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Global Forum on Competition

DOES COMPETITION KILL OR CREATE JOBS?

Contribution from BIAC

-- Session I --

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DOES COMPETITION KILL OR CREATE JOBS?

-- Business and Industry Advisory Committee (BIAC) --

1. The Business and Industry Advisory Committee (“**BIAC**”) of the Organization for Economic Cooperation and Development (“**OECD**”) is pleased to submit this paper to the OECD Competition Committee's Global Forum on Competition for its discussion on the links and drivers between competition and employment.

2. In BIAC's experience, pro-competitive policies increase economic activity and thus have a positive effect on employment. In industries where there is greater competition, there is generally increased productivity, whereas restrictions on competition have been shown to reduce both output and employment. While productivity gains or innovation may result in layoffs of individuals in the short-term, these same factors often lead to increased efficiencies in a given industry, which in turn will typically lead to wider benefits in related industries and the economy, through lower prices for inputs and/or services and greater demand and employment.¹ Policies that focus on pro-competitive factors, such as innovation and efficiency, should therefore be preferred over policies that introduce non-competition considerations, such as protection of regulated industries.²

3. Although this brief paper focuses on the effect on employment from the perspective of horizontal mergers, BIAC notes that other restrictive regulations and legislation may also have an adverse impact on long term employment.³

1. Competition and Employment

4. It is widely recognized that competition in markets for goods and services increases economic activity. The more intense the level of competition, the lower the prices; these lower prices increase demand, which, in turn boosts employment.

¹ For an overview analysis of efficiency claims in antitrust matters, see: OECD Competition Committee, *The Role of Efficiency Claims in Antitrust Proceedings*, Policy Roundtables, (BIAC), (October 25, 2012). DAF/COMP(2012) 23 (2013).

² The views of BIAC in this paper are largely consistent with the position set out with the paper issued by the Secretariat, *Does Competition Kill or Create Jobs – Links and Drivers between Competition and Employment*, Global Forum on Competition, July 20, 2015). DAF/COMP/GF(2015) 1.

³ Restrictive statutes and regulations that introduce industrial policy into the merger review process may build national champions and protect local jobs in the short term but also lead to anti-competitive outcomes which may have an effect on employment in the long term. For example, in Australia, in 2015, the Final Report of the Competition Policy Review Panel recommended the abolition of the liner shipping exemption in the *Competition and Consumer Act, 2010*, and deregulation of the current cabotage regime, opening freight routes to competition. See: Australia, *Competition Policy Review, Final Report, March 2015*, (Australia: Competition Policy Review, 2015).

5. This important linkage between competition and employment has been demonstrated by empirical analysis of the retail sector in France, where the heavy regulation imposed on that sector until 2008 was shown to have had a significantly negative impact on employment.⁴ Product market regulation in France is tighter than the OECD average, particularly in retail trade. This regulation has resulted in poor productivity performance as compared with other economic sectors and a scarcity of competition reflecting the structure of the market.⁵ If France had the same employment rate as in the U.S. in the retail sector or in the hotel and catering sectors, all of which are regulated and protected from competition in France, France would gain 3.5 million jobs.⁶

6. The idea that an incumbent should be protected in order to fight against job destruction is often put forward. However, most economic analysis shows that regulations that limit entry by less labour-intensive firms may save jobs in the short run but this effect quickly disappears, as other countervailing effects tend to dominate job protection. Firstly, the main effect of these regulations is to increase prices, which decreases demand and is detrimental to employment. Secondly, these measures also tend to limit innovation, which puts a brake on the development of new products, and limits job creation. Thirdly, regulation limits productivity gains. This can favour job protection only if the demand elasticity for the product concerned is low, which is rarely the case.

7. There can be a tendency by governments to enact competition policy to protect national sectors or “national champions” from the competition represented by imported products. For example, President George Bush had promised to limit steel imports during a campaign in the state of West Virginia, where many steel manufacturers were established. An *ex post* study demonstrated that this measure allowed 3,500 jobs to be saved in the steel manufacturing industry but eliminated 12,000 to 43,000 jobs in firms that used steel as an input;⁷ such firms may be located regionally and nationally and thereby job losses may have a consequence on the economy over a greater geographic range than just West Virginia.

8. In the U.S., over the years 1987 – 1997, employment reallocations in the retail sector explained 80% of the growth of productivity in that sector: that is, less than 20% of the increase came from reallocation of jobs inside existing firms.⁸ Online retail continues to expand and has remarkably innovated the retail sector which traditionally involved bricks and mortar centers of commercial activity.

9. Macroeconomic analyses of international data aim at establishing a link between obstacles to competition and a level of employment in each observed country. These studies, such as those of the OECD or the World Bank, show a very strong correlation between the rank of a country in terms of its competitive landscape and employment rate: that is, in countries where heavy regulation of markets,

⁴ M. Bertrand and F. Kramarz “Does Entry Regulation Hinder Job Creation? Evidence from the French retail industry”, (2002) 117:4, *Quarterly Journal of Economics*. 1369-1414.

⁵ OECD. “Better Policies Series: France – Restoring Competitiveness” (OECD Publishing: November, 2013), pages 25-26.

⁶ P. Cahuc and M. Debonneuil, "Productivité et emploi dans les services", *Rapport du Conseil d'Analyse économique*, 2004.

⁷ G. Hufbauer and B. Goodrich, “Steel protection and job dislocation” (2003), Washington: Institute for International Economics.

⁸ M. Baily, E. Bartelsman and J. Haltiwanger “Labor Productivity, Structural Change and Cyclical Dynamics” (2001), 83:3, *Review of Economics and Statistics*, 420-433.

including entry barriers, prevail, the employment rate is lower than in countries where the levels of state regulation is low.⁹

2. Mergers and Innovation

10. Innovation has a remarkable capacity to propel economic growth and job creation. The future prosperity of an economy is intractably linked to its promotion of research and development (“R&D”).¹⁰ In 2007, the OECD concluded that innovation has been the primary driver of the increases in material standards of living that have occurred since the industrial revolution.¹¹ Though economists disagree over the precise impact of R&D spending on economic growth,¹² there is a general consensus that the benefits of innovation are significant.¹³

11. In the context of competition policy, the interplay between innovation, job creation and mergers is complex. While some mergers have the potential to lessen innovation (by reducing the incentives to innovate, as discussed below), many increase innovation by combining R&D resources and streamlining product innovation. These innovation-enhancing mergers may, in turn, generate new, high-paying jobs within their respective jurisdictions.¹⁴ In addition, this innovation process may lead to job reallocation in related industry sectors as a result of changes in input requirements to these related sectors. The overall productivity across these sectors can increase due to this replacement process,¹⁵ even though individual jobs may not be safeguarded.

a) Positive Effects of Mergers on Innovation

12. When reviewing mergers, the overwhelming focus of competition authorities in developed countries has been the potential consequence of market concentration on the price of goods.¹⁶ The reluctance of competition authorities to methodically examine the non-price aspects of competition, such as innovation and other related efficiencies, extends largely from the fact that these variables are difficult

⁹ P. Conway, V. Janod, and G. Nicoletti “Product Market Regulation in OECD countries: 1998-2003” (2005) OECD Economic Department Working Papers No. 419. (World Bank: 2015).

¹⁰ J. Brodly, “Proof of Efficiencies in Mergers and Joint Ventures” (1996) 64 *Antitrust Law Journal* 575. Also worth noting that in his seminal research into the determinants of economic growth, Robert M. Solow determined that approximately four-fifths of growth in U.S. output per worker during the first half of the 20th century was attributable to technical progress. See: Robert M Solow, *Technical Change and Aggregate Production Function*, (1957) 39 *Rev. Econ. & Stat.* 312.

¹¹ OECD, “Innovation and Growth: Rationale for an Innovation Strategy” (Paris: OECD, 2007) at page 6.

¹² Some economists have challenged Solow’s quantitative analysis.

¹³ Edwin Mansfield et al., “Social and Private Rates of Return from Industrial Innovations”, (1997) 91 *The Quarterly Journal of Economics* 221. This article suggests that R&D displays a very high marginal social return.

¹⁴ The links between innovation and job creation are well-established. See, e.g., Greg Linden, Jason Dedrick and Kenneth L. Kraemer, “Innovation and Job Creation in a Global Economy: The Case of Apples’s iPod”, (2008) 3:1 *Journal of International Commerce and Economics*; Michael E. Porter and Mark R. Kramer, “Creating Shared Value: How to Reinvent Capitalism and Unleash a Wave of Innovation and Growth,” *Harvard Business Review* (January-February 2011).

¹⁵ L. Foster, John Haltiwanger and C-J. Krizan. “Aggregate productivity growth: Lessons from Micro-economic evidence” in Dean, Harper and Hulten eds., *New Developments in Productivity Analysis*. (University of Chicago Press: 2001). The authors demonstrate that in the sector of automobile maintenance, the increase of productivity is entirely due to new firms. The effect of productivity on the presence of incumbent firms is negative.

¹⁶ Richard J. Gilbert and Steven C. Sunshine, “Incorporating Dynamic Efficiency Concerns in Merger Analysis: the Use of Innovation Markets”, (1999) 63:2 *Antitrust Law Journal* 569 at 572.

to quantify.¹⁷ Nevertheless, BIAC believes that the role of innovation-enhancing mergers in generating economic growth and jobs warrants further consideration by competition authorities. Restraints on innovation, as BIAC noted in 2007, “may cause considerably greater social harm than restraints on price.”¹⁸ Beyond the direct effects of mergers on innovation, Steven Salop and Gary Roberts highlight the potential for market concentration to drive innovation through indirect means, including by speeding the pace of technical processes and reducing prices by facilitating innovations that initiate technological diffusion and induce competitive innovations.¹⁹

b) Negative Effects of Mergers on Innovation

13. Mergers that concentrate markets can, in some circumstances, have the unintended consequence of reducing innovation. As outlined by Kenneth J. Arrow, a monopolist may feel less pressure to innovate than a new entrant or a business in a highly competitive sector.²⁰ These views are contradicted by those of Joseph A. Schumpeter, a leading proponent of the view that the incentive to innovate is strongest where the risk of imitation by competitors is lowest.²¹ For businesses to be willing to compete through innovation, according to Schumpeter, the prospective returns from R&D investment must be substantial and cannot be undermined by the risk of losing market share to competitor firms.

c) The Challenge of Innovation for Competition Authorities

14. Economic theory provides a wide range of predictions concerning the relationship among market structure, innovation and the effects of mergers on economic growth and jobs. Determining the precise effect of competition on innovation is further complicated by the multitude of firm, industry and jurisdiction-specific factors affecting innovation. Despite these challenges, BIAC believes that an assessment of the impact of a potential merger on innovation is important to avoid the possibility that innovation-enhancing, and thereby job-creating, mergers would be disallowed by competition authorities.

3. Employment Considerations and Merger Review

15. In BIAC’s view, an efficiency analysis should be an integral component of a merger review, as any gains in efficiency have the capacity to generate innovation and otherwise offset anti-competitive effects,²² and thereby lead to job growth in the long term.

¹⁷ Dennis A. Yao & Susan S. DeSanti, “Innovation Issues Under the 1992 Merger Guidelines”, (1993) 61 *Antitrust Law Journal* 505; OECD Competition Committee, *Dynamic Efficiencies in Merger Analysis*, Policy Roundtables, (BIAC), DAF/COMP(2007) 41 (2008) [OECD (2008)] at 249.

¹⁸ OECD (2008), *Supra* not 17, at 249.

¹⁹ Gary L. Roberts and Steven C. Salop, “Efficiencies in Dynamic Merger Analysis,” (1996) 19:5, *World Competition Law and Economics Review*.

²⁰ Kenneth J. Arrow, “Economic Welfare and the Allocation of Resources to Invention”, in *The Rate and Direction of Inventive Activity* (Cambridge, MA: National Bureau of Economic Research, 1962): 609-625.

²¹ Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* 106 (1950). (In particular, Schumpeter concludes that “What we have got to accept is that the large scale establishment or unit of control has come to be the most powerful engine of progress and ... long-run expansion of total output ... In this respect, perfect competition is not only impossible but inferior, and has no title to being set up as a model of ideal efficiency.”).

²² In the UK, the UK *Enterprise Act*, 2002 (the “EA”) enables efficiencies to be taken into account in the form of relevant customer benefits. The Competition and Markets Authority (the “CMA”) must be satisfied that the efficiencies: (a) will be timely, likely and sufficient to prevent a significant lessening of competition; and (b) are merger specific (i.e., a direct consequence of the merger, judged relative to what would happen without it). In the U.S., pursuant to the Horizontal Merger Guidelines established by the U.S. Department of Justice (the “DOJ”) and

16. Although there can often be political pressure to maintain employment in the context of a merger, decisions reflecting employment directly are few and far between.

17. On 25 February 1992, the EC opened an inquiry under its merger regulation after Nestle S.A. formally notified its intention to buy Source Perrier S.A. The acquisition was approved in 1992, conditional on divestment of a mineral water brand. Trade unions challenged the EC's clearance of the Nestle-Perrier merger, arguing that the EC had failed to consult them properly and had thereby violated the Merger Regulation by failing to take employees' rights into consideration.²³

18. The EC argued that there was no obligation for it to examine a merger's impact on employment but the European Court of the First Instance ruled that the EC may have to ascertain whether the merger may have consequences on employees such as to effect the level of conditions of employment.²⁴

19. The Nestle decision has not been followed or cited on this point, however, from which it may be taken that employment considerations are not likely to influence future merger cases in the EU. The EC bases its assessments of whether a merger is compatible with the internal market on grounds that deal exclusively with competition criteria, to the exclusion of social or industrial policy considerations.²⁵ The current European position is reflected in statements by the EU Competition Commissioner Margrethe Vestager, recognising that the benefits of innovations have a significant impact on employment for EU citizens.²⁶

20. In South Africa, the *Competition Act of 1998* (No. 89 of 1998), identifies that the purpose of the statute is to promote employment and to advance the social and economic welfare of South Africans. Section 16 of the South African *Competition Act of 1998* sets out the statutory standard for merger review. Technological and efficiency gains that could offset any potentially anti-competitive effects from the merger are considered along with a number of other factors. However, public interest issues are also taken into account, including employment considerations as well as the ability of small businesses, or firms controlled or owned by historically disadvantaged persons, to become competitive.

the Federal Trade Commission (the "FTC"), efficiencies are considered as a factor in the analysis of whether a merger substantially lessens competition. Outside of this context, in the U.S. employment considerations are not generally part of the merger review process. To be considered, efficiencies must meet two conditions. First, the efficiency must be merger-specific, meaning it is: (i) likely to be accomplished with the proposed merger and (ii) unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anti-competitive effects. In Canada, The Canadian competition legislation provides for an explicit efficiency defence to an otherwise anti-competitive merger. Section 96 of the *Competition Act* creates a trade-off framework, under which efficiency gains that are likely to be brought about by a merger are evaluated against the anti-competitive effects that are also likely to result from the combination. Although the statutory framework does not specifically identify employment considerations, parties to a merger will most often include evidence of efficiencies expected to be gained by combining and reducing the workforce of the businesses, as long as such constitutes real cost savings.

²³ Comité Central d'Entreprise de la Société Anonyme Vittel and others v. Commission, T-124/93 [1995] E.C.R. II-2147 ; and Case T-964/92, Comité Central d'Entreprise de la Société Générale des Grandes Sources and others v. Commission, [1995] E.C.R. II-1213.

²⁴ Case T-124/93, *Supra*, note 23, para. 38.

²⁵ J. Bourgeois and C. O'Daly. "Changes in Competition Policy Over the Last Two Decades". Edited by Dr. M. Krasnodebska-Tomkiel. (Warsaw: 2010).

²⁶ Margrethe Vestager, "Intellectual Property and Competition" (Speech delivered at the 19th Annual Competition Conference of the International Bar Association. 11 September 2015. (Margrethe Vestager also stated that it is important to find the right balance between protecting incentives for inventors to develop new and useful technologies, and protecting consumers from the harms that patent abuse could wreak on the economy.)

21. In *The Metropolitan Holdings Limited and Momentum Group Limited*,²⁷ the Competition Tribunal established the principle of connecting job losses to efficiencies. The Competition Tribunal first assessed the competitive effects and concluded that the merger was unlikely to substantially prevent or lessen competition in any relevant potential market. However, the Competition Tribunal found that the parties were unable to show a rational connection between the efficiencies sought from the merger and the job losses claimed to be necessary; it held that the parties had to demonstrate that the employment losses could be justified for a public reason in order to offset the public interest in preserving jobs as a result of the merger. The Competition Tribunal also considered it necessary for a concerted effort to be made between the merging parties and labour unions to address employment losses as a result of the proposed merger.

22. In contrast, in Canada, section 96 of the *Competition Act* provides a statutory efficiency defence. Employment considerations, including preservation of jobs are not generally relevant. Indeed, real cost savings including reducing the quantity of employees to accomplish the same tasks are considered positive factors under the Canadian *Competition Act*. At the same time, more efficient entities tend to be more competitive over the longer term, which may lead to increased job security, again over the longer term.

23. BIAC acknowledges that placing emphasis on the social benefits of a merger at the expense of efficiencies and consequences on long-term employment, may appear relevant to preserve employment in developing or struggling economies. In BIAC's view, however, such considerations should not, in the long term, substitute for a competitive analysis of a merger with an emphasis on efficiencies. In such economies, too, the strengthening of the business, financial and market position of the enlarged company can result in more jobs in the long term.²⁸

4. Conclusion

24. As noted by the International Competition Network (“ICN”), as a general proposition, the merger review process should involve certainty, timeliness and transparency for all stakeholders. To that end, the ICN has previously advocated:

25. “If a jurisdiction’s merger test includes consideration of non-competition factors, the way in which the competition and non-competition considerations interact should also be made transparent.”²⁹

26. BIAC is concerned that many jurisdictions do not sufficiently consider efficiencies and their relationship to economic growth. Efficiencies that generate innovation provide an important source of not only wealth and consumer benefits, but also employment benefits to society at large, and should feature more prominently in merger reviews.

27. Moreover, BIAC firmly advocates the benefits of a competitive analysis over industrial policy whereby individual or national competitors or industries are protected at the expense of competition. As the U.S. Federal Trade Commission Chairperson Edith Ramirez stated:

²⁷ [2010] Case 41/LM/Jul10 (South Africa).

²⁸ European Foundation for the Improvement of Living and Working Conditions. “ERM Case Studies: The Consequences of Mergers and Acquisitions” (2008), at 9.

²⁹ International Competition Network, Merger Working Group: Analytical Framework Subgroup and the UK Office of Fair Trading, “The Analytical Framework for Merger Control” (Paper delivered at the ICN Annual Conference, 2002).

28. “The proper goals of competition law were best solved when a competition authority is focussed on competition effects and consumer welfare, and when its analysis is not interrupted to meet social and political goals.”³⁰

29. Similarly, the Canadian Competition Commissioner, John Pecman, has noted:

30. “Introducing industrial policy into the decision making process of an agency with a competition mandate is troubling and in my view can lead to sub-optimal outcomes. In contrast, basing such decisions exclusively on a solid competition analysis would lead to more efficient market outcomes.”³¹

31. Finally, BIAC supports competition authorities playing an advocacy role to thwart anti-competitive policies, such as protectionist industrial policies, particularly in countries where elected politicians may feel uneasy about being vocal advocates for competition.³²

32. Competition gives incentives to competitors to engage in research and development in order to promote innovation, including for the purpose of reducing labour costs. Competition authorities in their assessment of mergers should pay attention to the consequences of the proposed merger on efficiencies as a factor in the overall competitive analysis. Efficiencies gained by a merger may have short-term consequences on specific employees of the merging entities; however, the long-term consequences in that industry and in related industries may result in beneficial economic growth and greater innovation that will ultimately support more and better jobs. A consistent merger analysis across nations in this regard will lead to consistency in merger reviews and greater confidence by industry, thereby resulting in further investment, economic growth and innovation, all of which will be beneficial for employment.

³⁰ Edith Ramirez, U.S. Federal Trade Commission Chairperson, “Competition Law, Innovation and Economic Development Experience Sharing by Mature Jurisdictions.” (Speech delivered at the 3rd BRICS International Competition Conference, New Delhi, India, November 21, 2013).

³¹ John Pecman, Commissioner of Competition, “Competition Law in a Global and Innovating Economy – A Canadian Perspective.” (Speech delivered at the 3rd BRICS International Competition Conference, New Delhi, India, November 21, 2013).

³² In Australia, the Foreign Investment Review Board always seeks an opinion from the Australian Competition and Consumer Commission as part of the review process which gives the competition authority a direct role in promoting competition over narrower national interests. In 2015, the Australian Competition and Consumer Commission played a key role in impeding mining companies from engaging in coordinated reduction in production of iron ore in order to increase its price.