

Completing competition assessments in impact assessments? Draft guidelines for policy makers, Office of Fair Trading, OFT876, February 2007

Response to Consultation

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March 2007

1. Overall comments

These draft guidelines are clear and soundly based. They represent a very significant improvement on the Competition Filter set out in the previous guidelines.² In particular, we welcome the emphasis on characteristics of proposed measures as opposed to structural measures and the move from a complex parallel structure to a more focused list of characteristics that threaten competition. In summary, the test set out in this document appears to be both more practical to apply and more likely to identify problematical proposals than was its predecessor.

In the remainder of this document, we make some specific suggestions on areas where the guidance might be improved.

2. Specific comments

Q1 Is the draft guidance sufficiently clear?

Yes, but see comments below with respect to clarifying use of the term “counterfactual” and possible application of Competition Assessments to post-implementation reviews of existing policies. In addition, see below for some relatively minor comments, e.g. slight/clarifying expansions in examples.

Q2 Are there any substantive aspects of the guidance with which you disagree?

In general no, except for the (important) need to improve/clarify the concept of the “counterfactual” in the document; see below for further detail.

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² See Lyons and O’Toole (2006) for comments on the former guidelines (Office of Fair Trading (2002)).

Q3 Does the guidance have any significant omissions?

In general no, apart from the possible need to highlight its applicability to the renewal of time-dependent policies (or even the retention of previously imposed “restrictions”); see below for further detail.

Q4 Do you have any other suggestions for improvement to the guidance?

See Section 4 (Minor Issues/Suggestions) below.

Q5 Do you have any views on how the final guidance should be disseminated to those who may need to see it?

No/No comment.

3. Major issues/suggestions

Issue 1: Restriction of Competition Assessments to (new) proposed policies

“1.4 Impact Assessments (IAs) require policy makers to consider the impact – the costs and benefits – of proposed policies. Through consultation and the IA, policy makers will set out the effect of the policy proposal and the justifications underlying it.”

Comment: The context appears to be restricted to proposed, and hence new, policies as opposed to incorporating the examination of existing policies or, perhaps more importantly, the proposed retention of existing policies. We note that the RIA Guidance document published by the Better Regulation Executive³ emphasises the need for post-implementation review and suggests that policymakers consider the use of sunset clauses. It might be helpful to emphasise that effects on competition can and should be considered when policymakers are considering renewal or retention of existing legislation.

Issue 2: The identification of the appropriate counterfactual

“4.9 An initial assessment of the current state of competition (the counterfactual) in those markets is required before the effect of the regulatory proposal can be assessed.”

“4.28 Once the policy maker has identified the markets affected by the proposed regulation, and the existing state of competition in these markets (the counterfactual), ...”

Comment: The identification of the “counterfactual” with the “current state of competition” is understandable from an administrative perspective but, in at least some cases, potentially very misleading.

³ Section 10 in http://www.cabinetoffice.gov.uk/regulation/ria/ria_guidance/

Restricting attention to proposed (and hence new) policies, there are really three, as opposed to two, worlds to be considered: (i) the current state of competition (i.e. without the proposed policy); (ii) the likely future evolution of competition (i.e. without the proposed policy); and (iii) the likely future evolution of competition with the proposed policy.⁴

The appropriate comparison should be between (a) the current state of competition and its likely future evolution without the proposed policy (i.e. the counterfactual); and (b) the likely future evolution of competition with the proposed policy.⁵

Example of significance of this point

“5.19 The OFT is aware, through its market studies of private dentistry, pharmacies and taxis, that policy makers may be persuaded that there is a limit on the number of firms that can operate effectively in any market. As a result, policy makers may grant existing suppliers rights to veto new entry – protecting them from competitive pressure but harming consumers faced with less competition and choice.”

Comment: Given Lyons and O’Toole (2006), what can we say apart from “we agree”? Even allowing for the assumption that the current number of suppliers is optimal, when a restriction is introduced, the conceptual framework for the Competition Assessment must allow for the possibility/probability that this number of suppliers will not be optimal in the near-future, i.e. the counterfactual must incorporate consideration of the likely future evolution of the current state of competition.

To use a different example, within the context of domestic waste collection services, it is almost certainly “better” to have competition for the market as opposed to (excessive or no) competition within the market. However, the relevant local authorities must be open (perhaps via the standard regular competitive tendering process) to changing the geographic extent of the relevant market as circumstances demand (e.g. population changes). In summary, the concept of the counterfactual must allow for a time dimension.

4. Minor issues/suggestions

(1) England v. Wales

“4.18 ... Customers living near the English border could switch to having their hair cut in England to circumvent the effect of the regulation (and higher prices in Wales).”

⁴ One could argue that (iii) should be further broken into: (iiia) the likely current state of competition with the proposed policy; and (iiib) the likely future evolution of competition with the proposed policy.

⁵ One could easily expand this conceptual framework in order to consider different proposed policies. However, in each case, the appropriate counterfactual should be the current state of competition and its likely future evolution without the proposed policy.

Comment: This very useful example would benefit from the following extension/edit: “... (and higher prices in Wales) or customers living near the Welsh border could switch to having their hair cut in Wales to avail of the improved service (and arguably lower quality-adjusted prices in Wales).”

(2) Micro-chipping of Dogs

4.24 – 4.27: The hypothetical example is again very useful. There might be some benefit to “mentioning” (or perhaps better still, footnoting) an alternative policy whereby only new pups would be required to be fitted with microchip identification tags. This “grandfathering” version would reduce the extent (and costs) of some of the identified shocks (blips in demands in related markets) associated with the original version. Of course, the disadvantage of “mentioning” this alternative” is that it moves away from focusing on the basic comparison between one single proposed policy and the (appropriate) counterfactual.⁶

(3) Pollution permits

Within the context of 6.3, it could be useful to include a mention of pollution permits as an example.

(4) Maximum prices

Within the context of 7.5, it could be useful to mention taxi fares as an example. In addition, it could be noted, that where price ceilings are implemented, it should be made explicitly clear that lower prices are actively encouraged.

(5) Potential trade-offs between social benefits and limitation of competition

Section 7.6 includes a good example of how unnecessary restrictions on quality can damage competition. However, the text seems to suggest that there may also be cases where policymakers have to trade-off social benefits and the presence of benefits automatically eliminates potential competition effects: “Where safety is not an issue, such policies will restrict...”. In practice, policymakers may have to weigh up trade-offs between benefits and harm to competition. For example, the government might be justified in placing limits on permitted pack sizes for analgesic drugs to reduce certain health risks,⁷ but the expected health and safety benefits should be compared to likely effects on price and innovation when such a measure is being considered.

⁶ Notwithstanding this disadvantage, “mentioning” an/the alternative is in keeping with the overall approach contained in the document; for example: “4.29 ... Where there is a significant detrimental effect, policy makers should consider whether or not there are suitable alternatives to the proposed regulation that limit restrictions on competition whilst still achieving policy objectives.”

⁷ For background information, see Morgan, Oliver and Griffiths, Clare, 2005, “Impact of paracetamol pack size restrictions on poisoning from paracetamol in England and Wales: an observational study”, *Journal of Public Health*, Volume 27, Number 1, March 2005, pp. 19-24(6).

(6) Alternatives to regulation

Sections 4.30-4.32 make a useful point about the need to consider alternatives that might reduce the impact on competition. An example later in the paper could help to emphasise this point. For example, 7.7 notes that some types of regulation are likely to be less harmful to competition than others; it could go on to say that non-regulatory economic instruments such as emissions taxes or tradable permits may be still better for competition and more conducive to innovation.

References

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