Economic observations concerning competition policy following Brexit

Note prepared for BCLWG

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This note has been prepared by Oxera in response to selected issues outlined in the Brexit Competition Law Working Group's issues paper published in October 2016. Oxera economists are available to discuss the arguments presented in more detail, alongside any other competition economics issues arising out of Brexit.

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1 Introduction

The prospect of Brexit raises complex issues of policy in many areas of public life, and competition law is no exception. Many of the key questions in this field have been set out in the comprehensive issues paper published by the Brexit Competition Law Working Group (BCLWG).[1]

Oxera considers that the BCLWG, in light of both its distinguished membership and its envisaged approach, has significant potential to positively influence UK competition policy post Brexit. We are happy to support this initiative and contribute ideas on paper and in round-table discussions. Indeed, we believe that the BCLWG could, following this current issues paper, make important contributions to other important policy debates in this area, including the following.

- **State aid**. Brexit has significant potential implications for the way in which EU state aid rules are applied, or are no longer applied, in relation to UK markets and companies. UK industrial policies (for example, in relation to corporation

[1] Brexit Competition Law Working Group (2016), 'Issues Paper', October, http://www.bclwg.org/wp-content/uploads/2016/10/BCLWG-Issues-Paper-FINAL.pdf, accessed 25 October 2016 (henceforth 'BCLWG issues paper').

tax and industry support) could also take a different shape after Brexit. An informed and competition-oriented perspective from the BCLWG could help the UK government when it considers such policies, or any new state aid-related rules, in the UK.

- **EU competition law**. The BCLWG has focused its issues paper on the development of UK competition policy after Brexit. An equally important policy question is about what happens to EU competition law. Over the years the UK government and competition authorities have had a positive (economically oriented) influence on, competition policy in the EU and in other member states (as also described in the BCLWG paper). It would seem important for the UK, or at least UK-based voices such as the BCLWG, to remain engaged in the pan-European discussions on competition policy.

This note takes an economic perspective in responding to three of the issues discussed in the BCLWG paper. In particular, we consider that economics can play a particularly insightful role in the debate on:

- the economic consequences of applying non-competition concerns to merger decisions (section 2);
- the potential for policy movement towards effects-based analysis in the UK (section 3);
- demands on the CMA's resources and the necessary prioritisation of CMA activities after Brexit (section 4).

Consistent with the approach taken in the BCLWG issues paper, we focus on the scenario in which the UK leaves the EEA (sometimes referred to as 'hard' Brexit).

2 The economic consequences of applying non-competition considerations in merger approval

2.1 The BCLWG issue: the CMA could consider wider non-competition concerns in mergers

Under EU merger regulations, mergers between organisations above a particular size threshold must be reviewed by the European Commission. However, under Article 21 of the merger regulations, member states can in some circumstances intervene and take measures to protect legitimate public interests in relation to these mergers.[2] These interests are limited to:

a) public security;

b) media plurality;

c) financial stability ('prudential rules').

If a member state wanted to intervene on the basis of another 'public interest' consideration, this would need to be notified to, and approved by, the Commission, and tested for compatibility with the functioning of the single market. The UK has more discretion over how to review mergers that fall outside

[2] European Commission (2004), 'Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (the EC Merger Regulation)', *Official Journal* L 024 , 29/01/2004 P. 0001 – 0022, 20 January.

the EU's jurisdiction, although in practice the current UK public interest intervention rules are similar to those of the EU.[3]

After Brexit, the EU merger regulation would not apply automatically to UK mergers. This means that the CMA, or the UK government more broadly, could apply wider considerations of public interest to mergers that were previously analysed by the European Commission on competition grounds alone. The BCLWG has asked for an analysis of the pros and cons of such a development, and how it might be implemented in practice.[4]

2.2 Oxera response: any additional public interest test should be narrowly defined and objectively measurable

A public interest test was part of the UK's Fair Trading Act 1973 (the predecessor to the current Enterprise Act 2002). This test stipulated that the competition authority could consider 'all matters which appear to them in the particular circumstances to be relevant', including '(d) of maintaining and promoting the balanced distribution of industry and employment in the United Kingdom'. Under this regime, the competition authority would make recommendations based on this test, with ultimate decision making power of merger clearance and remedies remained with the relevant secretary of state.

The UK government has shown an increasing interest in issues of domestic ownership[5] and the distribution of wealth across skills and geographies.[6] While this is only a subset of the kinds of issues that might be included in a wider 'public interest' test, we focus on these issues in order to most closely link our note to current UK government policy priorities.

Free-market economists typically advocate leaving matters of foreign ownership and geographic location to the market. Government intervention in such decisions, including as part of merger reviews, will tend to result in a less economically efficient allocation of resources. To illustrate this with a theoretical example, if an investor identifies a profitable opportunity to cut costs by acquiring a factory in the UK, shutting down part of its operation and supplying the related parts from a factory located elsewhere in the EU, the merged entity will be able to produce the same amount of goods at an overall lower economic cost. For this reason, in the long term, policies that serve to limit or deter[7] mergers

[3] In the UK, the Enterprise Act 2002 contains a broadly similar list of three public interest considerations that can be applied when considering mergers. See Competition and Markets Authority (2014), 'Mergers: Guidance on the CMA's jurisdiction and procedure', January, para. 16.6. This was the basis on which the Lloyds takeover of HBOS was cleared in 2008, without reference to the then Competition Commission. Seely, A. (2016), 'Mergers & takeovers: the public interest test', House of Commons library briefing paper, Number 05374, 1 September.

[4] BCLWG issues paper, para. 3.2.

[5] The Business, Innovation and Skills Committee has launched an inquiry to consider, among other things, 'what the Government means by industrial strategy and questions how interventionist in the free market it should be, such as whether it should prevent foreign takeover of UK companies'. Commons Select Committee (2016), 'Committee launches inquiry into Government's industrial strategy', 1 August, http://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/news-parliament-2015/industrial-strategy-launch-16-17/, accessed 23 November 2016.

[6] For example, see the speech made by Prime Minister, Theresa May, to the CBI on 21 November 2016, https://www.gov.uk/government/speeches/cbi-annual-conference-2016-prime-ministers-speech, accessed 22 November 2016.

[7] The deterrence effect on foreign investment of a government preference for domestic ownership has some empirical backing. See Serdar Dinc, I. and Erel, I. (2013), 'Economic nationalism in mergers and acquisitions', *The Journal of Finance*, **68**:6, pp. 2471–514.

between non-UK and UK companies purely on the basis of nationality could be expected to result in lower overall UK GDP.[8]

This principled concern exists alongside a myriad of more practical efficiency concerns. A public interest test could result in substantial uncertainty for business compared with the current situation of a well-established competition-based regime. Moreover, to the extent that the test is conducted by government, it could be subject to short-term political expediency or populist concerns, particularly if defined vaguely. A lack of clarity for business, and subjectivity on the part of political decision makers were both criticisms made of the previous 'public interest test' under the Fair Trading Act 1973, where on 31 occasions between 1973 and 2001 the UK government acted contrary to the advice of the Director General for Fair Trading on whether to refer a merger.[9]

An economist can highlight the negative effects of such measures on economic efficiency while still recognising that the government may take a legitimate interest in other factors such as wealth distribution. It is a matter of policy judgement whether it is preferable to have a more efficient industry that concentrates distribution of returns, or a less efficient industry or set of industries that distributes returns more evenly.[10]

The difficulty in merger decisions is that the long-term distributional effects (such as the economic impact on a particular group or geography) are difficult to identify and understand, particularly given the strict timetables of merger reviews. Short-term direct effects (such as job losses) will tend to be more directly apparent and quantifiable than longer-term effects (such as price reductions or new job creation) that are inherently less certain and diffuse. Absent a careful assessment, this opens the risk of a bias towards blocking mergers on distributional grounds, even when such concerns are limited.

These considerations all suggest that a cautious approach is needed in implementing any broader test for mergers. If policy makers do decide to adopt such a test, that are a number of policy features that we consider desirable in order to minimise any negative economic consequences:

- **the public interest tests should, as far as possible, be encompassed within the existing merger framework**: extra criteria could be added alongside the public interest provisions in existing UK law (the Enterprise Act 2002). This would minimise transition costs and business uncertainty;
- **non-competition-related tests should not be subjective**: for a given public interest objective, the associated test of whether to allow or prohibit a merger should be conducted under a prescribed framework, with the authority and/or merging party being required to demonstrate, using that framework, the contribution or the harm that a merger poses to that objective. Established 'impact assessment' tools for assessing public policy or regulatory interventions may be a useful basis for such frameworks. These tool include guidance on how to quantify, and thus compare, competing public interests that are not inherently monetary such as distributional and environmental

[8] A survey of evidence for the ESRC confirms positive effects on overall employment and competitiveness from non-UK takeovers of UK firms. See Economic and Social Research Council (2010), 'Foreign ownership and consequences for British business', Evidence Briefing, December.
[9] Lyons, B., Reader, D. and Stephan, A. (2016), 'UK Competition Policy Post-Brexit: In the Public Interest?', CCP Working Paper 16-12.
[10] Economists often abstract from such issues by assuming that a social planner can redistribute income through taxation and benefits if desired. In practice, the government's ability to shift economic value may be more limited.

effects, which will help reduce the element of subjectivity if the test covers multiple objectives;[11]

the assessment should be conducted by an independent body: as in the current competition-based regime, there are benefits to removing merger clearance decisions from direct political control. In practice, the CMA itself may not have the expertise needed to assess a merger's impact on a public interest goal (although its large group of panel members come from a range of backgrounds, including public policy). Alternative independent assessors could be considered, such as sector regulators or a specialist panel, depending on the particular case or policy objective considered.[12] If such an approach was taken, mergers would likely be reviewed by (and need clearance from) both the CMA and the further independent assessor, though the CMA could continue its role as overall coordinator of the process.

3 Movement towards a more effects-based analysis

3.1 BCLWG issue: possible divergence between EU and UK competition law allowing for more effects analysis

After Brexit the CMA will have a higher degree of flexibility in competition law enforcement, for two reasons. First, the statutory requirement under section 60 of the Competition Act to interpret UK competition law in line with the competition case law of the European Courts and to have regard to decisions of the European Commission, could be repealed. Second, the CMA would have the power to investigate any conduct within the UK, including those practices already under investigation by the EU.[13]

The BCLWG notes that, as a result, the UK will have the option to move more strongly towards effects-based approaches in assessing alleged competition infringements that were previously investigated by the Commission under Articles 101 and 102 TFEU.[14]

3.2 Oxera response: a potentially beneficial long-term development

In recent years, the Commission has focused its enforcement efforts on cartels—48% of decisions adopted between 1 May 2004 and 31 December 2013 related to cartels.[15] The Commission is not required to show the effects on competition for these cases, because cartels are treated as object restrictions—anticompetitive effects can be presumed. This is in line with the economic consensus that cartels harm competition. For the most part, the same degree of economic consensus does not extend to other practices.

In the area of abuse of dominance (Article 102) there has been a long-standing debate on form-based versus effects-based approaches, with the Commission having sought to promote the latter—but the EU courts have not always endorsed this. In the area of restrictive agreements (Article 101) other than

[11] See for example OECD (2011), 'Regulatory Impact Analysis: A Tool for Policy Coherence', 11 September. UK frameworks include HM Treasury (2013), 'The Green Book: Appraisal and Evaluation in Central Government', 18 April and the National Audit Office (2010), 'Assessing the Impact of Proposed New Policies', Report by the Comptroller and Auditor General, 28 June.

[12] Gerard, D. (2012), 'Effects-based enforcement of Article 101 TFEU: the "object paradox", Kluwer Competition Law Blog, http://kluwercompetitionlawblog.com/2012/02/17/effects-based-enforcement-of-article-101-tfeu-the-object-paradox/.

[13] See BCLWG issues paper, para. 3.6 and following discussion.

[14] BCLWG issues paper, paras 3.8–3.10.

[15] European Commission (2014), 'Ten Years of Antitrust Enforcement under Regulation 1/2003, A*ccompanying the document*, Communication from the Commission to the European Parliament and the Council', para. 10.

cartels, the Commission has arguably used the procedural 'object shortcut' too often (a criticism that may also be applied to national competition authorities, including, until recently, the OFT). Out of the Commission's 18 non-cartel Article 101 infringement decisions between 2000 and 2010, 17 were framed in object terms (including cases in which the Commission also assessed the effects of the infringement).[16]

Some recent developments have been towards effects-based analysis, in both Article 101 and Article 102. The 2014 ECJ *Cartes Bancaires* judgment made it clear that Article 101 object cases should be limited to those where coordination between undertakings reveals a sufficient degree of harm to competition that there is no need to examine effects.[17] The Article 102 *Intel* decision of the General Court, which found that certain rebates offered by Intel to PC manufacturers constituted a restriction by their very nature (form), has been called into question by the opinion of Advocate General Wahl, who recommended a fuller examination of the competitive effect of Intel's conduct.[18]

From an economic perspective, such developments are welcome. Competition law serves to protect the competitive process with the aim of enhancing consumer welfare and producing efficient outcomes. If anticompetitive effects are presumed rather than analysed in complex cases, this increases the likelihood that agreements or practices with procompetitive effects will be found to breach competition law ('false positives'), resulting in worse outcomes for consumers.

The question remains as to whether the CMA should move further or more quickly to an effects-based approach following Brexit, even if such an approach results in diverging from the Commission. There are two reasons for caution:

- first, inconsistencies could arise with the EU regarding how certain types of agreements of practices are treated. This would have negative implications for business certainty during a transition period that may be characterised by economic volatility;
- second, a move towards more effects-based enforcement would increase the demands on the CMA, which could face capacity constraints following Brexit (a topic that is discussed in the next section).

Both considerations suggest that the most prudent approach would be for the CMA to make any methodological adjustments only over the long term, and avoid step changes in approach. However, in the long term the scale of potential benefits from more effects-based competition policy are likely to outweigh the costs of more demanding analysis. For this reason, from the point of view of obtaining the greatest benefit for consumers, we do not consider that procedural efficiency concerns should deter the CMA from applying effects analysis to a broader category of cases than under EU case law.

[16] Gerard, D. (2012), 'Effects-based enforcement of Article 101 TFEU: the "object paradox", Kluwer Competition Law Blog, http://kluwercompetitionlawblog.com/2012/02/17/effects-based-enforcement-of-article-101-tfeu-the-object-paradox/.

[17] European Court of Justice (2014), Judgment of the Court in case C‑67/13 P (*Cartes Bancaires*), 11 September. See also Oxera (2014), 'From sports bras to cigarettes: economic analysis of anticompetitive agreements', *Agenda,* September.

[18] Advocate General Wahl (2016), Opinion in Case C‑413/14 P (*Intel*), 20 October. See also Oxera (2016), 'The latest intel from Luxembourg: an Advocate General prefers effects analysis in abuse cases', *Agenda, November*.

4 Impact of Brexit on the CMA's resources

4.1 BCLWG issue: there will be increasing demands on the CMA

Mergers above certain thresholds currently fall under the scope of the EUMR and are reviewed by the Commission, rather than the CMA. Following Brexit, this will no longer be the case, and the CMA will have jurisdiction over these large mergers (in many cases alongside the Commission). All else being equal, this will place greater demands on the CMA.

The BCLWG has noted that, as a consequence, either (i) the resources of the CMA would need to be increased; or (ii) the CMA would need to cut back on work that it would have undertaken but for Brexit.[19] In this section, we make some observations on each possibility.

4.2 Oxera response: there is a case for reducing reviews of small mergers

Upfront, we note that the CMA is funded by HM Treasury and is accountable to Parliament for its expenditure.[20] This is an optimal funding model in terms of incentives, as it means that the CMA has no direct inducement to seek to levy higher fines or fees on companies. This could be changed, but this would represent a second-best funding option.

In terms of the impacts of Brexit, one approach to estimating the impact on costs is to estimate the proportion of 'UK-driven' work that is currently conducted by the Commission, and apply this proportion to the reported costs and employees of those elements of the Commission's responsibilities that will transfer to the CMA. Using this (admittedly crude) approach, Oxera estimates that UK competition authorities and regulators could require 80–90 additional staff, with an estimated cost of up to £4.8m per year.[21] To put this into context, the total direct cost of UK competition enforcement was £66m in 2014–15, with approximately 810 full-time (equivalent) competition staff.[22]

If the CMA is required to reduce its workload in some areas to allow for greater responsibilities in others, the largest non-mandatory element of its work in this context would be enforcement.[23] On this basis, enforcement might be seen by some as the lowest hanging fruit that could be dispensed with to save resources. However, such a reduction in enforcement efforts would go against the National Audit Office's (NAO) view and the CMA's own ambition to increase case flow in the enforcement of competition law.[24] Specifically, the NAO has noted that the 'UK competition authorities issued only £65m of competition enforcement fines between 2012 and 2014 (in 2015 prices), compared to almost £1.4bn of fines imposed by their German counterparts'.[25]

As a result of this tension, it may therefore be appropriate to alter the CMA's policy and priorities. The CMA's own impact assessment of its activities may be informative here, and some high-level results are shown in Table 4.1. These imply a lower ratio of benefits to costs for merger control compared with the

[19] BCLWG issues paper, paras 2.2–2.5.
[20] Competition and Markets Authority (2016), 'Annual Report and Accounts 2015-16', March, p. 22. HM Treasury (2015), 'Central Government Supply Estimates 2015-16, Main Supply Estimates', July, p. 218.
[21] This is an order of magnitude estimate derived by assuming that the proportion of DG Competition's work that relates to the UK is in approximate proportion to EU GDP. Staff numbers from European Commission (2014), 'DG Competition Annual Activity Report 2014. Annexes', accessed 5 May 2016.
[22] National Audit Office (2016), 'The UK competition regime', 5 February, para. 8.
[23] National Audit Office (2016), 'The UK competition regime', 5 February, para. 15.
[24] Competition and Markets Authority (2016), 'Annual plan 2016-17', March, para. 2.3.
[25] National Audit Office (2016), 'The UK competition regime', 5 February, para. 15.

CMA's other main competition functions. Typically from a public-policy perspective, when faced with a budget constraint, activity should be concentrated on those areas with the highest benefit–cost ratio. While such analysis is inherently uncertain, the scale of difference is quite substantial in this case.

Table 4.1 Benefit–cost ratio of CMA activities

CMA activity	Average annual consumer benefits (2013–16)[1]	Approximate annual direct cost (2014/15)	Implied benefit–cost ratio
Market investigations	£522.7m	£6.2m[2]	84.3
Enforcement (excluding deterrence effect)	£73.6m (competition) £74.1m (consumer protection)	£13.4m (not separately identified)[3]	11.0
Merger control	£16.4m	£6.6m[4]	2.5

Source: [1] Competition and Markets Authority (2016), 'Impact assessment 2015/16', July, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/537539/cma-impact-assessment-2015-16.pdf. 2014/15 has been selected for costs as it is the approximate midpoint of the period considered in the impact assessment (2013 to 2016). Cost are sourced from CMA Annual Report 2015/16, p. 120, and exclude shared services (e.g. Chief Economist's office and legal services). [2] Gross expenditure of 'markets' unit in Competition, Consumer and Markets Group. [3] Sum of Gross expenditure in 'cartel and criminal' unit and 'enforcement' units in Competition, Consumer and Markets Group. [4] Sum of Gross expenditure in 'Mergers phase 1 and sector regulation' unit and 'Mandatory work' unit in Competition, Consumer and Markets Group.

While the analysis underlying the CMA's impact assessment is not publicly available, such results could be taken to indicate that mergers are a possible area in which to reduce public expenditure. There are a number of ways in which this could be achieved.

- As the BCLWG working paper highlights, the CMA currently reviews small as well as large mergers.[26] To reduce the CMA's workload, one approach would be to introduce a merger threshold below which the CMA is not duty bound to carry out a review, even when a merger is notified by the merging parties. This would provide the CMA with greater flexibility in its priorities while also ensuring that its duties regarding large mergers remain.
- Alternatively, the UK could introduce a filter whereby the CMA no longer carries out in-depth reviews of global transactions that are already being reviewed by other major competition authorities—such as the US agencies, the European Commission and the Chinese authorities. Those major authorities typically have the greatest influence on a global deal, for example in terms of enforcing remedies or prohibiting the deal outright where needed. This second option may not always be desirable, in particular where the merger in question still has a large impact on the UK domestic market. The UK will remain a relatively large economy in its own right. However, there may be large global transactions where the impact of a CMA review would be minimal, for example, if if were expected that the Commission would block a merger, or require significant divestments that also cover the UK, then resources might be saved.

Any such changes to reduce merger review activity would also be likely to have some negative consequences. Reducing the duty to review smaller mergers, or no longer reviewing large-scale global mergers, could result in worse outcomes

[26] BCLWG issues paper, para. 2.5.1.

in ‘small’ domestic markets in the UK. Such consequences should be weighed against the ability for a potentially overstretched CMA to reliably and robustly fulfil its duties.