Agenda
Advancing economics in business

Does size matter? Competition and regulation in small jurisdictions

It is difficult to conduct competition and regulatory policy well, but the economic benefits can be substantial. This is particularly likely to be the case in small jurisdictions. Based on Oxera's review of the competition and regulatory framework in Jersey, what are the challenges faced by authorities in applying regulatory and competition policy, and how might these be resolved?

It is an accepted principle that, while governments are responsible for setting and delivering public policies, the achievement of many important economic, social and environmental objectives is frequently delegated to regulatory and competition authorities. As such, these authorities play a significant role in ensuring that markets work properly and that the public interest is safeguarded.

Applying regulatory and competition policy is not an easy task. There is a large body of literature that sets out best-practice principles for regulatory and competition authorities, including role clarity, independence, accountability, and transparency.[1] While these principles are applicable to authorities of all sizes, applying competition and regulatory policy in small economies creates particular challenges, due to the following features.

- Small domestic markets. This may limit competition possibilities and increase issues of market dominance, as there may be less room in the market for suppliers that can reach the minimum efficient scale, especially for particular goods and services that are not internationally traded and where economies of scale are significant.[2]
- Small population and administrative constraints. This implies that it is more difficult to find the required technical expertise for competition and regulation functions within the jurisdiction.
- Informal and multi-faceted relationships between individuals. This may mean that individuals are more likely to try to resolve issues in ways other than engaging the authority through formal procedures.

As a result, the small size of the economy is likely to have an impact on the institutional design of the authority, and the application of best-practice principles.

Organisational structure

The costs and resources needed to address competition and regulatory issues do not vary proportionately with the size of the jurisdiction. In other words, there are economies of scale, so the cost per resident is greater in smaller than in larger economies. For example, in 2014, the UK Competition and Markets Authority (CMA) spent approximately £1 per head of population, while the Malta Competition and Consumer Affairs Authority spent £9 per head of population, and the Channel Islands Competition and Regulatory Authorities (CICRA) spent £3 per head on its competition functions.[3]

To deal with this issue of scale, one approach that has been used in a number of jurisdictions is combining regulatory and competition functions in one authority, and/or having the authority deal with regulatory matters across a range of sectors. This is fairly common in smaller economies (such as Jersey and Guernsey), while some larger economies (such as Australia, New Zealand and the Netherlands) also have combined authorities.[4]

The literature explains that there may be benefits from integrating competition and regulatory functions, which can be especially pronounced in small economies. For instance, there may be economies of scope, easier access to resources, and a more efficient and coordinated portfolio of policy instruments that can be used in a combined authority. However, there may also be disadvantages to combining competition and regulatory functions in one organisation. There is a risk that a wide remit, combined with limited resources, could lead to a thinly spread senior management, reduced accountability, and reduced scope for performance monitoring.[5]

Given that both costs and benefits arise from institutional specialisation, it can be difficult to identify which model is preferable overall. However, the relative strengths of the costs and benefits can be expected to vary with the size of the organisation(s). The costs of maintaining separate competition and regulatory authorities seem to be particularly high in small economies.[6] As such, on balance, an integrated authority may be preferable.

Another institutional innovation that is often used in small economies is merging authorities from different jurisdictions. Jurisdictions that are close to one another may encounter similar issues, or have objectives of better regional integration, so that merging the authorities would provide synergies. The merger may also create access to a larger pool of resources as staff can be shared.

This approach was adopted in 2010 in Jersey and Guernsey through an administrative merger of their competition and regulatory authorities, which became CICRA. A number of Caribbean countries have also joined together through the Caribbean Community and Common Market (CARICOM).[7] Some jurisdictions stop short of merging their authorities, and instead rely on their counterparts in larger jurisdictions to assist on specific cases. For instance, Greenland's competition authority can outsource the analysis and administrative process for some of its cases to the Danish Competition Authority, before the case returns to Greenland for a final decision.

Regardless of the structure adopted, all competition and regulatory authorities have a duty to make best use of resources. In small jurisdictions this is especially important and challenging. Case analysis has fixed costs, and authorities in small economies may need to conduct a similar amount of analysis to their counterparts in larger economies. This underlines the importance of prioritising the limited resources that are available by focusing on the most important issues—i.e. those where there is likely to be the most consumer detriment.

Interaction and relationship with government

Competition and regulatory policy is not just a task for the authority concerned. Many institutions—above all, the government in various ways—have major effects on how well markets work in the local economy.

At a high level, the government creates the policy framework for competition and regulatory authorities through legislation. Independent regulators and competition authorities are then charged with carrying out their functions in line with their duties, within their legal powers. Reflecting their independence, governments stand back and let the authorities exercise their duties. Reflecting the complexities of real economies, however, and real political processes, governments are likely to take more of an interest in what their independent regulators are up to than might appear strictly necessary from the legislative framework.

Governments and competition/regulatory authorities are therefore interdependent. Making this interdependence work, while maintaining independence, is a responsibility that both parties should embrace. Indeed, the success of competition and regulatory authorities, and the success of achieving government policy objectives, can be materially influenced by the interaction between the authorities and their respective governments. In small economies, this can be a particular issue given the importance and complexity of the informal relationships between individuals.

Without care, government intervention can be anticompetitive. If smart, it can be procompetitive and make competition work to get the best out of the local economy for residents and businesses. The balance between interfering in ways that compromise independence and taking little interest in the authority's work, hoping that it will be effective, is not easy to strike, and requires a clear articulation of the respective roles of the government and the authority.

To regulate or not to regulate?

If the benefits of a competition regime are to be realised, government also has to play a more general role in getting competition to work effectively in the economy. This includes putting competition at the heart of government policymaking and, by implication, giving the competition authority the political authority it needs to carry out its functions.

However, regulation may be more appropriate than competition enforcement in relatively more cases in small economies than in larger jurisdictions, for a number of reasons: the number of monopolies and dominant firms is likely to be higher, especially in non-tradable goods; the market may not be large enough to accommodate multiple firms; and the market may not be able to self-correct market failures due to scale effects. There may therefore be markets where competition does not exist and is unlikely to be sustainable or provide an economically efficient outcome. In such instances, the government and regulator need to consider the feasibility of competition and identify whether promoting competition or direct regulation of the outputs of the sector/regulated entity will deliver better consumer outcomes.

Appeals mechanisms

Regulatory and competition law decisions often involve questions of judgement in relation to quite complex economic issues. It is the need for these judgements to be made that lies behind the creation of specialist authorities in the first place. Given the judgement involved, different authorities can come up with different answers, which may all be reasonable.[8] With the creation of a specialist authority to solve these complex economic issues, it may not make sense to allow a body that is likely to be less expert to substitute its conclusions, particularly in the case of small jurisdictions.

On the other hand, these regulatory and competition authorities are taking decisions that can have a material impact on the future profit (and even economic viability) of regulated companies and companies subject to competition law action. Some form of appeal on the substance would seem necessary against the decisions of the specialist body.

There are two main types of appeals system that are used for regulatory and competition policy decisions, which differ primarily in terms of the 'standard of review'.

- Judicial review. This type of appeal focuses on whether the authority acted appropriately within its powers. In these cases the appeals court does not conduct a full reassessment of the authority's decision, and does not second-guess the decisions made by the regulator or competition authority.
- Appeal on the merits. This essentially allows for the case to be reheard, and for the court to substitute its decision for that made by the authority, even when the authority's decision was reasonable.

Getting the appeals process right is not simple, as exemplified by the ongoing reforms that have been, or are being, instituted in the UK and other jurisdictions (such as those currently being undertaken in Malta). Reforms of the appeals process under regulatory and competition law have attempted to steer a fine line between often conflicting objectives. Many authorities have confined such appeals to decisions that are 'unreasonable', thus limiting the grounds of appeal.

Another issue that may arise with respect to appeals concerns the expertise of the body hearing the appeal. In a small jurisdiction, the issue of available expertise, and the extent to which an appeal uses up the resources of the authority, are likely to be more acute, making the optimal trade-off between the various objectives of an appeal process more, rather than less, problematic. On the other hand, given the economies of scale of regulation, an inefficient appeals process will have a higher cost per head in smaller than in larger jurisdictions.

Notwithstanding that the issues facing small jurisdictions are different, there is no obvious reason to suggest that a full merits appeal is reasonable in small jurisdictions if it cannot be justified in larger ones.

Conclusion

There are no straightforward answers to the optimal design of authorities in small jurisdictions. Even in larger economies, the question of the optimal design of regulatory and competition authorities has not been definitively resolved, with various governments continuing to combine and split apart competition, regulatory and consumer advocacy functions over time. However, as the economic benefits of conducting competition and regulatory policy well are substantial, it is important to ensure that an authority is designed in such a way so as to promote an efficient and effective economy for consumers and businesses.

This article is based on Oxera (2015), 'A review of the Jersey regulatory and competition framework', prepared for Government of Jersey, 16 November, http://www.oxera.com/Latest-Thinking/Publications/Reports/2015/A-review-of-the-Jersey-regulatory-and-competition.aspx.

[1] See, for example, OECD (2014), 'The Governance of Regulators', OECD Best Practice Principles for Regulatory Policy.

[2] This may not be the case for all goods and services, as the boundaries of the small economy do not always match the boundaries of the market. For instance, some goods/services markets are local (such as hairdressing), so the fact that a market is in a small economy does not always have a significant impact on competition. In other cases a market may also go beyond the borders of the economy as local goods compete with imported goods.

[3] CICRA also regulates certain sectors in Jersey and Guernsey, but we consider only the competition functions here in order to ensure that it is comparable to the CMA and the Maltese Authority, which do not directly regulate sectors of the economy. Competition and Markets Authority (2015), 'Annual Report and Accounts 2014-15'; CICRA (2014 Annual Report); Malta (2013 Annual Report).

[4] In some cases the authority may also deal with consumer protection issues (such as Trading Standards).

[5] OECD, Directorate for Financial and Enterprise Affairs, Competition Committee (2014), 'Institutional Design of Competition Authorities', Note by Allan Fels and Henry Ergas, 17–18 December.

[6] Oxera (2015), 'A review of the Jersey regulatory and competition framework', prepared for Government of Jersey, 16 November, http://www.oxera.com/getmedia/17401ec0-3dba-44f0-8b7e-cbc83208042e/A-review-of-the-Jersey-regulatory-and-competition-framework.pdf.aspx?ext=.pdf, p. 23.

[7] Member states are Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St Lucia, St Kitts and Nevis, St Vincent and the Grenadines, Suriname, Trinidad and Tobago.

[8] For example, although there are coordination processes in place, the UK economic regulators and the CMA (and the Competition Commission before it) have come to slightly different conclusions on issues such as the cost of capital.