence of new business models.

10. These distortive effects are especially likely to arise when government support:[7]

- is provided to only one or a few firms in a market, thereby giving them an advantage over direct competitors;

- is very large relative to the cost base of the firm;

- is re-occurring: providing recurring support over a period of time relative to a one-off lump sum is likely to affect firms' entry and exit decisions. For instance, potential entrants could be deterred from entering the market if they have to compete with incumbents that are expected to receive further support. And firms receiving support may stay in the market longer than it otherwise would because it has reason to expect further support in the future;

- is provided on terms that are materially different to those available in capital markets;

- takes the form of equity and/or grants, rather than debt;

- affects recipients' marginal rather than fixed costs. A change in a firm's marginal costs may be passed on to consumers as a change in price or output. Such a change is likely to have an immediate effect on the

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[7] See, for instance, OFT (2009) Government in Markets, and OFT (2007) Guidance on how to assess the competition effects of subsidies

competitive process, including the relative strengths of firms receiving and not receiving subsidies. A change in fixed costs will have no such direct effect on prices;

- is provided to incumbents in markets with significant barriers to entry, thereby exacerbating pre-existing protections they enjoy from potential competitors;

- Is given to incumbents in concentrated markets: if the affected market is concentrated and the subsidy recipient is a major player then it is more likely that competitors will have to alter their business in response to the subsidy;

- affects markets where products are not highly differentiated: in markets where the product is similar (and hence highly substitutable from consumers' points of view), the intensity of competition is often higher, and the distortive impact of support will be greater.

11. The CMA recognises that wider policy objectives may be at stake in any recovery package, which may on occasion conflict with the promotion of competition. These include, for instance, the levelling up of all parts of the UK; the promotion of more resilient supply chains for certain essential goods; the protection of jobs; or the development of sectors deemed to be strategically important. As with all measures that could affect competition, the CMA recommends that the consequences for competition and consumers of any targeted financial support are carefully assessed, with a view to designing interventions that distort competition no more than is necessary to achieve the policy objective at hand.[8] The CMA has published guidance on how to approach such assessments.[9]

12. In addition, it is important that, in considering whether and how to provide firm-specific support, the views of incumbent businesses are not given undue weight. While incumbents can be a useful source of information, they have incentives to strategically provide evidence that benefits them, particularly where they stand to lose out from policies that create more competitive conditions, or conversely to gain from policies that bolster their market power. Their views need to be set against the impact on consumers and potential competitors, whose views may be more dispersed and less well-represented.

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[8] Distinguishing between support provided to help firms weather the short-term consequences of the pandemic, and support that is linked to longer-term industrial strategy or other objectives, will be particularly important in this context.

[9] CMA (2017), Competition Impact Assessment: guidelines for policymakers

Is the Industrial Strategy still a relevant and appropriate vehicle through which to deliver post pandemic growth?

13. The CMA considers that an industrial strategy can complement competition policy where it entails carefully targeted government interventions that tackle market failures.[10] A pro-competitive industrial strategy could provide an important foundation for the delivery of increased productivity and growth.

14. The points made above – especially those on firm-specific support, and on the importance of openness to trade and investment – are all relevant to the development of a pro-competitive Industrial Strategy. Of particular relevance in this context are industrial policies that protect certain firms from normal competitive forces in order to create so-called "national champions". Such protection can be afforded through various means, including subsidies, regulatory policy, trade policy, government procurement, or the relaxation of merger control and/or competition law.[11] The available empirical evidence indicates that policies to promote "national champions" are unlikely to be growth- or productivity-enhancing in the long run.[12]

What lessons should the Government learn from the pandemic about actions required to improve the UK's resilience to future external shocks (including – but not limited to – health, financial, domestic and global supply chains and climate crises)?

15. It is important for both resilience and competition that investors in companies bear the losses associated with external shocks, with owners (i.e. shareholders) first in line.

16. In the present context, the last decade has seen a shift to more highly-leveraged capital structures, which have produced strong returns for shareholders and higher executive remuneration, but have left many companies more vulnerable to the shock that has now occurred. As set out above, where the Government deems it necessary to provide specific financial assistance to such firms, this should be conditional on a transition to more resilient business models and capital structures, even if that means shareholder and creditor losses, and lower valuations.

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[10] The CMA responded to the Government's Industrial Strategy Green Paper in 2017.

[11] It was in the context of calls for a relaxation of EU merger control to permit the merger of Siemens AG with Alstom SA that the CMA, alongside competition authorities in Belgium, Spain and the Netherlands, expressed concern about the widespread and significant loss of competition in the railway sector that would have been brought about by such a transaction. [Joint letter to Margarethe Vestager on Case COMP M.8677]

[12] See, for instance, OECD (2009) *Competition policy, industrial policy and national champions*

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