



Regulation for competition

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

Kings College lunchtime lecture
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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

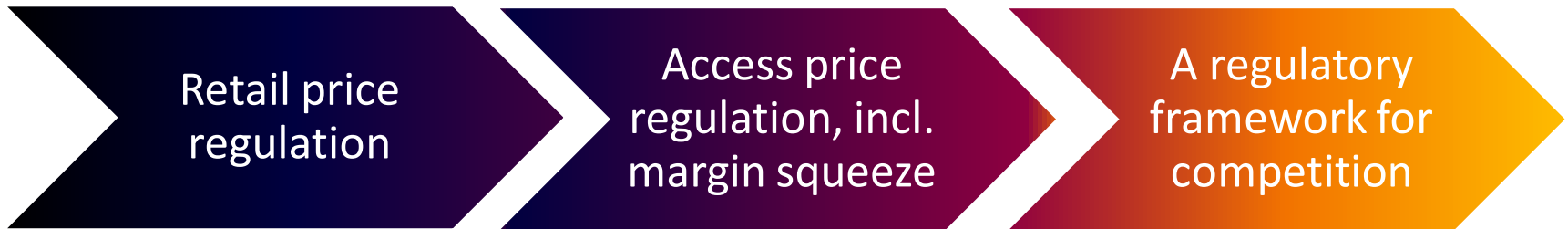
- ❖ The regulators should get the hell out of competitive markets because:
 1. markets work well when left to themselves

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



Most water and sewerage services

2nd class stamps

Heathrow and Gatwick airports

Regulated rail fares

Energy transmission and distribution

BT infrastructure

Water/sewerage wholesale

Network Rail

'Last mile' postal services

(Payment systems)

Financial services

Telecoms retail

Energy wholesale

Energy retail (so far!)

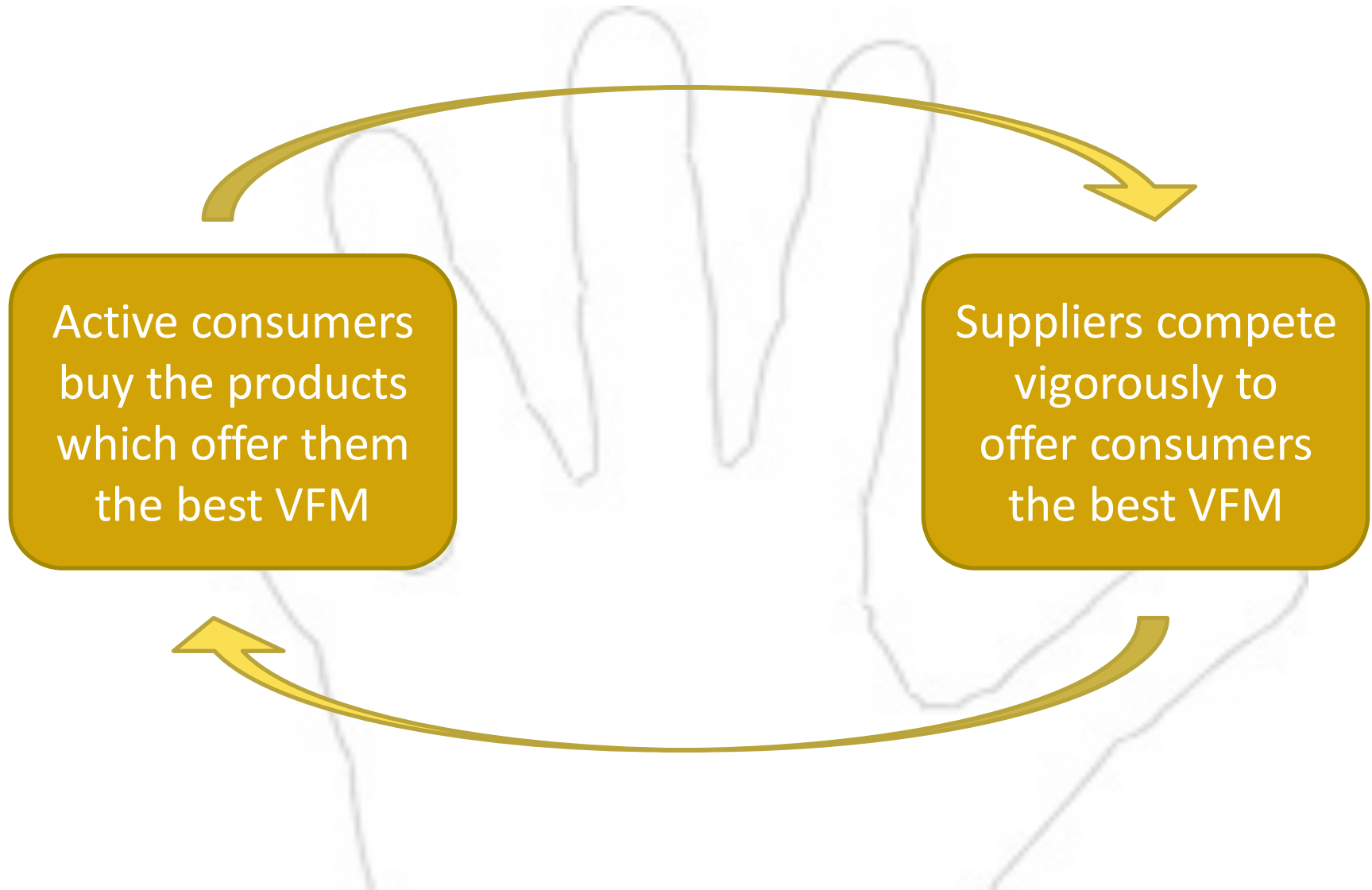
Water/sewerage services for large use customers

Other postal services

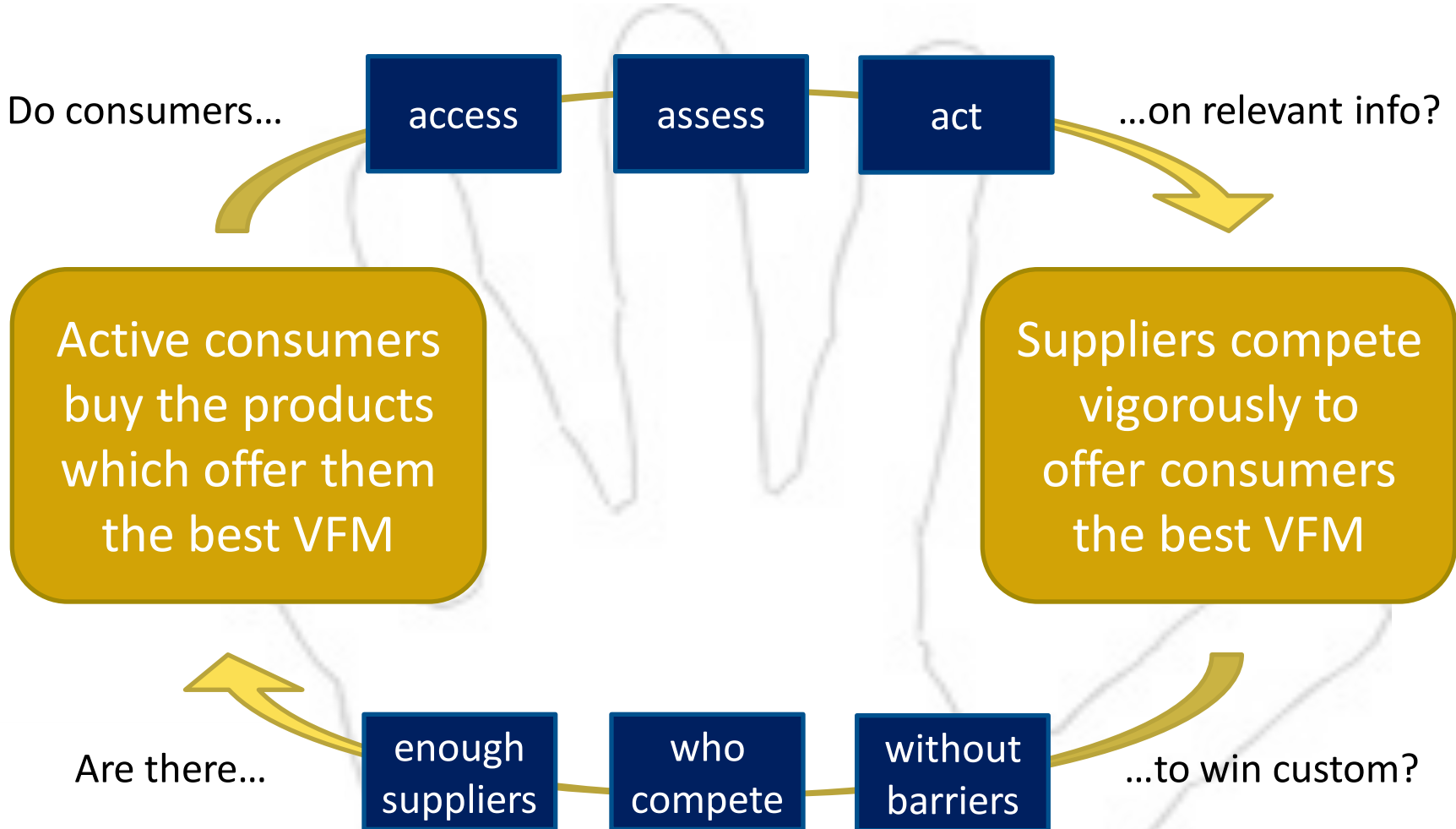
Other UK airports

Other rail fares

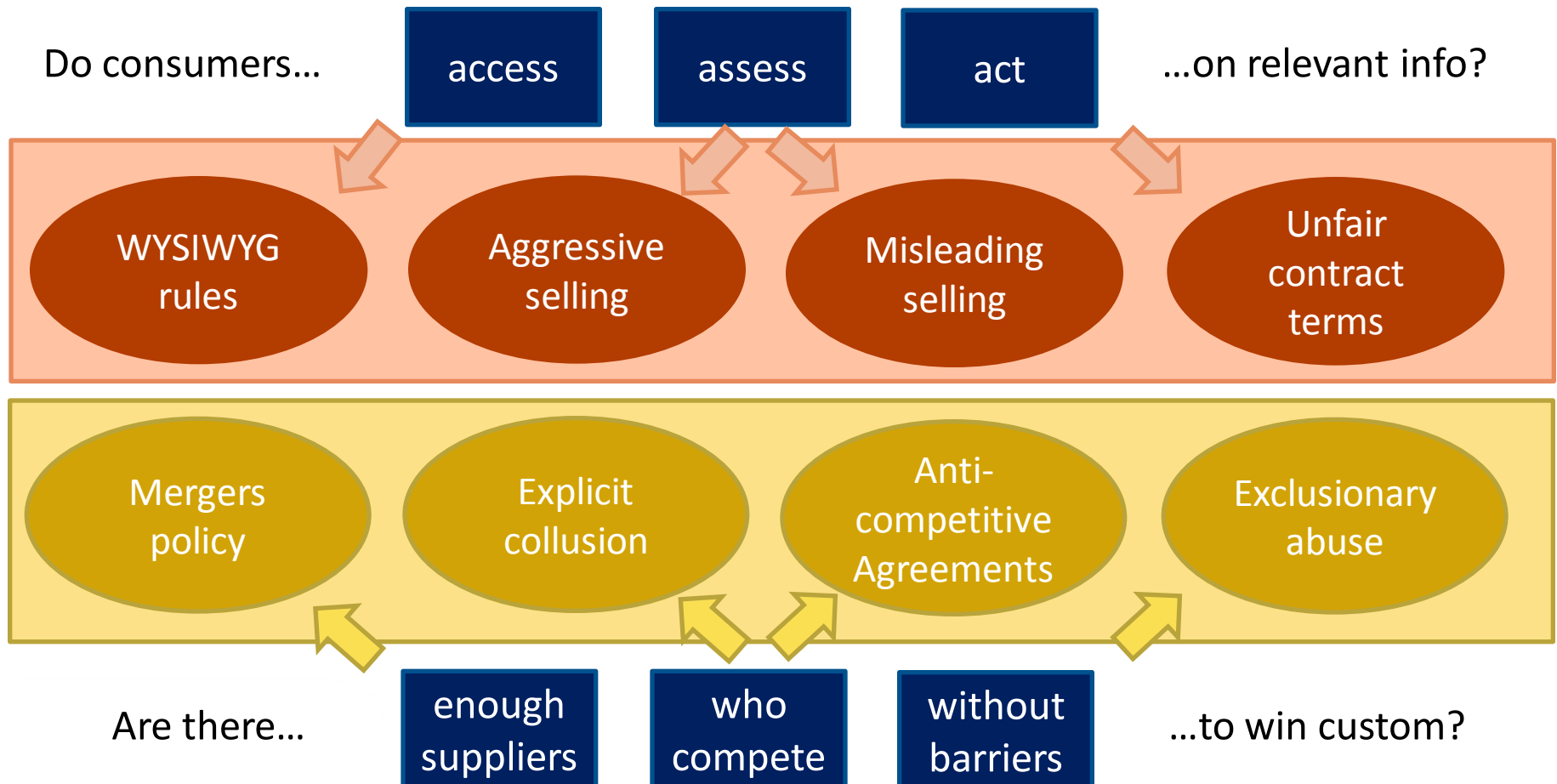
The competitive process as a virtuous circle



...but it needs certain key elements!



Ex post competition and consumer law are crucial tools

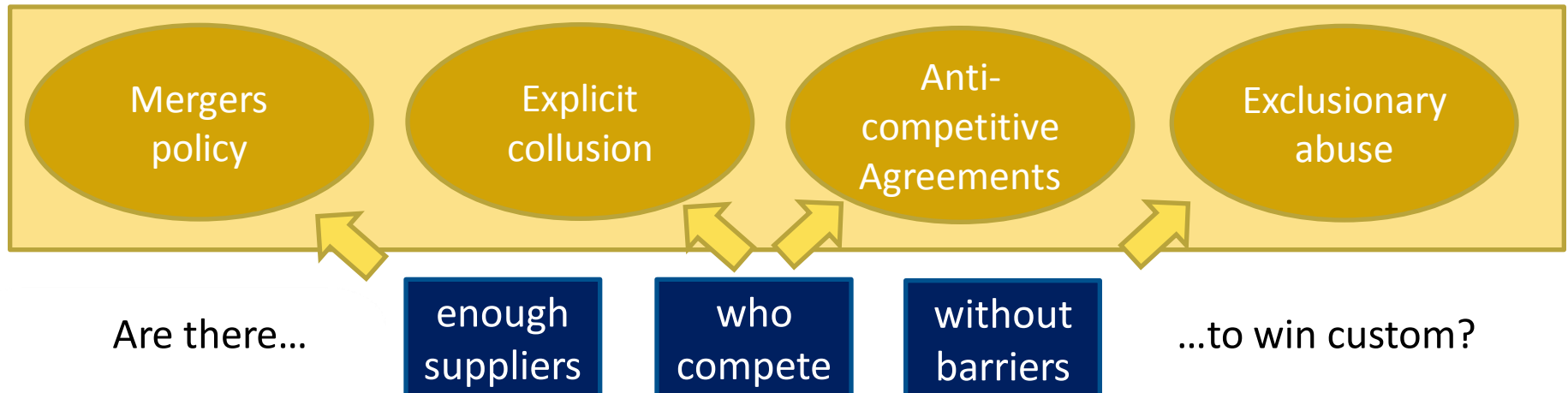


Straw man (?) arguments

- ❖ 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

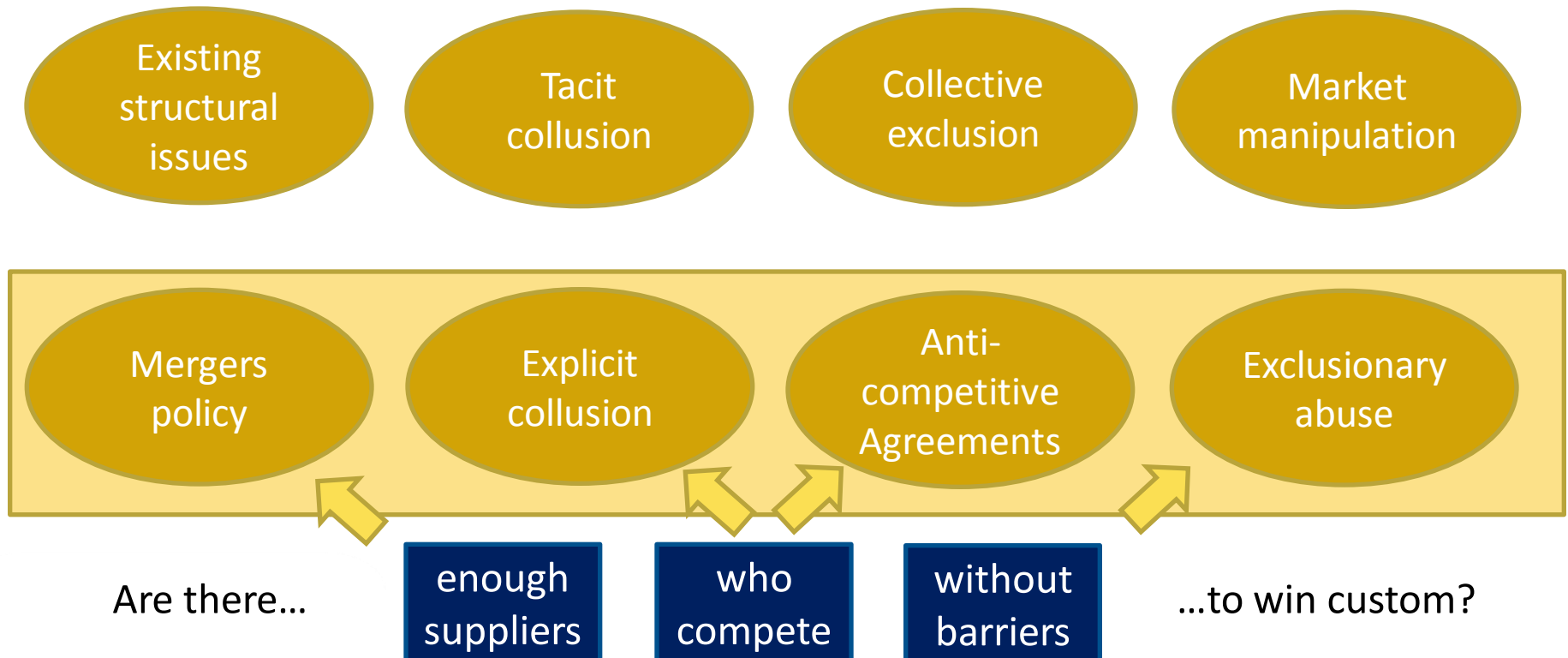
The gap on the supply side...

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

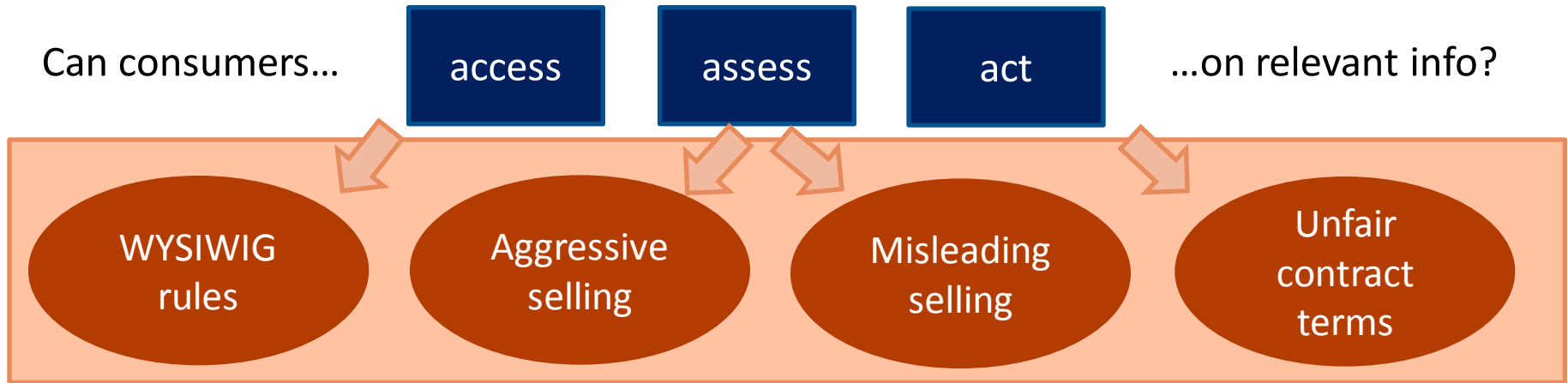


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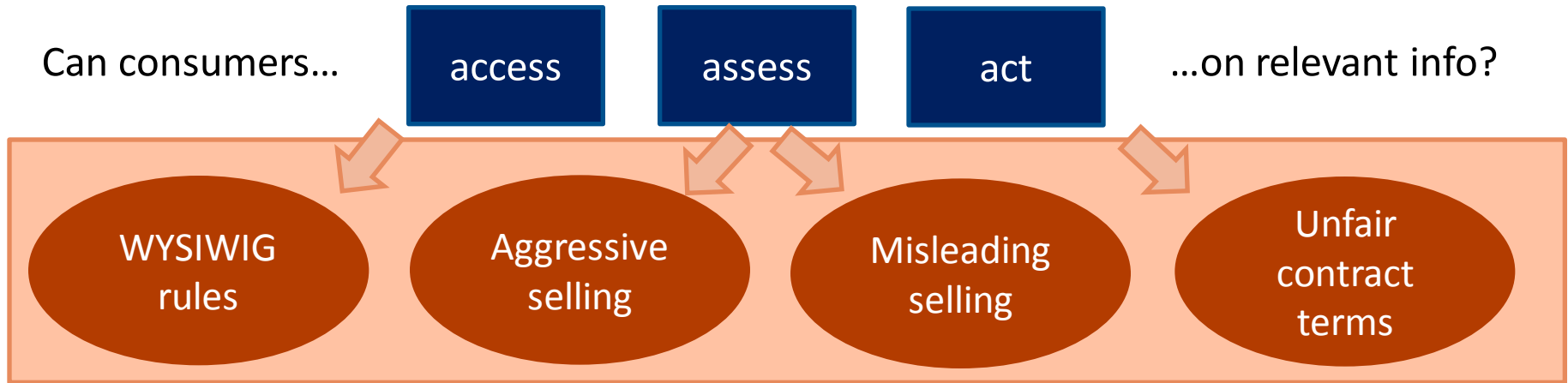


...and on the demand side

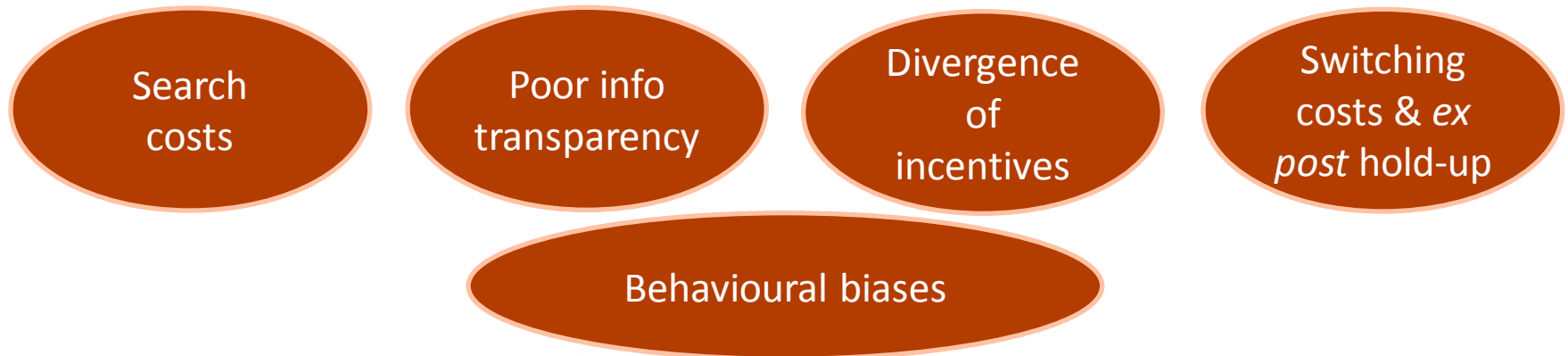


Standard *ex post* consumer law doesn't deal well with:

...and on the demand side



Standard *ex post* consumer law doesn't deal well with:



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

Ofcom	Ofgem	FCA (and FSA)
<ul style="list-style-type: none">• Oct 2013: Protection against mid-contract price rises through switching and enhanced transparency• Oct 2013: Improved accreditation of PCWs to facilitate search• Aug 2013: Proposal for Gaining Provider Led (GPL) solution to enhance switching• Sept 2011: Ban on rollovers to enhance switching• 2010: Voluntary code of Practice on Broadband speeds to enhance transparency	<ul style="list-style-type: none">• Oct 2013: Ban on mid-term price rises and rollovers on fixed-price contracts, to prevent ex post hold-up and enhance switching.• Aug 2013: New standards of conduct around transparency, including on info to facilitate search.• July 2013: Wholesale level market-making obligations in electricity – to ensure effective price signals and facilitate entry/expansion.• Feb 2013: Requirement that complaints data be comparable to aid search	<ul style="list-style-type: none">• Nov 2013: Upcoming consultation on transparency in asset management.• Oct 2013: Proposal for tougher rules on payday lending to limit behavioural biases and ex post hold-up and on P2P lenders to enhance transparency.• Jan 2013: RDR – new rules on financial advisors to enhance transparency and reduce divergence of incentives.• Oct 2012: MMR – new rules to enhance transparency (by reducing disclosure!) and limit behavioural biases

'Gap' issues also occur elsewhere

.... Selected CC inquiries

Date	Inquiry	Key findings
2013	Aggregates, cement and RMX concrete	<ul style="list-style-type: none">• Tacit coordination in GB cement market, including collective exclusion of imports
2013	Private healthcare	<ul style="list-style-type: none">• Market power in hospital services markets• Lack of transparency on performance by hospitals or consultants• Divergent incentives between patients and consultants due to referral Incentive schemes
2013	Statutory audit services for large companies	<ul style="list-style-type: none">• Lack of transparency about audit quality in advance, leading to barriers to switching• Divergence of incentives between shareholders and management
2009	BAA airports	<ul style="list-style-type: none">• Structural issues identified, giving BAA excessive market power in Scotland and South-East.
2006	Domestic bulk LPG	<ul style="list-style-type: none">• High switching costs, search costs and a lack of transparency

Straw man (?) arguments

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 - ~~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

Date	Inquiry	Key findings
Ongoing (to 2015)	Payday lending	<ul style="list-style-type: none">Issues include transparency, search costs, switching costs and behavioural biases (as well as barriers to entry and expansion)
Ongoing (to 2014)	Private motor insurance	<ul style="list-style-type: none">Issues include divergence of incentives, vertical integration, and switching costs (NB Careful recognition of ongoing FCA work!)
2009	PPI	<ul style="list-style-type: none">High search costs and lack of transparency, combined with switching costs and mis-selling
2007	PCA services in NI	<ul style="list-style-type: none">Poor transparency, search costs and switching costs
2006	Store card credit services	<ul style="list-style-type: none">Poor transparency, lack of clear APR info to enable search, ex post hold-up through high penalty charges
2006	Home credit	<ul style="list-style-type: none">Search costs, switching costs and lack of transparency

So why not leave 'gap' issues to the CMA?

Pros

- ❖ CMA truly understands competition, and how to analyse it empirically
- ❖ CMA has clearer focus on competition
- ❖ It comes to issues with a clear mind (sees wood for trees)
- ❖ It does not face 'perimeter' issues
- ❖ Legitimacy and a strong history of avoiding political intervention and regulatory capture

Cons

- ❖ Not always good at spotting problems
- ❖ Overly long and burdensome process for small issues/tweaks
- ❖ Short timetables and need for 'one-look' analysis
- ❖ Short timetables for remedy design
- ❖ Weak at ongoing monitoring of remedies (where needed)
- ❖ Lack of resources to cover the whole economy

So where are we?

Regulation
or
competition

So where are we?

Regulation
for
competition

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 - ~~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

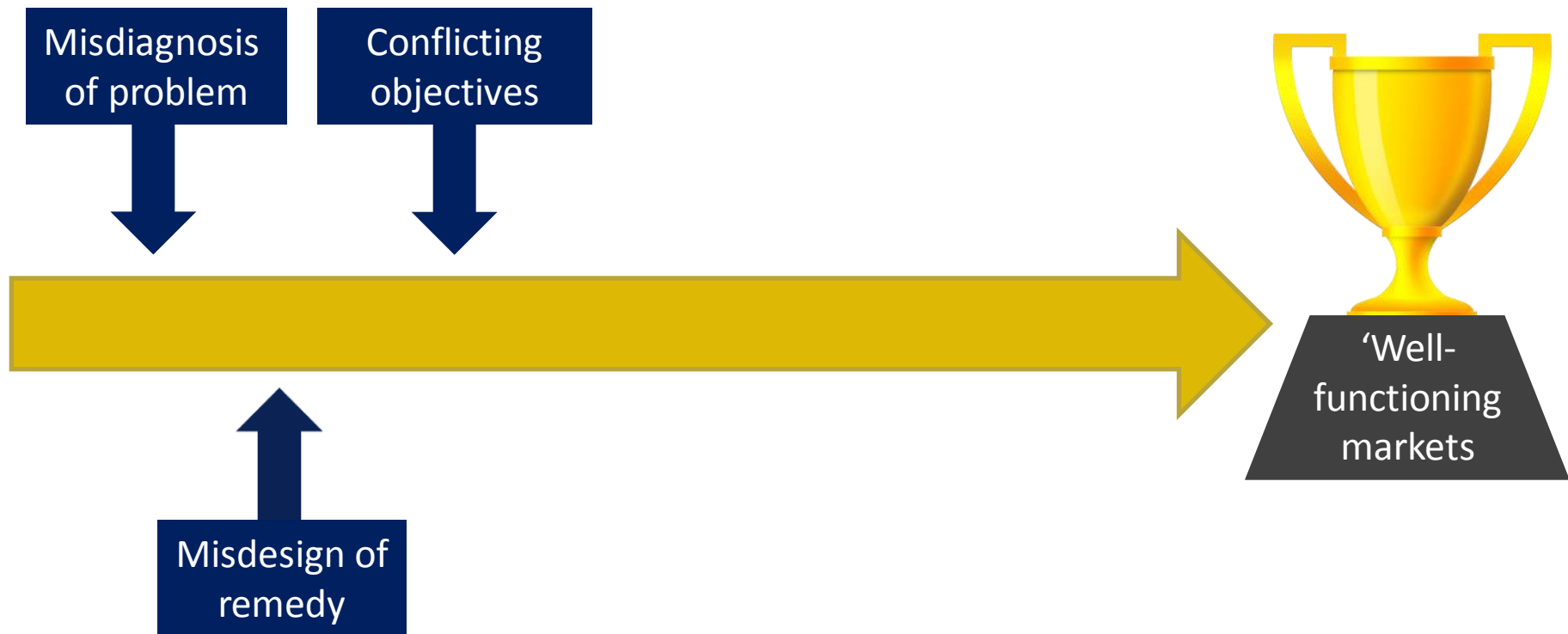


'Well-
functioning
markets

So what are the risks?



So what are the risks?

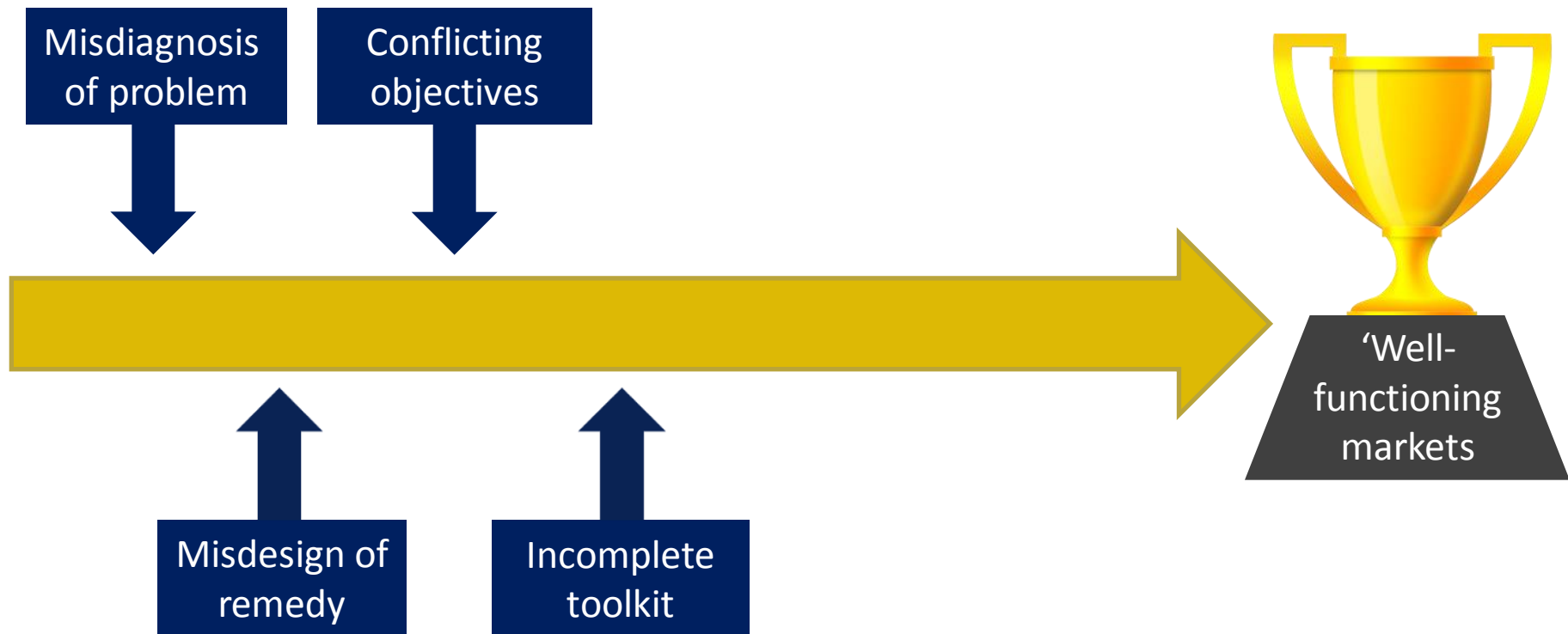


The UK Competition Network Statement of Intent (Dec 2013)

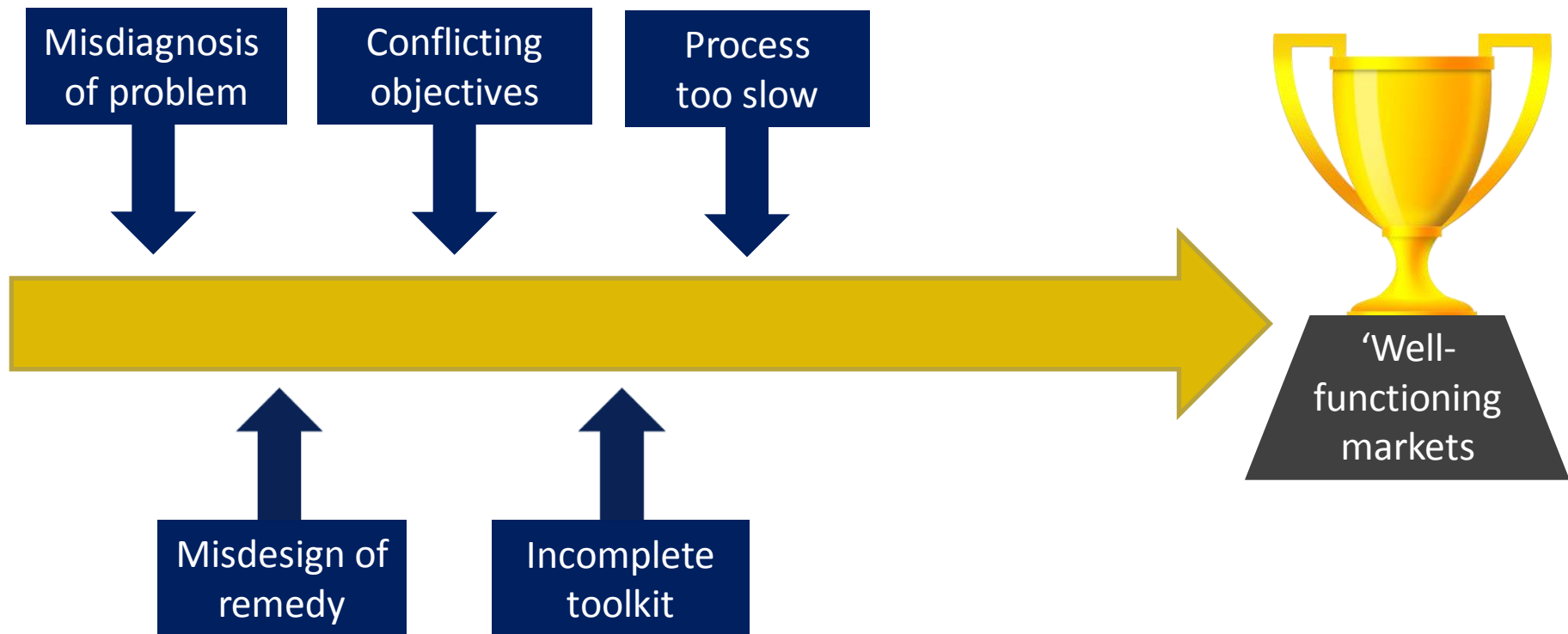


- ❖ The UKCN brings together the CMA with the CAA, FCA, Ofcom, Ofgem, Ofwat, ORR and the Utility Regulator of Northern Ireland. These sector regulators all have a duty to promote competition in the interests of consumers.
- ❖ The health-care regulator, Monitor, which has a statutory duty to prevent anti-competitive 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.

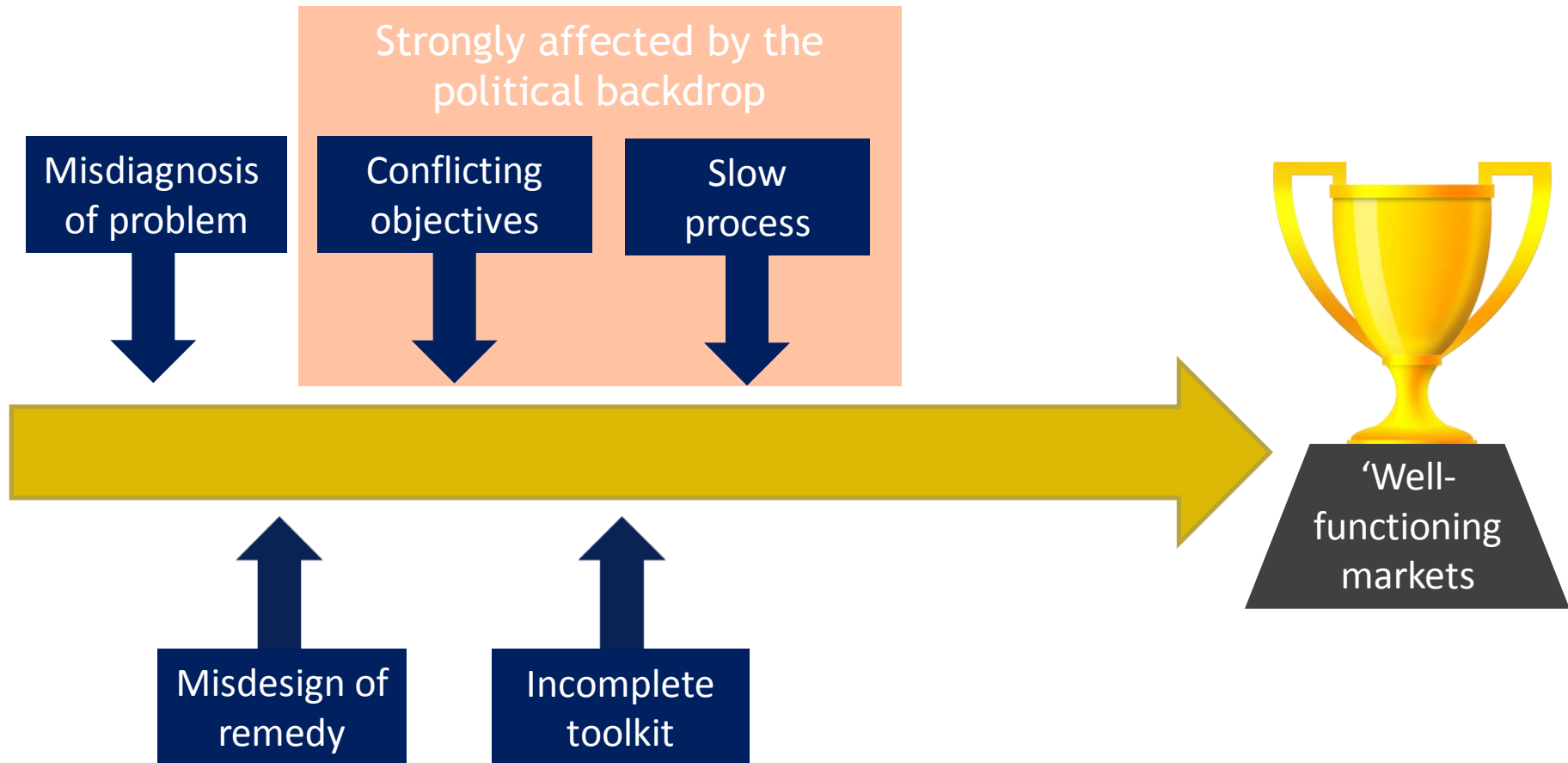
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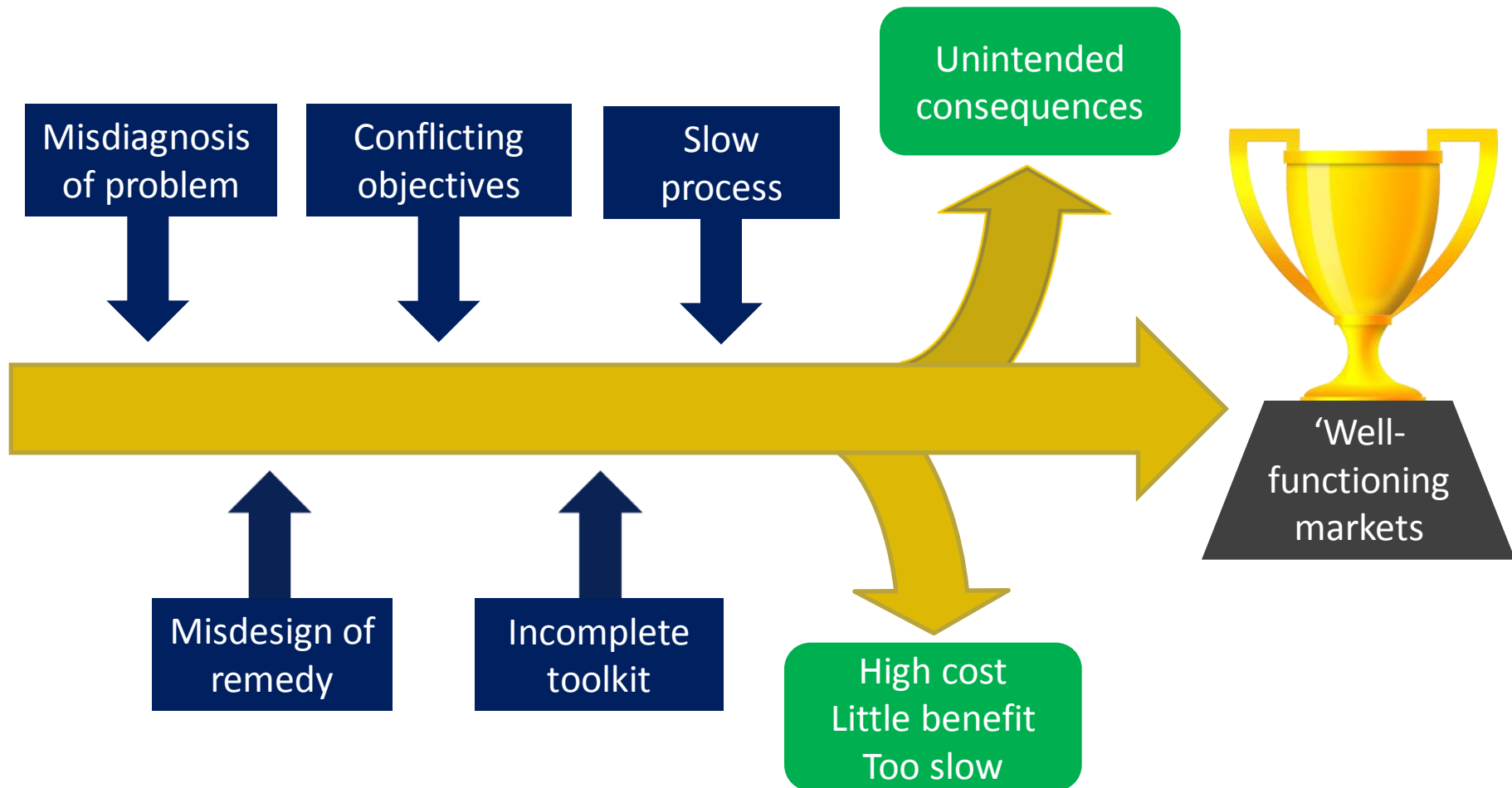
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Should competition and consumer law be left to the CMA?

- ❖ 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