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DOES COMPETITION KILL OR CREATE JOBS?

Contribution from United Kingdom

-- Session I --

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-- United Kingdom --

1. Introduction

1. The CMA's primary duty is "to promote competition, both within and outside of the UK, for the benefit of consumers" and our mission is "to make markets work well, in the interests of consumers, businesses and the economy". Our remit does not extend to wider economic outcomes, and as such we have not carried out any detailed analysis of the links between competition and employment. This note focuses mainly on the CMA's recent work on the links between competition and productivity, and offers some observations on how this might relate to employment.

2. The paper briefly sets out:

i) The UK context, where the CMA applies a competition-based test without taking separate account of employment or other general public interest aspects, and competition policy is viewed as a key driver of productivity.

ii) The reasons why we would expect competition to have a positive long-term impact on employment through its links to productivity and growth.

iii) Some observations on how competition might affect levels of employment in the short term both between and across firms, and examples of how this might lead to political or public pressure.

iv) Examples of our evaluations of competition interventions, which, while not directly measuring impacts on employment, suggest that competition can lead to an expansion in output.

2. The UK context

3. As in many other OECD countries, the application of competition policy in the UK is focused on competition effects. The CMA is not required or permitted to take account of employment or other wider economic outcomes in reaching its decisions – save insofar as they impact on competition.

4. This focus on competition was introduced relatively recently in the UK. Antitrust enforcement was established as independent of ministers under the Competition Act 1998. As regards mergers and market investigations, the Enterprise Act 2002 introduced a competition test, replacing the previous wider 'public interest' test.[1] The Enterprise Act also removed ministers from decisions on mergers and market

[1] The previous 1973 Fair Trading Act regime required the UK competition authorities to take into account 'all matters which appear to them in the particular circumstances to be relevant'. This included factors such as the alleged desirability of 'maintaining and promoting the balanced distribution of industry and employment in the United Kingdom'.

investigations[2], giving full operational independence (with limited, specified exceptions) to the competition authorities.[3] This independence was reinforced in the 2013 Enterprise and Regulatory Reform Act which created the Competition and Markets Authority.

5. The UK Government recently reaffirmed the importance of independent competition policy in its Productivity Plan.[4] The Plan highlights that 'competitive markets are fundamental to fostering productivity growth', that 'the UK's competition regime is a real strength', and that government's priorities are 'maintaining a strong, independent competition regime, to effectively tackle competition problems; ensuring consumer choice can drive competitive forces which will reward productivity; and ensuring the UK stays at the forefront of regulatory excellence and that its regulatory frameworks allow new and innovative firms and business models to start up and grow'.[5]

6. An important part of the recent policy context is that, while the UK economy has been relatively successful in creating jobs, its productivity performance has been much weaker. The Productivity Plan notes that 'Employment is around record levels and has risen by two million since the start of the last Parliament, while unemployment is continuing to fall. Rising employment has been a major source of growth, but over the longer term, productivity is the more essential ingredient. UK productivity has persistently lagged behind other major economies and although it grew in the decades before the financial crisis, it has stalled sharply in the wake of the crisis.'[6] Therefore, at the macroeconomic level, the UK Government is particularly focused on the potential for increases in competition to drive greater productivity.

3. Competition, productivity and long-run employment

7. There are strong grounds for thinking that effective competition should lead to higher levels of employment over the long term. Weak competition in markets leads to prices remaining above costs and hence lower output compared to the effective competition equilibrium. We would expect lower output economy-wide to be associated with lower overall levels of employment. In addition, increased employment must ultimately be underpinned by economic growth, and economic growth in turn depends on investment in capital and skills and on increasing productivity. The evidence is that competition policy has positive effects on both investment and productivity.

8. The CMA recently published a summary of the evidence suggesting a positive relationship between competition and productivity.[7] The report draws heavily on the OECD's own research on the links between competition and productivity[8] and on recent work by the World Bank.

[2] The Secretary of State retains residual powders to intervene in markets and mergers cases on specific, limited public interest grounds (which do not currently include employment). See further Enterprise Act 2002, section 58 (mergers) and section 153 (market investigations)

[3] At the time, decision-making on mergers and market investigations was transferred to the Competition Commission. Subsequently in 2014 the Competition and Markets Authority, which replaced the Office of Fair Trading (OFT) and Competition Commission, took on these powers.

[4] HM Treasury (2015), 'Fixing the foundations: Creating a more prosperous nation',

[5] Ibid. Chapter 13

[6] Ibid. pp 5-6.

[7] CMA (2015), 'Productivity and Competition: A summary of the evidence', July 2015.

[8] OECD Factsheet on the links between competition and productivity (DAF/COMP/WP2(2014)13)

9. Our report notes that there is a strong body of empirical evidence showing that competition can drive greater productivity. Within-country studies demonstrate a positive relationship between strength of competition and productivity growth across sectors. Similarly, cross-country studies suggest that countries with lower levels of product market regulation, enabling stronger competition, tend to have higher levels of productivity growth.

10. There is also an extensive literature examining the impact on productivity of changes in competition over time, including as a result of deregulation. These studies show generally strong positive effects on productivity in sectors where deregulation has occurred, including transport and utilities.

11. The evidence suggests that competition drives productivity in three main ways. First, within firms, competition acts as a disciplining device, placing pressure on the managers of firms to become more efficient. Secondly, competition ensures that more productive firms increase their market share at the expense of the less productive. These low productivity firms may then exit the market, to be replaced by higher productivity firms. Thirdly, and perhaps most importantly, competition drives firms to innovate, coming up with new products and processes which can lead to step-changes in efficiency.

12. In addition to the evidence of a general link between competition and productivity, a number of new studies focus specifically on the role of competition policy and competition authorities in enforcing it. While there are strong theoretical arguments to suggest that effective enforcement of competition policy should have a positive impact on productivity, there was relatively little empirical analysis of these effects until recently. However, several studies have now examined cross-country data on the existence and effectiveness of competition policy, and found that this can have a positive impact on economic growth and productivity.

4. Short-run and within-market effects

13. While this evidence suggests that competition can have a positive long run effect on employment, the short-term and within-market effects are less clear. We agree with the OECD secretariat that this can sometimes lead to criticism of pro-competitive interventions.

14. In considering the impact of competition on employment, it is important to distinguish between: i) transfers of employment between firms within a market; ii) the overall level of employment in a market; and iii) the economy-wide (macroeconomic) level of employment. In the short-term, effective competition is likely to lead to shifts in employment between firms, and can have an ambiguous effect on the overall level of employment in a market, even though we would expect the overall economy-wide impact to be positive.

15. The way in which competition is likely to affect employment can be seen by considering the three mechanisms noted in paragraph 11 through which competition can have a positive effect on productivity.

16. First, competition can create incentives for greater productive efficiency within firms. One such source of efficiency might be through a reduction in labour costs. To the extent that all firms in a market become more efficient, this can lead to lower levels of employment in the short term. On the other hand, where greater efficiency leads to lower prices or higher quality, this would typically stimulate higher demand and increased output and employment.

17. Second, competition drives entry and exit, with more productive firms gaining market share at the expense of the less productive. In this case the overall impact on employment is ambiguous, but there will certainly be transfers of employment between firms in a market. Employees at less productive firms will lose out, while those working for more productive firms will gain. In some cases this effect could also

have a regional dimension – for example if job losses occur in a particular local area, balanced by increases in jobs elsewhere.

18. Finally, competition can stimulate innovation, with firms coming up with new products or processes. In some cases these innovations might result in less labour-intensive production, and in transfers of employment between firms. However they can also create new markets and employment opportunities.

19. Overall then, the dynamics of competition will typically lead to winners and losers among individual firms and their employees within a market. Across the market as a whole, the employment effect is ambiguous[9]. While competition can drive efficiencies which might, of themselves, reduce employment in the short-term, stronger competition often leads to an expansion in output because lower prices stimulate higher levels of demand, and this in turn can act to boost employment levels. It can also have benefits in related markets up and down the supply chain.

20. Wider political pressures can sometimes arise where competition leads to shifts in employment between firms even if the overall employment effect is positive.

21. As noted by the OECD secretariat, there can also be pressure particularly in merger cases, where the rationale for a merger often relates to achieving greater operational efficiencies, including through a reduction in overall employment. For example, there has been political discussion in the context of potential mergers in the pharmaceuticals sector about whether UK jobs might be lost as a result[10]. However, we would note that this most recent debate focused largely on whether investment in R&D would be affected, rather than on concerns about loss of jobs per se[11].

22. There are also examples where deregulation or innovation leads to a reduction in monopoly rents to certain groups of employees. The taxi market is a good example, where past licensing schemes have tended to lead to higher rents, but restricted overall levels of employment. Deregulation and the

[9] Note also that the long-term effects of M&A activity are uncertain. Recent research by CASS business school showed that, in the short term, the effect of M&A activity significantly increased overall share value from combined firms. However, the longterm effect was more ambiguous, with the overall average effect suggesting an increase in value for shareholders, (Clare & Faelten, Short term value creation from M&A in general, long term effects uncertain (2014)). A similar, ambiguous story can generally be seen from the economic literature, with different studies yielding either similarly mixed or in some cases contradicting results. See, for example, Ravenscraft & Scherer, The profitability of Mergers (1989) compared to Ghosh, Does operating performance really improve following corporate acquisitions (2001). There is evidence to suggest that the effect of cross-border M&A is an overall increase in innovation as measured by patenting behaviour, although this is appears to generally be based on innovative gains in the acquirer's country and may coincide with a reduction in the target country's innovation (Stiebale, Cross-Border M&As and Innovative Activity of Acquiring and Target Firms (2014)). Further, the research shows that the effect is largest when the premerger difference in innovation activities between target and acquirer is largest. The research also suggests that an increase in innovation is accompanied by growth in sales and productivity from the perspective of the merged entity. This is consistent with previous studies that have shown a benefit to the acquiring firm in innovation following cross-border M&A. See, for example, Bertrand & Zuniga, R&D and M&A: Are cross-border M&A different? An investigation on OECD countries (2006).

[10] Mergers in various manufacturing sectors and their effect on UK employment have also previously proved contentious. For example, in 2010 the takeover of Cadbury by Kraft and the subsequent closure of a UK plant prompted changes to the formal takeover process applicable to UK public companies; see Takeover Panel, Review of Certain Aspects of the Regulation of Takeover Bids, 1 June 2010.

[11] Chisholm, Alex and Jung, Nelson, The Public Interest and Competition-Based Scrutiny of Mergers: Lessons from the Evolution of Merger Control in the United Kingdom (October 2014), Competition Policy International Antitrust Chronicle, Page 29, paragraph D

introduction of new business models has put pressure on licensed operators, but has generally led to an increase in wider employment opportunities in the market.

23. Given these ambiguous short-term and within-market effects, the CMA agrees with the secretariat that it is important to evaluate interventions over the long-term, and to consider wider-market impacts as far as possible.

5. Evaluation of competition interventions

24. The CMA and its predecessor bodies, the OFT and the Competition Commission, have not attempted to evaluate the impact of their antitrust interventions on levels of employment. This is because our primary role is to promote competition and generate benefits for consumers. Similarly the tests we apply in our merger and market investigations are focused, respectively, on ensuring that competition is not significantly lessened and on remedying adverse effects on competition. Our evaluations therefore typically focus on the preservation or promotion of effective competition following interventions (for example through greater entry and exit) and satisfactory consumer outcomes (for example through lower prices, better service or greater choice).

25. However, there is some evidence from our past evaluations to suggest that competition can lead to an expansion in output. While we cannot say unambiguously that this has led to higher levels of employment, it suggests that competition can create opportunities for employment growth.

26. For example, the 2010 evaluation of the OFT's pharmacies market study found that partial deregulation had led to an increase of 8.8 per cent in the number of pharmacies in England from a previously static level. This supported the OFT's prediction that liberalisation would lead to net entry. At the time of the evaluation report, market entry was continuing, and had not been accompanied by an increase in exit.[12]

27. Similarly the 2007 evaluation of the OFT's taxis market study (2007) found that around one third of all the local authorities (LAs) which had quantity restrictions in 2003 have de-restricted since then. Most of the benefits to consumers of derestriction outlined in the 2003 market study were found to have been realised in the newly derestricted LAs. The number of taxis in newly de-restricted areas grew by around 30 per cent between 2003 and 2007. In contrast the number of taxis in LAs which remain restricted barely changed during the same period.[13]

6. Conclusion

28. In the long run, we believe that effective competition supports economic growth, and hence creates opportunities for employment. However we recognise that the short-term and within-market impacts of competition on jobs can be ambiguous, and that this can sometimes lead to criticism of pro-competitive interventions. Against that backdrop, it is important to articulate the potentially beneficial longer term or wider effects of competition which, ultimately, can support employment, for example in terms of expanding output and stimulating the development of new markets.

[12] OFT (2010), 'Evaluating the impact of the 2003 OFT study on the Control of Entry regulations in the retail pharmacies market', March 2010

[13] OFT (2007), 'Evaluating the impact of the taxis market study', October 2007