…with Alejandra Palacios Prieto

In this month's edition of CPI Talks we have the pleasure of speaking with Alejandra Palacios Prieto, Chairwoman of Mexico's Comisión Federal de Competencia Económica (Federal Commission of Economic Competition ("COFECE")).

Thank you, Chairwoman Prieto, for sharing your time for this interview with CPI.

In the introduction of the document Market Power and Social Welfare by COFECE, you indicate the following:

> **(…) Competition is about ensuring that all citizens have access to the goods and services of their choice, according to their income levels, without restrictions produced by the exercise of market power of certain economic agents.[1]**

1. Do you think that competition policy can do something to increase people's income levels or can it just be limited to preventing companies from abusing their market power?

Household consumption is related to both consumer income and the price of goods and services. Public authorities typically lend more attention to individuals' income and intervene to increase them as a means of enhanced social welfare. Commonly implemented income-supplement policies include direct cash transfers, microcredit and food programs. All are relevant and potentially effective public policies that seek to increase consumer welfare.

That said, products prices — as opposed to what they *should* or *could* be — also have a significant impact on household welfare. The lower the prices, the more you can get for your available income. Therefore, the role of competition policy in increasing purchasing power and expanding the range of goods and services households can afford does help combat inequality.

In competitive markets, social welfare is maximized to the extent that companies compete to offer better products at lower prices. In contrast, companies that operate in less competitive environments exert an effect on consumers who run out of alternatives to meet their needs and must pay more for the same commodity, buy less of it, or stop buying it altogether.

Economic inequality has become a central issue in both public discussions and political discourse worldwide. Alongside the emergence of social movements and organizations dedicated to combating inequality, influential economists have published several studies that analyze this matter. Academics, politicians, activists and policymakers have begun to recognize inequality as a high priority issue on the public agenda and to propose solutions such as competition policy and efficient market regulation.

In Mexico, discussions on how competition policy can contribute to reducing inequality gaps are relatively recent. Since for most consumers the direct relationship between competition and social welfare can be unclear, we must encourage development of studies that show the costs families face when they purchase goods in concentrated markets. This is exactly what Andrés Aradillas does in the study *Market Power and Social Welfare* (which COFECE commissioned from him as an independent academic expert).

1 COFECE, "Estudio sobre el impacto que tiene el poder de mercado en el bienestar de los Hogares", October 12, 2018, available at https://www.cofece.mx/cofece-da-a-conocer-estudio-sobre-el-impacto-que-tiene-el-poder-de-mercado-en-el-bienestar-de-los-hogares-mexicanos/.

The results of the study find that market power negatively impacts household income, welfare and inequality. On average:

- Mexican households pay a 98 percent overcharge when there is market power.
- Mexican families allocate 16 percent of their income to pay overcharges when acquiring goods in the presence of market power.
- The impact is greater in lower income households, whose loss is 4.4 times greater than what the wealthiest families lose as a proportion of their income.

2. In this context, which sectors should be a priority for COFECE? Those that are accessed by a large part of the population or those identified as charging excessive prices, even if they are only consumed by people in the highest income deciles?

Lack of resources is a restriction that affects the scope of action of all public institutions. COFECE's overarching priority is taking on anticompetitive practices in markets that have the greatest impact on Mexican society at large. To that end, we have built a strategy that allows making the best possible use of institutional resources by identifying priority sectors in the Mexican economy. The Commission's 2018-2021 Strategic Plan establishes the criteria for carrying out this objective:

1. **Contribution to economic growth.** Sectors whose market size and growth rate most contribute to Mexico's GDP.
2. **Generalized consumption.** Sectors that produce goods and services subject to greater demand among the entire population.
3. **Crosscutting.** Sectors and subsectors that produce intermediate goods and services that are production inputs for relevant end-consumer goods and services.
4. **Impact on lower-income populations.** Sectors that produce goods and services that have the greatest impact on lower-income household expenditures.
5. **Prevalence of anticompetitive behavior.** Sectors and subsectors in which characteristics and regulations facilitate collusive agreements or market concentration.

Based on these criteria, COFECE identified six priority sectors:

a. The financial sector and all its related markets;

b. The agri-food sector and its links along the production chain;

c. The energy sector;

d. The transportation sector;

e. Pharmaceuticals and health services; and

f. Public procurement (which though not considered an economic sector in itself, is an economic activity of great importance to social welfare).

3. The same document quantifies the price premium that different products have (table 9 of the study) with respect to combating inequality. Do you think that the work of the Commission will end when this price premium is zero or when it has reached some reasonable margin? In each case, what else can the Commission do?

Monopolistic behavior generally results in higher prices. However, it is not necessarily anticompetitive conduct that leads to lack of competition in the market in the first place. In some cases, the origins of market power have to do with barriers to entry that arise from control over essential facilities, high returns on scale, technological superiority and, frequently, government-imposed regulatory barriers.

With regard to regulation, when deemed necessary, governments issue rules to regulate economic activity, to all manner of public-policy ends, including for environmental protection, public health issues, market failure corrections or to establish the parameters certain activities or services with externalities must be subject to. However, there are cases where these regulations, far from achieving their objectives, restrict market efficiency. In such a context, competition authorities must draw up analyses and studies that serve to persuade regulators that are responsible for competition inhibiting regulations of the costs society in general pay for these, and if possible, propose alternative ways to meet public policy objectives while not damaging market competition processes.

In contrast, when higher prices are a direct consequence of the exercise of market power through anticompetitive practices, it is, of course, our responsibility as competition agencies to enforce the law and make sure we sanction them.

Market Power and Social Welfare estimates the excessive prices paid by consumers, but does not determine the underlying causes, i.e. whether this is abuse of market power, cartelization or something else. Put another way, it does not distinguish between situations where market power derives from anticompetitive behavior, regulatory barriers or business efficiencies. What the study seeks to underline is the importance of competition policy in supporting consumer welfare as well as why it should be in all governments' interest to establish robust competitive markets.

4. Would you recommend including "Excessive Prices" in the LFCE as a monopolistic practice to combat inequality?

That's a very good question — to which I do not have the answer — and that I've asked myself many times.

On the one hand, as mentioned above, excessive pricing does not necessarily imply an exercise of market power and, therefore, Mexican law does not equate it with any type of anti-competitive behavior. Multiple factors, besides a firm's exercise of market power — such as increased production costs, changes to production processes and regulations — can lead to higher prices.

That said, one question that elicits great interest among competition experts is how far a price should be from its cost and, therefore, what producers/supplier' appropriate profit margin should be. A company's margin on a given product can reflect an exercise of market power, but could also have to do with innovation/development investments, efficiency distances between competitors or the existence of patents. However, in Mexico, we see certain "overconcentrated" markets in which prices charged seem "too high."

In such cases, Mexican competition law contemplates a protocol known as a "declaration of effective competition conditions" through which the antitrust agency can investigate if a supplier operates free from competition. COFECE's rulings in these declarations are directed to the sector regulator, which at its discretion can impose price regulations or modify legal frameworks in line with COFECE recommendations that permit competitive conditions to be restored.

5. Recently it has been argued that market concentration can also have an effect on factor markets, in particular on the labor market. Has COFECE considered or will it consider these effects in its determinations?

Several recent academic studies present evidence that increased market concentration reduces labor income share as a proportion of total income. They suggest that in industries in which there has been a growth in market concentration in recent years, labor costs have dropped sharply relative to profits. In other words, the return on labor has been transferred to investors as increased profit margin. As markets concentrate, workers have fewer employment options and therefore accept lower salaries. Despite all this, we do not consider factor market effects in merger analyses and other investigative procedures.

Also related to market concentration and labor markets, there is the fact that the existence of fewer employers increases the likelihood of agreements being struck between those employers so as not to compete by offering better conditions to competitors' workers (i.e. non-poaching agreements). This reduces employees' job mobility options. With regard to this type of practice, in 2018 COFECE initiated a (still-ongoing) investigation into possible monopolistic practices (cartel-like conduct) related to the recruiting and signing of Mexico's professional soccer players.

6. Do you think that the objectives of the LFCE should be expanded to include increasing employment levels and/or salaries?

Competition authorities must ensure the presence of conditions that allow efficient market development because, as those companies expand, consumer welfare also grows by offering higher quality goods and services at lower prices. Normally, competition authorities' goals do not include guaranteeing minimum employment or salary rates. Labor policies (apart from non-poaching agreements) are regulated by other government entities.

That said, I believe we must not lose sight that sometimes, especially in the short term, increased market competition can lead to job losses and can put downward pressure on certain (mainly non-specialized) salaries. This occurs because in competitive markets, companies may lay off employees and reduce salaries to create efficiencies related to cost reduction, limit profit margins and coax out even more competitive final prices. Likewise, less efficient companies often fail, taking jobs with them. In the short-term it could be a public policy dilemma, for which governments must generate policies to offset short-term job loss, instead of hampering competition. Studies indicate that the most competitive economies have greater prospects for long-term job creation and higher salaries.

7. What should be the relationship between industrial policy and competition policy? For example, should an industrial policy that guarantees an increase in employment and income levels but that results in an increase in market concentration be combated by competition policy?

Competition policy seeks to create conditions in markets that allow consumers to reap the benefits of competition: innovation, quality and alternative goods and services at better prices. After applying and enforcing competition policy over several decades, we have come to recognize that this dynamic generates short-term winners and losers (i.e. companies go out of business or entire industries disappear because of innovative production processes or novel products).

Years ago, industrial policy was notorious for picking winners and losers. Particularly in closed economies, it focused on driving a few large companies (so-called "national champions") that were protected from competition. The idea was that protection would allow them to become stronger and then more effective in competing abroad. Today, we realize that a more successful tactic is strengthening domestic businesses via intense internal competition to create efficient companies that can better compete against global companies. Thus, today's industrial policy should promote the creation of business ecosystems for industrial development, particularly in markets that play strategic roles in national economies. This means focusing on the success of specific industries, as opposed to individual corporations. At the same time, economic policy should focus on helping losers rejoin the market.

That said, we should also note that there can be complementarities between industrial and competition policy. Competition policy should not be understood as being opposed to large companies or their growth. If growth emerges from innovation and does not represent risks to proper market functioning, it must be welcome. On the other hand, industrial policy should not focus on artificially favoring chosen companies; instead it should generate conditions that support efficiency improvements for the entire industry.

8. **Recently, the issue of platform power has been considered in jurisdictions such as the U.S. and the European Union. In particular, mention is made of the acquisition of platforms by other platforms for the purpose of exporting their power to other markets or for the purpose of eliminating competition into the future. What is COFECE's position in this regard and does it believe that it has the same repercussions for emerging economies such as Mexico**

In emerging markets such as Mexico, different economic activities move simultaneously but at two different speeds. On one hand, a great part of our economic activity takes place in traditional, non-digitalized markets in which lower-income households purchase basic products and services (such as food and transport) that account for a large percentage of their total expenditures. In many of these economic activities, a high market concentration prevails among traditional suppliers. In some relevant cases, such as transport and retail, alternatives that digital platforms offer may be an interesting source of competitive pressure on the incumbents; their disruption in Mexican markets is welcome.

On the other hand, many sectors are already immersed in a modern global economy and are therefore part of the worldwide digitalization trend. In these markets, the competition authority faces similar challenges to those presented to their peers in developed countries and must allocate resources to addressing them. We are on it.

We have already issued a document which compiles the generally accepted challenges faced by competition authorities regarding both enforcing competition law in digital markets (including investigating anticompetitive practices and merger control) and advocating for pro-competitive regulation.

Moving forward, we plan to carry out diverse actions in order to meet new challenges. We are currently: (i) working on the design and creation of a multidisciplinary division to handle investigations related to digital markets (learning from the example of the first authorities to do so); (ii) gathering a group of outside experts to advise on how to take on challenges arising from the current context; (iii) planning a capacity building strategy regarding data management and economic analysis in digital markets; and (iv) working on bringing first-hand knowledge on the topic to our staff directly from those world-wide experts developing it.

9. **Do you think that similar treatment should be given to historical operators in certain markets (say the financial sector) towards the acquisition of digital platforms (say in the Fintech space)?**

Digital markets are characterized by being highly dynamic, which often results in dynamic efficiencies, a positive characteristic of competitive markets. Digitalization is transforming traditional markets by allowing customers to compare prices, as well as the quality of goods and services. Digital platforms are (1) creating new markets; (2) providing new ways for acquiring goods and services; (3) in many cases, reducing transaction costs and lowering prices; and (4) creating a collaborative economy. In many ways because of the existence of digital platforms we are better off as consumers.

Recently, COFECE issued its first ever merger decision involving a player in a digital market. It was a transaction between Walmart, the biggest brick-and-mortar retailer in Mexico, and Cornershop, a start-up that offers logistical services for the purchase and immediate delivery of products offered by different retailers (some of which are Walmart's direct competitors) to final consumers. In this case, COFECE blocked the merger because of the potential risks detected, which included the risk that the platform (Cornershop) could refuse to offer its services to Walmart's retail competitors and/or that the new economic agent resulting from the transaction could pass information produced by platform retailers to Walmart for retailing strategies. Cornershop is the largest player in the market for such services, as is Walmart in its own market, so the size of both merging parties did matter.

Thanks to this first experience, COFECE learned a great deal about how to approach a merger between a traditional supplier and a digital one. Without a doubt, we have a lot more to learn. Much of the knowledge we still need to gain will be related to a better understanding of digital enterprise business models, including their finance and exit strategies, the incentives these strategies bring about, the possibilities that the technology allows, the potential use and value of the data involved, among other aspects.

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