

## **Response from the Competition and Markets Authority to the Government's Industrial Strategy Green Paper**

### **Introduction and summary**

1. This paper sets out the Competition and Markets Authority's (CMA's) response to the Government's Industrial Strategy Green Paper (the Green Paper) that was published on 23 January 2017.
2. The Green Paper identifies and seeks to address a productivity challenge that has proved intractable over a number of years. Competition policy is critical to addressing this, because competition between firms drives productivity and long-term economic growth. When firms must compete vigorously to attract consumers, they are driven to become more productive and to supply the products that consumers want.
3. The CMA believes that an industrial strategy can helpfully complement competition policy and further increase productivity and growth where it leads to carefully targeted government interventions that tackle market failures.
4. The Green Paper recognises that success will come from promoting entry and innovation, and not from protecting the position of incumbents. Incumbent businesses often have the loudest voice in policy consultations; this can inadvertently lead to regulation and subsidies that are bad for productivity and for consumers. The CMA's response to the Green Paper details ways in which Government can guard against this risk, including competition impact assessment.
5. Some industrial strategy policies, in particular those that seek to drive more equitable growth across the country, may distort competition by favouring some firms over others, and may not work in the interests of consumers in the short or long term. Where this is the case, policy makers should ensure that policies distort competition no more than necessary and should be clear about any trade-offs that are being made.
6. The CMA would be happy to discuss any of the material in this paper.

## Linkages between industrial strategy and competition policy

7. Industrial strategy and competition policy are closely linked; both seek to encourage economic growth and increase consumer welfare. Indeed, an effective competition policy is a key element of any effective industrial strategy, given its proven ability to improve productivity and growth in the economy<sup>1</sup>.
8. Competition policy comprises laws and policies that preserve or promote effective competition among businesses; enable a competitive environment to develop;<sup>2</sup> and provide the conditions for a stable environment for business and investment, including overseas investment.
9. Competitive markets are characterised by an adequate number of firms competing vigorously to attract active and alert customers. Effective competition:
  - drives firms to improve their internal efficiencies and reduce costs; incentivises firms to invest in innovation; and reduces managerial inefficiency.<sup>3</sup> Competition also rewards more efficient firms and leads to the exit of less efficient firms thereby increasing the overall productivity of the economy;
  - benefits consumers. When markets work well, firms only thrive if they provide what consumers want better and more cost-effectively than their competitors; through greater choice, lower prices, and better quality goods and services.
10. The CMA works to promote competition for the benefit of consumers, including through:

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<sup>1</sup> See [CMA, Productivity and competition: A summary of the evidence](#) (2015). This cites authors including Buccirossi et al. (2013), who estimated the impact of competition policy on Total Factor Productivity growth using a sample of 22 industries in twelve OECD countries between 1995 and 2005. The authors derive an aggregate competition policy indicator (CPI) based on features that they believe have the strongest impact on effectiveness. They find that the aggregate CPI has a positive and highly significant effect on TFP growth.

<sup>2</sup> The relationship between competition and industrial policies in promoting economic development, Study by the UNCTAD secretariat, UNCTAD, 27 April 2009, page 3.

<sup>3</sup> For example, Bloom and Van Reenen (2010) find that strong product market competition appears to boost average management practices through a combination of eliminating the tail of badly managed firms and pushing incumbents to improve their practices. Based on a cross-country survey of management practices covering more than 6,000 firms, they find a positive relationship between the strength of management practices which improve performance and a range of competition measures: Bloom, Nick and John Van Reenen (2010), 'Why do management practices differ across firms and countries', Centre for Economic Performance, Occasional paper n°26. See also Aghion et al (2009) who find that reforms introduced by the UK government throughout the 1990s aimed at reducing entry barriers, such as market liberalisation and interventions by competition authorities, had a positive impact on innovation and productivity in the UK: Aghion, P., Blundell, R., Griffith, R., Howitt, P., and Prantl, S. (2009), 'The Effects of Entry on Incumbent Innovation and Productivity', Review of Economics and Statistics, 91, 1, 20-32.

- preventing anticompetitive arrangements and market abuse by dominant firms. The CMA's enforcement powers allow it to take action against companies that breach competition law and thereby deter businesses from future infringements;
- merger control, i.e. scrutinising mergers and acquisitions so as to prevent those that would substantially lessen competition or where necessary require remedial action;
- intervening, or encouraging government and regulators to do so, where laws and regulations inhibit competition;
- ensuring consumers can exercise choice and are motivated to do so. For example, the CMA recently used its powers to investigate retail banking, and decided to impose a range of reforms to ensure banks compete harder for customers' business. The CMA has also taken action to ensure consumers can trade safely on-line.

In doing so, the CMA works to prevent market power from arising where this could harm consumers, and takes action to mitigate harmful effects where these do arise.

11. Government intervention as part of an industrial strategy can complement competition policy, and increase economic growth and consumer welfare, where it:
  - tackles a clear and well-defined market failure: free markets can produce too much or too little of a good where market failures exist, including information problems, public goods and positive or negative spillovers; or
  - removes or reduces other distortions: poorly designed tax and regulatory systems can harm consumers by impeding competition, tilting the playing field or acting as barriers to entry, growth or innovation.
12. Policies adopted as part of an industrial strategy may pursue a range of objectives beyond economic growth, including for example the desire to drive a more equitable distribution between different social groups or geographical areas.
13. Whatever the objective of a particular policy, the CMA advises policy makers to:
  - where possible, seek to achieve policy objectives through mechanisms that harness competition and work 'with the grain' of markets;

- design interventions that distort competition no more than is necessary to achieve the policy objective at hand. This is particularly important as some proposals within the Green Paper will require careful implementation in order to manage the risk of distortions and unintended consequences; and
  - always avoid measures which directly or indirectly encourage anticompetitive conduct or collusion, or which create conditions in which anticompetitive conduct can thrive.
14. Just as policy makers subject new policy proposals to social cost benefit analysis, it may be desirable to assess the impact that proposals will have on competition and hence on consumers. CMA guidance<sup>4</sup> provides a structure for how to conduct such an assessment.

## Views on proposals in the Green Paper

### *Executive summary*

*Response to question 2: Are the 10 pillars suggested the right ones to tackle low productivity and unbalanced growth? If not, which areas are missing?*

15. The CMA welcomes the Government's recognition of the important role of competition<sup>5</sup>. A strong and active competition policy across the whole economy is critical to Government achieving its objective of raising living standards and economic growth while "creating the right conditions for new and growing enterprise to thrive, not protecting the position of incumbents".<sup>6</sup>
16. Whether it is considered a pillar or a cross-cutting supporting factor, competition policy will be critical to the success of the Industrial Strategy.

### *Investing in science research and innovation*

*Response to questions 5 and 6: What should be the priority areas for science, research and innovation investment? Which challenge areas should the Industrial Strategy Challenge Fund focus on to drive maximum economic impact?*

17. Innovation is subject to well-known market failures. For example, a business investing in innovation may be unable to capture all of the returns to that investment (some of the benefits will spill over to other businesses and wider

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<sup>4</sup> [Competition impact assessment: guidelines for policymakers](#)

<sup>5</sup> The Secretary of State for Business, Energy and Industrial Strategy notes in his foreword to the Green Paper that the UK has benefitted greatly from pro-competition rules, while the executive summary highlights trade, procurement and sectors as policy areas where there is an opportunity to "drive growth by increasing competition".

<sup>6</sup> Quote from the Secretary of State's foreword.

society) and therefore may underinvest. If well-targeted at market failures, support provided under the Industrial Strategy Challenge Fund has the potential to provide sustained benefits to consumers and wider society.

18. In practice it is challenging to direct subsidies so that they only address market failures without some degree of unintended distortion to competition. Subsidies that have different impacts on different firms in a market may distort competition in the following ways:
- subsidies that are available to incumbents but not entrants may make entry more difficult, by allowing an incumbent to stay in the market for longer, even in the face of a more-efficient competitor;
  - subsidies that strongly favour a particular recipient could allow it to increase its market share to a level where it can act independently of competitive constraints and profitably raise prices;
  - subsidies may protect a recipient from financial pressure to be efficient or innovate, with the result that its costs rise or it fails to adapt to consumer needs;
  - in traded sectors (those where firms are subject to competition from overseas), subsidies that insulate firms from competitive pressures may weaken their incentives to become more productive – and weaken their ability to compete with overseas rivals.
19. Guidance from the Office of Fair Trading (OFT) (2009)<sup>7</sup> notes that subsidies are more likely to cause competition concerns where these:
- are very large;
  - are re-occurring;
  - are provided to only one or a few firms in a market;
  - affect recipients' marginal rather than fixed costs;
  - affect a market that is concentrated and has significant barriers to entry;
  - affect a market where firms are of markedly different sizes;
  - affect a market where products are not highly differentiated, or where firms compete on R&D.

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<sup>7</sup> [OFT Government in Markets](#)

20. When deciding how to allocate the Industrial Strategy Challenge Fund, the CMA recommends that policy makers consider how competition currently operates in markets that are candidates for support, and how competition in the market might be impacted by the award of support. In general, horizontal measures that do not discriminate by location, industry sector, or firm are less likely to cause concerns.

### ***Developing skills***

*Response to question 11: Do you agree with the different elements of the vision for the new technical education system set out here? Are there further lessons from other countries' systems?*

21. Skills is another area that is generally understood to be subject to market failures. For example, when individuals or employers invest in learning, benefits may accrue not only to the individual (and their current employer) but also to other employers and wider society. Targeted support to account for market failures can benefit consumers and wider society.
22. The Green Paper commits £170 million of capital funding to support the creation of “a network of Institutes of Technology (IoTs) to ensure we have sufficient provision targeted at delivering high-quality technical education at higher skills levels, tailored around the needs of employers in local areas”.
23. The Green Paper does not set out in detail how the IoTs will operate, however the Government has made clear its desire to avoid measures which amount to ‘picking winners’. To that end, Government should be alert to the risk that the award of support could distort competition between IoTs and other learning providers (in particular those operating at similar skills levels), or favour providers that turn out not to be attractive to learners and employers. In general, support that is available to all providers of a type of learning would be less distortive than support that is focused on only some providers.
24. The Green Paper also highlights Government’s agenda in relation to technical education qualifications. The CMA has discussed this policy area with the Department for Education (DfE) and made recommendations on the Technical and Further Education Bill<sup>8</sup>. The CMA’s letter noted that:
- limited or exclusive licences for technical education qualifications could lead to benefits such as a clearer and more understandable system for learners and employers, and could allow greater focus on qualifications

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<sup>8</sup> [CMA letter to DfE regarding the TFE Bill](#)

that are more rigorous and useful – and ultimately more valuable to learners and employers; but that

- exclusive licence holders for a particular qualification may assume a quasi-monopoly position for the duration of the contract – meaning that training providers and learners would have limited scope to take their business elsewhere if service provision was not up to scratch; and therefore
- contractual arrangements (including contract specification and ongoing oversight) should be carefully designed in order to discipline licence holders and ensure that they are incentivised to supply qualification services that meet learner and employer needs.

*Response to question 12: How can we make the application process for further education colleges and apprenticeships clearer and simpler, drawing lessons from the higher education sector?*

25. The CMA's work on higher education has highlighted the importance of students being able to access, assess and act on comparable information.<sup>9</sup>
  - Firstly, if students are able to understand what providers are offering and what the differences are between different offerings, they may make more informed and hence better decisions.
  - Secondly, a process of informed student choice may provide an incentive for learning providers to respond to student preferences and hence improve the quality (or, where relevant, reduce the price) of provision.
26. The CMA would therefore support measures that arm prospective students and apprentices with more useful information and make it easier for them to make informed choices through the application system.
27. Government may wish to consider linkages between the application process and key sources of information on courses and apprenticeships. The OFT's call for information on higher education (2014) identified opportunities to better link the UCAS application website to the Unistats website (a key source of information on courses, including learner satisfaction and learner destinations).<sup>10</sup> These links have since been strengthened.
28. In addition, work by the CMA and its predecessors has highlighted the important role that intermediaries can play in public service markets when navigation is difficult for users. Intermediation becomes particularly important when users are required to make one-off decisions with long-term

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<sup>9</sup>CMA policy paper on Higher Education

<sup>10</sup>OFT report on Higher Education in England

consequences and do not have the opportunity to learn through repeated interactions with the system.

29. A report for the OFT (2010)<sup>11</sup> stressed that the interests of intermediaries and service users need to be aligned (either naturally or through careful design of regulation and payment mechanisms) if users are to benefit from these relationships. For example, concerns that financial advisors have incentives to recommend investment decisions that are best for themselves rather than their customers have informed regulation in this sector by the Financial Conduct Authority.

### ***Upgrading infrastructure***

30. The CMA recently responded to a call for evidence by the National Infrastructure Commission, drawing on its experience of competition issues in infrastructure sectors. Key linkages between competition and infrastructure are set out below.
31. Regulatory and competition frameworks are important in infrastructure markets. Competition authorities and sector regulators recognise that intervention can be necessary to protect users of infrastructure assets, where these have natural monopoly characteristics and consumers have limited ability to switch; but are also alert to the risk that such interventions may have a chilling effect on investment incentives - especially where firms have taken commercial risks in establishing their position.<sup>12</sup>
32. Competitive mechanisms (such as competitive tendering) can help maximise value for money when infrastructure investments are centrally planned or supported. For these to work cost effectively, as set out in the OFT's report on public sector commissioning (2011)<sup>13</sup>, those who run tenders should be alert to the risk that coordination or outright bid-rigging could drive up costs in the supply chain. This may be particularly challenging on large infrastructure projects with complex supply chains; lead contractors may lack strong incentives to guard against big rigging by their sub-contractors, where these costs are passed through to the public purse. In addition, authorities should be alert to the risk of 'hold-up' problems, where contractors that are essential to the completion of a project may be able to renegotiate for more favourable terms after contracts have been awarded.

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<sup>11</sup>[Frontier report for OFT on Choice and Competition in Public Services](#)

<sup>12</sup> For example, the OFT's [report on infrastructure ownership and control](#) noted that the owner of the M6 Toll Road was likely to have pricing power due to inelastic demand. However, since the asset was tendered on the basis of competition for the market, with initial investors taking a risk on construction costs and likely future revenues, and since the original contract allowed the owner to raise charges, ex post intervention would risk chilling investment.

<sup>13</sup> [OFT report on commissioning and competition in the public sector](#)

33. Where feasible, facility-based competition (where businesses invest in rival infrastructure assets) creates greater potential for innovation than purely service-based competition (where downstream businesses rely on the assets of a single infrastructure monopolist). Work by the CMA and its predecessors highlights the potential value of diversity of infrastructure ownership.<sup>14</sup>
34. Public bodies engaged in commissioning or funding infrastructure should be alert to the wider impacts (and potential distortions) of this activity on competition and market structure. Particular care is needed where public investment takes place in 'mixed markets' where private investors are also active.
35. Effective competition amongst downstream users can help maximise the productivity and wider consumer benefits of new infrastructure. For example, the CMA's rail report (2016)<sup>15</sup> found that on-rail competition amongst train operators could result in:
  - lower fares and growth in passenger numbers;
  - greater incentives for operators to improve service quality and innovate;
  - greater efficiency by train operators;
  - more effective use of network capacity.
36. Finally, new infrastructure deployment can represent an opportunity to make downstream markets more competitive. For example, new smart meter infrastructure is expected to facilitate innovative time of use tariffs, which will provide retailers with a new opportunity to engage customers in the market, and may lead to more effective competition over time.<sup>16</sup>

### ***Supporting businesses to start and grow***

37. Smaller firms can play an important role in the competitive process; for example, by bringing new and innovative products to market and placing pressure on larger incumbents, so that they must improve and become more productive, or lose market share.
38. Access to finance is an important issues for these businesses. The CMA's recent market investigation into retail banking found that SMEs face a number

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<sup>14</sup> For example, the [CMA's evaluation report on BAA airports](#) (2016) found that breaking up the common ownership of Heathrow, Gatwick and Stansted had delivered significant benefits to passengers, including more efficient capital investment in facilities and services at divested airports.

<sup>15</sup> [CMA report on passenger rail services](#)

<sup>16</sup> [CMA Energy Market Investigation final report](#)

of competition problems in retail banking markets.<sup>17</sup> These include difficulty in accessing and comparing information on products and services, barriers to switching providers and information asymmetries.

39. The CMA also found strong product linkages, for example with over half of start-up SMEs opening a business current account with their personal current account provider and around 90% of SMEs using a lending facility doing so from their business current account provider.
40. The CMA has put in place a number of measures to improve competition in the retail banking markets for SMEs. These include measures to increase the comparability of the cost and quality of SME banking products, and increase price transparency.
41. BEIS and the British Business Bank, following the CMA's recommendation, are also working closely to increase awareness amongst SMEs of alternative finance providers to help ensure that they can access products and services that best meet their needs.
42. The CMA's Open Banking reforms will play a crucial role in increasing competition in the provision of retail banking services to SMEs by allowing SMEs to share data with alternative providers, as well as facilitating the development of comparison tools through the Open Up Challenge being run by the innovation charity Nesta.

### ***Improving procurement***

43. The CMA and its predecessors have undertaken a range of work relating to competition and procurement<sup>18</sup>. The CMA's recent work to support the public sector's ability to identify and prevent collusion in supply chains includes:
  - working to incorporate awareness of the risks of illegal bid rigging into the curriculum for commercial professionals;
  - development of online training materials for the Civil Service Learning website;
  - development of a data analysis tool to identify signs of bid rigging.
44. Competition in procurement helps secure value for money for service users and taxpayers, encouraging firms to compete intensely on factors including price, service, innovation and choice. In addition, well-designed procurement

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<sup>17</sup> [CMA Retail Banking Market Investigation final report](#)

<sup>18</sup> See for example: OFT 2014 [Market Study](#) into the supply of ICT to the public sector; OFT 2004 [report](#) into public sector procurement; OFT 2010 [report](#) into competitive neutrality; OFT 2011 [report](#) into public sector commissioning; PwC 2011 [research](#) to accompany the OFT's 2011 report

can help promote effective competition in the markets in which procurers are active.

45. In order to maximise the effectiveness of competition in public procurement, it is necessary to maintain the following conditions:
- sufficient credible bidders in the market;
  - bidders have the ability and incentive to compete not collude;
  - the playing field is free of distortions and allows all to compete on a fair basis (whether bidders are incumbents or potential entrants, and from the public or private sector);
  - buyers are able to access and assess good information;
  - buyers consider competition in the long-term, as well as short term affordability (focusing solely on achieving the lowest possible tender price today, may lead to a narrow supplier base tomorrow, with reduced incentives to improve quality and innovate, making it harder to achieve value for money in the long term).<sup>19</sup>

#### *Comments on outcomes-based specification*

46. The CMA supports the Government's plan to promote outcomes-based specification in its new guidance. These contracts can allow the market to provide innovative solutions to procurers' requirements, while enabling outcomes-based payment and strong performance incentives. On the other hand, outcomes-based specification is subject to information problems and will only be effective when procurers are able to observe important variables and write these into contracts.

#### *Comments on balanced scorecard*

47. The balanced scorecard approach to procurement balances cost against social and wider economic considerations, while retaining value for money as the overall objective.<sup>20</sup>
48. 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 other factors above price (e.g. the location of bidders

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<sup>19</sup> [OFT report on public sector procurement](#)

<sup>20</sup> [Crown Commercial Service balanced scorecard paper](#)

in order to stimulate growth) may mean that taxpayers or consumers end up paying over the odds.

49. For example, where the geographical location of suppliers is given weight in a procurement exercise:

- the provider that offers the greatest value for money may not be selected;
- the pool of potential bidders may be diminished, reducing the pressure on remaining bidders to make competitive bids;
- local suppliers may be no better off, if local authorities each prioritise bids from local suppliers, such that there is a cancelling out effect;
- over time, favoured local (or domestic) suppliers may have less incentive to become more efficient, weakening their ability to compete with rivals in other regions or overseas.

Where balanced scorecards are used, the CMA recommends that procurers are explicit about the trade-offs that they make in their procurement decisions. In the example above, there could be trade-offs between achieving the lowest price in the short term and seeking to stimulate local growth.

*Comments on using the Small Business Panel to identify procurement-related barriers facing SMEs*

50. The CMA supports the proposals to work with the Small Business Panel to identify barriers facing SMEs.

51. The CMA recommends that the Government takes the following action to improve the extent to which SMEs (and other providers) can participate in and improve public procurement:

- Encourage procuring authorities to avoid imposing conditions that create excessive entry barriers. While Government has restricted procuring authorities' use of pre-qualification questionnaires, the Federation of Small Business (FSB) has indicated that some procuring authorities have used different means to achieve similar ends. Procuring authorities should ensure they comply with the spirit of the rules on the use of such measures.
- Encourage procuring authorities to use open non-proprietary standards where possible, and ensure that contracts have both clear pricing models and clear exit provisions that minimise switching costs. The OFT's 2014 ICT Market Study found that aspects of supplier behaviour contributed to switching costs and incumbency advantages. Specifically, suppliers used

complex pricing that was not always transparent to buyers. This made it difficult for the buyer to compare the incumbent supplier with alternatives in the market. In addition, suppliers created lock-in through the use of proprietary solutions, or by charging for data migration at the end of contracts.<sup>21</sup>

- Improve compliance with the requirement on procuring authorities to provide feedback to bidders on decisions made, potentially through requiring procuring authorities publish a summary of the decision on their website or on Contracts Finder. The 2014 Public Contracts Directive, as interpreted by the ECJ, states that a procuring authority must write to all bidders outlining the decision made, with reasoning that must include the merits of the winning bidder, rather than just the shortcomings of the losing bid. FSB has indicated that there is limited compliance with this requirement.

*Response to question 23: Are there further steps that the Government can take to support innovation through public procurement?*

52. As highlighted above, the CMA recommends that buyers consider competition in the long-term, as well as short term affordability (focusing solely on achieving the lowest possible tender price today, may lead to a narrow supplier base tomorrow, with reduced incentives to improve quality and innovate, making it harder to achieve value for money in the long term).<sup>22</sup>

### ***Delivering affordable energy and clean growth***

*Response to questions 27 and 28: What are the most important steps the Government should take to limit energy costs over the long term? How can we move towards a position in which energy is supplied by competitive markets without the requirement for ongoing subsidy?*

53. In the course of its recent Energy Market Investigation<sup>23</sup>, the CMA carried out a detailed review of the functioning of gas and electricity markets in Great Britain, covering wholesale markets and the retail supply of households and microbusinesses.
54. The CMA found that several features of energy markets were having an adverse effect on competition resulting in higher prices to domestic and microbusiness customers and less innovation than we would expect in a well-

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<sup>21</sup> [OFT ICT Market Study](#)

<sup>22</sup> [OFT report on public sector procurement](#)

<sup>23</sup> [CMA Energy Market Investigation final report](#)

functioning market.<sup>24</sup> In order to address these adverse effects on competition, the CMA designed a comprehensive package of remedies. The CMA has implemented a number of these remedies; however other remedies require the Government to act in order to put them in place. This package of remedies seeks to:

- facilitate the development of vigorous competition between suppliers in the market, with a view to reducing prices for customers and encouraging suppliers to operate efficiently and to introduce new and innovative service offerings;
- protect those less able to engage in the market over the next few years as competition develops; and
- bring in technical and regulatory changes to modernise the market and ensure it works in consumers' interests both now and in the future.

55. The CMA considers that the most important step for the Government to take to limit energy costs in the long run and to ensure that energy is supplied by competitive markets without the requirement for ongoing subsidies is to implement our recommendations. These recommendations are to:<sup>25</sup>

- improve the approach taken by BEIS to allocating Contracts for Difference to ensure that new renewable energy capacity support is provided at the lowest cost to customers;
- enhance the midata regime in order to make it easier for customers to shop around for a better deal;
- advance the introduction of half-hourly electricity settlement to ensure that the full benefits of the smart metering programme and other technological developments are realised for customers, including the significant potential cost savings that should result from shifting demand from peak to off-peak periods;
- strengthen governance of the energy market by clarifying Ofgem's objectives and ensuring transparency regarding regulatory and policy aims;

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<sup>24</sup> For example, we estimated that domestic customers had paid around £1.4 billion per year more than they should have for energy between 2012 and 2015.

<sup>25</sup> For a detailed list of recommendations see: [CMA Energy Market Investigation - recommendations](#)

- strengthen Ofgem’s oversight of the industry code modification process to ensure that important changes with clear benefits for energy customers are made in a timely and effective manner.

### ***Cultivating world-leading sectors***

*Response to questions 31, 32 and 33: How can the Government and industry help sectors come together to identify the opportunities for a ‘sector deal’ to address – especially where industries are fragmented or not well defined? How can the Government ensure that ‘sector deals’ promote competition and incorporate the interests of new entrants? How can the Government and industry collaborate to enable growth in new sectors of the future that emerge around new technologies and new business models?*

56. Policies that provide support based on the sector or location that a firm operates in may distort competition between firms that receive support and those that do not. This can lead to unintended consequences.
57. For example, when firms from different sectors compete (or could compete) for the same customers or investment, competition could be distorted in the following ways:
  - Government rather than market forces may end up ‘picking winners’. 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 (such as bricks and mortar retail) risk ossifying markets, slowing entry, and slowing the emergence of new business models.
58. By contrast, interventions that are targeted at market failures and do not discriminate by sector or location, for example economy wide R&D tax breaks, are less likely to create distortions. In progressing sector deals, the CMA recommends that policy makers:

- first identify the market failure(s) that needs correcting;
  - where possible, seek to achieve policy objectives through mechanisms that harness competition and work ‘with the grain’ of markets; and
  - design interventions that distort competition no more than is necessary to achieve the policy objective at hand.
59. In the sector deal consultation process, policy makers should avoid giving undue weight to the views of incumbents. While incumbents can be a useful source of information, they have incentives to strategically provide information that acts to their benefit, rather than that of consumers. This can lead to ‘regulatory capture’ and regulation that favours incumbents over consumers.<sup>26</sup>
60. One way to manage this risk would be to ensure that potential new entrants and consumers are also listened to as part of the sector deal process. The CMA supports the emphasis on consulting innovative businesses and potential entrants that was adopted under the Challenger Business Programme.
61. In light of the risks above, the CMA recommends that policy makers undertake a competition impact assessment of new policy proposals arising from sector deals. CMA guidance<sup>27</sup> provides a structure for how to conduct such an assessment and advice on how to do so. The CMA stands ready to assist departments in conducting competition impact assessments if required.
62. In the course of the sector deal process, policy makers should also be mindful that activity that promotes industry collaboration could potentially facilitate anti-competitive exchange of information between undertakings.
63. The CMA recognises that this is not the Government’s intention. Nevertheless, should competitively sensitive information or insight about competitors’ actions be shared among competitors, competition may be dampened and suppliers may be encouraged to breach competition law. For example, exchange of future investment intentions may give firms insight into the competitive constraints faced by their rivals and give an indication of their plans, reducing competitive uncertainty.

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<sup>26</sup> For example, an [OFT Market Study](#) (2003) found that quantity restrictions reduce competition between hackney carriage licence holders and thereby allow them to earn monopolistic profits at the expense of passengers. This can be seen by the fact that licenses in restricted areas sell for, on average, around £30,000.

<sup>27</sup> [CMA competition impact assessment guidelines for policymakers](#)

## ***Driving growth across the whole country***

64. Many of the same issues apply to place-based policy as sector-based policy; government interventions that provide support based on the location that a firm operates in may distort competition between those firms that receive the support and those that do not. This may distort production towards products that are not favoured by consumers; weaken incentives on firms to become more efficient; or impede entry and innovation.
65. In addition, evidence suggests that policy makers should be cautious of the potential for regional subsidy-races to develop, as these may see jobs or investment displaced from one region to the next without increasing total economic activity.<sup>28, 29</sup>
66. Some distortions arising from place-based policy may be intentional, for example if Government wishes to encourage investment in a particular geographical area for equity reasons.
67. When progressing growth deals between Government and Local Enterprise Partnerships, the CMA recommends that policy makers:
  - first identifies the market failure(s) that needs correcting;
  - where possible, seek to achieve policy objectives through mechanisms that harness competition and work ‘with the grain’ of markets; and
  - design interventions that distort competition no more than is necessary to achieve the policy objective at hand.
68. In addition, incumbents’ views should not be given undue weight in growth deal consultation processes. This will reduce the risk that the resulting policies act in the interests of incumbent suppliers, rather than consumers.

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<sup>28</sup> [Einiö, E. and Overman, H.G.](#) (2016) evaluated the UK’s Local Enterprise Growth Initiative and found that the programme increased employment in areas close to the boundary of treated areas, but did so at the expense of employment in nearby untreated areas.

<sup>29</sup> An [OECD report](#) (2010) cites evidence that:

- a. Competition between US states to attract firms has given rise to firms moving activities between states rather than generating new activity, which is unlikely to be efficient;
- b. Regional policies designed to attract firms to poor or peripheral locations within Europe did not give rise to efficiencies; and
- c. Subsidy races designed to attract automotive investment in India, Brazil and East Asia appear to have done no more than influence the location of plants (not necessarily in favour of the most efficient location) that would have been built even in the absence of the subsidies offered, rather than stimulating additional investment.