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THE GENERAL STRATEGY OF A COMPETITION REGULATOR - AN INTRODUCTORY FRAMEWORK

-- Contribution by Professor Allan Fels --

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ANALYSING COMPETITION REGULATION STRATEGY

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1. Introduction

1. This paper provides a short introduction to a framework or model which is useful for regulators in analysing the work which they perform. The framework is also useful for officials in government departments who may have to oversee the legislation and its general application by independent regulators, courts and others.

2. There are typically three key questions for a regulator or official in any country, developed or developing:

- What should be done (i.e. what would be of public value to the nation?)
- What may be done (i.e. what does the legislation permit or require to be done?)
- What can be done (i.e. what is administratively possible, given the resources and powers available to the regulator?)¹

3. The framework or model is based on strategy models first developed in business schools but now applicable, with adaptation, to the work of regulators, and public officials generally.

4. I then draw especially on the framework which has been developed by Professor Mark Moore² of Harvard's Kennedy School of Government, a teacher at the Australian and New Zealand School of Government (ANZSOG), for extending this model to the public sector.

2. Strategy Models

2.1 *A Private Sector Model*

5. I shall first briefly outline a particular private sector business strategy model.

6. It is useful to consider that model before considering its adaptation to regulation.

7. The model focuses on three key variables and their relationships. Essentially a business's strategy can be analysed by reference to:

- its output, or value added
- its operating capability
- market demand

and by reference to their interrelationships to one another.

Each variable can be fruitfully analysed in depth

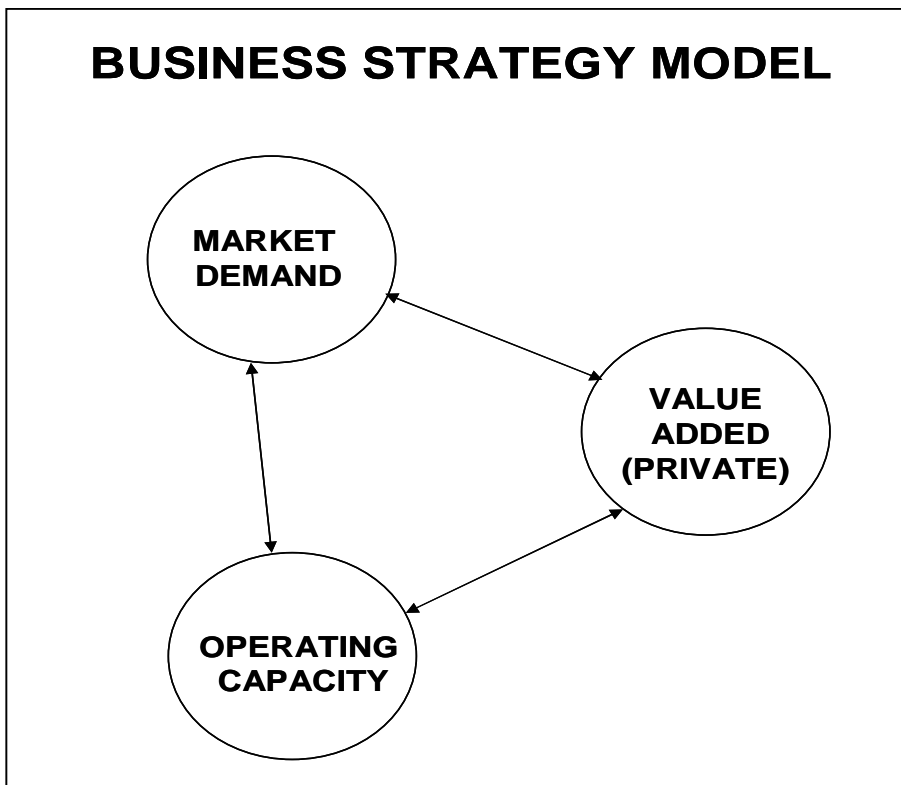


Figure 1 - A Business Strategy Model

8. Then the interrelationships of the three variables can be studied to throw light on the effectiveness of the firm's strategy e.g. value added may not match demand; or operating capability may not be sufficient to support the value added dictated by demand.

9. The model is useful in focusing on three key variables in a business strategy, in studying each in depth, in considering their interrelationships, and in reminding one that no one variable can be considered in isolation from the other variables e.g. value added cannot be considered without reference to operating capability or market demand.

2.2 A Competition Policy Strategy Model

10. Adapting this for a competition policy strategy, the key variables are:

- the value added to the public (public value)
- the operating capability. This includes the powers and resources of the regulator.
- the "authorising environment" i.e. the political environment which gives rise to legislation, regulation, and other political requirements and values which govern the work of the competition policy.

11. This model is shown below:

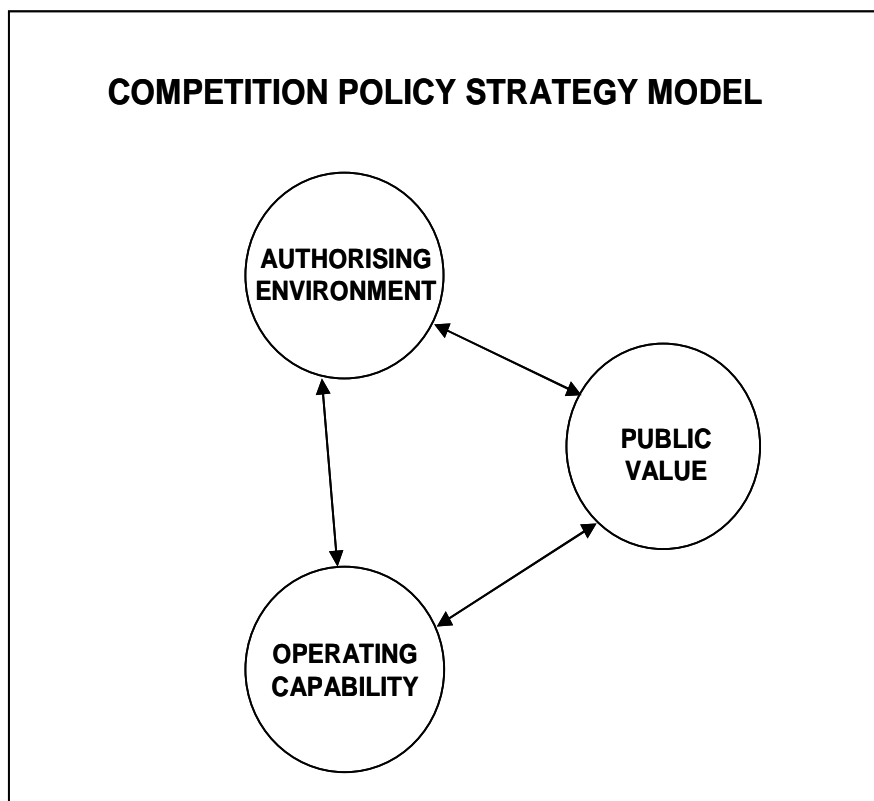


Figure 2 – Competition Policy Strategy Model

3. The variables

12. In this part of the paper, we discuss the nature of each variable briefly. It is contended that each variable is a useful focus in itself for regulators and administrators.

3.1 *Public Value Added*

- Public value is a concept which refers to the collective value created for the public of a country by government through services, laws, regulation and other action³. Public value is ultimately defined by citizens themselves. Value tends to fall into three categories: outcomes, services and trust.
- Public value may be compared with private sector output or value added but there are some substantial differences. Broadly speaking the private sector is judged by its output (as valued by the market). In the public sector, the contribution of a public agency is judged by its contribution to social outcomes or various social outcomes. This may or may not be measured by reference to a single, simple “output” or set of “outputs”. For example, a competition regulator would be seen as contributing to the outcome of a competitive, more efficient economy with lower prices and better goods and services. This may, in practice, be measured (somewhat controversially) by some indicator of its output, e.g. the number of successful court cases. Unlike in the private sector value does not stop here, however. Public value does not normally rest just on some notion of output. Under most public sector activities, there are a number of additional features which can add to public value. These include fairness in

process and perhaps fairness in outcome, or fairness in opportunity. Figure 3 suggests some dimensions of public value.

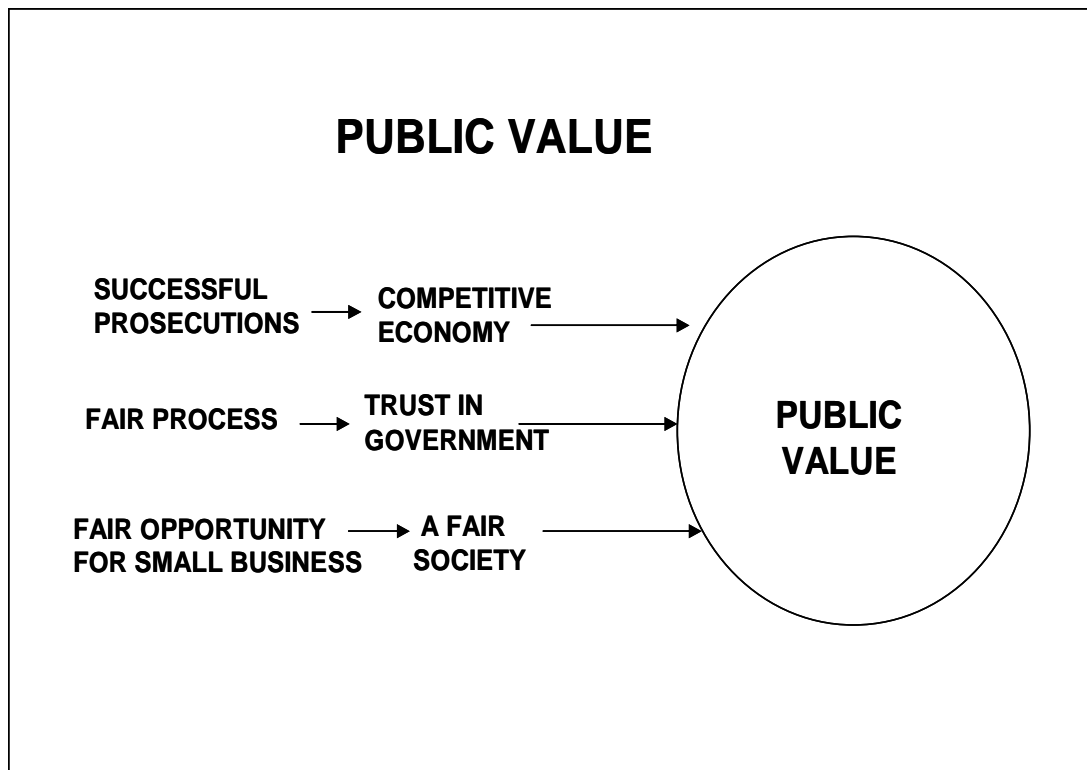


Figure 3 – Public Value

- The term “public value added” refers to the addition to or subtraction from the collective welfare of a country that results from a particular public policy or public institution. The term “value added” draws attention to the fact that value added can be increased by decreasing the amount of input per unit of output (e.g. by conserving resources) or by increasing the quantity or quality of output with a given amount of input. Some discussions of regulatory strategy neglect one or other of the dimensions of value added. They may emphasise the value achievable by reducing inputs for a given output or they may overstate the public value of an activity by stressing the value of outputs, ignoring the input costs. Some regulators may get locked into increasing value by reducing inputs ignoring that they can add value by increasing output quantity or quality. Or they focus on increasing output without regard to input cost.
- There is much discussion and controversy concerning what constitutes public value in competition law and policy. There are discussions about the objectives and outcomes of the application of competition law and the conclusions may differ according to the stage of development of the economy. The conclusions that are drawn in these controversies may be embodied in the framework set out in this paper.
- Even though the term “public value added” is difficult to reach agreement on and to specify, it is nevertheless a very useful device for focussing discussions about competition law and policy. If a policy does not add to public value, it is not justified.

3.2 *The Authorising Environment*

- The “authorising environment” refers to the laws and regulations (and other explicit or implicit values) which authorise the nature and scope of the public value which a competition policy strategy seeks to achieve.
- An analysis of the authorising environment requires some analysis of interest group pressures, the media, social attitudes, political parties, the courts and so on. Some of the influences are shown in Figure 4.
- Even though those implementing the policy are bound to comply with its instructions, nevertheless it is unwise in any strategy analysis to ignore the factors which drive that environment and which cause it to be unstable or changing, or to be the source of ambiguity, conflicting or ambiguous directives and so on. It is these factors which can give rise to sudden changes in the mandate of a regulator. Such possible changes may need to be recognised in strategy planning.

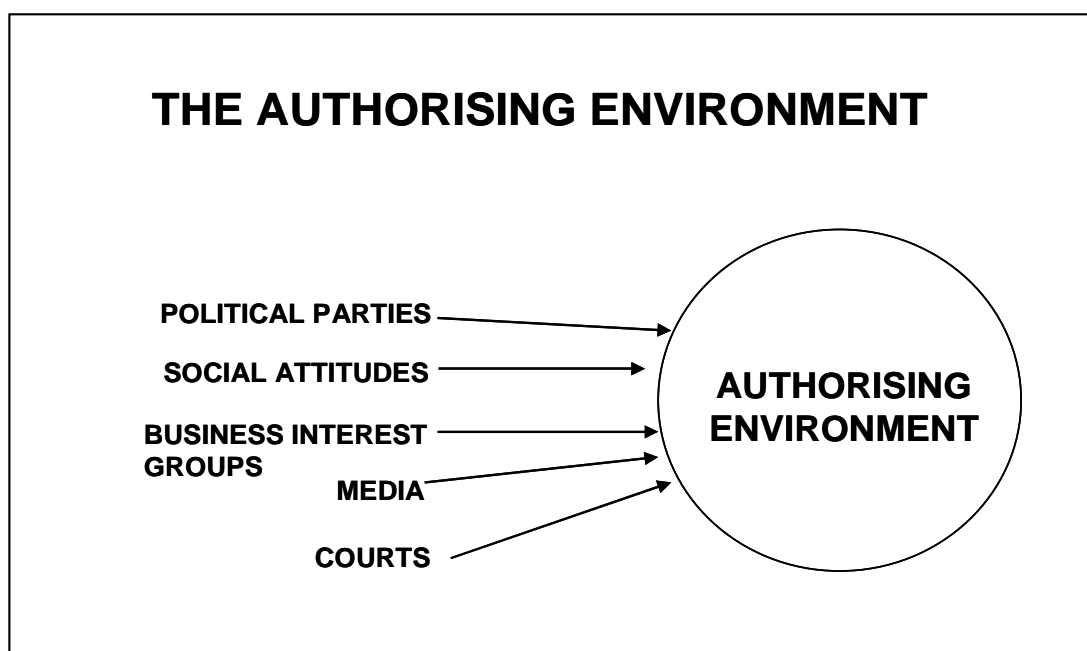


Figure 4 – The Authorising Environment

13. There is not time here to pursue a full analysis of the many factors affecting the authorising environment. However, some general points may be made about it, and some additional ones are made in **Appendix One**.

- The authorising environment is likely to differ from one country to another. In particular the authorising environment in a country with a newly established competition policy is likely to differ from that in a country with a well established competition policy. Likewise the environment will differ depending upon the stage of economic development. To develop this point further, one would need to make a more systematic analysis of the many factors affecting the authorising environment and to consider its implications for legislation or the exercise of regulatory authority. Simply this means that some laws are unacceptable in some countries, even though acceptable in others.

- It is clear from this discussion however that the role of advocacy is likely to be especially important unless one has a passive attitude to the authorising environment. Fuller analysis of this model would dig more deeply into the role and nature of advocacy particularly having regard to the likelihood of a mismatch discussed later in this paper between public value and operating capability on the one hand and the authorising environment on the other hand. Advocacy may change that relationship by altering the authorising environment.

3.3 *Operating Capability*

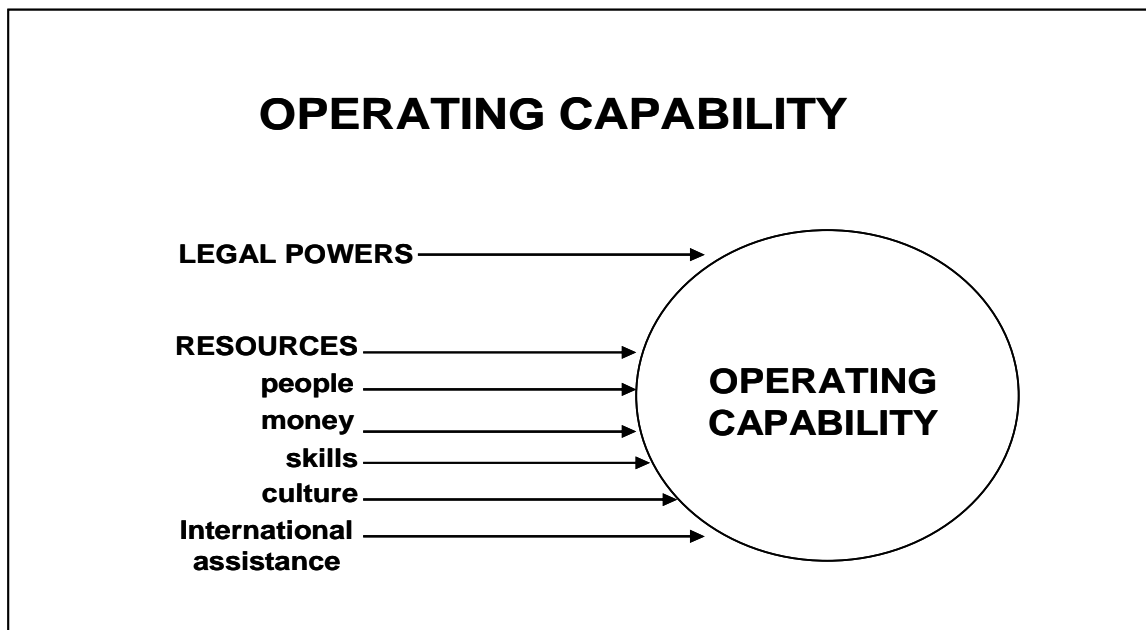


Figure 5 – Operating Capability

- Operating capability refers to the legal authority; physical, human and financial resources; culture, and organisational structure and arrangements employed to carry out the tasks of the regulatory authority or government agency.
- Competition policy requires very detailed enforcement and administration. It differs from some other policies where, once the law has been enacted, there is relatively little for the government to do. A tax rate change or an import tariff rate change, once enacted, requires relatively little implementation by the government. The law is changed at the stroke of a pen and nothing remains but for the market to get to work to reallocate resources. Competition law is quite different. Once the law has been enacted a plethora of activities must occur: the undertaking of investigations; decision making in the light of investigations; judicial processes including appeals; educational activities and so on.
- Substantial regulatory institutions need to be set up. They need to develop appropriate, economic and legal skills. In developing countries they can benefit from technical assistance and other help with capacity building. Sometimes regulatory institutions are in a weak position at the outset of the policy process and this means in turn that the law must be limited in its ambitions.

- In most countries the courts have a key role. They may or may not have good processes. They often have difficulty with economics. They are in many countries accepted as legitimate forums for the resolution of important disputes over property rights. In all countries, but perhaps especially in developing countries, they need education in this area of the law.

4. The interrelationship of the variables

14. The next step is to relate the three circles to one another to determine if they are in alignment. If they are this is not necessarily cause for complacency, e.g. the authorising environment may set a low public value on an important activity. However, even more interesting is a misalignment e.g. the public value is less than or greater than that desired by the authorising environment. Such misalignments tend to be unstable.

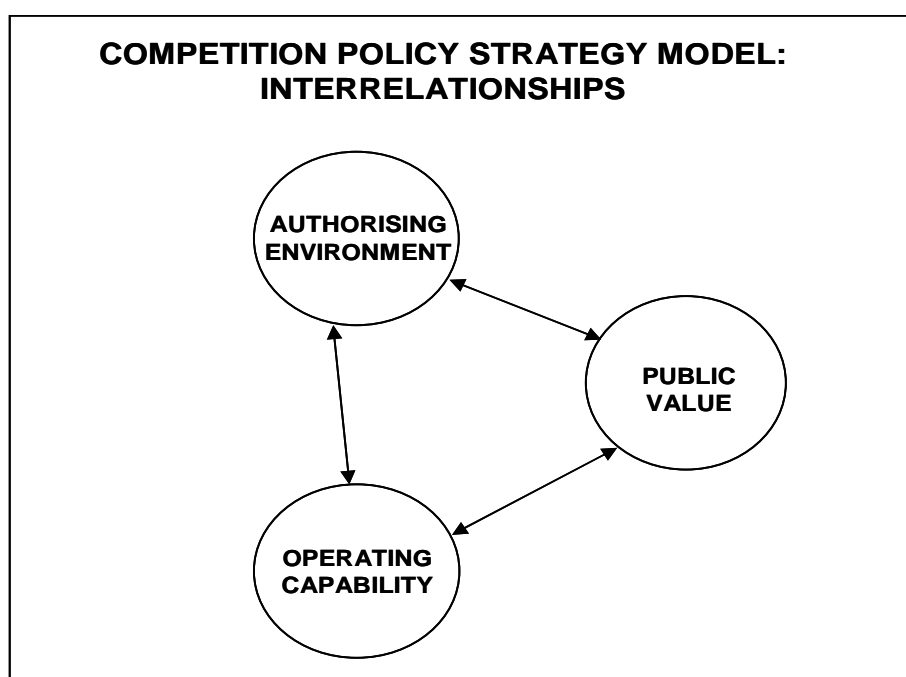


Figure 6 – A Competition Policy Strategy Model: interrelationships

15. Consider some of the possible relationships. First, public value may be misaligned with the authorising environment. The vigour of the regulator in enforcing the law and achieving public value may upset interest groups that are important politically. This may have consequences – the government may weaken the law, reduce the resources of the regulator, alter its membership. Or the regulator may pull back on its activity. Or it may through advocacy bring the authorising environment into line with its expanded public value. If the regulator is independent, it has more ability to survive political tensions compared to otherwise.

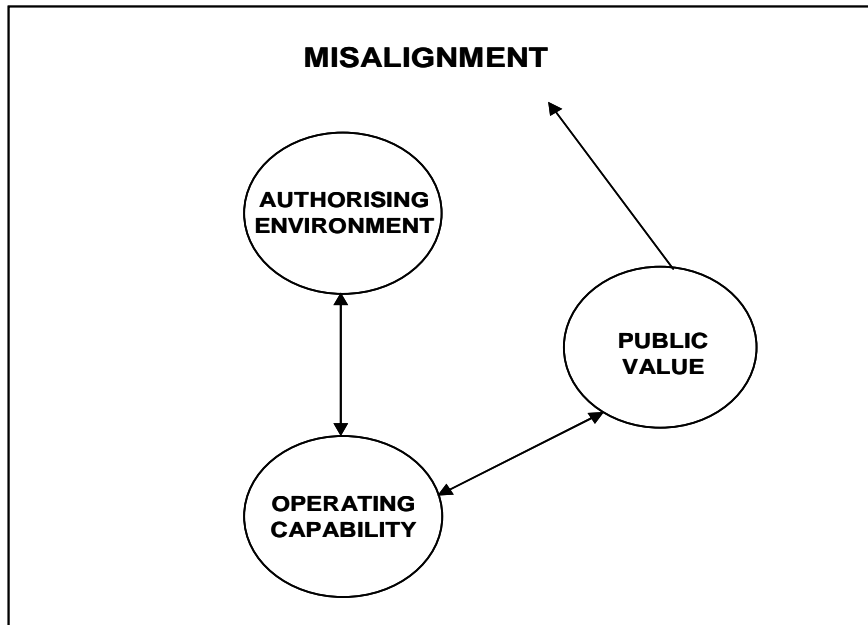


Figure 7 – Misalignment

16. Second, another misalignment may be between public value and operating capability. There may be great public value in having a full scale competition law with all the bells and whistles of an advanced economy but if there is no administrative capacity to implement it, value may not be achieved. Another possible instance of mismatch would be where there is a global cartel which harms a country which has no capacity to prosecute it. Public value can only be achieved by establishing operating capability.

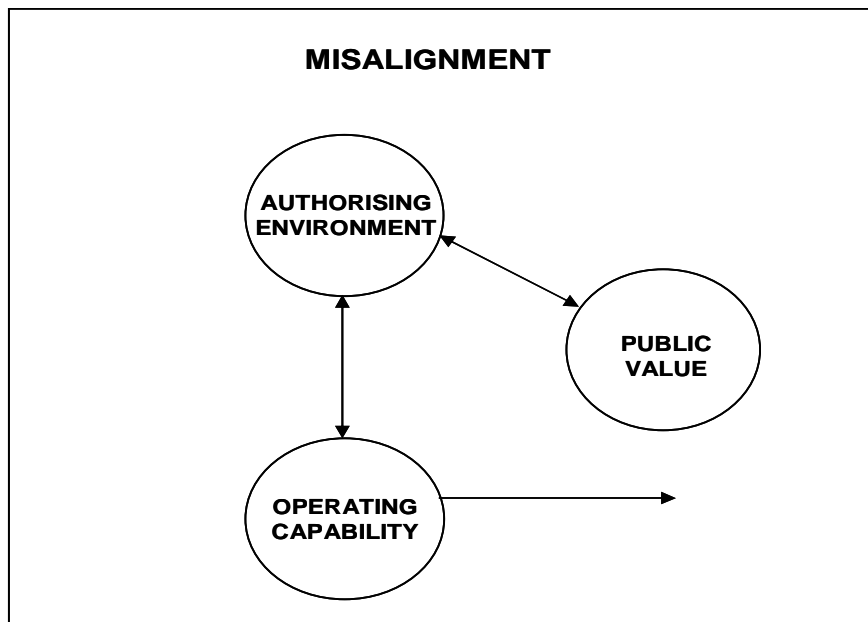


Figure 8 – Misalignment

4.1 Co-Producers

17. It is sometimes useful to extend the model to cover instances where those implementing the strategy need to receive help (or may receive hindrance sometimes) from others in achieving desired

outcomes. Co-producers include business, the legal profession, the courts etc⁴. Of great importance to developing countries is foreign assistance.

18. The issues of co-producers are not pursued in this paper.

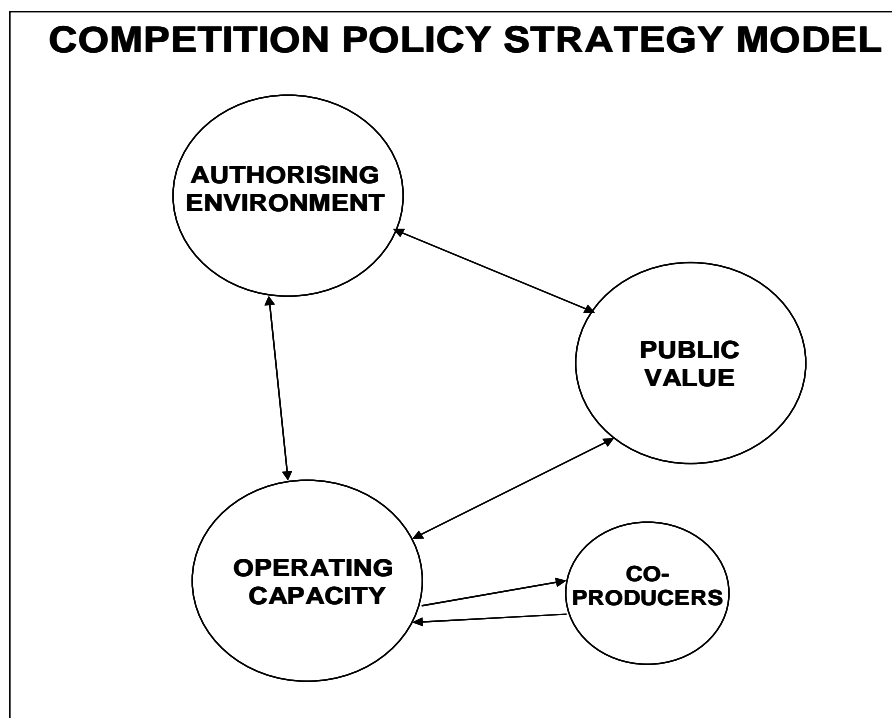


Figure 9 – A Competition Policy Strategy model: co-producers

5. The use of the framework

19. Each circle is important in itself. But its relationship with the other circles is of great importance since each depends upon and is influenced by the others.

20. A great deal of analysis of regulatory issues – whether by regulators, academics, lawyers, advisers etc – tends to locate itself in one circle and to disregard the others despite their relevance.

21. Much discussion at seminars and conferences is about the public value of a particular action or policy? e.g. there would be high value from merger law. This may overlook that there is no mandate for such a law from the authorising environment, or that there is no administrative capability of implementing such a law.

22. As has been mentioned, there is also a tendency to emphasise only the input or output side of value added, and to focus on narrow aspects of public value, e.g. on output measure.

23. Some discussions within regulatory bodies may focus entirely on what the authorising environment will permit (whether this refers to the political environment or to the courts as well). Such discussions would often benefit from a greater focus on public value.

24. Yet other discussions within regulatory bodies focuses entirely on operating capability, on what is possible, without considering public value or the authorising environment. The focus may be on

maximising the output given the operating capability. It may neglect, for example, that the authorising environment could be well disposed to increasing the operating capability with changed laws or more resources if it was persuaded of public value.

25. Finally, some problems are seen as beyond the capability of an organisation by virtue of ignoring the role of the co-producers.

26. This model is a useful way of organising discussion about a competition policy strategy, or part of it.

5.1 Competition Agencies and Competition Policy Administrators

27. In most countries, there is an independent regulatory authority. Policy is determined by government departments. The model is useful for either the regulator or the administrator although they may have somewhat different perspectives. The general policy maker for example may be concerned with more general questions than is a regulator. For example, the general policy maker may be as concerned with the operating capability of the courts and of other institutions as much that of the regulator with its narrower focus on its own operating capability.

NOTES

¹ There is a fourth question that is also usually important. This concerns whether the outcomes which the regulator seeks to achieve require or are facilitated by the actions of others. For example, if the aim is to secure compliance by business with the competition law, the regulator, in the end, depends upon business taking, of its own accord, certain actions e.g. educational programs for its employees so that they do not break the law. There is not time today to deal with the issue of analysing “co-producer” contributions even though it has far reaching implications for regulators and governments.

² See Moore, M. 1995, Creating Public Value: Strategic Management in Government, Harvard University Press, Cambridge, Massachusetts. I have also drawn on work by two other teachers at the School – Professor John Alford of ANZSOG and Professor Herman Leonard of the Kennedy School.

³ Creating Public Value, Strategy Unit, Cabinet Office, UK.

⁴ Depending on one’s perspective the courts could belong to any one of several circles. For the regulator, they may be in either the authorising environment or the co-producer circle. For the government official overseeing competition policy as a whole, they would be in the operating capability circle.

APPENDIX 1

- An important characteristic of competition law is that it encounters somewhat contradictory seeming attitudes by those affected by it. Most people and most businesses want their suppliers and their customers and sometimes their competitors to be subject to the stringent application of competition law. This is for their own benefit. However, when the law is applied to themselves they do not welcome it. It is usually harmful to their interests, and they put these ahead of any acceptance that there may be public interest considerations. And in any case they often fail to see the public interest considerations that may be involved in cases affecting their own immediate interests.

This inevitably leads to strong pressures against competition law. The losers from competition are most often a powerful lobby while the winners are a weak one. Moreover, the size of the property rights involved in competition law is very large and this exacerbates the tensions. In just about every country there is quite strong opposition by big business lobbies to the vigorous application of competition law. They seek its watering down, they may support its general application but seek special exemptions and special deals, and since the amounts of money involved can be very large they press vigorously to weaken competition law.

- Competition law normally involves substantial government intervention to achieve competitive market, so-called “free competitive markets”. This is in some respects a paradox and it can create unusual constituencies which either favour or oppose competition law. Some promarket-minded persons oppose competition law because too much intervention is needed to achieve good market outcomes. Other persons who temperamentally do not enthuse about the working of markets or who have some kind of antimarket attitude are often supportive that competition policy is applied because it is seen as striking at big business, a worthy target at all times in their view.