

**John Fingleton, Chief Executive of the Office of Fair Trading  
Beesley Lecture - Public Restrictions on Competition**

**Speaking notes**

**Slide 1: Context**

- UK is a champion of open markets
- Markets are increasingly accepted as a policy tool, as opposed to intervention
- Challenges exist – there is a risk of a rejection of markets in difficult times, as government can seek to over-define outcomes
- Localism agenda could bring risks of public restrictions
- There is an ever-present risk of rent-seeking

## Slide 2: Overview

- The OFT's mission is to make markets work well for consumers using a variety of tools:
  - Enforcement
  - Market studies
  - Competition advocacy – less well known
- Competition has an important role in stimulating growth, innovation and efficiency
- There is a threat to competition in the form of monopolies ...
- Regulation and public restrictions also act as a threat, but this is far more subtle – and harder to address
- This lecture series looks at government restrictions in the regulated sectors, such as water and energy. However, government regulation has a much wider scope and impact on all markets, the financial sector, retail etc.
- This, and the role of the OFT in tackling public restrictions in markets, will be the subject of this lecture

#### **Slide 4: Virtuous circle of competition**

- Competition provides a strong incentive for providers to improve the offer to consumers and to become efficient by ensuring that resources are allocated efficiently
- Competition works best when there is a well developed demand side (confident and well informed consumers) and an efficient supply side (a number of different suppliers all competing against one another to gain market share)
- OFT's mission is to make markets work well for consumers
- OFT remit covers public restrictions on competition as well as anti-competitive behaviour
- OFT has a varied and agile set of tools and powers that enable us to tackle private and public restrictions
- Choice and competition working well can drive dynamic efficiency – regulation can run the risk of stifling it

## **Slide 5: Restrictions on competition**

- There are broadly two types of restriction on markets – private and public restrictions
- Private restrictions are well understood they involve the abuse of dominance by firms, cartels, etc.
- Public restrictions are more subtle and come in the form of statutory entry barriers, pricing controls, incumbency advantage, etc.
- Public restrictions are harder to tackle as incumbents have the incentives and resources to lobby government to protect their market power
- The UK position is different to many other countries as significant restrictions have already been addressed, such as in the markets for utilities and dentistry
- Subtle restrictions exist but in some ways this creates a greater challenge

## Slide 6: Public restrictions in context

- The government faces a range of issues in making markets work well for consumers. There are traditional and well-known supply side issues:
  - Is there excessive market power within an industry?
  - Would further consolidation damage competition?
  - Are there reasons to believe collusion could be softening the market?
- Attention is now being focussed on the demand side and consumer behaviour:
  - How do consumers make decisions?
  - How do they interpret information provided by suppliers?
- Demand side behaviour is particularly relevant in opening up markets such as education and healthcare
- Finally, there is the impact government has on markets
- Later in this lecture there is a long list of markets within which OFT has concluded that the impact of regulation and legislation has not necessarily improved customer experience
- The key issue is that government interventions often have powerful unintended consequences

## Slide 7: Wide economic impact

- Government regulation is pervasive - often for very understandable reasons
- When we visit the dentist we expect a system in place which ensures that he/she is appropriately qualified and has a good track record
- Problems arise when regulation becomes disproportionate and lends itself to being hijacked by suppliers anxious to reduce competitive pressure
- BAA was probably more comfortable with a regulated monopoly than facing competition
- The regulation of Manchester airport on the other hand seemed to be adding very little that vigorous competition from Liverpool airport wasn't achieving more effectively
- Important to carefully consider where regulation is needed/not needed, for example in the taxi market

**EXAMPLE: When we published a report calling for the end of a system controlling entry into the Pharmacies market, there were predictions that patients would suffer. Although liberalisation was only partially independent evaluation shows there have been significant benefits to patients and no loss of coverage for patients**

**Slide 8: Government has a major influence on openness and competitiveness of markets**

- Government and markets are inextricably linked
- Government can wish to directly influence markets, for example, to encourage the market to deliver particular products/services for wider social benefit
- At other times it wants to discourage market products because of their wider negative effects
- Government also major buyer and supplier of goods and services
- Depending on the reason for intervention and the characteristics of a market, government either participates **directly** or **indirectly** in a market
- **Directly** – acting as a supplier or buyer of goods and services
- **Indirectly** – through taxes, subsidies and regulation

## Slide 9: Risk of regulatory harm

- Indirect government intervention in markets through regulation carries a number of risks
- Care must be taken to ensure that vested interests are challenged and rent-seeking is guarded against
- Firms can focus too heavily on regulation at the expense of innovation, creation of a 'tick-box mentality' – this could be a risk for public services reform
- Regulation gives larger and incumbent firms an advantage as smaller firms or new entrants find it difficult to enter the market – regulatory burden leads to a lack of dynamic efficiency
- Revenue can go to appeasing the regulator rather than on L&D etc.

**QUOTE from Irwin Stelzer: '[The industry] prefers the status of regulated monopoly to that of unregulated competitor because it knows the latter makes for sleepless nights. Regulated status ... turns the focus of executive effort from the hurly-burly competitive marketplace to the more congenial, sedate hearing rooms of the state regulatory agencies that are being charged with enforcing the profit limits.'**

## Slide11: Variety of OFT work

- OFT has undertaken a number of market studies (ex-post) for instance: Estate agents, CUPi and behavioural change
- The OFT has a track record in producing high-level, cross cutting publications to ignite debate in the public services area:

**EXAMPLE: Choice and Competition in Public Services:**

- **Competition and choice can be very powerful tools in driving both efficiency and innovation**
- **The absence of these levers in many public service delivery areas is arguably a major factor in the lag we see in innovation and efficiency, despite policy initiatives**

- We have a track record in the public service area, and are well placed to share our experience with policy-makers

## Slide 12: OFT work - UK and beyond

- OFT jointly chairs the Competition Forum with BIS
- The Competition Forum aims to raise awareness of competition issues across government and provide an open forum for senior policy makers to discuss issues related to competition and government's role in markets
- Topics discussed so far include the OFT's work on government and markets, the relationship between competition and regulation, EU competition policy and public procurement of prison services
- Shared understanding can help to foster a culture of factoring competition considerations into policy design – OFT has an advisory role
- OFT also has an international dimension to shape, influence and learn from other competition authorities. Specifically we engage in:
  - International Competition Network, currently co-chairing the Advocacy Working Group with Russia
  - OECD, World Bank; and
  - Bilaterally with other competition authorities

**EXAMPLE: The World Bank is preparing a report based on OFT's government in markets report (announced June 2010)**

### Slide 13: OFT work covers entire policy cycle

- On the rationale for government intervention: Can competition issues explain the underlying reason for the need to intervene?

**EXAMPLE: Estate Agents February 2010 - OFT looked at this market and found that consumers' interests would in fact be best served not by more regulation, but by less. This would allow new, probably internet-based players into the market, offering new products and services to home sellers, putting downward pressure on the prices charged by traditional estate agents. More regulation would only serve to further entrench the incumbent business' advantage and higher charges**

- Objectives, appraisal, monitoring and evaluation:
  - Ex-ante, there is a need to acknowledge impact that policies have on the market through rigorous appraisal and competition assessment
  - However, the policy making process will usually consider impact on incumbent businesses rather than the impact on potential new entrants to a market
  - This is exacerbated by the fact that business groups, by their nature, represent incumbent businesses that don't want increased competition in their own markets, and thus find it difficult to represent 'enterprise' in its fullest sense
  - The challenge comes particularly where changing markets pose threats to existing businesses and business models, and government comes under pressure to protect them
- Importance of building up expertise and feeding back into overall policy making cycle

**EXAMPLE: DEFRA discussed voluntary product standards for energy efficient bulbs with the OFT at an early stage. The OFT then published a report analysing the potential competition impacts of environmental standards. The OFT report not only helped structure the views put forward in this case, but is also likely to provide a basis of analysis to support future advocacy efforts in the area of product standards**

#### **Slide 14: OFT supports policy makers**

- Key to success in public services markets is achieving behavioural and cultural change within government
- Fostering and strengthening competition is then viewed as an alternative to other policy interventions
- OFT's Competition Advocacy Team has a formal role to 'oversee' competition assessments of Impact Assessments and provide advice accordingly
- There is a need for constructive, swift support to government in public service delivery area
- OFT can offer independent advice, which is crucial given the Government's ambitious reform agenda
- Important to share best practice on how to make markets work well for consumers

## Slide 16: Some current themes

- Customers value choice in public service delivery, for example in schools, health care and care homes
- However, there is a risk of replacing public monopolies with private ones in the quest for a smaller state
- Making choice work is not straightforward - lessons to be learned from experience to date in other sectors, work to be done on behavioural change for both Government and consumers
- Key issue is ensuring that customers are able to play an active role - that information is clear and that choices are not overly complex, supporting active consumers
- Need to understand where and how to make the best use of markets to drive competition
- Where Government is the supplier of key inputs it is important to ensure that short term opportunism by public agencies does not stifle the development of these markets – new markets using public information
- There is a risk that difficult times result interventionist policies on the supply side that are not based on evidence – this can create distortions that have the potential to damage economic growth.
- For example, the localism agenda carries with it risks in implementation, such as in the case of the planning regime where there is the potential for distortions to the development market

## Slide 17: Choice in public service markets

- The coalition has shown a commitment to the increased use of choice and competition
- Better quality and efficiency can be achieved by aligning the incentives of the provider with those of the user
- Many of the major public services have previously been delivered by public agencies directly funded by the State
- There have been some attempts in the past to open up these markets to competition from private and not-for-profit organisations
- But these have been partial, or restrictions on the scope of competition have not allowed the full potential benefits to flow through
- Risks of opening up markets:
  - **Rent seeking behaviour** - firms may compromise on service delivery or seek to deliver to those
  - **Cross subsidisations** - firms may enter the market by cross-subsiding from other markets, driving out potential competitors and in doing so creating a private monopoly
  - **Creation of market power**
- The OFT's recent publication 'Choice and competition in public services' found three key issues which are crucial to bear in mind on the supply side when directly intervening in public service markets
- These are:
  - **Importance of ensuring an open supply side** in which restrictions on entry and exit from the market are minimised. Other regulators will be familiar with these trade-offs. Are there lessons we can learn, such as side payments, service obligations? Do we need to be more pragmatic about vertical and horizontal integration in public service markets?

**EXAMPLE: Policies aimed at intervening in and supporting poorly performing schools, and closing them if need be, are an important part of the current policy framework. In part, they can be seen as mechanisms designed to replicate market signals, leading to eventual exit, but in a more managed way**

- **Diversity of supply** – or at least potential for multiple providers so that users can exercise a choice
- **Appropriate funding and incentives** – for instance relating providers' income to the number of users they attract/and or the outcomes they achieve and granting flexibility and managerial autonomy to incentivise innovation or efficiency gains

## Slide 18: Choice in public service markets – level playing field

- Need to ensure competitive neutrality otherwise:
  - Risk of incumbency advantage, and
  - Increased risk of major system failure
- OFT publication 'Competition in mixed markets' identified main barriers to competitive neutrality:
  - Differences in regulation, taxation and pension treatment between different providers
  - Incumbency advantages enjoyed by existing firms, for example access to information, pre-qualification and bid criteria and transition costs; and
  - Lack of clarity in the application of competition law
- Challenge is to identify such 'subtle' public restrictions and address them

## Slide 19: Activating consumers key to competition

- 'Nudging' consumers has resonance particularly in one-in-one-out regulatory landscape
- Economists have under-emphasised the role active consumers play in making markets deliver the wider benefits of competition
- A lack of clear information for consumers can mean that despite containing a plurality of competing providers, a market will not be working as well as it could
- Ways of making information simple and accessible, providing intermediation and ways of framing choice matter a great deal for the success of the market
- This issue is particularly important in public sector markets where services provided are commonly those which consumers cannot easily assess for value or quality: credence services

**EXAMPLE: Choice in healthcare is not yet fully embedded. In 2008, only half of patients surveyed were aware they could exercise choice over hospitals. Of those that were aware, only 5 percent of patients used the NHS Choice website when making their decision. The rest tended to rely on their GP for advice**

- This is not surprising given the complexity of a choice which requires patients to be able to interpret a range of information on quality of hospitals
- When choice in public service markets is implemented properly, there are many benefits

**EXAMPLE: In welfare reform, government has experimented with providing jobseekers with greater choice over who provides them with support into employment by opening up the market to private and third sector providers. Initial evaluation shows that opening up the market and extending choice has improved individuals' attendance, increased the level of engagement and reduced resentment**

- Need to recognise importance of supplier side response to anticipated consumer demand, for example by having the information available and easy to act upon, suppliers will respond accordingly and up their game clear example is food labelling and reformulation
- Even where consumers able to make a choice, demand rationing may still be necessary

## **Slide 20: Ensuring government procurement drives economic efficiency**

- Public procurement is a crucial form of demand and source of buyer power
- Short-term, government buyer power can increase the intensity of effective competition between existing firms – though there are risks through competitive tendering, for example bid rigging with the potential for collusion
- Longer-term: government as buyer has power to shape market structure positively, for instance, buyer power could be an effective control for entry of efficient firms and exit of inefficient ones
- Government need to consider price constraints versus keeping the market open – consider long-term impacts on competition
- OFT waste procurement 2006 recommendations to local authorities. Key points were:
  - Length of contracts for waste collection services should be set to enable suppliers to recover sunk costs, but no longer
  - Procurement should be open, free from overly restrictive criteria and ensure fair competition between in-house and private sector bidders
  - Further, joint procurement of collection with other waste management services must be carefully considered and the risks of collusion be recognised

## **Slide 21: Creating new markets from public information**

- Public bodies hold information assets, such as Met Office weather data, Ordnance Survey mapping data
- Private firms can add value to public sector information and in some cases public sector is competing with such value added products
- In 2006, OFT report into CUIPI – found that more competition could benefit economy by c. £1bn
- The report concluded that access to unrefined public sector information needed to improve. As a result number of positive changes have occurred in the sector
- However, recent moves to have a England wide Public Sector Mapping Agreement (PSMA) by the Ordnance Survey (for value for money reasons) need to be monitored carefully to ensure that the private sector can compete on an equal footing, particularly with changes in technology

**Slide 22: Ensuring government is aware of risks of intervening on supply side**

- 'Additionality' where it does not crowd out private sector is holy grail of government intervention
- But in addition to 'deadweight' effect need to be aware of
  - **Leakage effects** - those which spill into other markets
  - **Displacement effects** - benefits are offset by reductions elsewhere

**Example: Protectionist industrial policy - even subtle protectionist policies, such 'new industry, new jobs'. For example, 'green' jobs where the desire to address climate change and foster an industry may sit uncomfortably with competition**

**Example: Moving planning system towards decentralised, local focus**

- Therefore demand side policies need to be considered along side supply side

### **Slide 23: Conclusion**

- The policy landscape is dramatically shifting – the coalition reform agenda is ambitious and raises important questions on opening up markets and on government intervention
- The UK has fewer market restrictions than other countries but challenges remain and are more subtle
- There is a desire to extend use of markets but there is a risk that government will seek to over define market outcomes
  - Rent seeking etc.
- Need to hard-wire competition - and particularly activating demand side - into policy thinking
- OFT role in this context is less about direct intervention and more focused on competition advocacy and policy advice
- OFT poised to support policy making in public service markets: One of our key themes for 2010-11 is to be an objective arbiter of markets and a source of expertise, focusing our efforts on key government developments – this is highly relevant to the public restrictions debate