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DOES COMPETITION KILL OR CREATE JOBS?

Contribution from TUAC

-- Session I --

This contribution is submitted by TUAC under Session I of the Global Forum on Competition to be held on 29-30 October 2015.

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DOES COMPETITION KILL OR CREATE JOBS?

-- Trade Union Advisory Committee --

TUAC welcomes the opportunity to contribute to the session of the OECD Global Forum on Competition "Does competition kill or create jobs", 29 October 2015. The objective of the session – as outlined in an OECD Secretariat issues paper (DAF/COMP/GF(2015)1) – is to explore the nature of the relationship between competition reforms, including deregulation of industries, and employment, whether it is in the sector affected by the reform, or elsewhere in the economy, or even abroad.

1. OECD findings on the direct employment impact of de-regulation

1. Proponents of market de-regulation will argue that any negative impact on employment on the short term is likely to be compensated by a trickle-down effect that would happen somewhere, somehow and sometime in the economy on the longer term. For the upcoming discussion at the Global Forum on Competition however, it is important to focus first on the direct, measurable, impact that competition reforms may have on the employment of workers affected by the reform, including:

- Quantitative impact (job losses or creations);
- Qualitative impact, including the risk associated with job displacement (losing a job, finding another one, or not)

2. From that stand point of view what does recent OECD research tell us with regard to the direct impact of de-regulation on employment and job displacement? Two recent OECD research initiatives are worth considering with respect to (i) the employment impact of de-regulation of industries, and (ii) the risk of job displacement and how that risk is distributed among difference categories of workers.

1.2 Impact of product market reforms

3. De-regulation leads to loss in employment, loss in earnings, and loss in job security. A recent paper by the OECD Economics Dept.[1] on how deregulation of network industries affects people who work in these sectors, shows the following:

- The negative effects of deregulation for workers in network industries in terms of a reduced security premium do not occur immediately; they take about five years to unfold after reform.
- The empirical results strongly suggest that deregulating network industries creates costs for people working in these sectors, since their pay and job security fall. For illustration, the cumulated loss (over 30 years) due to the reduced wage premium from the deregulation since the mid-1980s for a worker who has been continuously employed in a network industry is about one annual labour income.
- Reforms deregulating network industries also lower the well-being of workers by reducing their job satisfaction.

1.3 Wider impact of job displacements

4. Looking at the impact of job displacement at large, that is the involuntary job loss due to structural change, including but not limited to competition reforms, and to economic downturns, a report

by the OECD published in 2013 "Back to Work: Re-employment and, Earnings and Skill-Use after Job Displacement"[2]. The key findings are:

- The costs of displacement appear to be mainly due to *non-employment spells*. Older workers and those with low education levels take longer to get back into work and suffer greater (and more persistent) earnings losses. Women are more likely than men to become disconnected from the labour market and experience longer spells of inactivity after displacement
- Displacement leads to *earning losses*: earnings losses tend to be fairly low in the Nordic countries, but much larger in the other countries examined in the report (Australia, Canada, France, Germany, Japan, Korea, New Zealand, Portugal, Russia, the United Kingdom and the United States).
- A decline in *job quality* after displacement. Re-employed displaced workers are more likely to work in part-time or non-permanent jobs than prior to displacement, and work shorter hours on average. Other measures of the quality of post-displacement jobs, such as the incidence of work at non-standard times, the availability of paid leave and whether workers have managerial responsibilities, also suggest a decline in job quality.
- Impact on *skills*: among displaced workers who use different skills in their new jobs, a number actually experience an upgrading in skill requirements. However, for a subset of displaced workers who experience professional downgrading – mostly women, older and mid-to-high-skilled workers – displacement brings in its train substantial human capital losses.

2. Indirect impact on employment and the economy

5. The standard argument goes that, even if opening up industries has negative effects on workers directly involved, it will still be beneficial for the economy (possibly even workers at large) because of effects and opportunities created in the rest of the economy even if these effects would take a longer time to materialise. While such a view can have its merits on occasions, it should also be stressed that this is still a limited view that does not take into account all of the factors at work. First, it needs to be established whether there actually are positive effects at work for the rest of the economy or whether positive effects are strong enough to outweigh negative effects.

2.1 The British case

6. Here, one case in point, referred to in the OECD issues paper as a 'natural experiment' is the liberalisation of the UK electricity generation sector resulting in a doubling of labour productivity and opportunities for employment further down the line. Such a view however does not take into account that, when privatised, power companies run at close to full capacity unlike the previous public company and that in consequence blackouts become more common. The costs from these are external and can be huge especially because they would disadvantage the competitive position of certain types of industries whose functioning is based on a reliable and secure supply of energy[1].

2.2 Wal-Martisation

7. Yet another illustration of the need to look at the whole picture on this issue, also referred to in the OECD paper, is the 'Wal-Mart' effect of zoning regulation (or the lack thereof) making it possible to set up enormous out-of-town centres. In the US in the nineties, this led to a major increase in retail

[1] Another example in this context is the privatisation of water companies where the usual strategy of equity capital is to push up profits and share prices by sharply reducing maintenance costs but with dire consequences in the medium or long run.

productivity (so large it also influenced the overall productivity numbers of the US) simply by the sheer size of these shopping malls. Meanwhile, business was taken away from centre town shopping. This had huge impact on the social environment and well-being of the latter – an 'external' effect which is typically not counted in mainstream economic analysis.

2.3 Real or statistical effect?

8. In a similar vein, if productivity effects are recorded in sectors or companies after opening up to competition, it needs to be examined whether these effects are real or only statistical. It may indeed be the case that, due to outsourcing of jobs such as cleaning or maintenance, jobs end up in other sectors with consequent effects on measured productivity. In "The Great Divestiture: Evaluating the welfare impact of the British privatizations 1979-1997", Massimo Florio, concluded "*I have been unable to find sufficient statistical macro or micro evidence that output, labour, capital, and TFP productivity in the United Kingdom increased substantially as a consequence of ownership change that privatisation compared to the long-term trend. There are exceptions for some firms and some periods but overall a significant productivity shock is lacking. I suggest that if one occurred, it was small.*" [3]

2.4 Pricing power

9. Furthermore, and as can be seen from the liberalisation of the electricity sector across the rest of Europe, new private players on the market tend to adopt dynamic strategies (of which non transparent pricing is one example, mergers to achieve economies of scale another) with the aim to restore a substantial degree of pricing power. When that happens, the wider trickle down effects to the economy are non or hardly existing.

2.5 Population density

10. Another effect that is however closer to the domain of mainstream economic analysis and yet rarely mentioned is the role of mobility in influencing the competitive position of economies. Not all of OECD territories are comparable to the United States. Whereas the US tends to be characterised by the availability of vast territories with low population density, other OECD countries – European countries and Japan in particular – tend to be far more densely populated. This increases the need to have robust zoning planification to avoid regional congestion creating structural problems of traffic and transport, problems which in turn would negatively impact the overall attractiveness for investment.

2.6 Deflationary risks in times of recession

11. Finally, the general effects of competition on the wider economy and employment are also determined by the state of the economy and, when the economy is in decline, the policy responses that are being enacted. This is an issue that is briefly raised in the OECD Secretariat issues paper. Indeed, while it is not the job of competition policy to stabilise the macro economy, it cannot always simply ignore what is happening in the wider economy.

12. In case of a deep recession, with inflation rates falling close to zero and monetary policy being constrained by the zero bound on interest rates, more deregulatory structural reform unleashing the forces of competition will aggravate the problem by pushing unemployment higher and prices and inflationary trends even lower, as stressed in the 2015 edition of the OECD Going for Growth publication[4]. Monetary policy, being already constrained by zero interest rates, will be unable to coop with this additional deflationary shock. The risk is then that, even if in theory the longer term effects would be positive, these longer terms effects do not materialise as the economy keeps stuck in this short term deflationary and depressionary equilibrium. However, in that case, not even the positive longer term effects would materialise as a prolonged period of depression would undermine the long term growth potential by a

multitude of effects (labour market hysteresis, emigration of skilled workers, deterioration of educational systems and performance, perverse investment incentives).

3. Mergers and Acquisitions

13. Mergers and acquisitions are usually justified by corporate management by the market opportunities and the "synergies" that such deals supposedly generate. By taking over other firms, it is claimed that M&As achieve synergies and thereby improve efficiency and productivity, and hence employment on the long run. It is also argued that the very threat or possibility of a hostile takeover is an important factor to ensure "discipline" on corporate management.

14. The positive impact of M&As on long term performance is largely debatable. A study covering 155 deals in Europe during 1997-2001 shows that performance deteriorates following hostile takeovers (by opposition to friendly takeovers) and tender offers (by opposition negotiated deals)[5]. Employees are most often, if not systematically to bear the cost of redundancies generated by M&As. M&As not appear be in the interests of long term shareholders neither, in whose name such deals are typically carried out. The winners are the shareholders holding short term positions in the companies and the executive managers when weak corporate governance rules prevail regarding executive compensation.

15. For trade unions, the rules governing M&As should be guided by the long term interest of the companies involved and of their stakeholders. In the UK, where the policy discussion on takeovers has been particularly vivid[6] and for a cause, the Trades Union Congress is advocating for decisions on takeovers not left solely to shareholders and for a "regulatory overlay that ensures that mergers and takeovers operate in the long-term interest of the company concerned", including a "long-term company interest test"[7]. TUAC called for similar requirements during the recent review process of the OECD Principles of Corporate Governance[8].

4. Conclusion

16. Competition, if it is used wisely, can be a force contributing to overall economic and social progress. However, when market competition is left on its own, it can quickly degenerate in 'cut-throat' competition where bad employers undercut the good ones. This not only results in poor social outcomes, with high poverty rates and sharp inequalities. It also risks to trap the economy in an 'low' equilibrium where poor work leads to poor productivity and where incentives for innovation are smothered because employers, instead of investing in innovation, have the alternative option of trying to address competitive pressure by dumping this pressure on the shoulders of labour[9].

17. Competition policy should never be "on its own". Competition policy needs to be looked at from the whole perspective of society. It cannot rely on taking a blind approach by assuming that competition will automatically and always and everywhere lead to better outcomes, including more and better jobs. For competition to work for all stakeholders, including affected workers, competition policy needs to be embedded firmly in the whole policy making process of an economy and this with the aim of balancing the different needs and objectives (employment, economic stability, environment, overall non-price competitiveness).

[1] "Who Gains and Loses From Structural Reforms? Preliminary Evidence From the Deregulation of Network Industries" - Working Party No. 1 on Macroeconomic and Structural Policy Analysis, ECO/CPE/WP1(2015)18

25 September 2015.

[2] Back to Work: Re-employment, Earnings and Skill Use after Job Displacement - October 2013 http://www.oecd.org/employment/displaced-workers.htm & http://www.oecd.org/employment/emp/Backtowork-report.pdf

[3] Massimo Florio, 'The Great Divestiture: Evaluating the welfare impact of the British privatizations 1979-1997' (2004). "I find mixed evidence among the industries I consider. In the electricity industry, we observe a clear increase of output per capita. The most convincing explanation of this increase is a changing technology, with the substitution of gas for coal as fuel. (…) In industries in which there was no change in technology, such as the gas industry, privatisation had a limited impact on long-term productivity trends." (343) "In conclusion, I have been unable to find sufficient statistical macro or micro evidence that output, labour, capital, and TFP productivity in the United Kingdom increased substantially as a consequence of ownership change that privatisation compared to the long-term trend. There are exceptions for some firms and some periods but overall a significant productivity shock is lacking. I suggest that if one occurred, it was small. (343-4)"

[4] http://www.oecd.org/economy/goingforgrowth.htm "Concerns associated with possible adverse effects of structural reforms under current cyclical conditions may also contribute to the reform slowdown. One concern is that GDP gains may take time to materialise or be preceded by short-term losses given wide aggregate demand shortages and deflation risks amid constrained macroeconomic policies and impaired fiscal positions in many countries, especially in the euro area. One particular risk is that pro-competition reforms may become counter-productive, namely contractionary, in the short to medium-term if monetary policy is constrained at the zero lower bound (ZLB) and, hence, unable to accommodate supply expansion by the standard means lowering policy rates." (p21)

[5] Martynova, Marina and Oosting, Sjoerd and Renneboog, Luc, The Long-Term Operating Performance of European Mergers and Acquisitions (November 2006). ECGI - Finance Working Paper No. 137/2006; TILEC Discussion Paper No. 2006-030. Available at SSRN: http://ssrn.com/abstract=944407

[6] "Takeovers and the Public Interest - Responsible Capitalism in Practice" Aeron Davis, David Offenbach, Richard Stevens & Nick Grant, Policy Network, July 2013 http://www.policy-network.net/publications_detail.aspx?ID=4435

[7] Among others, such "long-term company interest test" would include projections with and without the merger in terms of (i) financial indicators, including turnover, profitability and so on, (ii) Levels of debt and schedule for repayments, (iii), Levels of planned investment in Research and Development, training, (iv) Likely impact on employment, (v) Likely impact on suppliers and on local community. See "Mergers and Takeovers - Proposals for Reform", TUC, June 2010 https://www.tuc.org.uk/sites/default/files/Mergers%20and%20Takeovers%20TUC%20Briefing%20June10.pdf & "Beyond Shareholder Value: the reasons and choices for corporate governance reform" TUAC, 2014 https://www.tuc.org.uk/economic-issues/corporate-governance/economic-analysis/beyond-shareholder-value-reasons-and-choices

[8] TUAC proposal of marked of Principle II.H.1 "Markets for corporate control should be allowed to function in an efficient and transparent manner. (...) Transactions should occur at transparent prices and under fair conditions that take into account the long term interest of the companies involved and protect the rights of all shareholders according to their class and the rights of other affected stakeholders." see "The review process of the OECD Principles of Corporate Governance - Assessment by the TUAC Secretariat", September 2015 http://www.tuac.org/en/public/e-docs/00/00/11/0D/document_doc.phtml

[9] "Rigidities through flexibility: flexible labour and the rise of management bureaucracies", Alfred Kleinknecht, Zenlin Kwee and Lilyana Budyanto, Cambridge Journal of Economics, Aufust 2015, http://cje.oxfordjournals.org/content/early/2015/08/25/cje.bev056.abstract & "How 'structural reforms' of labour markets harm innovation" Alfred Kleinknecht, Social Europe, July 2015 http://www.socialeurope.eu/book/re-no-6-how-structural-reforms-of-labour-markets-harm-innovation/