CPI TALKS…

…With Frederic Jenny

In this month's edition of CPI Talks… we have the pleasure of speaking with Frederic Jenny. Professor Jenny is Chairman of the OECD Competition Committee.

Thank you, Professor Jenny, for sharing your time for this interview with CPI.

1. Your lecture at CRESSE was titled "Should competition authorities care about fairness and if so how?" What do you think is the correct answer? And what type(s) of "fairness" are you considering, procedural, political or substantive for instance?

I think that the correct answer is that competition authorities should care about fairness. A law or a policy can be successful in the long run only if it is understood and considered to be legitimate by the public. If it is misunderstood or considered to be illegitimate, at some point, the law will be abolished or fundamentally changed.

We are witnessing a growing rejection of globalization, trade liberalization, and economic competition which feeds the populist rhetoric on both sides of the Atlantic. International and domestic market competition are increasingly seen as leading to unfair results such as the loss of jobs for some who have no or little hope of finding another job or downward pressures on wages for others. In the U.S., and to a lesser extent in Europe, owners of capital and highly skilled labor benefit greatly from competition while low skill workers are hurt increasing the inequality of income and wealth and the feeling that a few profit from market competition to the detriment of many others who are victims. Competition law enforcement seems to be unresponsive to the perceived injustice of the results of the competitive market system and does not seem to decrease the rising economic inequality which is the foundation of the sense of unfairness. If anything, the actions of competition authorities to promote more competition seem to promote more inequality and unfairness. As a result, economic competition law enforcement comes under criticism from populists both on the right and on the left. The results of econometric studies by the highly respected Brussels based Think Tank Bruegel on the votes for the Brexit in the UK and for Trump in the U.S. show clearly that the major determinants for both votes were inequality of income, poverty, and unemployment at the local level.

The claim by competition authorities that competition increases consumer welfare does nothing to comfort those who have seen their economic situation take a turn for the worse because of economic competition. Competition authorities are used to arguing that gains from economic competition could be used to compensate the losers but they are also quick to point out that redistribution is not their mission. Yet we know that redistribution schemes do not work well and that the losers from competition are not compensated. The sense of unfairness of the results of the competitive process is not limited to those who lose out in the competition process. One thing we learned from behavioral economists such as Kahneman or Thaler is that a large fraction of individuals has some notion of fairness as an argument in their utility function and, to a certain extent, prefers fairer outcomes to larger gains. The sense of unfairness of the results of the competitive process has without doubt been reinforced by the disruptions due to the 2008 economic and financial crisis, the rapid development of international trade with China, and the digital revolution.

Economic fairness has a number of dimensions: horizontal fairness among competitors, horizontal fairness among consumers, vertical fairness between suppliers and consumers, procedural fairness. One could argue that competition law enforcement addresses the issue of horizontal unfairness among competitors by emphasizing the need to fight the creation of artificial barriers to entry preventing potential competitors from accessing the market. Similarly, one can argue that competition law enforcement addresses the issue of unfairness among consumers by fighting price discrimination. Finally, the work undertaken at the OECD and the ICN on developing due process good practices tends to address the issue of procedural fairness. But the work of behavioral economists like Kahneman or Thaler has largely focused on exploring the notion of vertical fairness between suppliers and demanders, in particular, but not exclusively, on labor markets. With respect to vertical fairness, competition law enforcement seems to have several weaknesses. Competition authorities rarely, if ever, look at the consequences of competition or anticompetitive practices on labor markets. Furthermore, on product markets competition authorities generally refuse to consider exploitative abuses of dominance such as charging high prices as a competition law violation. Equally they are reticent to deal with claims of "abuses of buying power." In short, they refuse to pass judgment on the fairness of the results of negotiations between suppliers and consumers on competitive markets. But behavioral economics tells us that the result of a transaction, even in a competitive environment, can be considered unfair by individuals and, conversely, that the result of an anticompetitive practice is not necessarily perceived to be unfair. It is easy to understand that workers who lose their jobs as a result of market competition or see their wages being reduced may not consider that the benefits of market competition in the form of lower price are worth the cost to them of competition.

2. What are some aspects of competition policy that need to be addressed in response to the challenges of globalization, a global economy, and bigger, more powerful companies?

The promoters of market competition, both domestic and international, do not address some of the fundamental findings of economic theory and occasionally make assumptions which are patently contrary to economic reality.

First, the Stolper–Samuelson theorem of international trade makes clear that, as long as trading countries do not specialize completely, in each trading country, the factors of production which are scarcer will suffer as trade barriers are eliminated and international competition increases. In relative terms, if we compare the EU and the U.S. to other countries with which they trade, capital and highly skilled labor are abundant in the U.S. and the EU and unskilled labor is scarce. This means that capitalists and highly skilled workers will benefit from globalization while low skilled workers will be made worse-off. This distributional effect, which is well-known by economists, is rarely publicly discussed when trade liberalization measures are considered and appropriate remedies are even more rarely designed to accompany these trade liberalization measures.

The reason for this lack of interest in the distributional effects of international competition rests with the commonly held assumption by competition experts that reallocation of resources will take care of the problem of displaced labor. If some firms are unable to withstand competition, they will exit the market and their factors of production will be reemployed in other activities. If the labor market is a vast, competitive and undifferentiated market, this reallocation of resources will allow labor to find equivalent jobs elsewhere at roughly the same wage as the one they had prior to the reallocation of factors, which means that labor will not lose either in terms of employment opportunities or in terms of wages. The problem is that, in reality, the reallocation of labor does not take place because, contrary to the assumption made, the labor market is very fragmented both regionally and by technical skills. Labor, and particularly low skilled workers largely lack regional mobility for a number of reasons such as the fear that the other wage earners in the family will not be able to find a job in another location, or the fact that they have sunk money in a house and face a possible loss if they have to sell their house at a low price in an economically depressed area and have to find one at a high price in an economically booming area. Studies show that labor mobility in the U.S. has been on a downward trend since the 1990s. But labor is also not mobile technically. The programs to train unskilled workers to acquire usable skills in fast growing, often hi-tech, industries have largely failed to deliver meaningful results in most countries for lack of adequate financing and because of poor educational quality or an inability to match supply of skills and demand for skills.

If labor is not mobile then in industries subject to a competition shock, unskilled workers are likely to lose their jobs without any prospect of finding another one or likely to have to accept deep cuts in wages.

Finally, competition economists assume that consumers derive utility from the consumption of goods and services exclusively. But behavioral economics has shown that they care about fairness and are willing to trade fairness for consumption in order to increase their utility.

There are a number of ways for competition authorities to deal with the issue of fairness which do not imply abandoning the consumer welfare goal which has been central to competition law enforcement over the last thirty years or the adoption of a public interest goal in addition to the consumer welfare goal. Indeed, I do not believe that the populists are critical of the attempt to promote competition in order to maximize consumer welfare as such but rather critical of the unfairness of the result of the competitive process in certain circumstances, namely when a part of the labor factor is not mobile.

First, competition authorities could use their advocacy powers to advocate for policies which could facilitate the geographical and technical mobility of labor. By advocating for measures which could facilitate the reallocation of labor, competition authorities would advocate for the realization of conditions which could make competition work better and be perceived as more tolerable and fair. But up to now, competition authorities have not usually used their advocacy power to address the functioning of labor markets.

Second, among the cases of suspected anticompetitive practices, competition authorities could use the lessons of behavioral economics to prioritize the cases which will appeal to the sense of fairness of consumers. For example, Kahneman and Thaler show that most individuals (in the U.S.) find that an increase in price not justified by an increase in cost is unfair while most individuals tend to see an increase in price by a supplier to pass on an increase in cost as fair. Competition authorities could use such results to prioritize the cartels in which firms have increased their price without having experienced an increase in cost rather than crisis cartels or cartels formed to pass on to consumers an increase in the cost of suppliers.

Third, competition authorities could analyze the impact of the remedies they impose in merger control or in antitrust cases on the labor market because they cannot assume that these measures will never affect labor. If a merger is found to be pro-competitive but is likely to create a large disruption for labor (with substantial lay-offs and little prospect for the laid-off employees to find alternative employment), competition authorities could request the merging parties to take at least transitory measures to alleviate the labor disruption. This is to a certain extent what the South African competition law mandates.

3. Is there a need for a supranational competition authority dealing with cooperation and enforcement on a global scale?

The creation of a supranational authority requires by definition an abandonment of national sovereignty to this authority by the founding members of the supranational authority. In a world in which there are about 200 countries of different sizes, with different levels of technological development, different economic histories, different legal systems, etc… and at a time of resurgence of political and economic populism in some of the most important economic blocs in the world, it is clear that the idea of the creation of a supranational competition authority dealing with competition enforcement on a global scale is dead on arrival.

However, regional supranational authorities may be an effective way for sets of neighboring small countries to overcome some of the difficulties they have in dealing with transnational competition law issues raised by global world players. The example of Comesa in Africa, a regional grouping of 19 Member States in Eastern and Southern Africa, in which the Member States have established a central merger control mechanism is an interesting one.

At the global level there are two ways to make competition law enforcement more effective and less costly to businesses in a world characterized by a combination of economic globalization and fragmentation of nation-states: convergence of national competition law regimes and cooperation in competition law enforcement. Over the last thirty years we have made considerable progress on convergence in merger control and in the treatment of anticompetitive agreements (even though there are still some divergences with respect to abuse of dominance). There is still work to be done for convergence on due process issues but this work is undertaken in the context of the OECD and ICN.

With respect to international cooperation, voluntary bilateral and regional cooperation both informal and formal between competition authorities has developed rapidly, particularly but not exclusively in the merger area, and some new instruments, such as waivers, have facilitated the development of fruitful exchanges among competition authorities. However, international cooperation on competition law enforcement is still spotty, costly, and insufficient. The main limitations are due to differences in legal standards, the existence of limits on what information competition authorities can lawfully exchange, the low willingness of competition authorities in certain jurisdictions to cooperate with other competition authorities, the occasional absence of waivers given by investigated firms, a lack of resources or time preventing each competition authority from cooperating with many others, etc…

What is necessary is a move forward to find ways to systematize international cooperation, to make it more inclusive and to make it less costly for competition authorities. In all likelihood, this requires inventing new instruments of cooperation. What these instruments could be is difficult to say at this point. But work is being undertaken at the OECD to investigate several possibilities such as the development of international standards for comity, systems of mutual recognition of other agencies' decisions, or possibilities of deference to one "lead authority."

4. In a time of increasing nationalism in the developed world, how do you see the most dynamic developing countries (BRICS) outweigh the need for competitive and open markets while dealing with issues arising from industrial policy and globalized economies?

The question of the compatibility between competition policy and industrial policy is neither new nor limited to developing countries. It is a question, however that may be of particular interest for developing countries which are faced with the challenges of under-development. The question for these countries is how to spur economic growth in order to catch up economically and eradicate poverty.

Industrial policies that are horizontal, such as government funding basic research, education, and national infrastructure projects are usually not in conflict with competition. Selective measures, particularly measures aiming to give a competitive advantage to some domestic firms over others or over foreign suppliers, may be in conflict with competition objectives. However, if selective measures are adopted in order to try to correct a market failure, for example, by supporting firms which choose to invest in a certain industry or technology having positive externalities, they can be compatible with competition policy. So, we should not be dogmatic about industrial policy.

Where the risk is greatest is when developing countries try to boost economic growth by creating national champions in the hope that these firms will eventually become world-class competitors. The hope is often that offering protection to those firms will allow them to operate at a bigger scale and to go down the learning curve faster than they would otherwise and therefore allow them to become more efficient than they would through the process of competition. Such strategies succeed very rarely not only because government are not particularly good at picking winners but also, and perhaps more importantly, because they rest on the hypothesis that the incentives of the protected national champion will remain the same as if it were not protected. But economics has taught us that protection weakens the incentive to perform so that dynamic efficiencies may not materialize or may be much more limited than anticipated. In addition, and by design, those policies involve a trade-off between certain static efficiency losses due to diminished competition and hypothetical dynamic efficiency.

The adoption in all the countries of a competitive neutrality framework protecting producers from distortions created when rival firms receive subsidies or other support from their governments would be extremely useful to complement competition policy and to minimize the possible contradictions between competition policy and law enforcement, on the one hand, and industrial policy, on the other hand. Such frameworks unfortunately only exist in a handful of countries such as Australia, Sweden, Ukraine, the European Union, and China. But in the European Union, it is limited to state aids whereas industrial policy can take many forms, such as political involvement in strategic deals, joint technological or industrial initiatives, public-private partnerships for infrastructure, administrative hardship or ease on certain industries, licensing requirements, etc… And in China it only applies to industrial policy measures at the provincial level but not to measures taken by the central government. The OECD Competition Committee is working on assessing the potential benefits from the adoption of competitive neutrality frameworks and on the design of such frameworks.

5. Is there a role for multiple goals for competition policy? Especially in light of the aims of some BRICS countries and other smaller competition authorities.

and

6. Altering the consumer welfare standard likely requires trading away some amount of consumer welfare in favor of some other values. How can antitrust authorities find the right balance, define the right goals, and use the proper tools for achieving them?

The enactment of a law is necessarily a political act. Because of this, competition laws often reflect the political realities of the countries in which they are adopted. In many countries, the protection of consumer welfare is seen as an insufficient reason to warrant the adoption of a competition law. Rather, it is considered that competition law should, while protecting economic competition, also promote the larger values of society. For example, a fundamental principle of competition policy and law in South Africa is the need to balance economic efficiency with socio-economic

equity and development, which is understandable given the history of apartheid in South Africa and the extensive poverty in this country. One of the objectives of the Chinese anti-monopoly law, besides the enhancement of economic efficiency, is the promotion of the healthy development of the socialist market economy. The fact that competition laws may have public interest goals is not specific to developing countries. To take a simple example, the official goal of the EU competition law is to prevent competition from being distorted to allow the development of the internal, single, market.

It is generally considered that in countries in which there is a sufficient political consensus on the benefits of economic competition, it is preferable to assign only one goal to competition law, the promotion of consumer or total welfare, and to leave to other institutions the role of promoting the wider socio-political goals pursued (inclusiveness, independence, employment, etc…). The obvious reason for this stand is that the competition authorities are not well-placed, do not have the analytical tools, to trade-off efficiency benefits against other public interest costs (such as, for example, job losses). However, the logical implication of this stand is that transactions or behaviors will be allowed only if they meet both the efficiency test (implemented by the competition authority) and the public interest test (implemented by another administrative body). The risk is then that some transactions or behaviors will not be allowed, in spite of the fact that they have clear efficiency benefits, because they do not meet the public benefit test.

But in countries where competition law is only acceptable if it pursues other socio-economic or socio-political goals as well as economic efficiency, the alternative is either not to have a competition law at all or to have a competition law which has several goals (presumably an efficiency goal and one or several public interest goals).

Firms which are operating on the global market, under certain conditions, prefer that countries to which they export or in which they are considering investing have a competition law framework rather than not having one, even if the competition law includes some public interest goals. Indeed, the existence of such a competition law framework is seen as a protection against possible anticompetitive strategies by the domestic firms of the country receiving exports or in which investments could be made and the lack of such a framework as a threat that the "law of the jungle" will prevail.

However, international businesses tend to expect that four conditions should be met in countries which have public interest goals in their competition law. First, the public interest goals must be clearly and precisely specified in the law; second, the competition analysis of the behaviors or transactions reviewed by the competition authority should be separate from the public interest analysis of those behaviors or transactions; third, the competition authority should publish guidelines about its interpretation of the public interest tests it is required to do; and fourth, the balancing between the efficiency effects of the transaction or the behavior analyzed by the competition authority and its public interest effects must be transparent.

This pragmatic position rests on two ideas; first, the idea that competition authorities, even when the competition law they enforce only has an efficiency goal, already have to make difficult trade-offs (for example, trading off a risk of price increase against a possibility of innovation in a merger control); and, second, the idea that, from the standpoint of private businesses, legal predictability (ensured by transparency of the process) is more important than the economic optimality of the competition law enforcement.

To a very large extent, it is precisely because the process implemented by the South African Competition Authority meets these conditions that it is considered to be tolerable.

In a number of countries, as the public and decision makers have become more convinced of the benefits of using economic competition to promote consumer or total welfare, the public interest goals which may be written into competition law either are eliminated by amending the law or are given less weight in the interpretation of competition law which then begins to converge with economic reasoning. This latter evolution has characterized the EU and its Member States since the beginning of the 21st century. History suggests that this evolution often happens several decades after the adoption of a competition law and that, therefore, we should be patient with countries which have only recently enacted a competition law with public interest goals. Effective advocacy on the part of competition authorities is key to speeding up this evolution.

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