Do People Really Want to be Nudged?

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Do People Really Want to be Nudged?

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This article summarises an exchange between Cass Sunstein and me about the justification of nudges, particularly in relation to healthy lifestyle choices. In their book *Nudge*, Richard Thaler and Sunstein claim that the criterion by which they assess nudges is that of making the people who are nudged ‘better off, as judged by themselves’. The exchange is about how this clause should be interpreted and about the extent to which people who would make unhealthy choices in the absence of nudges believe those choices to be mistaken and want to be nudged away from them.

People can expect longer and healthier lives if they make certain kinds of lifestyle choices. This is known not only to health specialists, but also to the general public. In the UK, for example, you can consult an accessible website maintained by the National Health Service (NHS), with the banner ‘Your health, your choices’. A few minutes browsing will teach you some simple guidelines: you should eat at least five portions of fruit and vegetables a day; you should not drink more than 14 units of alcohol each week; you should have at least 150 minutes of physical activity each week. These guidelines are widely known and are frequent topics of media attention. Nevertheless, many people do not follow them.

Behavioural economists often argue that governments should respond by nudging people towards healthy lifestyles. The value of nudges is the core message of the influential book *Nudge*, co-authored by Richard Thaler (the winner of the 2017 Prize in Economic Sciences in Memory of Alfred Nobel) and Cass Sunstein. The idea is to design the environments in which choices are made in ways that engage with psychological mechanisms that economists have traditionally regarded as non-rational, but which are known to influence actual choices. These mechanisms are to be used to increase the likelihood of ‘good’ choices while not restricting other opportunities. But what criteria should policy-makers use in deciding the directions in which people are to be nudged?

In three papers that feature in the citation for Thaler’s Nobel Prize, I and co-authors have argued that behavioural economists’ answers to this question often make the unwarranted assumption that each individual has ‘true’ or ‘latent’ preferences that are rational, but which psychological mechanisms interfere with. One version of this assumption appears in *Nudge*, where Thaler and Sunstein go out of their way to claim that the criterion by which they assess nudges is that of making individuals better off, not as judged by a policy-maker, but as judged by the person who is being nudged. Their recommendations for nudging, they say, are designed to ‘make choosers better off, as judged by themselves’. What exactly this means is not altogether clear, but Thaler and Sunstein often suggest that most individuals want to make (what experts judge to be) healthy lifestyle choices, but at crucial moments – in a bar, in a restaurant, thinking about taking a run on a cold, damp morning – they are unable to resist the temptation to choose unhealthy options which, even at the time, they do not really want.
In a paper discussing this claim, I offered a thought experiment. Consider Jane, a cafeteria customer who is currently in good health but seriously overweight. Despite knowing what dieticians advise, she chooses the cafeteria’s cream cake rather than its fresh fruit option. Imagine that, in an attempt to uncover the reasoning that leads people like Jane to ignore dietary advice, we are designing a questionnaire which asks: ‘Which of the following statements best represents your reasons for choosing cake rather than fruit, contrary to the recommendations of health experts?’ The thought experiment is to produce statements that Jane might plausibly assent to, and that could be used to diagnose her mode of reasoning.

My list of statements included:

(a) I always go into the cafeteria having resolved not to choose cake, but when I see the cake at the front of the counter, I can’t resist the temptation.

(b) I get a lot of pleasure from eating sweet and fatty foods, and the thought of living to a great age doesn’t appeal to me.

(c) When I am a few years older I will adopt a healthier diet, so my current eating habits are not a problem.

(d) The expert advice sets unrealistic standards. Most of the people I know eat at least as much sugar and fat as I do.

(e) All my grandparents were thin but died relatively young. It’s quite likely that I will die young too, whatever I eat.

(f) Whatever I eat, I put on weight, so for me there is no point in trying to eat more healthily.

Thaler and Sunstein’s implicit hypothesis is that most respondents would choose (a), revealing a self-acknowledged problem of self-control. But behavioural science provides a lot of evidence of psychological mechanisms that might induce other answers. These include lack of empathy for one’s older self (b), procrastination (c), matching one’s behaviour to that of others (d), over-weighting personal experience (e), and self-deception (f). The point of this thought experiment is that there are many ways in which, without acknowledging any error or failure of self-control, a person can explain why she knowingly acts against unwelcome recommendations from experts. The assumption that individuals want to be nudge should, I concluded, be treated with scepticism.

I wrote my paper with the aim of stimulating debate, and am pleased that Sunstein has responded by writing a comment on my paper. He cites a lot of survey evidence from the United States, Europe and Australia showing majorities in favour of policies that nudge people towards healthy lifestyles. He also reports a ‘preliminary’ online survey that he has carried out on Mechanical Turk, in which about 200 people were asked:

Many people believe that they have an issue, whether large or small, of self-control. They may eat too much, they may smoke, they may drink too much, they may not save enough money. Do you believe that you have any issue of self-control?

15 per cent of the respondents ‘strongly agreed’ and another 55 per cent ‘somewhat agreed’. At a more theoretical level, he offers (what I think is) a new reading of the ‘as judged by themselves’ clause. He gives the example of Thomas, who has a serious illness and has to decide whether to undergo a risky operation. Thomas’s decision will depend on how his doctor presents objective information about benefits and risks. The doctor judges that the benefits outweigh the risks, and so presents the information in a way that induces Thomas to choose the operation. This is a nudge. According to Sunstein, Thomas did not have an ‘antecedent preference’ to be nudged towards the operation, but ‘if we look ex post, people [like Thomas] do think that they are better off, and in that sense the [‘as judged by themselves’] criterion is met’.

In a reply to Sunstein’s comment, I acknowledge that there is widespread political support for nudges that promote choosers’ own health. However, I question how far this is evidence for the claim that people would like to be nudged, as opposed to believing that nudges are good for other people and accepting being nudged themselves as a small price that has to be paid for this. Sunstein’s Mechanical Turk survey addresses the more relevant issue of whether people believe that they sometimes act contrary to their best interests, but by asking respondents whether, scanning over
all domains of life, they have any issue of self-control, large or small, it sets the bar very low. And the opening sentence of Sunstein’s survey question, ‘Many people believe…’ is a classic nudge in itself. I argue that the story of Thomas misses the crucial point that ‘behavioural’ preferences are context-dependent: rather than changing preferences, nudges change the context in which preferences are activated. At the moment of choice, Thomas is thinking about his options in the frame provided by the doctor, and so he thinks he is making the right decision. But that does not imply that he will continue to believe that the nudge has made him better off. Suppose that, just before he is wheeled into the operating theatre, Thomas looks at some medical website that uses a different frame. If his preferences are context-dependent, he may now wish he had chosen differently.

References:

CCP 14th Annual Conference
7-8 June 2018, The Enterprise Centre, University of East Anglia, Norwich

Competition Policy and Industrial Policy: Is there a need for a new balance?

For many years there has been a wide consensus that competition policy should not be used as an instrument to achieve industrial policy goals. In fact, state aid policy was primarily seen as a competition policy instrument to assure that industrial policy intervention did not distort competition in markets, and thus focused on market failures.

This consensus has been increasingly challenged since the financial crisis. It has been criticized that merger policy has not allowed the emergence of national or European champions. In antitrust policy, part of the benefit of intervening against the large US-based internet companies is sometimes seen as protecting the future interests of European industries. The restrictions arising from state aid policy are increasingly seen as obstacles to nurturing industry and protecting jobs instead of creating an industry dynamic that fosters growth.

- Is competition policy too focused on prices instead of broader economic and social outcomes?
- Does the focus on competitive markets impede the competitiveness of UK and European industries?
- Is the strong position of US Internet companies creating bottlenecks that bias the playing fields of the future industrial landscape?

To help delve deeper into these issues, this conference will explore and debate a broad range of topics concerning the tensions between competition policy practice and new goals for industrial policy. It will bring together insights from legal, political science and economic perspectives on how to rebalance policy goals and how to design the competition regime of the future in light of these challenges.

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A momentous shift in global politics has ushered in a new age of nationalism, populism and protectionism, which has led many to question the European Commission’s resolve to continue enforcing its strict competition-based approach to merger control. The election of President Trump, the impending realisation of Brexit and a sharp increase in the number of Chinese takeovers of EU firms have, to varying degrees, fuelled anxieties in several EU Member States, who fear the EU’s openness to foreign direct investment (FDI) may have negative implications for security and the economy. In his recent article, David Reader reflects on recent developments that have given rise to this anti-globalisation sentiment and why it may leave EU merger control at a crossroads.

Could EU merger control be headed towards an unfamiliar protectionist stance on foreign takeovers? The astonishing rise of anti-globalisation sentiment in global politics – epitomised by the UK’s ‘Brexit decision’ and the US’s election of President Trump in 2016 – afford greater plausibility to this prospect than at any point since the Global Financial Crisis of 2007-08. As a result of the regulatory freedoms the UK will obtain upon relinquishing its EU membership, and the implementation of President Trump’s “America First” foreign policy, both the UK and US could be set to relax their largely competition-based approaches to mergers and acquisitions (M&A) and subject foreign takeovers to notably stricter scrutiny. This led some EU Member States (most notably, France, Germany and Italy) to ask why the EU was not also taking steps to protect important firms in its strategic sectors from “unwanted” foreign bidders.

But while Brexit and Trump have certainly played their part in reinforcing protectionist sentiment in the EU, the primary catalyst in the context of merger control has been the sharp increase in the number of European acquisitions by Chinese firms. Chinese M&A activity in the EU doubled in 2016 compared to the previous year, while overall Chinese investment in the EU is said to have risen by 77% to over 35bn in the same period. In contrast, EU direct investment in China fell for a second consecutive year to 7.7bn in 2016, indicative of a growing perception that there exists a lack of regulatory reciprocity between the EU and China.

In June 2017, Emmanuel Macron (the newly elected French President, whose election manifesto contained an explicit pledge to lobby for a new EU mechanism to control foreign direct investment (FDI) in strategic sectors) successfully sought the support of German Chancellor Angela Merkel on plans to press the EU towards adopting a ‘tougher stance’ on foreign takeovers. The result of this...
was a bold move by Macron to table a draft communiqué at his European Council debut, calling on EU leaders “to screen foreign investments where necessary in order to mitigate risks to national security.” While these proposals failed to achieve a consensus among the Member States, the Council’s conclusions acknowledged a desire to see the Commission afford consideration to the motives of foreign investment. Indeed, the President of the Commission, Jean-Claude Juncker, revealed that he and other senior colleagues were broadly in agreement with Macron’s proposals.

Going forward, a question remained over the route that the Commission would take to address the issue of ‘unwanted’ foreign investment. Would it choose to introduce new soft laws to encourage greater reciprocity? Perhaps it would seek to establish a formal instrument for foreign investment review, separate and parallel to its merger laws? Or maybe it would extend the enforcement of its existing merger laws to allow for the consideration of wider ‘non-competition’ (public interest) interests related to protecting strategically important sectors. This latter option is intriguing because there is compelling evidence to suggest that the existing EU merger regime provides a legal basis for the Commission to afford greater consideration to public interest factors in merger cases, which would allow it to undertake this task in lieu of legislative reform.

A cursory glance of the EU Merger Regulation (EUMR) reveals little in the way of anything other than the competition or economics-based measures that guide the Commission’s approach. Scratch a little deeper, however, and one finds that public interest considerations are afforded scope via the EU’s underlying Treaty objectives. Article 7 TFEU imposes a requirement on the EU to ‘ensure consistency between its policies and activities, taking all of its objectives into account’. Under a literal interpretation, this would appear to confer a duty upon the Commission to consider the EU’s wider policy goals when pursuing its merger control policy. In the specific context of its merger proceedings, the Commission derives the power (and, indeed, the duty) to consider wider Treaty goals under Recital 23 EUMR. Scholars have traditionally assigned a restricted interpretation to this provision, suggesting it imposes a non-binding duty on the Commission to reach a decision that is largely compatible with EU objectives, rather than requiring the Commission to afford express consideration to each and every fundamental objective during its assessment process. However, the General Court’s ruling in Vittel suggests that ‘certain cases’ may arise where it would be necessary, by virtue of Recital 23, for the Commission to afford explicit consideration to the wider public interest issues at play in a merger. Thus, while the former interpretation may carry more weight in practice, the case law at least affords the possibility that the Commission can legitimately block a foreign takeover which threatens the pursuance of a Treaty goal, including: high employment, national security and even industrial policy.

**Update: Straight ahead at the crossroads**

In September 2017, the Commission tabled proposals for a new Regulation that would establish a framework for the EU to screen foreign direct investment. Introducing a standalone FDI Review procedure is a surprising initiative for the Commission but, if adopting a more protectionist approach was an inevitability, it is understandable that it has chosen to keep FDI review and merger control separate. To combine the two would risk undermining the stability and predictability of the EU merger regime, at the likely cost of deterring both foreign takeovers and some ‘domestic’ mergers. Moreover, given Commissioner Margrethe Vestager’s unyielding pursuit of a strict competition-based approach to merger control, a separate regime seems altogether more feasible in practice. Although, as the proposals now make their way through the legislative process, the EU institutions should be vigilant when walking that fine line between addressing regulatory imbalances and conceding to protectionism.

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5. Andreas Rinke and Andrea Shalal, ‘Chinese foreign investments up 40 percent to record in 2016; study’ Reuters (11 January 2017).
Market Power and the Laffer Curve

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Using data on alcohol sales and prices in Pennsylvania, a state that monopolizes the retail sales of alcoholic beverages, a new research paper looks into the trade-off between consumption tax rates and tax revenue (using the so-called ‘Laffer curve’). The authors find that Pennsylvania’s current tax policy overprices spirits and that firms respond to reductions in the state’s ad valorem tax rate (i.e. sales tax) by increasing wholesale prices. This limits the state’s revenue gain to only 14% of the incremental tax revenue predicted under the common assumption of perfect competition. The burden of such naïve policy falls disproportionately on older, poorer, uneducated, and minority consumers – and these effects are exacerbated by upstream collusion.

The ‘Laffer curve’, which models the relationship between tax rate and tax collection, was one of the defining elements of “Reaganomics”. It implies that raising taxes beyond a certain rate is counter-productive as it results in decreasing tax revenue. At the beginning of the 1980s, experts argued that the prevalent tax rates enforced by the US Government were too high, placing the economy on the prohibitive range of the curve. This reasoning inspired substantial tax reductions that subsequently prompted growth and increased tax revenue. In our recent paper,¹ we use market data from Pennsylvania to test the predictions of the Laffer curve, adjusting for market power in concentrated liquor markets.

Since its conception in the mid-1970s, macroeconomists have developed numerous theoretical models that are able to generate a Laffer curve. The prohibitive range of the curve arise as an equilibrium feature as the supply of labour becomes less responsive when higher tax rates reduce net wages for higher income earners. Labour or capital supply incentives lead, under reasonable conditions, to a non-monotonic relationship where tax revenue peaks for some non-confiscatory tax rate.

The inverted U-shaped curve is thus the result of nonlinear incentive effects. It is commonly assumed that all product and input markets are competitive. Despite the practical success of supply economics, there are very few empirical studies corroborating the negative trade-off between tax rates and tax revenues.
Our research takes a completely novel approach. We recognize that most industries are not perfectly competitive and notice that, in the presence of market power, firms’ revenue function is concave. Our argument is as follows: As the government increases excise taxes, it pushes prices into increasingly more elastic regions of demand, i.e. fewer products that are subject to higher taxes are being bought. This, in turn, reduces firms’ total revenues and possibly tax revenues. To compensate, taxed firms find it optimal to reduce their pre-tax prices and, thus, firms’ optimal behaviour unravels, at least partially, the effect of the tax policy. This optimal reaction by the taxed firm is robust for a wide specification of demands (log-concavity) but are absent in three common scenarios: (i) when industry behaviour is competitive, (ii) when the policy maker is naïve regarding the optimal reaction of consumers, and (iii) when demand is of the CES (constant elasticity of substitution) form – a function widely used in trade and macro models.

Our empirical analysis tests these predictions in a policy relevant environment involving taxation of liquor products. Policy makers wrongly assumed that demand for alcoholic beverages is generally inelastic while neglecting that the distilling industry is concentrated and spirit manufacturers have substantial market power. Our analysis of the Pennsylvania liquor market shows that, for most products, taxation has reached the prohibitive region of the Laffer curve and further tax rate increases will result in reduced tax collection (Figure 1).

The case of Pennsylvania is particularly interesting. The distribution of alcoholic beverages is in the hand of a state agency that purchases wine and spirits directly from distillers and sells them directly to consumers. Data for both retail and wholesale prices are available, as well as daily sales data of more than 8,000 product in each of the 624 stores across Pennsylvania. Pricing regulations require that retail products charge a common 30% markup over wholesale prices. This simple pricing regulation of alcohol is very common, not only across control states in the U.S., but across the world because it is equivalent to a single excise tax that does not differentiate by demand responsiveness of the different alcoholic products.

Our empirical analysis focuses on sales of 312 spirits over three years. We link store sales to local demographics using U.S. Census data and take advantage of price increases and the temporary sales of these products over time in order to better estimate the demand responsiveness to own and cross prices. Our estimates confirm that distillers have substantial market power, with nearly all demands being elastic at the current market prices. We also confirm that there is substantial heterogeneity across product segments and consumers with smaller bottles, inexpensive products, and brandies having less elastic demands and higher income consumers being less price responsive to prices than any others.

We find that, even in an oligopolistic market, the existence of market power induces firms to respond to price increases by lowering their wholesale prices and vice versa; that is, wholesale prices and tax rates are strategic substitutes. The reaction of consumers is substantial because the tax revenue actually accrued when distillers behave optimally is only 14% of the level that a naïve policy maker expects to achieve.

Higher tax rates and prices result in lower consumption which, in the case of alcohol, might be considered a desirable outcome. But given the heterogeneity of preferences for alcohol across the population, the incidence of the tax is also very asymmetric. Overall, the burden of alcohol taxes falls disproportionately on older, poorer, uneducated, and minorities who respond with stronger demand reductions to ever increasing prices.

Our empirical analysis characterizes the Laffer curves that the policy maker faces and distinguishes them depending on whether the regulator is naïve or has perfect foresight regarding the optimal response of the taxed firm. The more accurate the regulator’s expectations, the higher the tax revenue (thereby maximizing the tax rate) and the flatter the curvature of the Laffer curve. This indicates that while a slight change of rates may result in limited variation of tax revenues, the response in consumption will be quite substantial and suggests that – when properly designed – taxation might be an effective way of reducing the health incidence of excessive alcohol consumption. Our analysis also shows that the benefits of this policy will not be evenly distributed across the population but will instead depend on their taste for different liquor types or bottle segments and their ability to substitute among them.

References:
2. Extract from ibid, p.40, Figure 6. The prohibitive range of the Laffer curve arises if demand is sufficiently elastic. It starts at higher tax rate if the policy maker correctly anticipates the pricing revisions of taxed firms. Overall, tax revenues are higher the more competitive the behaviour of the industry is.
The passing of the European Union (Withdrawal) Bill (more commonly known as the Great Repeal Bill) could present both an opportunity and a major headache for regulators within the jurisdiction. Commentary from various sources has suggested that the profile of regulators will be raised as a consequence, but limited analysis of this has been undertaken to date.\(^1\)

Firstly, let’s take a look at what is meant by the term “regulation”. These days, very few of us view regulation in terms of the specific laws applicable to the domain in question. Regulators, in particular, adopt a much more nuanced vision that transcends even Selznick’s definition of an exercise of ‘sustained and focused control’ by a public authority and includes a deployment of techniques or strategies to achieve compliance effects.\(^2\) However the ‘purchase’ for these control forms begins with the substantive provisions themselves. Without the provisions, the regulations cannot be applied or enforced. Much of the legislation emanating from the EU has assumed the form of delegated (or secondary) legislation and has the function of giving rise to regulatory effects, such that the powers of regulatory agencies are derived from their enforcement in a broad sense. Given its range and extent, it will be no mean feat to make provision for the effect of existing regulations and their future application, let alone repeal. The introduction of a European Union (Withdrawal) Bill (announced in the Queen’s Speech on 21 June 2017) and its passing to the Committee stage in the House of Commons, provides currently for all existing EU legislation to remain in force, in the first instance, and to be removed, altered, or left alone subsequently. It raises a number of issues, not least the process of making, applying and enforcing regulations.

It is not at all clear, though, that the aim of Government or the Brexiteers to enable the UK to make its own laws will be achieved – indeed, the objective could prove counterproductive for a number of reasons. Firstly, despite the people’s decision in a referendum, the views of the public can have little, if any, input in the substantive changes to existing provisions to be brought about. The focus shifts, therefore, to the conventional institutions in the legislative process, that is, Parliament, the government, and the courts and, for the EU, the Commission, the European Parliament and the Court of Justice of the European Union (CJEU) in particular. As has been indicated by Lord Neuberger, the retiring President of the Supreme Court the final arbiter of civil cases in the UK, considerable guidance will need to be given to the courts regarding the role of the CJEU after ‘Brexit’ occurs.\(^3\)

Similarly, provision will be required for pan-European regulatory agencies responsible for the harmonisation of technical specifications. These agencies are many and are highly interdependent. To illustrate, some agencies – such as the European Medicines Agency (EMA) through its centralized authorization procedure and its pharmacovigilance system and the European Food Standards Agency (EFSA), which responds to requests from both Member States and the institutions of the EU (such as the European Parliament and the European Commission) – function in a highly structured manner to secure safety across the whole of the EU. Others
such as the Body of European Regulators for Electronic Communications, the Council of European Energy
Regulators and the European Agency for Safety and Health at Work are ‘looser’ bodies bringing together the
expertise of national regulators by promoting networks and collaboration. Aside from the well-documented institutional
implications of leaving the EU, particularly the role of Parliament and the powers of Government, the quest for
regulatory effectiveness will warrant closer scrutiny. It needs to be recalled that the European ‘project’ is not a static
one but rather a dynamic which, inevitably, will change over time in accordance with both global and internal
demands. This is particularly pertinent when considering the implications of Brexit for regulators.

The powers of government

Much EU legislation has taken the form of delegated or secondary legislation, by reason of both its technicality and
volume. This is particularly so within the fields of consumer, economic, environmental, food safety, and pharma regulation,
much of which emanates from the EU. The prospect of the UK Parliament considering the future applicability of each
piece of EU legislation is alarming and clearly unrealistic, not least because of a lack in expertise and indeed a lack of time.
The likely consequence will be for ministers to be donated further powers to revise or amend pieces of legislation as
necessary. The prospect for parliamentary scrutiny will be slight and further questions will remain as to how and when
the powers exercisable by ministers will be triggered. For example, how will it become possible to assess when and
whether existing legislation should be repealed or regulations modified? Will this provide for an even stronger role for
regulatory agencies and in particular one that is further removed from democratic oversight?

Regulators will inevitably need to align their strategies with their European counterparts for two reasons; (i) to minimise
firms’ transaction costs by obviating “double accounting” through aligning regulations and, importantly, (ii) to ensure an
appropriate level of continuing public protection consistent with existing measures. Thus, given the multitude of
regulations already coming from Europe, some mechanism will be needed to achieve consistency in regulations and
indeed regulatory strategies for the future.

As we know, regulation is not a ‘static’ concept; both the creation of new regulation and the enforcement of
existing provisions need constant revision to keep up with technological advances. The Bill appears, at this stage, to
transpose into domestic law existing European provisions but, as is known, European laws are dynamic and subject,
like most laws, to ongoing revision. Is it anticipated that environmental or consumer protection regulation will be
frozen in time until either Parliament (unlikely) or Ministers take steps to revise them? Techniques of regulation,
when effective, are responsive to the needs of both business and those requiring protection and yet, to date,
their scale deriving from Europe seems not to have been
acknowledged. Perhaps it would be foolish to think that the role of the institutions of the EU will be avoided simply by reason of Brexit, given the levels of interdependence—both formally and collaboratively—that exist between both its institutions and the UK and at lower levels between the regulatory agencies operating at national levels within Member States.

It's not just the position of the courts after Brexit, what about the regulators?

The vexed question of regulatory enforcement will always pose significant challenges for both regulators and those made subject to enforcement. Unfortunate situations can arise where future amendments (which seek to introduce “improvements”, in the sense of providing clarification to existing EU law) are made at that level but, in reality, will not apply without some form of domestic enactment.

In the case of the enforcement of those provisions originally deriving from European law but now being expressly part of national law by reason of the European Union (Withdrawal) Act, is it envisaged that these will be interpreted in a manner consistent with any amendments coming from Europe, whether as Regulations made by the institutions of the EU or as decisions of the CJEU? Firms, in particular, may raise challenges to the validity of regulations (particularly in enforcement contexts) if domestic laws contain “flaws” subsequently picked up and revised at a European level. Environmental and public protection, in particular, could conceivably be quite seriously compromised in a similar way.

As a dynamic concept, the law—and with it regulation—evolves over time. Similarly, regulators could conceivably find their powers compromised in scenarios like the one mentioned above. They may also find themselves exercising greater powers with diminishing forms of democratic oversight. Regulatory practices and their enforcement demand serious consideration. It is surely only after the Great Repeal Act comes into force that the vital role played by regulatory agencies domestically will be amplified. The problem is that, without formal institutionalised mechanisms in place before the UK leaves the EU, chaos may abound.

Make no mistake, without the repeal of all EU legislation applying within the jurisdiction, its reach will remain with us for many, many years to come, and it will be down to the judges to make sense of this as best they can. Further, is it conceivable that the sharing of intelligence between regulatory agencies, a vital aspect in many domains, will be left to chance after Britain’s departure from the EU?

Rather than establishing the conditions for the emergence of a novel political landscape, the enactment of the European Union (Withdrawal) Act promises more of a constitutional “business as usual” with, if anything, a lessening of popular input and a greater centralization of power. The modification or repeal of regulations is most likely to be left to ministers (with minimal, if any, parliamentary input and consequently a loosening of democratic controls) or—in the worst case scenario—the regulatory agencies themselves. If anything, Brexit amounts to the beginning rather than the end of a very long game. The institutional project of the EU is not static and will remain ongoing despite Britain’s exit and this should not be forgotten. For regulators, however, this could signify a “brave new world” of institutional and legal creativity and uncertainty.

The problem is that, without formal institutionalised mechanisms in place before the UK leaves the EU, chaos may abound.

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1. See, for example, the Committee on Standards in Public Life’s Report, Striking the Balance: Upholding the Seven Principles of Public Life in regulation, Committee on Standards in Public Life Sixteenth Report Cm 9327, 15 September 2016.
3. Lord Neuberger in an interview with the BBC; Clive Coleman, ‘UK judges need clarity after Brexit - Lord Neuberger’ (BBC News, 8 August 2017)
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Affordable energy in the home continues to be a challenge for many UK households. This study focuses on each of the UK Home Nations (England, Scotland, Wales and Northern Ireland) and reflects on their experience in formulating ‘fuel poverty’ policy between 2012 and 2017. Fuel poverty can be understood as an outcome related to ‘distributional justice’ by highlighting the inequitable access to energy in people’s homes. However, the so-called ‘Energy Justice framework’ has emerged as a powerful tool to extend analysis beyond this narrow context and into concerns about the processes of policy making in terms of ‘procedural’ and ‘recognition’ justice. Using the Energy Justice framework, emerging results suggest that, in the period of this study, (i) there is little new divergence between the Home Nations following changes in England; (ii) energy prices are a key policy lever for formulation; and (iii) there are concerning inequalities between policy stakeholders. The research on fuel poverty policy is part of the UKERC Research Package on ‘The Impact of Devolved Administrations’.

Despite decades of policy intervention, a lack of affordable energy continues to be an issue for many people in Britain. Most of the contemporary policy interventions have focused on “the eradication of fuel poverty”, with steps taken to respond to the interlinked challenges posed by the poor thermal efficiency of homes, low incomes and rising energy prices. In 2012, the Hills Report recommended that the Coalition Government adopt a new definition of “fuel poverty”. England subsequently adopted a new strategy linked to the new definition. This began a period of definitional divergence between the devolved administrations of England, Wales, Scotland and Northern Ireland. While England moved to a relative measure, Wales, Scotland and Northern Ireland retained an absolute measure based on 10% of income spent on securing a particular level of modelled energy usage. Concerns were raised that the new relative measure of fuel poverty used in England could dilute the visibility of the impact of energy price fluctuations on fuel poverty. Critics also argued that a relative measure effectively removed the UK Government’s commitment to eradicate fuel poverty.

This study focuses on the separate experiences of the devolved administrations in formulating fuel poverty policy between 2012 and 2017. It examines the initial five years of their policy formulation after the Hills report in the context of: changes in devolved powers, government spending and understanding of the outcomes of fuel poverty policies. The analysis produces novel findings regarding policy formulation – an often-obscured stage of the policy cycle, away from the traditionally more public elements, such as agenda-setting in manifestos or more visible policy delivery. Unlike those latter elements of the policy cycle, policy formulation, in contrast,
draws on a variety of policy tools and experts to develop and design the process by which public commitments by governments translate into programmes. This less transparent arena of policy expertise is particularly central for those concerned with Energy Justice that focuses not only on outcomes of policy but also how those policies were developed.

Fuel poverty can be understood as outcomes related to distributional injustice with some households unable to secure required levels of heat, light and other energy services in their homes. The Energy Justice framework of considering distribution alongside procedural and recognition concerns has been highlighted as a powerful tool to extend analysis beyond this into concerns of procedural and recognition justice. The Energy Justice framework is particularly relevant for understanding fuel poverty policy due to the contested nature of many of the policies which have a specifically distributive aim. Fuel poverty policies are specifically seeking to deliver access to energy services to a targeted group of households defined as ‘vulnerable’ in some way. It lends itself, therefore, to the investigation of how decisions are framed in order to deliver a particular set of distributive outcomes and, moreover, what policy processes shape them.

This application of the Energy Justice framework acknowledges that responding to the problems of fuel poverty incorporates a need for the recognition of social groups (including those identified as ‘vulnerable’ and/or ‘marginalised’) and a further need to incorporate these groups in order to influence decision-making processes by considering procedural and recognition justice.

The emerging results of this analysis, based on documentary analysis and elite interviews with policy practitioners, highlight three key themes:

1. **New divergence between the Home Nations has not yet occurred**

   Policy practitioners adopt similar proxies for targeting fuel poverty schemes at particular households. This has led to little divergence in fuel poverty policies to date. While the differing definitions of ‘fuel poverty’ lead to different calculations of headline rates across England, Scotland, Wales and Northern Ireland, the development and delivery of schemes are based on proxies for fuel poverty such as age or receipt of particular benefits.

   Unsurprisingly, then, the change in definition itself has had little impact on schemes in this time period. However, it is important to note that interviewees are concerned that the inability to meaningfully compare rates of fuel poverty between the Home Nations could in time reduce the ability to hold the UK Government to account for delivering frameworks for fuel poverty reductions. Further, the impact of significant changes in devolved powers in Scotland may lead to more divergence in the future.

2. **Energy prices are a central focus of policy formulation**

   There are three ‘traditional’ policy levers of fuel poverty policy – income, energy efficiency and energy price. These three policy areas have not been equally impacted by policies beyond the energy field. Specifically, the austerity-related policies of the removal of a national level energy efficiency programme in England and changes in the benefits system across Britain mean these policy responses are limited and declining.

   This leaves regulatory policy of energy prices as the sole ‘traditional’ fuel poverty policy response within the scope of policy formulation. In the period of this study, the narrative of fair outcomes of the energy market has been more consistently linked to fuel poverty with an unsurprising focus on the Competition and Markets Authority (CMA) investigation into the energy market.

   Fuel poverty policy practitioners highlighted concerns about engaging with processes of regulatory policy formulation. In particular, the focus on the economic outcomes of an efficient market meant that the concerns regarding switching energy providers at the market level were perceived to be more of a priority than the experiences of vulnerable groups. A subset of interviewees speculated that this may have been important in restricting price caps to consumers with Pre-Payment Meters rather than a wider intervention.
3. Inequalities in access to policy formulation processes

Efforts by key institutions to proactively engage with a broad range of stakeholders have provided new opportunities for procedural and recognition justice to be delivered. Policy formulation cases in this study reveal that the Welsh Assembly and the regulators Ofgem and the Utilities Regulator NI, in particular, take significant steps to ensure key outcomes that are considered imperative for procedural justice – establishing accessible, meaningful and transparent policy formulation processes. Compliance with transparency requirements and standards across the Home Nations also mean that another key tenant of procedural justice – redress and the ability to challenge decisions – is also present.

However, key to procedural and recognition justice is access to meaningful policy formulation processes. The ability of key stakeholders to take up this opportunity is significantly limited and highly unequal. In particular, charitable organisations with key insights into the lived experience of fuel poverty have significant barriers related to the funding environment over the period of the study. Further, charitable organisations that are not already in the energy sector lack equal access to the well-developed community of experts active in this policy area. This can exacerbate unequal access to policy formulation processes by excluding some from the community of experts. The nature of this community is well known by its members, many of whom were interviewees for this study. They often refer to each other by first name and their networks can span years, if not decades. Public records of movement between organisations are not available for study. However, the nature of the community can be indicated by the movement of interviewees (Figure 1). This is articulated within the community as a benefit as it allows for highly efficient communication within the community. However, its members also consistently highlight the need for other perspectives and the restricted nature of their own expertise.

Fig 1: A Revolving Door for Fuel Poverty Policy?

Emerging findings suggest an extension to the way in which we consider the energy justice implications and interaction of distributional, procedural and recognition justice in the formulation of fuel poverty policy (Figure 2).

As the ability to secure a warm home with electricity is so important to health and wellbeing, it is unlikely to become any less politically salient as an issue. The emerging findings of this study suggest that there is a need for further consideration of how stakeholders are engaged within policy formulation processes. Access to processes and procedures is an important foundation for procedural and recognition justice and there are a wide range of opportunities to engage. However, institutions wishing to consider recognition and procedural justice concerns need to carefully consider the highly unequal ability of stakeholders to take up these opportunities.

Fig 2: Injustice of Fuel Poverty Policy Formulation

References:
In a post last year, I argued that it was time for competition economists, both academics and practitioners, to start seriously tackling one of the big unknowns: how much harm is deterred by Competition Law and the Competition Authorities (CAs)? In this blog I pull together some results from three recently completed papers on cartel deterrence. I believe that these importantly move forward our understanding of this great unknown, and merit exposure to a non-academic audience in a non-technical way.

We have three ‘headline’ results. First, our estimates confirm that the deterrence effect is considerable, and is likely to be quantitatively far more important than detection in the fight against cartels. On the most conservative of our estimates, more than half of all potential cartel harm never occurs, because it is deterred. This is very much a lower bound, and the proportion could be as high as 90%.

Second, it is unlikely that those cartels which are detected and therefore observed are representative of those which are deterred. Deterrence appears to be greater for potential cartels which would otherwise set either relatively low overcharges or very high prices in the absence of the cartel offence. Third, it is dangerous to judge the success of a CA purely on the basis of the number of cartels it detects – the strong CA might detect only few, because its strength deters more cartels from forming in the first place.

Given that deterrence can never be directly observed because it refers to events that never occur, how do we come to these findings? Putting aside the niceties of our economic theory and econometrics, these papers are based on two statistical regularities that we have uncovered from close scrutiny of large databases already in the public domain.

The first comes from an historical comparison of the...
overcharges set by 500 legal and illegal cartels. This reveals a significantly lower incidence of illegal cartels in the two tails of the distribution – when it is illegal to cartelise, relatively fewer cartels charge either very low or very high prices. We explain this theoretically in terms of deterrence. On the one hand, the threat of detection and penalty will likely outweigh any potential benefit for those ‘weak’ cartels which can at best only moderately raise prices. On the other hand, those cartels with the ability and market conditions favourable to high prices may be deterred from setting very high overcharges, for fear that it would increase the temptation for cartel members to run to the CA under a leniency programme, and/or the likelihood of consumer complaints and/or detection by the CA.

This intuition and result are developed in the second paper, and placed alongside theoretical insights and empirical results (e.g. on cartel detection) from the existing literature. We construct a framework capable of estimating the proportion of total potential cartel harm which is deterred, as opposed to undeterred and detected, or undeterred and undetected. This is operationalised using a simulation model, and making the most conservative of assumptions, we find that deterrence accounts for at least half of all potential harm. We interpret this very much as a lower bound estimate – in our simulations, the upper bound is higher than 90%.

One intriguing result from these simulations concerns the relative magnitudes of deterrence and detection. We find that a relatively “weak” competition authority, which deters few cartels and then detects a smaller proportion of those that are undeterred, may nevertheless detect a larger absolute number than will a “strong” CA which has much higher deterrence and detection rates. The reason for this superficially paradoxical result is that, although the strong CA is far better at detecting cartels where they exist, far fewer cartels exist in the first place because most have been deterred.

The dangers of judging CAs simply by the number of cartels they detect is pursued in a third paper.

This uses a second database, which is an international comparison of the number of cartels detected by over 30 CAs over a number of years, recognising that different CAs lie at different parts of their life cycles. We find evidence that, as a CA builds expertise and experience and its enforcement activities feedback to the business community, this deters future cartel formation, which results in an inverted U shape time pattern in the number of detected cartels. Thus, over the first decades of its existence, a CA typically increases its detection rates, sometimes very rapidly, but gradually as successful enforcement begins to feedback to the business community and begins to deter, we observe a tailing off, and even a decline, in the number of cartels detected.

Of course, these results are preliminary, and inevitably somewhat speculative. But the subject is so important, and I believe our results are sufficiently plausible to deserve further testing and development by others as well as ourselves in the future.

It is now nearly two decades since the Department of Justice (DoJ) acknowledged that “we firmly believe that deterrence is perhaps the single most important ultimate outcome of the [Antitrust] Division’s work. We are just as sure that it presents the most significant measurement challenges…”. Since then, there have been few serious attempts to quantify the deterrence effect. This silence is surprising given that practitioners are always under pressure from politicians to justify their existence by quantifying their beneficial impact on consumer welfare. For academic economists too, whether researching the nature of collusion, or assessing the motives and success of mergers, or the efficiency versus abuse trade-off in vertical practices, etc., it is surely unsatisfactory that so many of our stylised empirical facts are drawn from those cases reported by the CA, i.e. undeterred but detected, when we know little or nothing about those cases which are deterred and therefore never observed. We hope that we have made a useful first step in addressing these gaps.

We find that a relatively “weak” competition authority, which deters few cartels and then detects a smaller proportion of those that are undeterred, may nevertheless detect a larger absolute number than will a “strong” CA which has much higher deterrence and detection rates.

References:
2. “Quantifying the deterrent effect of Anti-Cartel Enforcement”, Davies, Ormosi & Mariuzzo, 2017

The CCP Competition Policy Blog comments selectively on a variety of issues related to competition policy. It could be on something in the news, on policies from either the Government or agencies, or it could be on a new piece of academic research that particularly catches our eye. All our posts are founded in our understanding of the latest academic research and have been written to be accessible to practitioners, academics, students and journalists.
Since the last Research Bulletin, this period has been dominated by conferences. Over the past five months, CCP has both put together and has had substantial involvement in four successful public events. Our flagship Annual Conference, “Just Markets: Distributional Effects of Competition Policy and Economic Regulation”, which took place over two days in June, attracted over 110 delegates and brought together a variety of perspectives with contributions from leading academics, policy makers, consultancies and regulators. Going beyond the traditional emphasis on improving market efficiency for consumers, the conference explored issues around distributional effects in competition and regulation policy, both generally and in specific markets, with lively and informative presentations and debate. The two days also showcased some of the first findings from CCP’s large UK Energy Research Centre (UKERC) funded project “Equity and Justice in Energy Markets”, led by conference organiser, Catherine Waddams.

Following the Annual Conference, Farasat Bokhari organised a one-day conference in London on “Competition Issues in Pharmaceuticals: The Challenges Ahead”. This popular event brought together academics and leaders from both industry and regulatory groups to identify and discuss the challenges facing the pharmaceutical industry today. Then, in August, CCP supported an event which showcased UEA-based results from the CREATe funded project ‘Intermediaries and Human Rights’. The event was aimed at participants in the creative sector and was a sell-out event with over 50 representative from the creative industries. And, in September, Sebastian Peyer organised a one-day conference with scholars, economic experts and practitioners to take stock of recent developments in the private enforcement of competition law.

This bulletin spans the break between academic years, which inevitably sees a turnover in CCP membership. In this period, we have welcomed Dr Wynne Lam to NBS whilst we have had to say goodbye to Subhasish Chowdhury, Joo Young Jeon, Chris Hanretty and Hao Lan who have left to join other universities.

CCP has completed research on Increasing Block Tariffs commissioned by Anglian Water and Collective Switching commissioned by Ofgem. CCP members Amelia Fletcher, Bruce Lyons and Bob Sugden are also part of a successful bid to the ESRC for a four-year extension of funding for the Network for Integrated Behavioural Science (NIBS) - a programme of research into the science of consumer behaviour. Along with another UEA-based research centre, the Centre for Behavioural and Experimental Social Science (CRESS) as the UEA lead, and the Universities of Nottingham and Warwick, the aim of the network is to advance the understanding of how individuals and households make consumption, spending and savings decisions, and draw out the implications for public policy formulation and evaluation.

Finally, I am pleased to record that we now have seven public sector subscription members, with the Financial Conduct Authority (FCA) recently becoming a member. This scheme not only provides the Centre with some core funding but also offers a very important link between the Centre’s research and policy makers.

Recent Working Papers

**Cartel Enforcement and Deterrence Over the Life of a Competition Authority**
Khemla Prishnee Armoogum, Stephen Davies & Franco Mariuzzo
CCP Working Paper 17-4

**Switching Energy Suppliers: It’s not all about the money**
David Deller, Monica Giulietti, Graham Loomes, Catherine Waddams Price, Ana Moniche Bermejo & Joo Young Jeon
CCP Working Paper 17-5

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