8 June 2009

Responses to the economic and financial crisis: whither competition ?

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In order to contain the damage done by the financial and economic crisis and to prevent the occurrence of new crises, governments are under strong pressure to intervene in the financial sector and in the real sector.

In the financial sector, the interconnection between banks and financial institutions and the fact that this sector operates on trust means that a bank run could contaminate the entire sector and lead to a systemic failure which would bring the economy to a standstill. Governments are eager to intervene to ensure the stability of the financial system.

In the real sector of the economy, governments are also under strong pressure to intervene not because of the possibility of a systemic failure but to alleviate the effects of the economic downturn. Governments are expected to take whatever measures are necessary to revive demand, to stimulate supply, to prevent the possible bankruptcy of firms hit by the hard economic conditions and to stem the growth of unemployment. Additionally, the current crisis has made a large number of people in developed countries more aware of the importance of the personal costs they have to bear in an economic downturn and realize that such a downturn can be the result of factors over which neither they nor their employers have any control. Hence, it is likely that voters have become more risk averse than they were before the crisis occurred and that there is high social demand for government measures designed to protect them from market forces (including domestic and foreign competition). This trend is dramatically illustrated in a recent survey in Germany by Ernst and Young which found that 78% of small and medium size companies favour the state embracing "protectionist measures" to shield them from the global recession, as compared to 43% a year ago[1].

Thus, since the beginning of the financial and economic crisis, a large number of measures designed to shore up the financial sector, to provide assistance to businesses, to restructure industries or to protect domestic producers have been adopted in many countries.

In this context, and from a policy perspective we will address three questions. First, what kind of measures potentially harmful to competition and trade are governments considering or already implementing and do we have evidence as to the importance of the harm they could entail? Second, to what extent should competitive concern regarding such measures be taken into consideration when they are adopted? Finally, what recommendations or good practices can governments follow to minimize (or eliminate) the toxic effects on competition and trade of measures designed to contain the current crisis or prevent its recurrence?

I) Measures adopted by governments in a period of crisis

1 See Time magazine, Wednesday February 4, 2009, "Protectionism on the rise in Europe ?"

Government interventions either to contain the crisis or to prevent the occurrence of a new crisis are varied, substantial and, as we shall argue, a number of these interventions, whether in the financial sector or in the real sector of the economy, entail serious risks of an anticompetitive effect.

Measures taken by governments can be divided between measures aimed at shoring up the financial sector and ensuring the stability of financial markets and measures aimed at addressing the effects of the economic downturn on the real economy. These measures can be either included in comprehensive schemes at the national level or implemented independently from such comprehensive schemes when the type of intervention required does not fit a general model.

1) Measures aimed at restoring confidence in financial markets and ensuring the stability of financial markets.

The aim of such measures is to lessen the impact of the crisis by injecting liquidities in the financial sector, to offer reassurance that weak banks or financial institutions will not fail, to restructure the banking sector, to restore the efficient functioning of the credit market.

These measures include:
- Injections of large amounts of liquidity into financial markets by central banks;
- Guarantee schemes covering new issuances of short and medium-term debt to assist banks, credit institutions, pension funds or insurance companies unable to access interbank funding to overcome a temporary liquidity shortage;
- Explicit government guarantee of financial institutions' liabilities to restore confidence in the banks;
- Regulatory capital forbearance, which allows banks to overstate their equity capital in order to avoid the costs of contractions in loan supply,
- Recapitalization measures for banks and insurance companies. The nature, scope and conditions of recapitalization schemes vary considerably. Banks can be recapitalized through government bonds, subordinated debt, preferred shares, purchases of bad loans, credit lines, assumption of bank liabilities, ordinary shares or cash[2].
- Carving-out of insolvent banks' bad loan portfolios (usually accompanied by organizational restructuring of the banks);
- Restructuring of the banking and financial sector in order to increase the stability of these sectors. There have been many examples of such restructuring such as those of Bear Stearns, Morgan Stanley, Northern Rock, Fortis, ING, IKB, West LB, and Hypo Real Estate, to mention a few.

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2 The European Commission indicated on 8 April 2009 that since the beginning of the crisis it had authorized State Aid to the European financial sector for a maximum amount of 3000 billion Euros. A large part of this amount (2300 billion Euros) of State Aid was in the form of state guarantees of the liabilities of banks which Member States would have to pay only if the banks failed. Another 300 billion Euros of State Aid authorized by the European Commission was for recapitalization of financial institutions and 400 billion Euros of State Aid authorized were for the restructuration of the financial sector. In the United States, as of January 2009, capital injected in recapitalization schemes amounted to US$ 265 billion.

Some of these measures can distort incentives and have potential anticompetitive effects both on domestic markets in the country implementing them and internationally.

The Irish experience offers a good example of the way in which a bank guarantee scheme can be discriminatory and trade distorting as well as competition distorting. On 2 October 2008, following a crash in the value of bank stocks on the Irish stock exchange, Ireland's finance minister announced that the Irish Government had decided to grant a sweeping unlimited guarantee on all bank deposits at its six main banks for the next two years, to maintain financial stability. The potential value of this insurance amounted to €400 billion insurance ($560 billion). The Irish Government did not propose to underwrite the non-Irish banks which were competing with the Irish Banks, thus creating a potential domestic competition problem[3]. Furthermore, the announcement of the guarantee for Irish banks triggered a cross-border flow of cash from British businesses to Irish banks and the value of the stocks of those banks increased considerably. This cross-order movement made the British banks more fragile and drew an angry reaction from the British Government who called on the Irish government "to look quite closely at the arrangements they are putting in place to make sure they comply with EU competition law.". The British Government rightfully denounced the discriminatory and anti-competitive nature of the Irish scheme. Under the pressure of the European Commission the Irish Government was forced to amend its scheme and to provide for the non-discriminatory coverage of banks with systemic relevance to the Irish economy (not just "Irish" banks), in order to bring it in line with European law. On 13 October 2008, the European Commission approved the amended Irish Government scheme to guarantee deposits and debt to eligible banks active in the Irish market.

If we now move to recapitalization schemes, the United Kingdom experience with Northern Rock shows that such schemes also have the potential to disrupt competition. In August 2007, Northern Rock plc experienced extreme funding difficulties as a result of a liquidity shortage in wholesale money markets. The British Government granted various public support mechanisms to Northern Rock and the bank was taken into temporary public ownership (TPO) in February 2008. At the time, Northern Rock was the only bank in the United Kingdom receiving public support and, as a result, there were concerns about the impact its public support could have on competition in the banking market. The Office of Fair Trading[4] pointed out that in the personal current account, savings and investment product markets, elements of public support such as TPO and deposit guarantees might create a perception among consumers that Northern Rock was 'safer' than other banks. As a result, consumers concerned about the stability of banks might choose Northern Rock because it was the only bank with a 100 per cent deposit guarantee. Northern Rock might therefore be in a position to expand its market share. In a market characterized by natural customer inertia, consumers might not switch back to other banks offering better rates and the anticompetitive effect of the TPO might extend to the long term. A second concern expressed by the OFT was that Northern Rock might be able to take advantage of a lower cost of capital in money markets to offer lower rates on its mortgages. As the OFT explained: "If Northern Rock's rivals were, or still are, unable to access capital at equivalent costs for the sole reason that they did not receive public support, then this distortion may allow Northern Rock to expand its market

[3] The Irish guarantee scheme can be contrasted with the Slovenian guarantee scheme which was adopted in December 2008. The Slovenian Guarantee scheme (with a capped value of 12 billion €) is available to all solvent Slovenian credit institutions, including Slovenian subsidiaries of foreign banks.

[4] Northern Rock: The impact of public support on competition, Office of Fair Trading, March 2009

share. This could lead to an adverse impact on competition that may in turn lead to consumer harm. When public support is withdrawn, and the cost of capital rises, it will be unlikely that such attractive mortgage rates will still be made available by Northern Rock. Consumers may not switch to take advantage of other suppliers and so will end up paying more". The competitive risk associated with the government takeover of Northern Rock was not lost on its competitors or the press. "Banks protest at Northern Rock's unfair advantage", reported the Evening Standard in February. "Northern Rock rivals complain of unfair competition," said The Times one month later. "Northern Rock cuts mortgage rates as rivals go up," reported the Daily Mail. "(…) with interbank lending once again ground to a halt — but with the full weight of tax-payers' funds stood behind them — what's to stop Fannie, Freddie, Northern Rock and all the other government-owned lenders from dominating their markets…pumping out tax-funded loans at politically-friendly rates of interest"? asked another commentator[5]. To alleviate those concerns, the Northern Rock Restructuring Plan issued in March 2008 included a chapter on "Working within the Competitive Framework", which stated that Northern Rock recognised the responsibilities it had during the State aid period and the need to avoid competitive distortions in the markets in which it operated. The restructuring plan included a number of commitments by Northern Rock designed to minimise risk of competitive distortion. In particular, Northern Rock committed itself not to promote the Bank's offering on the basis of Government guarantee arrangements, not to sustain a prolonged market leadership in any product category and to maintain market shares at well below historic levels. The sheer existence of such commitments and the fact that they required an elaborate monitoring system (originally the OFT was to report annually on the competitive implications of the public support for Northern Rock) is a testimony to the difficulties for the competitive process associated with bailouts of failing banks. It is only through commitments by bailed out banks that they will not compete or develop their market shares that one can hope to counteract the effects of state intervention, but those commitments are at least difficult to design and risk decreasing competition on the market rather than maintaining it[6].

Bank mergers may also have the potential to restrict competition. This can be illustrated again by the British experience.

To put into perspective the events of September 2008 regarding the UK government engineered acquisition of HBOS Plc by Lloyds TSB for 12.2 billion pounds ($17.8 billion), it is worth recalling that in 2001 Lloyds TSB had considered buying Abbey National. At the time this merger was prohibited by the UK Competition Commission, on the grounds that it would have

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5 Adrian Ash, Worldwide Bank Bailouts, OpenMarket.org: http://www.openmarket.org Oct 2nd, 2008

6 In the case of Northern Rock, the OFT published a monitoring report in 2009. With regard to the personal current accounts savings and investment product markets, the OFT while noting the fact that the market share of Northern Rock was minimal on these markets also found that any adverse impacts on competition arising from changed consumer perceptions caused by public support were likely to be minimal. In the mortgage market, the OFT considered that it was unlikely that Northern Rock would be able to use public support as a means to access funding at rates likely to distort competition in the mortgage market.

An important element noted by the OFT in its report was that a number of circumstances which occurred after the Northern Rock restructuring plan was adopted may have lessened the potential anticompetitive impact of the Northern Rock bail out, such as the fact that public support was eventually granted to a number of other banks, the fact that the British Government announced a number of measures designed to increase the funding available to SMEs and to support the mortgage market.

led to a substantial lessening of competition on retail markets for personal customers and SMEs. The Lloyds TSB/ Abbey National merger would have resulted in Lloyds TSB having a share of around 27% on the market for personal accounts. The collective share of the big four UK banks would have risen from 72 to 77%, and according to the Competition Commission, the concentrated market structure, combined with the fact that entry was considered unlikely, would have facilitated tacit collusion among the big four. In September 2008, HBOS and Lloyds TSB announced their merger plans. On 24 October 2008, the Office of Fair Trading issued a report on the merger. The report stated that the merger between HBOS and Lloyds TSB would lead to Lloyds TSB having a share of around 33% on the market for personal accounts and 28 % of the U.K. home-loan market; the collective share of the big four UK banks would rise from 67 to 80%. Thus, from a structural point of view, the merger between HBOS and Lloyds TSB would lead to a higher level of concentration on the market for personal accounts than what the merger proposed in 2001 between Lloyds TSB and Abbey National would have led to, had it been authorized.

Unsurprisingly, the Office of Fair Trading Report on the Lloyds TSB /HBOS Plc[7] proposed merger stated that: “there is a realistic prospect that the anticipated merger will result in a substantial lessening of competition in relation to personal current accounts, banking services for small and medium sized enterprises and mortgages.” The OFT was also concerned by size and behaviour of the combined business post-merger and by the loss of HBOS as a leading challenger to the four established retail banks. The Office of Fair trading examined the question of whether “the failing firm defence” applied to the case. The OFT considered that the defence was not available: “it is not realistic to consider that HBOS would have been allowed to fail (or that its assets would have been allowed to exit the market”. The OFT, suggested an alternative solution which would be less threatening for competition. HBOS could remain independent with some government support, and in the longer term either sold to a third party with no competition issues or returned to independent operation. Given the competitive risks associated with the merger, the Office of Fair Trading recommended to the Secretary of State that the merger should be sent for review to the Competition Commission.

The British Government was determined to see the merger through but none of the public interest grounds which allowed the Secretary of State to ignore the opinion of the Office of Fair Trading and allow the merger to go through, without referring it to the Competition Commission, was applicable to the case. In order to achieve its goal, the UK government then decided to change the applicable law. On 24 October 2008, the same day that the OFT published its report, an amendment to the UK’s merger control rules came into effect. It introduced a new public interest consideration to be weighed against the consideration of effect on competition: “maintaining the stability of the UK financial system”. On 31 October the Secretary of State swept aside competition concerns and cleared the transaction on financial stability grounds.

2) Extending the reach of regulation in the financial sector

7 OFT, Report to the Secretary of State for Business Enterprise and Regulatory Reform on the anticipated acquisition by Lloyds TSB plc of HBOS plc, 24 October 2008

There is a natural tendency for governments to extend the reach of regulation in order to insure themselves against a recurrence of the crisis. It seems intuitively obvious to risk averse policy makers that had the financial sector been better and more comprehensively regulated, the financial crisis and therefore the subsequent economic crisis would have been avoided.

Not only is regulation seen as a guarantee for stability in the future, but it is also seen as a necessity to restore confidence in financial markets and a necessary condition to put economies back on a growth trend. There is a widespread opinion that the crisis has shown that during the 1990s standing rules and regulations governing financial markets did not keep pace with major developments in financial markets. Whereas the development of new instruments and innovation in financial markets is seen as a positive development, it is also retrospectively clear that there were insufficient independent verifications of the risks associated with these instruments.

Calls for more regulation have been heard in an number of areas.

For example, some have suggested that banking should be regulated with a view to preventing banks from being simultaneously present in different lines of business (such as commercial banking, investment banking, asset management and insurance). One of the rationales for such a proposal is that these different activities have different risk profiles and require different prudential ratios and that when a bank is engaged in a variety of such activities, there is a possibility that it will use assets coming from operations requiring the lowest prudential ratio to finance its more risky activities. Another rationale is to prevent excessive concentration in the banking sector. For example, in March 2009, when Joseph Stiglitz, Chair of the Commission of Experts on Reforms of the International Monetary and Financial System convened by the President of the United Nations General Assembly, presented the conclusions of the Commission, he observed that the focus on inflation had prevented a sustained consideration of the underlying problems of financial stability and that regulatory problems had compounded that situation. Insufficient regulation had allowed banks to grow so large that they were deemed "too big to fail". Joseph Stiglitz concluded that market economies worked when effective competition existed, but that when there was a failure in competition, as in the case of mammoth banks, they broke.

With respect to the scope of regulation, there have been proposals to regulate hedge funds, in particular, to force them to be more transparent regarding their financial structure and the financial links they have with regulated entities. It has also been suggested that they should be subject to prudential constraints as banks are.

With regard to financial instruments, it has been suggested that CDOs should fall within the purview of banking regulation, that limits should be imposed on the securitization of mortgages, that the recourse to off-balance instruments to hide risky assets should be limited, that accounting rules for banking assets should be changed to avoid the pro-cyclical effect of the mark to market rules.

It has also been proposed that the financial incentives of bank managers and traders (such as bonuses and stock options) should be regulated. It is clear that problems of corporate governance that had been recognized early in the decade during the Enron and WorldCom scandals have not been appropriately addressed. According to some observers, there is a need to better link the rewards of managers with long term rather than short term performances of banks.

Finally, it has also been suggested that credit rating agencies which rate the credit worthiness of their clients and combine credit rating activity with consultancy should be regulated or that public credit rating agencies independent of the rated firms should be created.

The G-20 communiqué of the London Summit reflects the move toward extending regulation in the financial market. The G-20 member states agreed, among other things: "to extend regulation and oversight to all systemically important financial institutions, instruments and markets (including systemically important hedge funds), to endorse and implement (…) tough new principles on pay and compensation and to support sustainable compensation schemes and the corporate social responsibility of all firms". They also agreed to: "prevent excessive leverage and require buffers of resources to be built up in good times" and "to call on the accounting standard setters to work urgently with supervisors and regulators to improve standards on valuation and provisioning and achieve a single set of high-quality global accounting standards" and "to extend regulatory oversight and registration to Credit Rating Agencies to ensure they meet the international code of good practice, particularly to prevent unacceptable conflicts of interest".

All these proposed regulations may have an anti-competitive effects and, if they are not well designed, such effects may go beyond what is strictly necessary to achieve their prudential goals.

For example, regulation designed to separate commercial banking and investment banking may have the effect of limiting structural competition between banks. Regulations designed to alter the valuation methods of bank assets will necessarily have an effect on the ability of individual banks to extend credit and therefore on the level of competition on the credit market.

The examination of the proposals to regulate credit rating agencies (CRAs) also illustrates the potential risks of such proposals on competition in the credit rating market. Initiatives by regulators and legislative bodies to scrutinize the functioning of credit rating agencies (CRAs) were prompted, before the start of the financial crisis, on both sides of the Atlantic by such accounting scandals as those of Enron, Worldcom and Parmalat, companies that were still rated "investment grade" a few days before they filed for bankruptcy. The massive failure of risk appraisal of assets and firms which led to the financial crisis only increased the urge to improve regulation of CRAs[8].

Credit ratings helps lenders allocate capital to creditworthy borrowers and investors to invest in in instruments of credit worthy firms. But security and banking regulators have also relied on credit ratings. For example, in June 1999, the Basel Committee proposed a revised capital adequacy accord, finalized in June 2004 (the "Basel II Agreement"), which provides that banks have the option of relying on ratings provided by CRAs to assess counterparty credit risk, for the purpose of calculating their capital requirements. The US SEC also relies on CRAs assessments of the riskiness of assets of financial institutions it regulates.

8 For a comprehensive discussion of the CRAs and their performances see Amélie Champsaur: "THE REGULATION OF CREDIT RATING AGENCIES IN THE U.S. AND THE E.U.: RECENT INITATIVES AND PROPOSALS Seminar in International Finance, mimeo, Harvard Law School, 2005

The inaccuracy of credit ratings could distort incentives, cost structures and competition. If banks are able to use credit ratings in order to calculate capital requirements (as under the Basel II rules), they have an incentive to select highly rated borrowers since doing so mechanically lowers their capital requirements. If credit ratings do not adequately reflect credit risk, the bank's capital structure might give the illusory impression that it constitutes a sufficient "cushion" against risk, which could threaten the safety and soundness of the banking system.

The question then is whether competition on the market for credit rating will spontaneously lead to the elimination of CRAs giving inaccurate assessment of the risk quality of assets. There are several reasons to doubt that good quality credit rating will spontaneously emerge from a competitive market for credit rating.

First, regulated financial institutions which have constraints on the credit worthiness of the assets they can hold to meet their capital requirements may have an interest in having CRAs underestimate the riskiness of some of their assets so they can more easily meet their capital requirements. In such cases, CRAs may be tempted to implicitly or tacitly collude with their clients to underestimate the risk of their assets.

Second, there is the possibility of conflicts of interest for CRAs. Issuers who buy credit rating services may be tempted to pressure a CRA into issuing a higher rating if they are not capitalistically independent of the issuers or if the issuer accounts for a large percentage of the CRA's revenue. Furthermore, CRAs sometimes provide other services besides credit ratings such as comprehensive analyses of ratings for investors and market professionals, who are often paying subscribers, access to databases and tools for research and credit risk modelling, general information services, such as general news, macroeconomic and industry analysis, impact of current events, market trends, and credit default surveys, and "rating assessment services" for strategic projects, which involve giving an opinion on potential ratings, given scenarios described by the issuer for strategic acquisitions, mergers and spin-offs. The provision of these services may lead to a conflict of interest in the CRA/issuer relationship if the issuers are tempted to buy some of those services from their CRA in order to obtain higher ratings.

Third, it is far from obvious that market competition will necessarily lead CRAs providing poor quality (i.e. unreliable) credit ratings to exit the market because the demand for credit rating services seems to be inelastic to price and to quality. Indeed there are no close substitutes for the service rendered by CRAs, and each issuer tends to buy credit rating services from several CRAs,

Fourth, structural competition between CRAs is at best weak. The market for credit rating services is dominated by 3 major rating agencies acting worldwide (Standard & Poors, Moody's and Fitch Ratings), which together have a 90% market share and the remaining 10% are shared by a number of smaller, regional and/or specialized agencies. In addition, there are high "natural" barriers to entry. As the Committee of European Banking Supervisors (CESR) has noted : "New CRAs face a number of natural barriers to entry (…). The very nature of the CRA market might make it difficult for new CRAs to succeed. Issuers usually only desire ratings from those CRAs that are respected by investors.(…) Investors could be reluctant to accord the ratings of a new entrant the same regard as those of established CRAs because new entrants lack historical default rates by which investors can compare performance to that of other CRAs. As a result, issuers may be reluctant to engage a new entrant for a rating. Without investor or issuer interest, it may take considerable time for a CRA's rating business to become self-sustaining". In addition, there has been concern that the fact that regulators use the "credibility" criteria in order to recognize CRAs for regulatory purposes, this may further increase the dominant position of the established CRAs – and thus potentially diminish credit rating quality, since smaller, recently created or foreign CRAs that might produce objectively reliable ratings obviously have greater difficulty doing so.

Over recent years, the debate has thus been about what should be done to ensure reliable credit rating services. Some have argued that there is no need to regulate CRAs since regulation is costly and serves only the purpose of protecting investors who do not have the competence and resources necessary to conduct their own, in-depth credit analysis. According to this view, disclosure of CRAs' conflicts of interest and methodologies should be sufficient for those investors to assess whether credit ratings are reliable and to discourage them from using unreliable CRAs. However, others commentators consider that because credit risks assessments are incorporated into a variety of contractual and regulatory structures, investors and lenders no longer have the option to rely on them or not and in most cases must rely on several CRAs. As a result, competition cannot discipline the market and ensure good quality risk assessments. One option would then be the regulation of credit ratings. Another would be the regulation of CRA activities (such the imposition of a code of conduct to ensure the integrity of the credit rating process) as a means of ensuring credit rating reliability.

Whereas self-regulation was the preferred solution until the beginning of the crisis, recently, the regulatory option has gained ground in Europe. However, some questions remain about whether the adopted solution guarantees the maximum amount of competition compatible with the regulatory goals.

In December 2004, the International Organisation of Securities Commissions ("IOSCO") published a voluntary code of practice to which a number of CRAs, including S&P, Moody's and Fitch have since adhered[9]. On 19 May 2008 the Chair of the CESR task force on CRA, stated: "The events of last year surely merit a thorough re-evaluation of the current self-regulatory regime"[10]. The European Regulation on Credit Rating Agencies was approved on 23 April 2009. It aims to ensure that ratings will be: "independent, objective and of adequate quality". It establishes a mechanism for CRAs to be registered with their home member states' competent authorities, and for their EU affiliates to be supervised by a "college of supervisors" co-ordinated and moderated by CESR. A CRA's home regulator can withdraw the CRA's registration, pursuant to the processes set out in the Regulations. Credit institutions (i.e. banks) may only use, "for regulatory purposes" (i.e. for the calculation of regulatory capital), ratings which have been issued by a CRA that is registered within the EU, or satisfies an "equivalence criteria" which is defined in the Regulation. Under certain conditions, registered CRAs can endorse the ratings of entities or instruments given by their affiliates outside the European Community. The conditions are that the registered CRA can verify on an ongoing basis that the conduct of the third country CRA operates under a no-less-stringent supervisory regime; that there is an objective reason for

[9] This code was updated in 2009

the rating to be performed in the third country rather than within the European Community; and that there is an "appropriate" co-operation agreement in place between the national regulator of the registered CRA and the third country CRA's regulator. Ratings of third country CRAs relating to third country instruments or entities may be used by credit institutions for regulatory purposes provided (amongst other things) that a cooperation agreement between the Commission and the third country regulator is in effect; that the European Commission has adopted an "equivalence decision" confirming the standards of regulation in the third country equivalent to EU standards and that the third country CRA has been "certified" by the CESR.

The Regulation aims to set behavioural standards for CRAs, such as increasing transparency and improving their standards of corporate governance. For example, the Regulation imposes standards of internal governance to ensure (amongst other things) that CRAs manage any conflicts of interest, have independent compliance departments and review their rating methodologies periodically. Additionally, the analysts or persons who approve ratings must not "make proposals or recommendations, whether formally or informally, regarding the design of structured finance instruments on which the credit rating agency is expected to issue a credit rating." The Regulation also prescribes time periods during which former analysts may not take up certain positions within entities they have rated. Those conditions are fairly similar to the prescriptions set out in the IOSCO Code of Conduct.

This Regulation imposes an increased administrative, disclosure and supervisory burden, although for CRAs that already comply with the IOSCO Code of Conduct Fundamentals, the transition required to be Regulation compliant may be less than the changes that they have already undertaken.

However, as some commentators have pointed out, for third country CRAs looking to do business within the EU, and for EU credit institutions looking to buy securities rated only by third country CRAs, the impact of the Regulation may be considerably harsher. Thus, whether the Regulation reflects the right trade-off between competition and regulation and the promotion of competition is open to debate[11].

3) Measures aimed at preventing the extension or the deepening of the economic crisis in the real sector.

Stimulus packages are plans intended to contain the scale of the downturn, to stimulate demand and confidence, and to boost long-term competitiveness. They tend to propose countercyclical macro-economic responses to the crisis in the form of ambitious sets of actions to support the real economy. Most stimulus package measures tend to boost demand. Some measures, however, boost supply of specific products.

Typical stimulus measures will include:
- Direct aid to ailing business firms or small and medium size firms which are collateral victims of the credit crisis;
- Subsidized interest rate;

[11] Edmund Parker, Miles Bake and Kevin Hawken , EU Regulation of Credit Rating Agencies approved, 24 April 2009, www.mondaq.com

- Sectoral aid designed to boost demand in specific sectors.

With respect to the general stimulus packages, a widely quoted report of the World Bank published in early 2009[12] notes that some countries, fearing leaks may benefit foreigners, have inserted discriminatory conditions into their fiscal programs to prevent such seepage when they consider using budgetary deficits as a means to support demand.

A good example of the discriminatory nature of such a plan is the attempt to introduce sweeping “Buy American” procurement rules in the US plan. The American Recovery and Reinvestment Act (ARRA) adopted in February 2009 includes two provisions that require government procurement of US produced products. One provision requires the use of US produced steel, iron and manufactured goods in public works funded by the ARRA, subject to certain exceptions (public interest, non-availability or unreasonable cost). The second provision requires the Department of Homeland Security to procure US manufactured textile and apparel goods.
However, following President Obama’s intervention, the ARRA requires that these provisions be applied in a manner consistent with US obligations under international agreements. Further, Congress has indicated that the "buy American" provision for iron, steel and manufactured goods is not intended to apply to LDCs. Even though the US government backed off to some extent in response to international pressure, US state and municipal governments will be able to impose restrictions on the origin of steel and manufactured goods in procurement markets[13]. Other countries have followed the US example. For example, in February 2009, Uruguay adopted an anti-crisis programme including the "Buy Paraguayan" plan, which establishes a 70% preferential margin for domestic firms in government procurement.

With respect to sectoral aid, a number of markets have been deeply affected by the consequences of the financial crisis. The automobile sector is one of them. As a result, a number of countries have taken specific measures to help this industry. For example, besides the United States, Argentina, Brazil, the United Kingdom, Canada, China, France, Germany, Italy and Sweden, which have all provided direct or indirect subsidies to carmakers, Australia provided support to its car dealers and South Korea and Portugal supported their components suppliers. The World Bank estimates that proposed subsidies for the car industry amount to US$48 billion, mostly in high-income countries. Nearly 90% of this was in rich countries, where it was part of budgetary packages to stimulate demand. From the standpoint of competition, such measures may have adverse effects on competition if they are designed, voluntarily or involuntarily, in a discriminatory way (i.e., if they benefit some competitors but not all market participants).

For example, in France, in addition to an auto bailout plan which dedicated up to US$7.7 billion (€6 billion) to the failing auto industry in the form of credit lines, a French “Cash for Clunkers” scheme was implemented in December 2008 and will run through the end of 2009. A controversy

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12 Elisa Gamberoni and Richard Newfarmer, Trade Protection: Incipient but Worrisome Trends, Trade Notes, 2 March 2009.

13 For example, the Canadian press has reported that a Toronto area company that exports water treatment technology to the U.S., Hayward Gordon Ltd., has been pursuing a Maryland contract that could be worth $200,000; but the bid document asks the company to "provide a list of all iron, steel and manufactured goods `not' produced in the United States to be precluded from the funding."

erupted in February 2009 as to whether the French auto bailout plan was compatible with EU competition rules. On 5 February 2009, President Sarkozy had indicated that he wished that: “the movement toward relocating plants outside France be stopped and that, if possible, jobs be repatriated to France” He added: “If financial aid is given to the automobile sector for restructuring, it is on the condition that no new plant will be moved to the Czech Republic or elsewhere”. On 10 February 2009, the EC Competition Commissioner’s spokesman stated that if the aid granted by the French Government to the automobile industry was conditioned on the fact that the recipients had to maintain their production units in France, such aid would be illegal under EU competition rules. That same day, the EU presidency (exercised under the rotation system by the President of the Czech Republic) denounced the “ protectionism” of the French Government. So did the German Government. On 11 February 2009, EC Commissioner Neelie Kroes wrote to French governmental authorities to ask them the detailed provision of the automobile sectoral aid plan and on 27 February 2009 the Commission approved the aid measures.

Another good example of support measures which distort competition is provided by the "cash for clunkers" bill which was discussed in February 2009 by the U.S. Congress. Incentives of up to $7,000 were to be provided to owners of vehicles at least 8 years old to purchase fuel efficient models, but the incentives were to apply only to vehicles built in North America, and would favour US made vehicles over Canadian made vehicles.

4) Protectionist measures

Protectionist policies as a response to the crisis come in many forms[14].

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As we have seen, developed countries frequently resort to subsidies to troubled industries but they more rarely resort to erecting border barriers (such as custom duties increases). This is due to the fact that global sourcing has changed the political economy of protection. The preference for subsidies to troubled industries reflects the fact that industries in developed countries import many of their components[15].

But direct protectionist border barriers are occasionally erected even in developed countries.

For example, the United States gave in to lobbying by the Teamsters Union and US trucking interests and, as part of the U.S. economic stimulus package, the U.S. Congress cancelled a 2007 demonstration project allowing importation of some Mexican trucks into the US, thus violating a provision of the 1994 North American Free Trade Agreement permitting Mexican trucks to carry goods to and from the U.S. In response, Mexico is imposing tariff increases on 90 U.S. products, with a value of US$2.4 billion.

The resurgence of antidumping actions (initiated by developed and developing countries) is another observable trend.

14 Globalisation and trade The nuts and bolts come apart, 16 March 2009, from The Economist.

15 Globalisation and trade The nuts and bolts come apart, 26 March 2009, from The Economist.

Parallel to a substantial increase of cases at the WTO in 2008, antidumping proceedings at the national level also seemed to be on the rise and trade frictions led to acrimonious debates. A World Bank report states that between 1 July and 31 December 2007 the reported number of initiations declined by 7 per cent compared to the number reported during the corresponding period in 2006. However, during the first half of 2008 (1 January to 30 June 2008) the situation changed and on 20 October 2008 the Secretariat reported a 'surge in new anti-dumping measures' of 39 per cent compared to the corresponding period of 2007. India was the biggest initiator of anti-dumping actions, accounting for 29 % of total initiations. In December 2008, India initiated actions involving both hot and cold rolled stainless steel products and affecting 19 countries (including Japan, China, South Africa and Thailand). The US and the European Union imposed duties most frequently. According to the World Bank report, in December 2008 the EU imposed duties on preserved fruits from China as well as on imports of welded tubes and pipes of iron or non-alloy steel from Belarus, China and Russia.

The Report of the WTO Director General to the Trade Policy Review Body of this organization at the end of March 2009 notes that the trend toward more numerous antidumping actions at the national level has continued in 2009.

For example, in January 2009 the EC imposed anti-dumping duties from 26.5% to 85% on imports of certain iron or steel fasteners from China.

In February 2009 the EC imposed provisional anti-dumping duties of 3.7%, 8.6%, or 24.9% on imports of certain bars and rods, of iron, and non-alloy steel or alloy steel other than of stainless steel, originating in China and Moldova. China initiated an antidumping investigation on terephthalic acid imports from Thailand and Korea.

Antidumping investigations against Chinese footwear imports have been initiated in Argentina, Brazil, and Canada. In early March 2009 Argentina initiated an anti-dumping investigation on road wheels for trailers and semi-trailers imported from China. Brazil imposed definitive anti-dumping duties on: phenol (from EU and the US); glassine papers (from Finland and the US); and ammonium nitrate (from Russia and Ukraine). In March 2009, the EU also imposed provisional anti-dumping duties on imports of "biodiesel" originating in the United States for a maximum period of six months. That same month, the United States imposed anti-dumping and countervailing duties on welded stainless steel pressure pipes from China and Canada imposed final anti-dumping and countervailing duties on aluminium extrusions from China.

U.S. steel mills filed a suit with the US Department of Commerce on 8 April 2009, complaining that rising imports from China have hurt the US steel industry, provoking a sharp reaction from China's Ministry of Commerce accusing the US of blatant protectionism and declaring that it would pay close attention to the suit filed by the U.S. which could be worth $2.7 billion.

Whereas tariff increases represent, according to the World Bank report, about one third of the protectionist measures implemented between October 2008 and February 2009, they represent about one half of the measures implemented by developing countries. Indeed, in many developing countries applied tariff rates on imports are significantly lower than bound duties, which means that tariffs can be raised legitimately without governments having to face the sanction of WTO action.

For example, in October 2008 Turkey imposed additional duties as a safeguard measure imposed on imports of cotton yarn from all countries. In December 2008 it imposed import tariff increases on a number of products such as iron-steel – hot rolled flat products (up to 13%); iron-steel cold rolled flat products (up to 14%); iron-steel-coated flat products (up to 6%-15%); wheat, buckwheat, rye, barley and oats, unprepared cereal straw and husks (from 50% to 80%); and dried apricots, prunes, apples (from 41% to 43.2%)
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In January 2009, Ecuador raised its custom tariffs on 630 products (from cereals to cell phones and tennis shoes), accounting for 8.7% of its imports, for one year to restore its balance of payments. Russia imposed temporary increases of import tariffs on a number of products such as cars (up to 30%); trucks (up to 25%); buses (up to 25%); particular types of flat metals (up to 15%); particular types of ferrous metal pipes (up to 15%-20%); butter and certain types of dairy products, milk and dairy cream (up to 20%); and rice and milling products.

In February 2009, Indonesia increased import tariffs on 17 tariff lines such as petrochemical, steel, and electronic parts.

In March 2009, Ukraine imposed import duty surcharges up to 13%, except for "critical imports", for a period of up to six months, with a view to restore its balance of payments. That same month, Vietnam increased import tariffs on semi-finished products of iron or non-alloy steel from 2% to 5%; and for bars and rods of iron or non-alloy steel from 5% to 12%.

A number of developing countries have also resorted to non-tariff barriers, sometimes called “creative protectionism”.

For example, in November 2008 India introduced licensing requirements for imports of certain steel products and auto parts. Also, in November 2008, Malaysia imposed new technical regulations for 57 steel products, requiring certificates of approval for conformity with Malaysian Standards.

In December 2008 and January 2009, China tightened safety rules and stopped imports of a wide range of European food and drink products, including Irish pork, Belgian chocolate, Italian brandy, British sauce, Dutch eggs, and Spanish dairy products.

In January 2009, India tightened its safety rules and banned Chinese toys.

In February 2009, Argentina introduced reference prices covering around 1,000 imported products considered sensitive (such as auto parts, textiles, TV, toys, shoes, and leather goods) and further non-automatic import licensing requirements, covering products such as textiles, steel, metallurgical products, and tires. That same month, Indonesia imposed new licensing, reporting, and pre-shipment inspection requirements on over 500 goods (food and beverages, toys, electronics, footwear, and garments). It restricted entry points for those products to six seaports and all international airports.

Finally, as unemployment increases in many countries, labour policies may have a protectionist dimension. For example, on 26 February 2009, US President Obama, in his first budget speech, said his administration would do away with tax breaks for firms outsourcing jobs to overseas destinations, including India. In the United States, Section 1611 of the ARRA (adopted in February 2009) requires that recipients of Trouble Assets Relief Programme (TARP) funds and certain other forms of support comply, for a limited period (two years), with additional attestation requirements when hiring H-1B workers.

In the United Kingdom, there has been a debate about the use of Portuguese and Italian contractors in oil refining which resulted in labour disruption during January 2009. Malaysia is reported to have imposed a ban on the hiring of new foreign workers in key services and manufacturing sectors. Such policies are likely to have serious consequences for developing countries as their amount of remittance revenues will, in all probability, decrease significantly.

Overall, the World Bank report has warned about the resurgence of protectionist policies, notably among the G 22 member countries, in spite of numerous calls from trade economists and political leaders both in developed and in developing countries against such policies and in spite of a commitment of the G-20 leaders, on 15 November 2008, not to implement such measures.

According to this report, since the beginning of the financial crisis, officials around the world have proposed and/or implemented roughly 78 trade measures. Of these, 66 involved trade restrictions and 47 of these trade-restricting measures eventually took effect. Worse is the fact that 17 of the G-20 members have implemented 47 different measures whose effect is to restrict trade at the expense of other countries.

II) Concerns for competition raised by measures implemented by governments to fight the financial and economic crisis

As is clear from the previous section, a large number of policy responses to the crisis have direct or indirect potential (or, in some cases, are designed) to reduce competitive pressures, either domestically or internationally, on financial markets or on real markets.

There is very little concrete evidence of the quantitative impact of these measures on the importance of trade or on the intensity of competition and it is possible that so far they have had only a limited impact. However there is a concern that, as the economic crisis deepens and unemployment increases, more measures of the types previously described will be implemented in the near future. Thus, even if the measures adopted in the past have only had a limited impact, there is no certainty that this will continue to be the case in the future.

The adoption of measures which, directly or indirectly, restrict trade and competition has led to a lively debate.

With respect to the effect of some of these measures on international trade, Paul Krugman[16], discussing the Buy American Act, has argued that in the absence of an internationally coordinated fiscal stimulus, such a provision may offset the extra trade benefit enjoyed by countries which choose not to stimulate demand through fiscal policy and free ride on countries

[16] Paul Krugman , “Protectionism and stimulus (wonkish)”, 1 February 2009, New York Times

which do implement such fiscal stimulus. As he puts it: “My fiscal stimulus helps your economy by increasing your exports — but you don’t share in my addition to government debt”. But, Krugman’s argument does not guarantee that protectionist measures will totally offset the benefits enjoyed by the free riding countries and therefore cannot be used as an argument in favour of protectionist policies. What Krugman does, however, is point out the fact that the absence of an internationally coordinated fiscal stimulus response to the crisis will create an incentive for countries which implement such stimuli to engage in protectionist anticompetitive policies.

With respect to whether the competition limiting effect of measures adopted to respond to the crisis, contributes to speeding up or slowing down recovery is also a topic of debate.

Protectionist and competition limiting measures are sometimes justified in reference to the New Deal cartelization policies, included in the National Industrial Recovery Act (NIRA), which suspended antitrust law and permitted collusion in some sectors provided that industry raised wages above market clearing levels and accepted collective bargaining with independent labour unions.

For example, Gauti B. Eggertsson[17] argues that government policies that increase the monopoly power of firms and the militancy of unions are expansionary when certain “emergency” conditions such as zero interest rates and deflation exists and that these conditions were satisfied during the Great Depression in the United States.

Harold L. Cole and Lee E. Ohanian[18], have an opposite point of view. They do agree that anticompetitive practices were allowed to develop in the post depression era and they give interesting evidence on the extent to which competition was disregarded in the US during the 1930s. In particular, they point out that for a twelve month period starting in June 1935, the Interior Department received identical bids from steel firms on 257 different occasions, and that these bids were 50% higher than foreign steel prices. Wholesale prices in 1935 were 24% higher than they should have been and even by 1939 they remained 14% higher. But, according to Cole and Ohanian, cartel prices fed through to unrealistic wages and unemployment was 25% higher than it would have been otherwise. The authors conclude that the recovery from the Depression would have been much stronger if these policies not been adopted and that the Depression may have lasted seven years longer than necessary.

Luc Laeven and Fabian Valencia[19], basing themselves on a study of a sample of 42 well documented systemic banking crises episodes (in 37 countries), suggest that accommodative policy measures are fiscally costly and do not necessarily accelerate the speed of economic

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17 Gauti B. Eggertsson Federal Reserve Bank of New York Staff Reports, Staff Report no. 264 : “Was the New Deal Contractionary?”, October 2006.

18 , ‘New Deal Policies and the Persistence of the Great Depression: A General Equilibrium Analysis’, Journal of Political Economy, vol. 112, no. 4. 2004.

19 In reviewing crisis policy responses it is useful to differentiate between the containment and resolution phases of systemic restructuring.

recovery. They also point out that “a lack of attention to incentive problems when designing specific rules governing financial assistance can aggravate moral hazard problems, especially in environments where these institutions are weak, unnecessarily raising the costs of resolution”.

Overall, the arguments in favour of a positive link between a restriction on competition or a restriction on trade and the speed of recovery seem rather unconvincing.

Even if it were established that a decrease in competition has the potential to speed up recovery, a question would remain about the long term cost of this acceleration (i.e. whether the short term benefits from boosting the economy would be commensurate with the long term costs to society due to the restriction of competition brought about by the policy responses to the crisis).

There is a large body of literature, both theoretical and empirical, linking competition, productivity, growth and innovation. This literature is the basis on which competition law and policy as well as trade policy rest and the sheer fact that we are experiencing a crisis, albeit a severe one, does nothing to render invalid the assumptions on which those policies were built and have expanded over the past several decades.

Thus, an important concern is that by engaging in short term quick fixes, which directly or indirectly limit competition and restrict international trade to try to revive their economies, governments will durably weaken their countries’ prospects for economic growth and development.

This may occur in two types of situations. In some cases, the anticompetitive effect or the negative impact on trade and competition of the measures considered is clearly perceived and the adoption of the measures results from a deliberate choice by policy makers (for example, the adoption of discriminatory provisions in rescue packages). In other cases, (such as the adoption of measures to promote domestic consumption or the definition of bailout plans for financial institutions or for firms in the real sector), it is far from clear (at least in some countries) that the policy makers are even aware of the possible implications for competition and trade of the measures they seek to design and implement.

In the EU, rescue schemes and state aids of EU Member States are reviewed by the EU Commission before they are implemented, to ensure their compatibility with competition principles.

The EU Commission expresses concerns about the impact on competition of general guarantee schemes covering the liabilities of financial institutions. While recognizing that they might constitute an effective tool for contributing to financial stability and maintaining credit supply to businesses, the Commission imposes conditions on such schemes, such as the fact they must be non-discriminatory, limited to the strict minimum, and provide for private sector contributions as well as for remuneration and create no undue distortion of competition. As a practical matter, the Commission focuses on three elements in its review of national general schemes covering the liabilities of financial institutions: first, on eligibility criteria, to avoid discrimination; second, on pricing, to make sure that prices come as close as possible to the market price and reflect the beneficiaries' risk profiles and third, on safeguards to minimize distortions of competition.

As far as recapitalization schemes are concerned, the same principles are applied by the EC Commission. It requires that the pricing of state capital injections into fundamentally sound banks be based on base rates set by central banks to which a risk premium is added, that it has to reflect the risk profile of each beneficiary bank, the type of capital used and the level of safeguards accompanying the recapitalization.

But in most countries state aid is outside the scope of competition law and competition authorities are not always in a position to advocate for competition when measures which may have adverse effects on competition or trade are being drafted, much less to impose conditions to ensure their innocuousness.

In contrast with the EU, in the US, antitrust is a statutory law and thus is not guaranteed by the US Constitution. Also, in normal circumstances, state aid is granted by individual states rather than by the US federal government. There is no mechanism providing for the scrutiny of federal aid from the standpoint of its impact on competition. As an example, in a recent discussion at the OECD Competition Committee, the then Chairman of the FTC, Bill Kovacic, admitted that he had waited in vain for a phone call from the Treasury Department or the White House to consult him or his office on the drafting of the bailout plans for US automobiles manufacturers.

Besides rescue schemes, the rise in protectionist measures is a second (and serious) source of concern, not only because such measures tend to restrict competition and trade directly (at a time when trade volumes tend to decline as a result of the economic recession due to weak demand and a decrease in trade financing) but also because the adoption of such measures leads to retaliation which will further affect trade and competition.

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Furthermore, attempts by governments to safeguard their domestic industries at the potential expense of others entail the risk of escalation, with governments outbidding one other to attract economic activity, ultimately leading to a subsidy race. For example, Canada has already matched the subsidies the US gave Detroit automakers to ensure that the Canadian plants of American automakers would remain open[20].

Concern about the use of such measures is important because multilateral agreements provide little insurance against domestic subsidies, use of anti-dumping or the other forms of protection. WTO action against subsidies is not easy. Claire Brunel and Gary Clyde Hufbauer[21], argue that the support of the United States and of most other countries for their auto industries falls within the purview of the WTO definition of actionable subsidies. But, they explain : “fuel-efficiency and environmental standards complicate the issue, and bringing a case to the WTO based on environmental mandates would be hard to justify politically. Moreover, since virtually all major auto exporters have implemented some auto industry aid, any country that brings the first case to the WTO can expect to be challenged with a case against their own auto measures. Therefore, it is unlikely that WTO cases will arise on auto-assistance measures”. In such circumstances, the

20 David Crane, “Protectionist measures delay recovery: A key lesson from the Great Depression is that protectionism made everyone worse off” Toronto Star, 26 March 2009.

21 Claire Brunel and Gary Clyde Hufbauer “Money for the Auto Industry: Consistent with WTO Rules?”, Peterson Institute.

imposition of national countervailing duties, further eroding international trade, is the more likely response. But even if countervailing duties are imposed, it is far from obvious that the target country will abandon its subsidies as it has another option, which would be to reduce its exports.

Finally the proposed extension of regulations in the financial sector raises a third general concern about the extent to which the design of such regulations is likely to have either incentive distorting effects or anticompetitive effects.

A large body of research on regulatory reform has been undertaken by the OECD (and elsewhere). This research suggests that poorly designed product market regulations are a serious impediment to competition, employment, productivity and growth in many economies[22].

There are a number of links between deregulation of product-markets and employment. Studies suggest that easing anti-competitive product market regulation may have a positive effect on employment[23]. Reducing barriers to entry curbs market power of incumbents and makes entry of competitors possible, which would raise the activity level and thus labour demand. More intensive competition lowers product market rents and, to the extent that these rents are partly appropriated by workers with bargaining power, decreases wage premia helping to close the gap between wages and productivity[24]. It has also been suggested that competition by putting downward pressure on prices of goods and services raises real wages, which stimulates labour supply. At a more general level, other studies show that competition on product markets forces companies to be more efficient and to increase labour or multi-factor productivity, for instance by adopting new technologies and being innovative. Nicoletti and Scarpetta[25] show that countries in which public ownership in the business sector is limited and barriers to entry are low are more successful at improving multi-factor productivity growth (MFP) than countries with stringent anti-competitive regulation. Some studies find a positive link between regulation and productivity at the firm level[26] thus complementing the industry-level analyses. These studies suggest that

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22 For a comprehensive analysis see Anita Wölfl, Isabelle Wanner, Tomasz Kozluk and Giuseppe Nicoletti: " Ten Years of Product Market Reform in OECD Countries – Insights from a Revised PRM Indicator, OECD Economics Department Working Papers No.695

23 See, for example, Blanchard, O., F. Giavazzi (2003), "Macroeconomic Effects of Regulation and Deregulation in Goods and Labor markets", *The Quarterly Journal of Economics*, Vol.118, Nicoletti, G. and S. Scarpetta (2005), "Product Market Reforms and Employment in OECD Countries", *OECD Economics Department Working Papers* No. 472, OECD, Paris, Griffith, R., R. Harrison (2004), "The link between product market reform and macro-economic performance", *European Economy – European Commission Economic Papers*, No. 209, Griffith, R., R. Harrison and G. Macartney (2007), "Product Market Reforms, Labour Market Institutions and Unemployment", *Economic Journal*, Royal Economic Society, Vol. 117(519), pp. 142-166

24 Fiori, G., G. Nicoletti, S. Scarpetta and F. Schiantarelli (2007), "Employment Outcomes and the Interaction Between Product and Labour Market Deregulation: Are They Substitutes or Complements?", IZA Discussion Papers 2770, Institute for the Study of Labour (IZA); Griffith, R., R. Harrison and G. Macartney (2007), "Product Market Reforms, Labour Market Institutions and Unemployment", Economic Journal, Royal Economic Society, Vol. 117(519), pp. 142-166

25 Nicoletti,G., and S. Scarpetta (2003), "Regulation, Productivity and Growth", Economic Policy, Vol. 18, No. 36 (April).

26 Arnold, J., G. Nicoletti and S. Scarpetta (2008), "Regulation, Allocative Efficiency and Productivity in

burdensome regulations are harmful for the ability of the economy to allocate resources to the most efficient firms and for productivity growth in firms operating close to the technological frontier.

What holds for product markets regulation is also relevant for regulations in the financial market. Whereas it is clear that securing the stability of the financial sector is an important policy objective, maintaining a sufficient level of competition in the financial sector is and must also be an important policy goal. Indeed, at a time when governments are trying to revive the credit market and to stimulate demand, it is particularly important that banks have an incentive to pass on to consumers the advantages they get from cheaper refinancing costs. But a lack of competition (or distorted competition between financial institutions) may prevent this result. Thus, there is a trade off between two objectives in the regulation of the financial sector.

This trade off is not always perceived because of the way in which regulation is produced (i.e., without sufficient interaction between sectoral authorities and competition advocates to discuss the least disruptive way of meeting the goal of the regulation).

Yet, as was mentioned previously, the regulation of the structure of the banking sector could entail a social cost in terms of reduced competition between banks. Similarly, the regulation of bonuses in financial institutions may lower the incentives for promising managers to pursue a career in this sector. Finally as we have seen, several directions have been suggested for reforming credit rating agencies, with different implications for competition.

The work undertaken in the OECD on the relationship between product market competition, employment, productivity and growth has been one of the foundations of the advocacy work undertaken by this institution in the area of regulatory reform. Member countries have been urged to undertake systematic regulatory reform programs, to consider regulatory impact assessments for new laws or regulations and to be peer reviewed on the quality of their regulation. In this context, tools have been designed to identify unnecessary restraints and develop alternative, less restrictive policies that still achieve government objectives, such as the "competition assessment toolkit" of the OECD. Similar instruments have been devised in a number of countries. These tools can be used in different ways. The most common use for these instruments is an overall evaluation of existing laws and regulation (in the economy as a whole or in specific sectors). But these instrument can also be used to evaluate draft new laws and regulations (for example, through regulatory impact assessment programs at the centre of government) and there is good reason to believe that, at a time when governments feel the urge to engage in sweeping regulation updates for the financial sector, a systematic assessment of the possible effect on competition of these regulatory changes is necessary.

When thinking about the consequences of our brief description of the policy responses to the financial and economic crisis, four elements must be taken into consideration.

First, we must consider the prevalence and the diversity of policy responses which are likely to lead to restrictions in trade and competition. Such responses may imply fiscal incentives,

OECD Countries: Industry and Firm-level Evidence", *Economics Department Working Paper*, No. 616, OECD, Paris domestic regulations, restructuring of industries or trade measures.

Second, the fact that there is no unique reporting system on these policy responses. It is striking from this point of view that the World Bank report and the WTO report, mentioned previously, are based partly on press articles to try to get a comprehensive view of policy responses to the crisis around the world. This may be due to the fact that policy responses to the crisis are diverse, as mentioned previously, and therefore that they are implemented by different branches of governments.

Third, the fact that the competition oversight of the policy responses to the crisis, when it exists, is disjointed and, for the most part, limited. For example in the EU, the Commission controls state aid granted by Member States. But the DG Competition is not consulted on other measures which restrict trade and competition, such as the imposition of antidumping duties. At the level of the EU Member States, not all national competition authorities are consulted on new regulations which limit competition. Even in countries where the law provides that national competition authorities should be consulted, because most such authorities are independent of the executive branch of the government, they do not participate in the final drafting of new regulations or of bailout plans. In the US, the situation seems even more unsatisfactory, since there is no competition oversight of federal bailout plans. It may be possible that the Antitrust Division of the US Department of Justice is informally consulted on some policy responses to the crisis (the FTC does not seem to be consulted at all); but this process, if it exists, is not transparent and does not guarantee an effective competition oversight. In other countries, competition authorities are for the most part not directly involved in the decisions of the executive branch of the government.

Yet it is clear that the adoption of policy responses which are thought to have an immediate effect on the level of activity or on the soundness of the financial sector, but unduly restrict competition, will expose the countries where these policy responses are adopted to a cost in the future. By adopting such measures these countries, sometimes unknowingly, limit their future growth opportunities thus delaying or making impossible the full recovery of their economy

Fourth, the examples we have mentioned clearly show that the policy responses to the crisis adopted by governments often restrict competition and international trade simultaneously and may lead to trade retaliation. Thus the domestic effect of these policy responses cannot be considered independently of their international repercussions.

III) Recommendations and conclusion

The first recommendation for governments is to achieve a greater co-ordination of fiscal stimulus schemes. As we have seen, lack of coordination between governments in their effort to revive demand leads to a desire by countries which have the most ambitious stimulus packages to ensure that there will be no leakage for the benefit of countries with less ambitious packages. This pushes theformer to include in their plans, or to add to their plans, protectionist measures which in turn lead to retaliation and the imposition of more trade or competition restricting measures.

One of the indirect consequences of the need for greater coordination of fiscal stimulus schemes is that there is also a need to enlarge representation in the institutions of global economic governance. As the Institute of Development Studies argued in a recent brief[27], and as Dominique Strauss Kahn remarked in a speech at OECD in February 2009, the G20 excludes most of the developing countries and a number of developed countries. This grouping therefore has not only a problem of legitimacy but also a risk of ineffectiveness in promoting international cooperation.

The second recommendation is that world leaders complete the Doha round of trade negotiations. A reduction of tariff ceilings is urgently needed when, as we have seen, governments are tempted to increase tariffs. A stronger multilateral discipline over protectionist measures is necessary at a time of economic recession. Improving the safeguards mechanism would reduce the temptation of governments to rely on antidumping measures. A lower cap on agricultural and industrial subsidies is required to give some breathing space to developing countries at a time when the demand for their raw materials or manufactured products is declining.

Third , and most importantly, there is a need for governments to be more aware of the fact that all of their direct or indirect interventions in the financial or real markets, whether through stimulus packages designed to increase domestic demand or to support supply, or through protectionist measures or through regulation are likely to alter (and in many cases to distort or to dampen) competition. They must be reminded that quick fixes or attempts to ensure a safer world are likely to have a long term cost in term of efficiency and growth. Governments should, at the very least, be aware of the trade-offs, so as to be in a position to tailor their responses to the economic and financial crisis.

From this standpoint, it is worth noting that the regulatory reform movement which started in the late 1990s and developed the early 2000s at a time of economic expansion (when there was primarily a need to verify that past legislation still had a valid purpose and that changing economic conditions did not make this past legislation more restrictive than what was strictly necessary to ensure the attainment of the goals they had been assigned) needs to be adapted to the current situation of economic crisis. Indeed, we are in a period when a large number of new direct or indirect government interventions in market mechanisms are contemplated, as well as the adoption of a large number of sweeping new regulations. Rather than waiting for these changes to take place and then examining ex-post whether they have unduly limited competition, there is a need to minimize the risks of disruption due to policy responses to the crisis. In other words, it is necessary to move decisively from ex post regulatory reform to ex ante competitive assessment of contemplated government interventions.

Furthermore, because, as mentioned previously, a large number of the policy responses adopted by governments have the object or the effect of limiting international competition, it is in every country's interest to ensure its trading partners will not adopt responses which will limit international trade and competition. Thus, it would be desirable for all trading nations to commit

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_Will the Global Financial Crisis Change the Development Paradigm? Institute of Development Studies Policy Brief, March 2009.

themselves to carry out transparent competitive impact assessment of all financial rescue packages, state aid plans to particular sectors or new regulations proposed as a response to the economic and financial crisis, prior to their implementation. In other words we should move decisively from a system of disjointed and optional competition assessment to a system of comprehensive mandatory competition assessment of the policy responses to the crisis.

The results of these competition assessments (and the contributions to any public consultations undertaken) should be made immediately available to all the trading partners of the government contemplating the measures as a response to the crisis. Not only would such a commitment enlighten each government contemplating the adoption of policy responses to the crisis as to the long term risks of the measures they consider, but by forcing each government to reveal to its trade partners the impediments to competition they are contemplating, it would facilitate retaliation by these trading partners and therefore it would discourage each government from unduly adopting competition and trade restrictive measures. Thus, we should move decisively to a system of transparent, independent, and public competition assessment.

As we all know: the sun is the best detergent.