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Back to the Recovery: Promoting Competition Friendly State Measures

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To ensure a robust economic recovery, competition principles need to be built into the design and execution of the State measures that support it – from subsidies and loans to laws and regulations. Few if any government entities are better placed than competition authorities to provide advice on the effects of such interventions on markets, and how these can be minimized. Markets need to function well in order to continue providing the benefits to productivity, innovation, and economic growth that they are known to deliver. Better functioning markets lead to better living standards or, to paraphrase the OECD motto, "Better Markets for Better Lives."

This approach is more relevant than ever as approximately 16 trillion USD in rescue and support packages have been introduced over the last year across more than 160 jurisdictions.[2] Among high-income countries this has represented on average 13.3 percent of GDP in 2020.[3] Three of the largest rescue packages have been in China, the EU, and the U.S., where rescue packages have been in the magnitude of 5, 10, and 25 percent of GDP, respectively. Many advanced economies are still implementing significant fiscal measures in 2021, to a tune of 6 percent of GDP on average. More can be expected as countries move further away from rescue and into recovery. Support efforts have taken many forms – mostly through loan guarantees and direct lending facilities, and in more limited cases, equity programs[4]. Significant accommodative monetary policies have accompanied such fiscal measures.

We have yet to fully measure the medium- to long-term impact of this crisis on governments, economies and societies. Nevertheless, what is clear is that today's policy response cannot be short-sighted as this will have an impact on our ability to exit from the current economic crisis. Interventions must be targeted and act as a foundation for a prompt recovery and a hopeful future.

Competition Policy is Broader than Enforcement

Competition enforcement, including merger control, helps ensure markets are well-functioning and that market power is neither created (through mergers or cartels) nor abused by firms. The crisis may lead to increased market power as firms exit or are acquired by competitors. Other firms may become more financially vulnerable so that those with deeper pockets may engage in exclusionary practices that are more effective and less costly than they normally would.

To prevent lasting harm to markets, competition authorities can be expected to make more frequent use of interim measures. Many are also targeting their limited resources to practices and strategic sectors that may have more of a bearing on the recovery (for instance digital markets, green innovation, no-poach agreements, etc.)

Antitrust enforcement deals with markets as they are, and behaviors that have taken place. Even merger control cannot but keep transactions that significantly lessen competition in check.

Rescue and stimulus packages have the potential to change how markets operate. Building market competition considerations into

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[2] IMF's Fiscal Monitor of April 2021.

[3] Data from WEF Chief Economists Outlook June 2021.

[4] COVID-19 Government Financing Support Programmes for Businesses, OECD 2020.

these packages will help ensure that markets remain or become well-functioning.

Enactment of such packages does not depend on competition authorities but on the State (including governments, parliaments, or agencies in charge of disbursing funds or drawing up legislation). Since this is a prerogative of other state entities, many competition authorities have traditionally focused more on enforcement and not been so involved in helping governments design state interventions and support.[5]

However, given the magnitude of the current state interventions we have seen in this crisis, competition authorities may wish to step-up their engagement in shaping the rescue and recovery packages to reduce long-term competition distortions in markets. A lack of intervention now may mire our economies with malfunctioning markets, less open international markets and ultimately holding back the robustness of recovery for years to come.

Competition and Well-functioning Markets Act as Drivers for Recovery

The policy lessons from the history of economic crises show that competition principles should pervade policy responses to the crisis. There is ample evidence from the Great Depression, the Japanese crisis of the 90s, and the Global Financial Crisis, that less competition enforcement and more restrictive regulations and measures adopted in times of crisis hold back recovery[6].

Further empirical evidence shows that the amount of market power in an economy negatively influences the impact of monetary and fiscal measures, as it changes firms' incentives to invest[7]. The fiscal multiplier from stimulus measures will be lower the higher the profit margins of firms in an economy is.[8] So, to increase aggregate demand, fiscal policy is more helpful when product markets are competitive.[9]

To maximize these important policy levers now and in the future, markets need to be well-functioning. This means markets that are not captured by a persistent monopoly, or by firms with significant market power.

Even well intended state measures may lead to increases in market power across the economy. This may especially be the case in the current crisis given the already quite high levels of concentration and that it is the smallest firms that have been the hardest hit.[10]

This requires that impacts on competition in markets are considered when developing, changing, or exiting rescue packages, along with effective and smooth recovery packages that reallocate resources to "build back better." Measures to support productivity will have to be complemented by competition – in both labor and product markets – in order drive innovation, and support technology deployments across the economy – the keys to the recovery.

The Role for Competition Authorities: Not Just Watchdogs, Also Guide-dogs

Competition policymakers and authorities can play an active part in a whole-of-government response to the COVID crisis, and can help promote structural and regulatory pro-competitive reforms.

Competition authorities' skill-sets and knowledge of how markets work means they are well placed to give advice to governments in designing support measures and ensure that

[5] The EU is one of the few jurisdictions to have control over state support measures, in the form of State Aid powers.

[6] The Role of Competition Policy in Promoting Economic Recovery, OECD 2020.

[7] IMF Staff Discussion Note March 2021 on "Rising Corporate Market Power: Emerging Policy Issues."

[8] IMF Staff Discussion Note March 2021 on "Rising Corporate Market Power: Emerging Policy Issues," p. 31.

[9] A Keynesian antitrust response to the COVID-19 crisis, Jorge Padilla, Journal of Antitrust Enforcement, 2020, 8.

[10] IMF World Economic Outlook – Managing Divergent Recoveries, April 2021.

these do not distort competition unnecessarily – particularly in markets where they have experience from previous enforcement actions or market studies, for instance. In this way, they can help governments make a better assessment of the potential costs and benefits of alternative policy measures that are less restrictive of competition.

Policy decisions, given their complexity and especially in a moment of crisis, may lead to non-optimal solutions. First, policymakers face short-run costs and often look for benefits that are immediately tangible. This may lead to policy responses that give less consideration to long-term costs and benefits, even if they may be more significant. Second, short-term benefits will accrue to specifically identifiable stakeholders and can be traced directly to a certain political action. This may bias policymaker's incentives towards short-term fixes which may give less weight to, or even disregard, the policy consequences for longer-term market structures. Third, the huge amount of state support being deployed in the current context may lead to opportunistic behaviors by firms. For instance, firms may lobby to influence the regulatory framework to protect or increase their market power via, for instance, entry barriers.

Competition authorities may counterbalance these proclivities by informing policymakers of the potential impacts on market structures of proposed measures. In other words, ensuring that state measures are geared towards creating better markets in the future.

To play this wider role, governments must empower authorities and provide sufficient resources so that they can rise to the task of pushing for deeper and more frequent advocacy actions when measures are being designed, whilst maintaining effective levels of enforcement.

Competitive Neutrality and an International Playing Field: The Power Couple of the Recovery

Less carefully crafted state support may distort the competitive process and disrupt the dynamics of market entry and exit of firms.[11] The exit of less efficient firms and their replacement through entry and expansion by other firms in the market is an important driver of efficiency, productivity, and growth.

A level playing field between public and private market participants, and between different private market participants, is a fundamental part of the competitive process that relies on merits to deliver important economic benefits. A sloping playing field, on the other hand, can disrupt market dynamics as some firms benefit from rules or government support and no longer need to rely on their efficiency and ability to innovate in order to compete and gain market share.

Selective state support that benefits only some competitors may put firms that are more efficient, productive, and innovative at a disadvantage. This reduces their profitability thereby hindering their incentives to invest, or even forcing them to exit the market. Further, selecting "champions" is fraught with difficulties and the track record of governments is not strong.[12] It is prone to several problems, including protectionism and information asymmetry between the business recipients and governments, as well as insufficient consideration of changes to the dynamic incentives of firms.[13]

This does not mean we should be dogmatic in that no state support can be given in circumstances where there exists a systemic firm playing an important role in a regional ecosystem of companies or for a value chain.

It does mean, however, that any such competition distortions need to be accounted for and integrated into the decision-making process

[11] The Role of Competition Policy in Promoting Economic Recovery, OECD, 2020.

[12] Industrial Policy and the Promotion of Domestic Industry, OECD, 2018.

[13] Competition and the Industrial Challenge for the Digital Age, J. Tirole, 2020.

regarding the measure in order to fully understand its pros and cons in the medium-to-long term.

There is also an important international dimension to this interplay as there are significant costs tied to insulating domestic firms from international competition.[14] This can be in the form of trade barriers, but also as a consequence of state support. State support can provide undue advantages to less efficient domestic firms *vis-à-vis* their more efficient foreign rivals, thus protecting them from entry by foreign firms. Protecting or even increasing the market power of domestic firms lowers their incentives to increase efficiency and productivity levels compared to firms that are subject to international competition or to the threat of entry by international firms. Other countries may try to recreate a level playing field by responding with subsidies or other forms of support for their own domestic players. This can lead to a race for state support, which may cause significant and possibly escalating distortions in both domestic and international markets.

A strong and effective competition policy goes hand-in-hand with an open trade policy that can ensure open markets. On the one hand, an open trade policy without a robust competition policy and enforcement will not have the full desired effects of increased trade, since there will be domestic distortions caused by the market power of firms that make it more difficult for market entry to occur. On the other hand, firms that are shielded from international trade (in goods and in opportunities for entry into domestic markets) will not be as efficient or as ready to enter other markets if they have not created the efficient processes and products they would have had to develop had they been playing the competitive game.

As a guide and tool, competition authorities and governments should consider the newly adopted 2021 OECD Recommendation on Competitive Neutrality.[15] The Recommendation establishes a set of principles that promote a level playing field among competitors and prevent situations where the state grants advantages to certain entities selectively, distorting competition within a market.

For the reasons explained above, this OECD instrument is particularly important during the recovery phase where countries attempt to better target measures – even more so in the context of an increasingly constrained fiscal space and the increased debt ratios of governments.

What Can Competition Authorities Recommend to Governments?

Competition authorities should prioritize data-driven advocacy efforts, focusing on markets where they have experience. They can make use of the data and know-how they have acquired on those specific markets. It was clear from our debate during the December OECD Competition Committee, for instance, that credibility is a crucial attribute of competition authorities in debates with government – particularly in times of crisis where decisions are often taken quickly.[16] Credibility is gained by using concrete data to make the message sharper for governments to listen to. This leads to more buy-in and to a higher probability of being considered in the measure design phase.

[14] The Role of Competition Policy in Promoting Economic Recovery, OECD 2020.

[15] https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0462.

[16] https://www.oecd.org/daf/competition/role-of-competition-policy-in-promoting-economic-recovery.htm , in particular videos by Bill Kovacic & Philip Lowe, two speakers at the Committee session.

What Specific Recommendations Can Competition Authorities Make, When Advocating in the Context of State Support Measures?[17]

First, advocate for state support measures to be proportionate to the goals, for instance, to avoid bankruptcy of a firm considered to be systemic. This can be accomplished through a counterfactual analysis, comparing the current situation with the scenario where COVID-19 had not occurred. The outlook of the sector in question should also be considered when determining the most appropriate policy measure. Selective state support measures may be appropriate for sectors where the crisis will likely only have a temporary negative effect. More careful consideration needs to be given to those sectors experiencing a permanent shock[18]. In such cases, state interventions could rather focus on measures aimed at scaling down and restructuring.[19]

Second, advocate for built in claw-back mechanisms, so that any support that is later considered to have been disproportionate can be returned to the state. This is particularly relevant in markets facing a very significant degree of uncertainty as to how they will evolve in the recovery.

Third, if the support measure would most likely bring competition distortions that would outweigh the positive effects, the government should require compensatory measures or remedies as a condition for the state measure. These proposed remedies may be structural in nature — for example, requiring a divestiture of assets — or behavioral, similar to what would be applied in merger control. These may be used to try to reduce barriers to entry and market power.

Fourth, advise on exit strategies from the support measures to ensure a competition-friendly exit from the crisis. Indeed, one of the main challenges in the following months will be the phasing out and exit of the recovery packages without leading to a wave of bankruptcies, caused by the artificial support provided to zombie firms[20] and due to changed market circumstances. Such exit strategies should be built into the design phase of public support measures from the outset — "sunset clauses" allowing flexibility to adapt to prevailing market circumstances, perhaps by setting criteria that include competition parameters in their analysis.

Fifth, advise that any privatizations that may result from the sale of equity following state support should be undertaken using an open, transparent, and non-discriminatory sale process. They should also advocate for any structural competition issues — such as excessive market power — to be tackled before privatization (by for example divesting assets).

The OECD will bring competition authorities and Governments together in a high-level event to be held during the first quarter of 2022 to discuss these issues further.

Competition Rules to Regulate the Future

Given that many economies are at the cross-roads of a transition to a digital and more green economy whilst recovering from a deep recession, an important aspect of government policies going forward will be designing policies

[17] There are a number of examples at The Role of Competition Policy in Promoting Economic Recovery, OECD 2020.

[18] The permanent shock may result directly from the COVID pandemic or from subsequent policy choices such as green policies.

[19] Motta, M. & M. Peitz (2020), "EU recovery fund: An opportunity for change," *VOX CEPR Policy Portal*, https://voxeu.org/article/eu-recovery-fund-opportunity-change.

[20] OECD, February 18, 2021, "Business Dynamism During the COVID-19 Pandemic: Which Policies for an Inclusive Recovery, "*Financial support to firms' liquidity and temporary changes to insolvency procedures have been effective in reducing bankruptcies, on average, by more than 30% relative to the pre-pandemic period. Policy measures may have protected viable and productive firms and avoided the systemic risks posed by a wave of bankruptcies, but at the risk of potentially keeping non-viable (the so-called zombie) firms afloat*."

for the reallocation of resources to effect that switch.

Industrial policies will be put in place to drive the reallocation, and to foster innovation and technology uptake throughout the economy. These should bolster competitive markets to continue to provide for the full and ongoing benefits of competition – continued innovation and productivity gains that will allow for wide-spread dissemination of technology gains.

In all such policies that will drive our common recovery, competition authorities have a greater role to play, beyond enforcement, in helping to support a strong and resilient recovery by providing invaluable advice to governments.