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Clampdown on mergers could make Britain less competitive

By Ali Nikpay

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How intensely should competition authorities police markets? Until recently, the clear consensus among policymakers in the US and UK was that most markets work well and that authorities should only intervene where there is clear evidence of consumer harm. That's no longer the case. Today, there is a growing feeling that unfettered markets lead to slower growth and greater inequality.

At first glance, the data appear to support the revised view of markets and the role of competition policy. For example, in every decade between 1950 and 2000, real US GDP per capita increased annually by between 2pc and 3pc. However, during the 2000s, this dropped to 0.8pc.

Things were even worse in the 2010s with real GDP per capita growing by around 0.6pc per year. At the same time, inequality has risen. The share of income earned by the top 1pc in the US has more than doubled from 10pc in the late Seventies to around 20pc today.

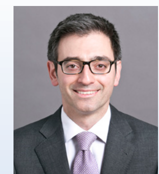
In a fascinating new book, Thomas Philippon, a professor of finance at the University of New York, puts much of the blame for this on a failure of US competition authorities to block mergers. This resulted in a significant increase in the market power of big companies that in turn slowed innovation while increasing profit margins to the detriment of society as a whole.

Despite its focus on the US, Philippon's thesis has had a powerful effect on how the UK competition authority, the CMA, thinks about its role. In its recently published 2020-21 annual plan consultation, the authority announced that it planned to take a much tougher line on mergers and generally to intervene more than it has done in the past.

Is it right to do so? While Philippon's work is impressive, it's not the last word on the subject. In an important paper presented at the 2018 Federal Reserve annual symposium in Jackson Hole, LSE and MIT professor John Van Reenen, one of the world's leading experts on productivity, looked in detail at the data that have been used by Philippon and others.

He argued that focusing on overall trends in margins, inequality and productivity – all of which seem to imply a general weakening of competition – may be misleading.

In particular, Van Reenen showed that most US firms have, in fact, seen either no increase or a fall in their mark-ups. This means that the rise in overall profits in the US has been driven by the success of a minority of companies. As for the industries that look least competitive in terms of the number of suppliers, many have in fact seen rising productivity and innovation.



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Van Reenen also points to research showing that the share of corporate income going to workers at most companies has remained steady; the deterioration we see in the aggregate data appears to be driven by the activities of a minority of firms.

Van Reenen stresses that his conclusions are preliminary and that more work needs to be done. What seems clear though is that the jury is out on whether market power has, in fact, increased in most markets in the US. And, to the extent that it has, Van Reenen's research suggests that this may be because of globalisation and the application of new technologies, rather than a failure of competition authorities to intervene sufficiently.

For example, the success of firms like Google may be as much due to the nature of the "winner takes all" markets in that they operate – most people only use one search engine for example – than anti-competitive mergers or collusion.

Furthermore, even in lower tech markets like retail and wholesale, rapid falls in quality-adjusted ICT (information and communication technologies) prices may give larger firms – who can invest heavily in developing proprietary software – big advantages in logistics and inventory control management.

None of this is to say that competition authorities should not be vigilant and active. Even if firms have attained their strong positions by innovating and out-competing rivals fairly, that doesn't mean that they will always use their power for the good of consumers.

Much of what the CMA plans to do is, therefore, to be applauded. This includes taking on cases in which consumers are being ripped off, rooting out fake reviews, tackling abuses of subscription traps and attacking anti-competitive practices that push up the price of drugs for the NHS.

Unfortunately, however, the CMA is planning to put fewer resources behind these types of initiatives than you might think – right now it has only 18 competition cases and seven consumer enforcement cases under way. By way of comparison, in 2012 its much more resource-constrained predecessor organisation, the Office of Fair Trading, ran 14 competition and 22 consumer cases.

Why is the CMA allocating its resources in this way? As it explained in its annual plan consultation, the CMA believes that competition in the UK is getting weaker and profitability increasing. In other words it believes that Philippon's view of developments in the US apply here in the UK.

As a result, despite the issues identified by Van Reenen – and Philippon's own view that his conclusions don't really apply to Europe – the CMA thinks that it should focus much more than it did in the past on policing mergers. This is presumably why it has decided to spend so much time and money investigating Amazon's planned purchase of a small, minority shareholding in Deliveroo, an investment that it would not have looked at a few years ago.

To be clear, the CMA is right to worry about the impact of mergers. But given the uncertainties about whether there has been a general increase in market power in the UK (and, if there has, its causes), the CMA would do better to reallocate some of the resources it plans to spend on mergers to rooting out practices that are unambiguously harmful to competition like cartels.

As part of this, it should reverse its decision to hand over prosecution of individuals who have participated in price fixing agreements to the SFO, an organisation that is highly unlikely to prioritise these cases over its day job.

The CMA should also put even more of its resources into stopping consumers from being misled and ripped off by rogue companies. Finally, it should use its independence from political interference and influence to investigate markets that are not working well because of governmental restrictions and distortions. A good place to start would be public sector broadcasting and the commercial activities of the BBC, an issue that Ofcom has not really grasped properly.

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The general consensus among competition law experts is that the CMA has done a good job of looking after consumers since its creation. But its plan to pivot towards investigating mergers rather than taking more action against practices that are unequivocally harmful risks making UK markets less, not more, competitive.

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