# Reforming Competition and Consumer Policy

## Comments on the BEIS consultation

[redacted]

6 October 2021

1.1 This note summarises our comments on BEIS's consultation on *Reforming competition and consumer policy*, launched in July 2021.[3] It is not intended to be comprehensive, but instead identifies some areas where we think the evidence base for reforms could be improved, with possible follow-on implications for the nature of those reforms. We focus on the proposed reforms to competition policy; we support the broad aim of the consumer policy reforms to increase the standing and importance of consumer protection, and we do not have detailed comments on the proposed approach. The views in this note are those of the authors alone, and do not represent the corporate position of Compass Lexecon or any other organisation.

1.2 We would be pleased to discuss any of our comments further if you would find it helpful to do so.

**Summary**

1.3 Analysed over a long time period, the UK competition regime has generally performed well. The UK's record of innovation and growth is strong. High-level indices of competition, such as concentration measures, have fluctuated over time, but do not seem to have exhibited the significant secular increases that some scholars have identified in the US. More narrowly, the competition regime itself is well-regarded internationally, and is seen as leading international debate on important issues such as the regulation of digital platforms.

1.4 There is though always room for improvement, and changes to increase the speed and effectiveness of decision-making, and to improve access to competition enforcement for groups without deep pockets, such as consumer representatives, could benefit consumers and society as a whole.

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3 Department for Business, Energy and Industrial Strategy, *Reforming Competition and Consumer Policy: Driving growth and delivering competitive markets that work for consumers*, 20 July 2021.

1.5 Making effective reforms to the regime relies however on a strong evidence base about the current system and its strengths and weaknesses. Here, we are concerned that there are potential problems in three principal areas:

a. Limited evidence on the state of competition in the UK, with possible over-interpretation of developments in high-level aggregates.

b. Limited evidence on the deterrent impacts of competition enforcement, which may dwarf the direct effects on mergers that are permitted or blocked.

c. Limited evidence on the costs that smaller businesses incur from the merger control process, and the potential implications for investment.

1.6 The lack of evidence in these areas may have implications for the government's judgement of potentially beneficial reforms. For instance, a conclusion that competition has diminished in the UK due to under-enforcement may lead to a reduction in appeal rights that could harm decision-making, while lack of evidence on deterrent effects may result in reforms that reduce the predictability of the regime and thus lead firms not to propose beneficial mergers.

1.7 We expand on these points in the following sections.

**The current state of evidence**

*Aggregate measures of competition*

1.8 At a high level, there are two main sources of evidence on the state of competition in the UK: concentration measures in different industries; and mark-ups in industries or across the economy as a whole.

1.9 Concentration measures, assessed at the level of administrative definitions of industries, tend to find that concentration has fluctuated over time, with increases associated with exits following the financial crisis, but decreases since.[4] Evidence based on mark-ups appears less ambiguous, with evidence that mark-ups have consistently increased since the 1980s, particularly among the highest-performing firms.[5]

1.10 Taken together, these have been interpreted as indicative evidence that competition has fallen in the UK, and thus as providing some support for the idea of under-enforcement. However, we would highlight several caveats to this conclusion:

a. Administrative classifications of industries may not match markets as consumers experience them. Recent work in the US suggests that markets experienced by consumers may have become more competitive over time, rather than less, because of entry by firms into adjacent product classifications.[6]

b. There are many possible explanations for increases in mark-ups, including:[7]

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4 CMA (2020), *The State of UK Competition*.

5 E.g., Aquilante et al (2019), *Market power and monetary policy*.

6 Benkard et al (2021), Concentration in Product Markets, NBER Working Paper.

7 See Berry et al (2019), Do Increasing Markups Matter? Lessons from Empirical Industrial Organization, *Journal of Economic Perspectives*.

i. Technological changes. If important industries have become more capital-intensive, for instance due to increased investment in IT, this would tend to imply higher mark-ups without any particular connection to changes in market power.

ii. Changes in bargaining power between firms and employees. If employee bargaining power has fallen, for instance due to deunionisation, this may help to explain why mark-ups have increased, absent any significant changes in product market power. Unlike in the US, however, there is thus far surprisingly little work on changes in monopsony power in the UK.[8]

iii. Globalisation. If global firms have access to global input chains that give them an advantage over national firms, this may provide them with increased market shares and higher mark-ups across an industry as a whole. This explanation would seem to be consistent with evidence that increases in mark-ups are particularly concentrated in the highest-performing and most internationalised firms.

c. The conclusion does not seem consistent with high-level studies of dynamics in regulation and competition in the US and the EU, which tend to find increased competition in the EU, particularly relative to the US.[9]

d. There is some evidence that enforcement, particularly of merger control policy, has increased over time in the UK within the existing framework, suggesting that evidence on changes in concentration from a decade or more ago may not be particularly relevant to assessing the current performance of the regime.[10]

1.11 High-level assessments of competition can therefore provide only limited support to the idea that there has been consistent under-enforcement over time. Concentration measures show little change, and if anything suggest improving competition over the last decade, while there are many possible explanations for observed changes in mark-ups, which require further investigation.

*Deterrent effects*

1.12 Understanding the deterrent impacts of competition enforcement has long been recognised as crucial to understanding its overall effects. Gordon and Squires (2008) conclude that *"The available evidence confirms that the deterrent effect is more important than the direct effect of a competition authority's work. It follows from this that any attempt to evaluate the benefits and costs of enforcement which ignores the deterrent effect will be seriously incomplete."*[11]

1.13 Similarly, in describing the motivation of a 2015 joint conference on the deterrence effect, the Dutch ACM, the CMA and DG Comp stated that *"Measuring only direct effects may lead to perverse conclusions and incentives as improvements in the application of competition law may reduce the direct benefits of a Competition Authority's work. For instance: A merger*

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8 An exception is Abel, W, S Tenreyro, and G Thwaites (2018), "Monopsony in the UK", CEPR Discussion Paper 13265.

9 See Gutiérrez and Philippon (2019), How European Markets Became Free: A Study of Institutional Drift, NBER working paper.

10 See, for instance, Financial Times, *UK competition watchdog is most active antitrust enforcer,* 2 March 2020.

11 Gordon and Squires (2008), 'The Deterrent Effect of UK Competition Enforcement', *De Economist*.

*control regime that deters anti-competitive mergers from being contemplated in the first place may lead to small direct benefits as few if any anticompetitive mergers are proposed*."[12]

1.14 However, there is limited available evidence on the size or nature of the deterrence effect in the UK, and the consultation does not appear to mention deterrence in the context of merger control. The two main studies we are aware of are:[13]

a. A review commissioned from Deloitte by the OFT in 2007,[14] summarised by Gordon and Squires (2008). This was based on surveys and interviews with companies, lawyers and economists, and found that about five mergers were abandoned or modified on competition grounds (before the OFT became aware of them) for every merger where there was a finding of a substantial lessening of competition or undertakings in lieu. The absolute size of this effect was significant; the study found that, between 2004 and 2006, 485 mergers were abandoned or modified on competition grounds following external legal advice, compared to 92 mergers where there was an SLC finding or undertakings in lieu. This was judged to be a lower bound estimate of the deterrence effect, since mergers are often abandoned without external advice, and because more external advisors are likely to be consulted on mergers that are ultimately blocked by the OFT.

   The legal survey carried out by Deloitte found suggestive evidence that merger deterrence has both benefits and costs; 127 of 193 respondents to the survey reported that the UK competition regime at least sometimes deterred mergers that would not be anti-competitive, but only four thought it did so frequently.

b. A report commissioned from London Economics by the OFT in 2011, again based on interviews and surveys with businesses and lawyers, but with a greater focus on the business survey.[15] This also suggested an important deterrence effect of merger control, though the small number of qualifying mergers meant estimates were inherently uncertain. The authors reported that their business survey *"found that six mergers (18 per cent) were abandoned and five mergers (15 per cent) were modified on competition grounds before the OFT became aware of them. Six mergers (18 per cent) resulted in a finding of Substantial Lessening of Competition (SLC) or Undertaking in Lieu of Reference (UiL)."*

1.15 This work suggests that the deterrence impacts of merger control is likely to be significant, and significantly greater than the direct impacts. Reforms to the regime should therefore consider carefully how they will affect the deterrence impacts, both the benefits of deterring anti-competitive mergers and the costs of deterring pro-competitive mergers or deterring efficient investment. Recent theoretical research by Compass Lexecon economists has identified potential effects of the merger control regime on innovation and investment, particularly in industries that require large sunk investments.[16] Stricter merger control policies may deter efficient investment, as the option of exiting via a merger is reduced in value.

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12 See https://ec.europa.eu/competition/information/macroeconomy/invitation_en.pdf.

13 CMA (2017), *The deterrent effect of competition authorities' work: Literature review*, summarises a wide range of literature (most of it not focussed on the UK), with similar conclusions.

14 OFT (2007), 'The Deterrent Effect of Competition Enforcement by the OFT', OFT 962.

15 OFT (2011), 'The impact of competition interventions on compliance and deterrence', OFT 1391.

16 Bisceglia, Padilla, Perkins and Piccolo (2021), 'Optimal Exit Policy with Uncertain Demand', SSRN.

*Impacts on smaller firms*

1.16 The impact assessment accompanying the consultation attempts to estimate the administrative costs of merger review on firms, judging that:[17]

a. Internal costs of phase 1 reviews are around £2,500.

b. External costs of phase 1 reviews are around £300,000.

c. Internal costs of phase 2 reviews are around £9,700.

d. External costs of phase 2 reviews are around £2 million.

e. Firms have to pay additional merger fees of between £40,000 and £160,000, depending on the value of the transaction.

f. External costs for smaller transactions are assumed to be one-tenth of the level for large transactions (i.e., £30,000 for phase 1 reviews and £200,000 for phase 2 reviews).

1.17 We welcome the attempt to quantify the impacts of merger control on firms' costs. In our experience, such costs can deter what appear to be clearly pro-competitive mergers (such as mergers involving firms that would otherwise exit the market), often involving smaller enterprises.

1.18 However, the estimates provided *prima facie* appear to be flawed in two important respects:

a. Estimates of internal costs seem implausibly low. While we do not have direct experience of the costs incurred by firms, the amount of time that senior managers at large international firms spend engaging with the merger control process suggests that the impact assessment may underestimate both the time involved and the cost per hour incurred.

b. Estimates of the costs for smaller transactions have limited justification. While we would expect smaller transactions to cost less than large ones, in our experience these are unlikely to scale linearly. There is an irreducible cost in responding to, for instance, lengthy requests for information that suggests that even small transactions incur significant external expense when subjected to CMA review. More generally, there is significant variation in the external costs of both Phase 1 and Phase 2 reviews, driven by the type of market, data availability and competitive issues (for example, mergers involving local markets can require extensive analysis, in particular where an established economic methodology has been established that needs replicating).

*Further work*

1.19 Based on these gaps in the evidence base, we would recommend further work on:

a. *The factors behind changes in aggregate competition measures*. There are many potential explanations for changes in, for instance, concentration measures and mark-ups, and poor policy could result from an assumption that developments are primarily due to under- or over-enforcement. In particular, it would be helpful to understand the balance of factors such as product market competition, globalisation, technological change and deunionisation in the observed increases in mark-ups. At first glance, falling concentration

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17 BEIS (2021), *Reforms to merger control: Impact assessment.*

levels and increasing mark-ups since the financial crisis do not seem to be consistent with an explanation based on declining product market competition.

The CMA's planned annual state of competition report might be a good place for such research. While it is unlikely that the aggregate metrics themselves will change frequently, the document could provide a good forum for in-depth research aimed at understanding the underlying causes of long-term developments.

b. *The impacts of past merger control decisions.* The CMA has commissioned valuable recent work on the effects of some past decisions in the tech sector,[18] but this is an exception, and rigorous evaluations are rare. This suggested that, with hindsight, some important factors were overlooked in the assessment of mergers such as Facebook / Instagram and Google / Waze, including both potential anti-competitive effects (such as the scope for Instagram to become a credible competitor to Facebook) and pro-competitive effects (such as the efficiencies resulting from combining datasets). Further work could try to understand better the effects of both prohibition and clearance decisions in different sectors.

c. *The scale and nature of deterrence effects.* The evidence reported above on deterrence effects is interesting, but it does not reflect any of the major changes that the UK competition regime has gone through in the last decade, including the establishment of the CMA. We think it would be particularly valuable to update previous work to understand how deterrence effects might have changed over time and what types of mergers are more likely to be deterred (e.g. small or large mergers, and the extent to which deterred mergers had high or low competition risk associated with them).

d. *The costs that small businesses incur during the merger control process.* It would be valuable to assess rigorously the experience of different types of small businesses at phases 1 and 2, perhaps through a survey, and to try to understand how costs have changed over time. Such research would enable a fuller and more accurate analysis of how changes to merger control could affect smaller enterprises.

1.20 We would be very happy to provide our experience and expertise to help BEIS or the CMA to assess these issues.

**Potential implications**

1.21 It is of course difficult to draw any clear implications from what appears to us to be a relatively limited evidence base for making significant reforms. We would though suggest three issues that BEIS may wish to consider as it develops its proposals further.

a. *The benefits of predictability*. If deterrence effects are important – and typically more important than the direct effects of enforcement – this suggests that predictability is crucial in providing the benefits of the competition regime without the costs of many uncertain interventions. Predictability is likely to be enhanced by maintaining a strong, independent appeals regime (including appeals on the merits), but it may be harmed by a perception of

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18 Argentesi et al (2021), 'Merger Policy in Digital Markets: An Ex Post Assessment', *Journal of Competition Law and Economics*.

frequent policy changes, for instance if the government's strategic steer to the CMA is updated sporadically.

b. *The trade-off between discretion and predictability*. Existing evidence on the scale of the deterrence effect and the costs of merger review suggests that the pendulum should generally be tilted towards predictability rather than discretion, as the benefits of a clear deterrent impact are likely to be substantial. But taken as a whole, the proposed reforms appear to enhance the CMA's discretion considerably, for instance in reducing the independence and scope of Panels and in designing and varying remedies. While several of the proposals may seem reasonable independently, there is a risk that collectively they would undermine the predictability of the regime, increasing costs and harming effective deterrence. If there is seen to be a need for greater enforcement, it may be that this could be better achieved by, for instance, expanding the scope for consumer organisations and other third parties to appeal merger decisions, rather than by providing greater discretion to the CMA.

c. *The benefits of reducing the costs of the merger control process, particularly for smaller firms.* If the costs of the merger control process are higher than currently estimated, particularly for small firms, this suggests that the benefits of expediting merger control, and of expanding safe harbours, are likely to be greater than suggested. This has potential implications for the thresholds for merger control. It may suggest, for instance, that thresholds should be based on the UK turnovers of companies rather than their global turnovers.