

# Agenda

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## Don't forget the remedies: what could competition policy learn from regulation?

In March 2009, the Competition Appeal Tribunal in the UK upheld an appeal in relation to the Competition Commission's groceries market investigation, concluding that the Commission had not sufficiently assessed the potential cost and benefits of the suggested remedy; namely, the introduction of a competition test for planning applications. What are the wider implications for the evidence required to justify remedies in competition cases?

In a market investigation, when the Competition Commission (CC) finds an adverse effect on competition and consequent detrimental impacts on consumers, it is required, under the Enterprise Act 2002, to determine the appropriate remedy and what actions need to be taken to address specific detrimental effects. Sub-section 134(6) of the Act stipulates that:

the Commission shall, in particular, have regard to the need to achieve as comprehensible a solution as is reasonable and practicable to the adverse effect on competition and any detrimental effect on consumers so far as resulting from the adverse effect on competition.

The *Tesco* case marked the first occasion on which one of the CC's market investigation final reports had been appealed.<sup>1</sup> By upholding the appeal on the grounds that there was insufficient evidence to justify the proportionality and effectiveness of the proposed remedy; namely the 'competition test' (see box below), the Competition Appeal Tribunal (CAT) gave a clear signal of what evidence would be required to justify specific remedies in competition cases.

The CAT's main concern was that the CC had not provided sufficient evidence to support the application of the test; it did not raise any concerns with respect to the legality of the test itself. For example, there appeared to be insufficient evidence that the costs of the competition test would not be disproportionate or would not exceed the potential benefits, or that the outcome of applying the test would be effective or reasonable.

In particular, the CAT noted that:

there is a significant gap in the Commission's analysis in relation to the 'costs' of the competition test. The Report does not fully and properly assess and take account of the risk that the application of the test might have adverse effects for consumers as a result of their being denied the benefit of developments which would enhance their welfare, including by leaving demand 'unmet'.<sup>2</sup>

The CAT not only found that the CC had provided insufficient evidence for an assessment of the test's potential welfare costs, but also criticised the CC's assessment of the likely benefits of such a test:

### The competition test for planning applications, as proposed by the CC

The CC recommended that the competition test should be applied to grocery retail planning applications as part of a package of remedies to address the adverse effects on competition caused by high levels of concentration in local markets. A planning application for a grocery store development within a particular local area would pass the test if:

- the retailer who would operate the developed store was a new entrant in the local area;
- the total number of fascias (ie, grocery retailer brands) in the local area amounted to four or more; or
- there were three or fewer fascias in total, but the relevant retailer would have less than 60% of grocery sales within the local area.

Source: Competition Commission (2008), 'The Supply of Groceries in the UK Market Investigation', April 30th.

the Commission seems simply to have based its proportionality assessment on an assumption that the whole of the estimated customer detriment would be remedied by the test, in combination with the other remedies ... There is in the Report no recognition or weighing of the non-acknowledged possibility that the existing [adverse effect on competition] might not be satisfactorily remedied or mitigated for many years.<sup>3</sup>

Overall, the CAT ruling implies that, in order both to advance a legally sound remedy such as the competition test and to establish its proportionality, it is necessary to undertake a comprehensive analysis of the costs and benefits of the remedy. Such cost-benefit analysis (CBA) is essentially an economic test, which in many cases cannot be reduced to a simple 'black or white' decision. This is because, in many cases, an exact quantification of costs and/or benefits is not possible. A qualitative assessment is also required, combined, where possible, with a quantification of the approximate orders of magnitude of the main categories of costs and benefits.

Following the CAT ruling, the CC undertook further analysis of the competition test's effects on market structure, as well as its wider cost and benefits, and its effectiveness and proportionality. In its provisional decision, published in July 2009, the CC concluded that the test would deliver positive value to consumers, on the basis that any reduction in consumer welfare in the short run would be offset by the longer-term benefit of increased competition.<sup>4</sup>

The CAT ruling is likely to have consequences that go beyond the groceries market investigation. Remedies find broad applications in competition policy, driven by an intention to frame market outcomes in a more efficient way. In mergers, remedies aim to restore or maintain competition while allowing the relevant merger efficiencies and other benefits to be achieved; in abuse of dominance cases, the main goals of remedies are to terminate the defendant's anti-competitive conduct, prevent its recurrence, and re-establish the opportunity for competition in the affected market; and consumer remedies address market failures (such as incomplete or misleading information) that give rise to an adverse effect on competition. Remedies should achieve these goals without unnecessarily constraining legitimate competitive conduct and incentives. Moreover, the effects of remedies on efficiency and innovation (as well as on consumer choice) need to be carefully considered.

Although competition policy remedies may have wide-reaching effects, the assessment of their effectiveness and wider economic impacts seems to have been neglected somewhat.<sup>5</sup> In fishing, it is said

that if you are not willing to clean the fish, you should not catch it in the first place. With regard to competition infringements, there seems to be a notion that, as one panellist in the US Section 2 (Monopolisation) hearings put it: 'everybody likes to catch them, but nobody wants to clean them up'.<sup>6</sup> The CAT ruling implies that more thorough 'cleaning up' needs to be done before advancing remedies for such infringements. CBAs of this sort in competition cases share some significant similarities with regulatory impact assessments. These types of CBA are commonly undertaken when introducing new rules, in both ex post or ex ante regulation.

## Costs and benefits in the balance

CBA is a versatile methodology for assessing the proportionality of competition remedies, other forms of regulatory intervention or the application of government policies. It is widely applied in ex ante regulation. For example, the European Commission in its 2008 review of the regulation of the electronic communications sector, commissioned an in-depth CBA of proposed regulatory measures as part of the regulatory impact assessment.<sup>7</sup> In regulation, there are a number of guidelines covering how such assessments should be undertaken. For example, the Impact Assessment Guidelines of the European Commission state that, when considered proportionate:

selected impacts are estimated using quantitative techniques varying from simple extrapolation—based for instance on previously derived coefficients (e.g. units of CO<sub>2</sub> per unit of industrial activity)—through to proper quantitative modelling. Essentially, the aim is to understand the extent of the impacts on the policy options and to estimate the costs and benefits in monetary form when this is feasible.<sup>8</sup>

In the UK, the Government's Green Book lays out the methodology to be used in making any economic assessment of the social costs and benefits of all new policies, projects and programmes.<sup>9</sup> Individual sector regulators have also developed detailed guidelines on how to undertake CBAs in impact assessments of their interventions.<sup>10</sup>

Although guidelines exist, the quantification of the costs and benefits of decisions by government and regulatory or competition authorities is sometimes controversial as it implies that, for example, health and environmental effects, or effects on consumer choice, can be priced or valued in monetary terms. Despite some objections to such techniques, the value of CBA often lies as much in the conceptual insight it provides into the economic and other effects of a decision, as in the (monetary) quantification of the effects themselves. The analysis

**Main categories of costs and benefits*****Direct costs of market regulator.******Direct costs of firms:***

- compliance costs;
- costs of specific proceedings.

***Economic costs to the market in question (negative market impacts):***

- allocative efficiency;
- productive inefficiency;
- distortion of incentives (reduced dynamic competition and/or innovation);
- reduced product and/or service quality;
- restriction on market functioning.

***Economic benefits to the market in question (positive market impacts):***

- allocative inefficiency;
- productive inefficiency;
- enhanced dynamic competition and/or innovation;
- increased product and/or service quality;
- enhanced market functioning.

involves a detailed assessment of one-off and recurrent costs and benefits and an overall evaluation of the likely intervention and/or policy impact. The box above gives an overview of the main categories of costs and benefits that would typically need to be assessed.

Given the nature and purpose of intervention in both regulation and competition cases, assessing direct costs is often easier than assessing benefits, although the CAT ruling clearly indicates that it is not sufficient to take into account only the direct costs of intervention. Furthermore, due to the types of costs and benefits typically under assessment, accurate quantification is often not possible.

Therefore, CBA usually combines a limited quantification of costs and benefits with qualitative assessments and an analysis of the likely impacts on incentive and market structures. If the benefits of a proposed remedy are seen to exceed the estimated costs by at least an order of magnitude then estimates that claim accuracy beyond two or three significant figures are unlikely to be any more useful than 'ball-park' figures.

Given that estimates of costs and benefits are related to future outcomes once a measure has been introduced, their use carries considerable uncertainty—particularly for competition remedies, where the impact on the dynamic process of competition is of key importance. Thus, precision may be spurious, and sensitivity analysis may be a more appropriate means of dealing with the associated issues of accuracy and uncertainty.

**Direct costs**

Direct costs cover the additional expenditure incurred by a government, regulator or competition authority in designing and enforcing any proposed remedy. They can include, for example, the costs of extra staff and IT resources. These costs may arise not just in one division or team, but throughout the regulatory body in question—they may relate, for example, to policy-making, supervision or enforcement—thereby adding complexity to the measurement.

Direct compliance costs, broadly defined, are the costs borne by those companies subject to the proposed remedy. In classifying compliance costs, it is useful to distinguish between those costs that emerge as part of firms' good business practice, and those that are incremental costs arising solely as a result of regulation. Only the latter are direct compliance costs.

**Economic costs of negative market impacts**

While the objective of regulation is to improve market functioning, actions by regulators can have unintended adverse consequences on the market as well. Such actions may change the nature of markets, prevent or discourage firms from entering markets, or have a significant effect on the nature and availability of the products provided, the extent of consumer choice, and the level of innovation in the industry. These negative effects may also have repercussions for the wider economy. Economic costs take a number of forms, the most relevant of which include the following.

- **Impact on incentives.** If a regulation or remedy creates perverse incentives, significant costs can arise in the long run. For example, a price cap remedy could reduce incentives to invest.
- **Impact on market structure.** Remedies or regulatory measures can affect market structure in several ways. A cap on the market shares or on the growth potential of particular companies (for example, as in the case of the CC's competition test) could, in theory, reduce consumer choice and have detrimental impacts on consumer welfare by blocking the expansion of those firms that more efficiently meet consumer demand. Alternatively, as the CC had intended, such a cap could increase consumer choice by creating a more diverse retailer base.

Economic costs are more difficult to assess than direct costs because they are often concerned with dynamic effects that are difficult to predict with certainty. This holds, in particular, for CBAs of competition remedies, where their impact on the dynamic process of competition is often the key reason for their being

proposed (as in the groceries market investigation). However, modelling techniques can be used to generate simulations of markets and firm behaviour in order to arrive at an estimated cost.

In some cases, such quantification may not be possible and the costs would have to be analysed on a qualitative basis. Such an assessment should focus on making explicit the different trade-offs, and would require analysis of the likelihood that intervention could result in negative effects on the market, as well as analysis of what weight the regulator gave to these when reaching its decision.

## Assessing benefits

In regulation, the economic benefits of the enforcement of regulation can be measured in terms of productive and allocative efficiency; enhanced dynamic competition and/or innovation; enhanced market functioning; and macro-economic effects. In competition policy, the focus is generally on reducing adverse effects on competition in order to increase efficiency and consumer welfare. Overall, the assessment of benefits presents potentially significantly greater challenges than the cost side of the equation.

Putting a monetary value on benefits such as increased consumer choice is often difficult. While people tend to value greater choice—at least to a certain extent—there is no economically efficient way in which they can pay directly in order to enjoy more options in this respect.<sup>11</sup> However, in some cases, the value that people place on benefits where no direct market value is observable can be deduced by surveys of revealed and stated preferences, and through econometric analysis of more complex data on how people behave (or say they would behave). Where sufficient data is available, such techniques can often provide reasonable measures of such benefits.

While these techniques can address the direct and indirect effects of the remedy on specific market participants, further modelling may be required to evaluate broader market impacts or effects on the economy as a whole. Market simulation models and computable general equilibrium models may be well suited to this purpose.

## What are the lessons for competition policy?

With its *Tesco* decision, the CAT has raised the bar on what evidence is required to show that remedies work. Perhaps as a result of this appeals mechanism, competition cases remedies will, in future, need to be evidenced more robustly than at present.

It would seem to be good practice for competition authorities to provide evidence that proposed remedies are likely to be proportionate and effective, and, in order to do this, the likely costs and benefits of any such measures must be thoroughly assessed. CBAs provide an appropriate and well-tested tool to undertake such comprehensive assessment.

In the *Tesco* appeal, the proposed remedy was novel—the use of the planning system to achieve an impact on local market structure—and, therefore, evidence that the remedy would work might be seen as a necessary condition to evaluate proportionality. However, at least in theory, the principle that remedies need to be shown to work could be applied to all competition law remedies, including the more conventional ones. For example, a recent study suggests that consumers benefited by about £130m per year from the intervention of the UK Office of Fair Trading in enforcing the inclusion of all compulsory charges in the ‘lead’ (or initially displayed) prices of airline tickets sold online.<sup>12</sup> At first sight, this remedy might look quite effective, but did it really transfer £130m from producers to consumers, or did it result in price rises elsewhere? The intervention might also alter the landscape of competition between various forms of transport on routes such as London to Paris. Has this reduced the frequencies of flights on these routes, and, if so, how do customers value the associated reduction in the choice of flight times?

It is possible that, in future, a remedy may be challenged on the basis that, in the specific case in question, it would not work or would be unusually expensive relative to its likely benefits. This would bring the application of competition law remedies closer to the structure within which regulatory changes are made; namely, full CBA of the specific remedies in a specific case.

<sup>1</sup> Competition Commission (2008), 'The Supply of Groceries in the UK Market Investigation', April 30th; and [2009] CAT 6: Case Number: 1104/6/8/08.

<sup>2</sup> [2009] CAT 6, Case Number: 1104/6/8/08, para 111.

<sup>3</sup> Ibid, 1104/6/8/08, para 162.

<sup>4</sup> Competition Commission (2009), 'Groceries Market Investigation: Remittal of the Competition Test by the Competition Appeal Tribunal: Provisional Decision', July 16th.

<sup>5</sup> This is beginning to change. For example, studies that assess the effectiveness of remedies, both before they are introduced, to understand what types of remedial intervention are likely to be the most effective, as well as in hindsight, to learn what worked and what did not, include European Commission (2005), 'Merger Remedies Study', October; Duso, T., Gugler, K. and Yurtoglu, B. (2006), 'EU Merger Remedies: A Preliminary Empirical Assessment, Governance and the Efficiency of Economic Systems', Discussion Paper No. 81, January; and Competition Commission and Office of Fair Trading (2009), 'Road Testing of Consumer Remedies: Final Report', July, which discusses some quantitative and qualitative methods that can be used to assess the effectiveness and proportionality of remedies in competition cases.

<sup>6</sup> Federal Trade Commission (2007), 'Section 2 Hearings: Understanding Single-firm Behavior: Remedies', p. 47, March 28th.

<sup>7</sup> The European Evaluation Consortium (2007), 'Cost-Benefit Analysis of Options for Better Functioning of the Internal Market in Electronic Communication', final report prepared for the European Commission Directorate General for Information Society and Media, October 22nd.

<sup>8</sup> European Commission (2005), 'Impact Assessment Guidelines', SEC(2005) 791, June 15th.

<sup>9</sup> HM Treasury (2003), 'The Green Book: Appraisal and Evaluation in Central Government', January 16th.

<sup>10</sup> See, for example, Ofcom (2005), 'Better Policy Making. Ofcom's Approach to Impact Assessment', July 21st; and Financial Services Authority (2000), 'Practical Cost-Benefit Analysis for Financial Regulators', version 1.1, June.

<sup>11</sup> Oxera (2007), 'Spoilt for Choice: Consumer Decision-making and the Optimal Market Outcome', *Agenda*, August.

<sup>12</sup> London Economics (2009), 'Assessing the Effectiveness of Consumer Protection Intervention', presentation given at the Office of Fair Trading, Association of Competition Economists and Competition Commission Evening Economics Seminar, July 9th.

If you have any questions regarding the issues raised in this article, please contact the editor, Dr Gunnar Niels: tel +44 (0) 1865 253 000 or email [g\\_niels@oxera.com](mailto:g_niels@oxera.com)

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