Global Counsel

Are competition regimes ripe for change?

Blog post by Chief Economist Gregor Irwin, 17 April 2019

There is a growing body of evidence that suggests corporate market power may be increasing and that this is damaging macroeconomic performance. Moreover, the effects may be strengthening as the market power of some firms becomes more entrenched and capable of exploitation. This, combined with growing political attention in some major economies, means policymakers may come under increasing pressure to overhaul their competition regimes.

The evidence

This month, the IMF published analysis on the extent and impact of rising corporate market power across 27 advanced and emerging countries. As with any rigorous study of this sort, the results are equivocal and nuanced, requiring careful interpretation. But they nevertheless present a vivid picture of how competitive outcomes in markets are changing, with implications for the macroeconomy and for consumer welfare.

The IMF finds there was a broad-based increase in corporate market power in the 15 years to 2015, with the average economy-wide mark-up of prices over marginal costs – a good metric of corporate market power – rising over 6% on average in the countries assessed and by nearly 8% in advanced economies. Moreover, this has coincided with an increase in profits and market concentration.

The increase in the mark-up is concentrated in the top 10% of firms, and also in non-manufacturing sectors, which also tend to be the most productive and the most likely to invest and innovate. In the aggregate, however, these changes have tended to suppress overall investment and may have contributed to the lowering of the of real interest rates, which has characterised advanced economies since the financial crisis. It may also have contributed to a fall in the labour share of GDP and hence to rising inequality.

Some of these effects are modest. And their causes are debateable with, for example, the broad-based increase in mark-ups across countries suggesting that product markets may be changing rather than (country-level) competition frameworks failing. Even so, the conclusions are sufficiently striking – and relevant to politically-sensitive issues – for policymakers to take note.

Implications for policy

There are two competing impulses that are likely to influence future policy. One is the political sensitivity of the issues, which creates a strong motivation for reassessing policy. Sluggish investment, declining productivity growth, falling labour shares and rising inequality can all be traced back to concerns about competition and these are all currently hot-button political issues.

We have already seen increasing political attention on competition policy, with US presidential candidate, Elizabeth Warren, wanting to break up tech giants and the German economy minister, Peter Altmaier, calling for changes to European policy to allow European companies to compete globally. That attention will increase should more politicians perceive that increasing market power is partly to blame for some of the macroeconomic problems facing advanced economies.

Countering that is the contestability of the evidence, which means cautious policymakers will be loath to overhaul long-standing competition frameworks before they are sure that anti-competitive behaviour is driving these outcomes.

There are, however, some reasons why pressure on policymakers to reform competition regimes may win out. One is that even though technology-driven structural changes, which result in what the IMF describes as "winner-takes-most" outcomes, might justify rising mark-ups in some sectors, this may also mean that those sectors become more vulnerable to anti-competitive behaviours in future as those firms seek to entrench their market power.

Another is that the threat of future entry may be having a less-constraining impact on incumbents. International competition can play an important role here, but in some countries and some sectors markets are becoming less open to foreign investment and competition, placing a larger burden on competition authorities to ensure competitive outcomes.

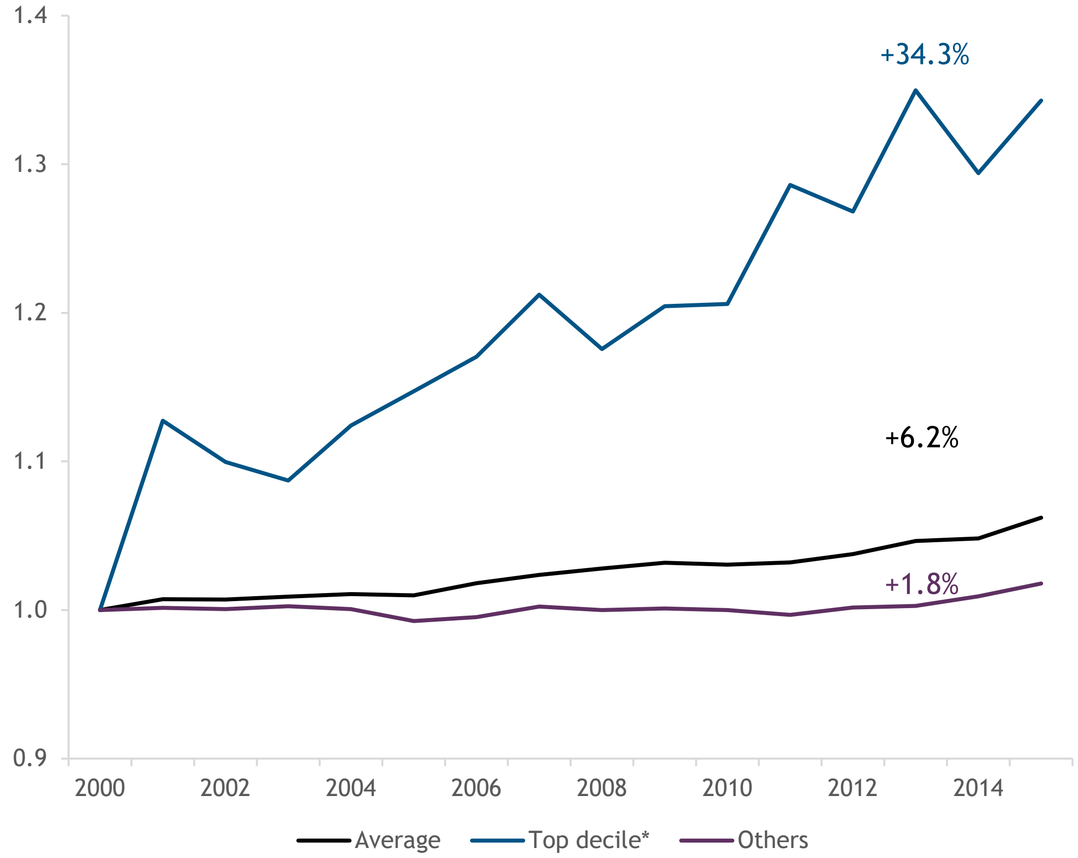
The IMF notes that a wide range of policies may need reforming to ensure competitive outcomes, including tax policies, intellectual property protections and data governance regimes. But the natural starting point is with competition policy itself. This means confronting difficult issues like how to assess the potential loss of competition when large incumbents buy up smaller, but fast-growing companies that could become future competitors. It also means challenging the very way in which markets are currently defined and the impacts on competition are tested.

We should not expect radical changes to policy overnight. The UK has, for example, just produced a long-awaited report on digital competition, which takes a cautious, incremental approach. The European Commission has also produced a comprehensive analysis of the issues, but also favours an adaptive approach and concludes that "the basic framework of competition law … continues to provide a sound and sufficiently flexible basis for protecting competition."

But we can expect that political interest in these issues will increase and with that will come a more intense and multi-fronted policy debate, with policy innovations in some countries closely followed and potentially imitated by others.

For some companies this may be threatening, while for others it will create opportunity. For all companies in those sectors where structural changes have been fastest and most pronounced it means policy uncertainty.

Fig. 1: Evolution of mark-ups by firm group



*top 10% of the mark-up distribution

Source: IMF