

The deterrent effect of competition authorities' work: a brief summary¹

1. Since 2007 the UK competition authorities have had a “positive impact” target imposed on them. Originally this was that the direct benefits to consumers of competition policy enforcement should be at least five times greater than the cost of the authorities, measured over a rolling three-year period. This target was raised when the CMA was created and now stands at ten times costs. Over the first three years of its existence, the CMA achieved a direct impact figure of more than 18 times costs.
2. But, and it is a significant but, there is a problem with only measuring the direct impact on consumers of our work. The problem is that it omits the benefits to consumers due to our work deterring anti-competitive behaviour.² We should expect that the existence of a competent competition authority should deter some companies from engaging in anti-competitive behaviour that they would otherwise have engaged in. The better the competition authority is at its job, the greater should be this deterrent effect. The result is that our estimates of our direct benefits to consumers will be an underestimate of our total benefits.
3. The omission of this deterrent effect has two implications. One, it makes it hard for government to know what the return to funding competition policy is and therefore how much to spend on it. The greater the total benefits to consumers of competition policy enforcement, the more worthwhile it is for the government to devote resources to it.
4. Two, it makes it hard for a competition authority to make prioritisation decisions on which cases to investigate based on the expected impact on consumer welfare. If we thought that the omitted indirect benefits of competition policy were the same for all our tools, there would be no concern here. But we do not think that. For instance, the direct benefits of our market investigations are typically large (£887m per year 2014-17)³ as they cover whole markets (e.g. retail energy, personal and SME banking). This is unlike

¹ This note summarises the findings of a longer literature review, ‘[The deterrent effect of competition authorities' work](#)’.

² It also omits the benefits from competition policy incentivising increases in productivity. For further details, see “Productivity and competition: a summary of the evidence” CMA45 (9 July 2015) available [here](#).

³ The figures in this paragraph are from Table 1 of the “CMA impact assessment 2016/17”, available [here](#).

other investigations which typically only deal directly with one or a few firms in a market. It is plausible that the deterrent effect across the rest of the sector is larger in the latter case than the former.

5. The direct benefits of our merger regime (£143m per year) and competition enforcement work (£138m per year) are much smaller, but we expect that the regime has a substantial impact of deterring anti-competitive mergers and behaviour. At the limit, a perfect regime that blocked all anti-competitive mergers should deter all such mergers being proposed in the first place. The same is true of the perfect cartel enforcement regime: it should deter all cartels. In these cases, the deterrent impact of the competition authority would be very large compared to its direct impact. If the regime really was perfect, the direct impact would actually be zero.
6. If we just use the direct benefits figures for prioritisation, we are likely to spend too much time on market investigations and potentially too little on other types of interventions, such as merger control and cartel enforcement. This raises the question of whether we have any evidence on the size of these indirect effects? The answer is yes: we have some survey evidence.⁴ This suggests that:
 - (a) for each cartel uncovered by the OFT, between 5 and 28 were deterred;
 - (b) between 4% and 18% of mergers are abandoned on the grounds that the authorities will find them anti-competitive, whilst a further 2-15% are restructured to avoid being found anti-competitive;
 - (c) for each abuse of dominance decision, a further 4 to 10 abuses are deterred.
7. These are reassuringly large numbers and they certainly give us some confidence that the indirect impact of our work is likely to be very important. But they are not precise estimates, they are relatively old, they do not measure the actual amount of harm avoided and they are based on responses to survey questions rather than on actual observed behaviour.
8. In the hope of getting more precise estimates, and perhaps of generating some new research, we have undertaken a review of the economic literature on the deterrence impact of competition policy interventions. What does it tell us?

⁴ These figures come from "The deterrent effect of competition enforcement by the OFT" (Deloitte 2007) and "The impact of competition interventions on compliance and deterrence" (London Economics 2011). These can be found [here](#) and [here](#).

9. First, there is reasonable evidence that the indirect benefits from cartel enforcement outweigh the direct benefits. More cartel enforcement seems to lead to fewer cartels being formed, with those that are formed being less stable, shorter lived and less able to raise prices. Whilst the literature does not provide precise estimates for the effect of anti-cartel policies, there are reasonable grounds for believing that good cartel enforcement might deter more than 50% of the potential harm from cartels. That is a much larger number than the direct impact of cartel policy.
10. Second, there is good evidence that a merger regime improves consumer welfare by deterring anti-competitive mergers. However, there is much less good evidence as to the effect on deterrence of incremental increases in spending on merger control. So, we know that it is worth spending money on a merger control regime, but we do not know what the optimal amount is.
11. Third, there is almost no literature on indirect effects outside of cartel enforcement and merger control. Given the amount of competition authority resources that are devoted to enforcement against the abuse of dominance and against various other types of anti-competitive agreements, this is a significant gap in the literature.
12. Fourth, much of the existing literature focuses on the US and there is less evidence from the European perspective. Whilst it is not clear why the reactions of firms to competition policy enforcement should be different in Europe compared to the US, it would be reassuring to have more specifically European evidence.
13. Where does this leave us? We think the following conclusions flow from our work.
 - (a) There are significant deterrent effects arising from competition policy enforcement. This is no surprise, but it is reassuring to have some evidence on this. It implies that our direct impact assessments are an under-estimate, and quite possibly a very significant under-estimate, of our overall effectiveness.
 - (b) We do not have good estimates of the size of these deterrent effects, either in absolute terms or in relative terms. This makes it hard to know where a competition authority should focus in order to have the most impact on consumer welfare.
 - (c) It would be great if we had more evidence on the deterrent effects of competition policy interventions. By its nature, it is hard to get such evidence as it is evidence on an unobservable variable (i.e. how much behaviour that would otherwise have happened was deterred). However,

it is an important area for further research and this report provides a very good starting point for such research.