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Summary of Discussion of the roundtable on Barriers to Exit

Annex to the Summary Record of the 132nd Meeting of the Competition Committee held on 3-4 December 2019

3-4 December 2019

This document prepared by the OECD Secretariat is a detailed summary of the discussion held during the 132nd meeting of the Competition Committee on 3-4 December 2019.

More documents related to this discussion can be found at
http://www.oecd.org/daf/competition/barriers-to-exit.htm

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Summary of Discussion of the roundtable on Barriers to Exit

On 4 December 2019, the Competition Committee held a roundtable on barriers to exit chaired by Professor Frédéric Jenny.

The Chair introduced the topic and noted the literature on barriers to exit and their impact on competition is relatively limited. The roundtable was structured around four issues: the definition of barriers to exit and their role in competition law enforcement; legal and economic barriers to exit and competition policy; the impact of different bankruptcy laws on firms' ability to exit; and finally, the impact of barriers to exit on allocative efficiency, innovation and productivity. The expert speakers were **Matthew Johnson**, Partner, Oxera; **Mary E. Deily**, Professor of Economics, Lehigh University ; **Jocelyn Martel**, Professor, Finance Department, and Co-Director, Chair ESSEC - AMUNDI Chair on Asset & Risk Management; and **Müge Adalet Mcgowan,** Senior Economist, Economics Department, OECD.

The Secretariat began introducing the topic by noting that, while there is no commonly adopted definition, barriers to exit are considered to be obstacles that prevent or delay firms from exiting the market, due to the economic costs of exit being higher than the costs incurred by remaining. The level of exit barriers affects market dynamism: lower exit barriers make it easier for less efficient and less innovative firms to leave the market, and contribute to the renewal of the population of firms in the industry. Exit barriers may be one of the factors explaining the decline in firm dynamism in many OECD countries since 2010.

The most common type of exit barrier in the literature is sunk costs, i.e. an investment that cannot be recuperated in the event of market exit; in particular, sunk costs may affect exit as firms may delay exit until the investment is recuperated. Another closely related type of exit barrier is the cost associated with cutting long-term contracts short. Other examples of barriers to exit include government intervention such as efforts to rescue failing firms, regulation such as environmental regulations requiring site cleanup, labor related costs such as redundancy pay and pension liabilities, and ineffective bankruptcy regimes. Many of these measures are designed with specific policy goals in mind (e.g. social, environmental, stability policy goals). Therefore, the key point is whether these policies are effective and proportionate, and in particular, whether these policies create unnecessarily high barriers to exit.

Barriers to exit interfere with the market discipline mechanism. They may lead to overcapacity issues, higher concentration, misallocation of resources, and impact the type of market entry. Competition authorities may be required to intervene in affected markets or advocate other government agencies achieve their goals with a minimal impact on competition.

The Secretariat's background note raises three key points: first, the different approaches competition authorities adopt regarding barriers to exit and the potential need for these to be more transparent; second, determining appropriate policy responses to deal with exit, especially when pressure is put on competition authorities to be lenient in times of economic distress; and third, advocating policies which could reduce unnecessarily high exit barriers, or advocating transparency of the trade-offs made when selecting among policy options with different competition implications.

The Chair introduced the first topic of discussion – the definition of barriers to exit and their role in competition enforcement.

Matthew Johnson believes this topic is unexplored and many times overlooked. He proposed candidate definitions for the term "anti-competitive exit barrier" - "something that reduces market exit by inefficient firms"; and for the term "exit" – "a firm leaving a market along with its inefficient assets". While debatable, both definitions center on relevant competition policy considerations: the first definition focuses on the process of firm rivalry; the second departs from the conventional idea of "binary exit" (i.e. focus solely on a firm's presence in or out of the market) and introduces efficiency considerations.

He proceeded to discuss barriers to exit in the context of different cases, beginning with mergers. While all types of theories of harm may be affected by the presence of barriers to exit, they are hardly ever taken into account. He believes the reason is a tendency to focus on mergers' incremental effects, and as mergers tend to have little or no effect on the level of exit barriers, these are just taken as a given and not accounted for in the analysis. However, he believes mergers, in particular, horizontal mergers, do have an effect on exit barriers. He mentioned that in the Statoil Fuel and Retail/Dansk-Shell case, environmental clean-up costs related to the closure of gas stations were not taken into account by the European Commission, despite their influence on the operation of the market. The strict approach to the application of the failing firm defense is also relevant in this context, as it may act as a barrier to exit preventing inefficient firms from exiting. In such cases, competition authorities should focus on whether efficient or inefficient assets remain or exit the market.

Barriers to exit are rarely considered in anticompetitive agreements cases, whether because agreements rarely affect barriers to exit or because they are considered to be given both in the agreement scenario and the no-agreement counterfactual. However, there are agreements, such as crisis cartels, which do raise exit barriers.

As for abuse of dominance cases, the common theory of harm involves the exclusion of rivals. In this context, competition authorities employ the "as efficient competitor test" to assess whether the dominant firm is using its power to exclude a competitor that is at least as efficient as the dominant firm, or one that is less efficient. While the former case is likely to be harmful to competition and merit intervention, the latter is not. Employing this type of test does not raise a barrier to exit and is therefore in line with the competition policy goal of promoting efficiency.

Barriers to exit are sometimes relevant in the context of market investigations, although they are often framed as barriers to entry. For example, in the United Kingdom Groceries case, forcing supermarkets to divest land they were not using to operate stores essentially forced exit, ensured efficient use of land and reduced entry barriers for others. Second, in the Private Motor Insurance case the sunk cost of advertising, which in many ways is a barrier to exit, was seen as a barrier to entry rather than a barrier to exit per se.

Decisions regarding state aid explicitly discuss barriers to exit by inefficient firms. To avoid inefficient firms being continually resuscitated, rescue and restructuring aid may be given only on a "first-time-last-time" basis. Some remedies depart from the binary exit model, for example, after the economic crisis of 2008-2009, United Kingdom banks received aid subject to remedies forcing them to divest branches and thus reduce their market share. The remedy was successful in the case of Lloyds, but unsuccessful in the case of Royal Bank of Scotland. These remedies were designed in line with the principle of market discipline of inefficient firms and rewarding efficient ones. Finally, a study performed by Oxera for the European Union showed aid had no significant impact on aided firms' exit, but there was evidence showing competing firms leaving the market. Inefficient firms remaining while efficient firms exit may be of concern.

Regarding the wider competition policy perspective, the reason exit barriers are bad for competition goes back to the fundamental idea of competition being a means for increasing efficiency in the market. Exit barriers have a negative impact on external restructuring, i.e. the process of firms either exiting the market completely or reshaping themselves by closing unproductive branches or units. This is sometimes more important than the process of internal restructuring, whereby competition disciplines firms to operate more efficiently within their current structure. However, it is unclear exit barriers are always negative. For example, while providing a particular product standalone may be unprofitable, it may be profitable to provide it together with a complementary product.

It may be interesting to look beyond traditional market definition in the context of barriers to exit, as these may affect different markets altogether. For example, a clothes shop bound by a lease may be prevented from exiting, thus preventing the use of the property as a restaurant.

Finally, insolvency and bankruptcy laws should ease exit of inefficient firms or asset, while ensuring efficient ones remain. In this context, it may be wise to differentiate between inefficient firms and inefficient assets, as there are cases where a bad management simply runs an otherwise efficient asset badly, while a different management could run it efficiently.

The Chair thanked Matthew Johnson and asked Germany, the European Union, the United States and Russia to describe how the different authorities consider barriers to exit.

Germany explained that since the incentive for market entry decreases with exit costs, barriers to exit and barriers to entry are considered two sides of the same coin. Germany's merger guidelines briefly discuss barriers to exit, as these result in unprofitable or unsuccessful suppliers remaining in the market, which in turn could reduce prospects for potential entrants. Among the example of barriers mentioned in the guidelines are long-term contracts, environmental impact costs, and regulations imposing costs upon closure of certain facilities or business activities.

Germany explicitly referred to exit barriers in very few cases, among them two mergers between do-it-yourself home-improvement stores, where stores' specific building permits were deemed barriers to exit and entry. The mergers were cleared, subject to divestiture of specific sites.

The European Union noted barriers to exit do not play a central role in their decisions and that there is no specific definition of the term or applicable coherent framework within European Union legal rules. However, barriers to exit may be relevant and taken into account, first, because of their links with entry barriers; and second, because of the need to address mergers or collusion in markets experiencing overcapacity issues.

Competition authorities' strict application of the failing firm defense is warranted, and the European Union may take account of the firm's distress even outside the scope of the defense.

The issue of exit barriers in the context of state aid is much more central and there is a framework in place to deal with them. In principle, state aid should focus on viable assets.

As for advocacy, the Commission is working on a new industrial policy that should be published next year, and it is important that competition authorities contribute to this debate.

The United States Federal Trade Commission focused on two additional types of barriers to exit. It noted that regulations that shield incumbents from competition ensure inefficient producers remain in the market and therefore should be considered as barriers to exit. This had been the case in the airline industry in the 70s, before entry barriers were lowered. Another example of barriers to exit are rules restricting or even banning the purchase of nascent companies (e.g. startups) by established firms. While there may be valid reason to reject a particular purchase of a nascent company by a dominant firm, a blanket rule restricting such mergers is wrong mainly for three reasons. First, because such a rule is very blunt, it dispenses with the foundational requirement to conduct a case-by-case assessment and it may lead to the rejection of pro-competitive mergers. Second, prohibiting large firms from purchasing new technologies and ideas may reduce their ability to innovate. Third, such a prohibition might take away startups' projected earnings and reduce their incentives and ability to innovate, especially because large firms tend to pay more for startups than to other players. Such rules would be especially problematic in high tech industries, populated by entrepreneurs, like Elon Musk, who rely on "exit capital" to fund their next venture.

Russia's formal procedure does not provide rules regarding the examination of barriers to exit as an obligatory stage of market analysis, the reasons being, first, that there are few cases when such analysis is strictly needed; and second, because adding such analysis to the procedure would allow parties to appeal the Federal Anti-Monopoly Service's decision on the grounds it had not conducted such analysis properly, even in instances where there is no practical need to do so. However, nothing stops FAS from analysing barriers to exit when the need arises. In such cases and especially in regulated or concentrated industries, FAS examines regulatory requirements, the specificity of business contracts, the level of concentration on sectoral markets, existence of specific assets like IP rights and other kinds of barriers to exit.

The Chair noted a consistent pattern among authorities: all are in agreement this issue is not a central one, and that, once a link between entry and exit barriers has been established, there is usually no need to focus on exit barriers as such; there is also agreement that barriers to exit can lower the level of innovation and competition. He noted that BIAC's contribution points at competition law enforcement as a potential exit barrier.

BIAC's contribution focuses on two areas where competition law enforcement may raise barriers to exit. The first regards "intentional exit" by serial entrepreneurs or inventors, many of whom do not intend to commercialise or operationalise their inventions, but rather rely on others, sometimes large and even dominant competitors, to do so. For example, it is clear that inventing a new component for a cell phone is very different from producing the same component, and that some inventors may not have the ability or desire to implement their invention.

The second area is that of "unintentional exit" of failing firms. In some cases, failing firms are reluctant to acknowledge their own failure, and point at dominant firms as the cause. Competition authorities should be careful not to perpetuate the operation of failing firms in such cases. Incidentally, failure is not necessarily a product of inefficiency; sometimes a lack of business acumen is the cause. Competition authorities should consider implementing an "equally street-smart competitor test" in addition to the "as efficient competitor test" already employed.

The Chair thanked BIAC and acknowledged the warning to competition authorities. Then the Chair turned to Spain to discuss its advocating efforts to facilitate exit in the power generation sector.

Spain shared its experience advocating against regulations raising barriers to exit of nuclear power plants. In that case, the Government considered subjecting approval of nuclear power plants' closure to the fulfillment of a number of conditions, among them, that the closure would not threaten competition in the electricity market. The authority's reaction to the proposed regulation reiterated the notion that healthy competition is dependent on free entry and exit into the market. The regulations were rejected.

The Chair thanked Spain and turned to Colombia to discuss their Quimpac and Mexichem merger case. This case touches on the point previously made by BIAC that merger control can act as a barrier to exit.

Colombia has recently rejected a proposed merger between Quimpac and Mexichem Colombia. The merger raised significant competitive concerns in markets for various chemicals, and the remedies proposed by interested parties were deemed insufficient to alleviate them. The merger was therefore rejected despite Mexichem's attempt to exit the market on the grounds it had not made sufficient profits on its investment. Colombia believes this is a clear example of merger control maintaining the level of competition in the market in a case where a firm wishes to exit.

The Chair then asked Germany, the European Union and the United States to react to BIAC's proposition that competition authorities sometimes raise barriers to exit and maintain inefficient firms in the market, and to give examples of relevant cases.

Germany noted it is currently dealing with a case that may be relevant, but that it is impossible to provide details at this time.

In respect of cleared mergers, the **European Union** noted that mergers occur because market operators value the assets they intend to acquire and integrate into their own business. There is no case experience showing specific inefficiencies caused by a cleared merger.

The **United States** noted its aim is to protect competition and not competitors. Decisions in this context are predictive in nature, and are made on the basis of limited information and finite understanding. It is possible to imagine subjecting a dominant firm to remedies which ultimately protect a smaller competitor or circumstances where the failing firm defense is rejected. Retrospectives of enforcement actions are helpful to inform future predictive decisions.

Matthew Johnson found BIAC's contribution interesting, especially the idea of an "equally street-smart competitor" test, as this differentiates between the firm's assets and the way they are run. He agrees with the United States that the goal is to protect competition and not competitors, and in his experience, competition authorities reject many complaints on these grounds.

The Chair moved the discussion to legal and regulatory barriers to exit and the role of competition authorities in this respect and invited Professor Deily to take the floor.

Mary E. Deily presented the experience of the integrated steel industry. In the early 1970's the industry was populated by big firms and demand peaked, but by the early 2000's most of the firms were liquidated and hundreds of thousands of workers lost their jobs. Exit costs were in the hundreds of billions of dollars' worth of specific physical assets, severance pay, pensions liabilities, and environmental remediation. Entry to the market was not deterred however: imports grow, and "mini mills" started producing steel using new technologies. The barriers to exit of traditional manufacturers delayed their exit for a long time. This was aggravated because expectations about the industry's performance were slow to change. It took time for firms to assess their future and change behavior, cancel expansion plans, diversify their product portfolio, change management, press labor for concessions and eventually close plants. While the world today is more accustomed to disruptive innovation, the same thing could happen in other industries, banking for example. Some firms will choose to struggle to survive until the end. This strategy failed in the steel industry.

Firms in the steel industry underwent both types of bankruptcy – reorganisation and liquidation. Reorganisation helped some firms, such as LTV and Willing Pitt, survive for quite a long time, but they were eventually liquidated, with some assets being sold to other firms, which in turn merged with other firms or were liquidated as well. Some assets, including plants, continue to be operated, in particular under international groups like Wilbur Ross or ArcelorMittal; other assets were liquidated. On the whole, the industry's capacity was slowly reduced.

The failing firm defense makes the most sense in stable or growing industries because in declining industries the goal is to have capacity exit in order to allow prices to rise and help surviving firms. However, pressure on competition authorities to allow horizontal mergers in such markets is the greatest, even though such mergers do not always work: despite LTV being an amalgamation of three out of the eight biggest steel firms, it went bankrupt and was ultimately liquidated. Other types of mergers, such as US Steel's purchase of oil and gas businesses, were sometimes, but not always, more successful.

To summarise, there is little evidence exit barriers prevented new entry but it shows exit was delayed. Slow adjustment of expectations and reorganization bankruptcies contributed to delays. The biggest horizontal merger failed to create an efficient competitor that would survive.

The Chair thanked Professor Deily and noted that this experience was different to what had been heard so far, in that this was an example where there was not a direct relationship between barriers to exit and barriers to entry. The Chair also noted the point of caution made in relation to mergers of failing firms in declining industries. Then the Chair turn to labor laws as a barrier to exit and asked Belgium to share its experience in the supermarket sector.

Belgium noted that a study concerning the significant differences between supermarket prices in Belgium and those in neighboring countries, showed that one major player in Belgium was relatively inefficient compared to competitors, who lacked incentives to compete fiercely. One reason was that the inefficient chain, who had tried to restructure several times, was forced to pay higher wages compared to its competitors, because of the structure of collective bargaining at the time. This structure made it difficult for supermarket chains to adjust, especially if they had an old workforce. Over time, the situation seems to have improved through advocacy work, which has brought changes to the structure of collective bargaining, placing all employees under the same bargaining committee and pressuring that committee to adopt sufficiently flexible rules. Prices differences still exist, but the causes are not exactly the same anymore.

The Chair thanked Belgium and turned to Spain to discuss the consolidation of the banking sector during the crisis, how the process of consolidation had a risk of creating barriers to exit, and how this risk was mitigated.

Spain shared its experience with the banking crisis, which led to consolidation in the banking sector. Prior to the implementation of a conditional financial assistance program, the Spanish banking sector was consolidating very quickly: in the period spanning 2008-2012, the number of savings banks declined from 45 to 15. Subsequent studies showed that some of the merged entities were bigger, but not stronger, and that they continued to pose a risk to financial stability.

The turning point was the implementation of the conditional financial assistance program in 2012, which aligned shareholders and managerial teams' incentives regarding exit. This was achieved through different mechanisms such as the segregation of assets from banks, receipt of public support, recapitalization and restructure of viable banks and resolution of non-viable banks with private sector service as a prerequisite. Other measures, such as reform of governance structures, were also introduced. In 2015, Spain began following the European Union's bank recovery and resolution directive, which introduced regular insolvency proceedings as a default for failing banks, with the exception of banks being subject to resolution upon the social authority's decision. State aid was also subject to resolution and to different mechanisms aimed at ensuring the bail out succeeds. As of 2013, state aid was contingent on shareholder and subordinate contribution, and on the adoption of a restructuring plan. Consolidation in the sector was significant – from 122 banks or institutions in 2008, there exist 61 today; total assets have decreased by 20%; 20,000 branches – 44% of the total in 2008, were closed; 1/3 of the jobs were lost. However, quality seems to be better, and the taxpayer is better protected. The HHI level have risen from 500 to below 1,200, which is still lower than 1,800.

This is an example of a case where issues related to competition were dealt with through financial regulation and conditionality. There are still many challenges to competition which could be dealt with by financial regulation, one concern is the homogeneity of the resolution framework in Europe and the heterogeneity of the bankruptcy frameworks – a situation which could lead to different outcomes in similar situations and to an uneven playing field. Close cooperation with different regulatory channels should therefore be the rule.

The Chair thanked Spain and turn to Italy and their advocacy effort in the taxi industry to find a solution to ease exit.

Italy has significant experience with the assessment of exit barriers in the context of advocacy. Many sectors of the economy suffer from high entry and exit barriers which lead to excessive fragmentation and low scale operations, and inhibit the tackling of the challenges of globalization and innovation. Lack of competition and of exit of inefficient firms does not serve the interest of promoting social welfare. Barriers to exit represent an important element in the competitive dynamics of markets, which intersects with other public policies. Competition policy in this area should complement other public policies and should not undermine the government or parliament's assessment. Addressing barriers to exit may play a key role in removing opposition to much needed liberalisation reforms.

The Italian Competition Authority has pointed at social clauses aimed at promoting employment security as barriers to entry and exit in the context of the liberalisation of different sectors. This barrier is particularly significant where labour costs are relatively high. The Authority has long been advocating for a total reform of the taxi industry – an effort intensified with the introduction of digital transportation platforms. The Authority proposed offering compensation to incumbent taxi drivers, in order to ease their possible exit, despite that measure being outside the scope of the Authority's powers. While this proposal is not directly linked to competitive aspects, it may be considered as a complementary tool to enhance competition.

Antitrust authorities cannot ignore the fact that transition to global and online economies may result in significant social costs, especially in times of economic downturn. However, impeding competition by protecting incumbents is an improper welfare measure. Policies designed to accompany inefficient firms' exit may play an important competitive role. Policies should favour competition instead of protection from it.

The Chair thanked Italy and noted the important issues raised in relation to what the scope of advocacy should be, and how far competition authorities should go into recommending complementary policies to ease exit. Then the Chair turn to Turkey and Mexico to discuss their experience with long-term contracts as barriers to exit.

Turkey explicitly discussed exit barriers in its investigation of the natural gas market. Among the barriers identified were the requirement of high-volume investments, the time required for recuperating them, the difficulty of liquidating assets for use in other industries, and the existence of long-term import-export contracts.

Mexico noted that the Federal Telecommunications Institute, empowered to regulate competition in telecom and broadcasting, views barriers to exit from the same perspective it views barriers to entry, because the latter are not foreseen by the competition law and, generally, entry decisions are based on the size and nature of investments, including sunk costs. Barriers to entry or exit are only considered as such if they reduce market contestability. Sunk cost, legal restrictions or requirements which increase exit costs, and long term agreements or clauses that delay exit or limit the utilization of productive assets, are generally considered exit barriers. Particularly relevant to telecommunications are sunk costs related to transmission infrastructure investments and spectrum licensing; among those relevant to broadcasting are long term content licensing contracts. Competition policy has played an important role in reducing these barriers to exit. Furthermore, competition provisions in the Mexican telecommunications law mandated interconnection and the sharing of active and passive telecommunication infrastructure; duration of contracts, and empowered the authority to monitor tariffs and players obligations to allow non-discriminatory access. In addition, the spectrum licensing regime allows for the trading of spectrum rights in secondary markets.

The Chair thanked Turkey and Mexico and turned to Ukraine to discuss the relationship between state aid and barriers to exit.

Ukraine noted it had extensive experience in the realm of state aid: the Anti-Monopoly Committee conducted two market studies in the electricity sector and has been following the development of the state aid framework through legislation and agreements with the European Union. The Committee has been active in the establishment of a transparent state aid regime, designed to limit market distortions. The Committee has also been involved in formulating a resolution regarding state aid to coal mines and is of the opinion that discontinuing subsidies is a prerequisite for the development of competition in the electricity sector. The resolution is being reviewed by the Cabinet of Ministers.

The Chair noted there were different sources of barriers to exit and different policies which either reduced or increased them. He then moved the discussion to the issue of bankruptcy proceedings and their effects on exit, and noted competition authorities may be interested in advocating changes to bankruptcy regimes. The Chair invited Professor Martel to take the floor.

Jocelyn Martel explained that, typically, when a firm is in financial distress, its creditors consider running for its assets. However, typically, the firms' assets will not suffice to satisfy all creditors. Bankruptcy laws aim to create procedures for optimal allocation of resources is such situations, by offering collective proceedings which avoid a "common property" problem. In some cases, this involves freezing creditors' rights and evaluating assets and creditors' rights. The idea is either to liquidate the firm if it is non-viable or to allow negotiations between debtor and creditors to allow re-organisation.

In theory, bankruptcy laws should follow a number of basic principles. One is to provide the right incentives to avoid bankruptcy; the second is to maximize the value of the firm and of recovery to creditors in the event of bankruptcy; the third is to save viable firms and eliminate non-viable ones; the fourth is to respect absolute priority rules, which essentially give those most affected by bankruptcy more power to control the future of the firm and reduce external intervention, e.g. by judges, government authorities etc.; and finally, to reduce bankruptcy costs, as this too may affect firms' ability to exit the market. These principles may conflict with one another. For example, deviating from priority rules and allowing "soft-landing" for manages may save viable firms which would have otherwise been liquidated.

In 1993, Canada reformed its bankruptcy regime and made a move towards a pro-debtor system. This changed many agents' incentives: a pro-debtor regime tends to decrease the elimination of viable firms but also save more non-viable firms. Changing systems is therefore not simple and may have many efficiency implications. There is no optimal law. - different countries have different laws, with different criteria and different objectives, which have implications on the way people behave. The change in Canada was aimed to encourage financial reorganization in order to save jobs that would have been lost in the event of liquidation. But saving jobs should not in itself be a goal. Rather, the goal should be to save viable firms in order to save valuable jobs. In practice, the number of reorganization procedures was multiplied by 10 because firms were much smaller, had poor financial health and higher proportions of government claims, and had offered lower returns to unsecured creditors; there was no change in the success rate of reorganization. It appears the intention to save jobs resulted in the saving of many non-viable firms – not the correct direction to go from an efficiency point of view.

Bankruptcy, corporate, antitrust laws are often linked to particular countries' history and culture, and one must be careful before changing any type of law because it is part of a global system. There is extensive literature regarding the impact of bankruptcy regimes on productivity. Lenient laws may be good for entrepreneurs who may seek a "fresh start" and may foster innovation, but is less important for corporations, whose assets may be redeployed for other uses.

Bankruptcy law and antitrust law share the goal of promoting efficient allocation of resources, but they have conflicting applications. Bankruptcy law may provide distressed firms resolve a crisis through merger, but such a merger may raise competitive concerns which are incompatible with antitrust law. Both laws have different perspectives: bankruptcy is a backward looking procedure, dealing with a problem that arose before and with downstream investors and creditors; a rapid solution is required. Antitrust law is forward-looking and focused on future harm to competition and consumers; the analysis takes longer and is costly. These conflicts may lead to inefficient resolution of financial distress, when an optimal merger from a bankruptcy standpoint is blocked on antitrust law grounds; or to suboptimal antitrust enforcement when courts pressured to make quick decisions fail to apply antitrust law. Both regimes are compatible when the conditions of the failing firm defense are fulfilled, but the conditions are very strict and not simple to satisfy. These conflicts stress the importance of cooperation between regulatory authorities, especially in cases involving large firms, when large assets and sums of money, and many employees and creditors, are affected. Cooperation may contribute to finding optimal solutions in such cases; otherwise, misallocation of resources will be increased.

The Chair mentioned that the Eurotunnel case – a merger resulting from bankruptcy, where the French Competition Authority opposed the sale of a particular set of assets, is an example of a conflict between bankruptcy and antitrust laws. He wondered whether competition authorities should be more involved in bankruptcy law reform. He then proceeded to the final part of the discussion – a macroeconomic perspective of the issues discussed and invited Müge McGowan to take the floor.

Müge Adalet McGowan presented the results of a large OECD project regarding Zombie firms and barriers to exit, completed a couple of years ago. The motivation for the project was a concern that productivity was slowing down in a number of OECD economies. Available data usually concerns barriers to entry and Policymakers were mostly concerned with that. But boosting productivity growth requires both healthy entry and exit, so the study sought to improve understanding and data availability on exit. The analytical framework focused on productivity growth as a goal and on relevant policies which affect it through two channels: first, the strength of market selection; and second, resource reallocation from exiting firms to more productive firms. The study focused on two policies, which affect both channels: barriers to effective competition and the role of efficient insolvency regimes.

The analysis of firm-level data showed that in a number of OECD countries, there are “zombie firms”, i.e. firms that should exit the market or be restructured, but instead remain active while being in a bad financial state. While this may suggest the existence of barriers to exit in those countries, the data does not imply which policies should be reformed. The three main conclusions from the analysis were, first, that the gap between the most productive and least productive firms is increasing, especially in the services sector; second, resources are misallocated and it is getting harder and harder for the best firms to grow by attracting more resources, especially in countries that suffered a crisis; third, business dynamism is decreasing in a number of OECD countries as manifested by a decline of firm entry and by an increase of the burden of zombie firms: over time, the number of zombie firms has increased, even after the crisis had ended, and they have become less productive relative to non-zombie firm.

There are various explanations why zombie firms have become a drag on productivity growth. Some are related to the financial crisis, prolonged low interest rate environment, weak banking sectors in some countries and government support to small and medium sized enterprises for example. Barriers to competition and weak insolvency regimes are also possible explanations.

Part of the project aimed to develop indicators to assess the efficiency of insolvency regimes. Analysis of answers member countries provided to a questionnaire about personal and corporate insolvency showed significant differences between member countries’ regimes. Empirical analysis linking the assessment indicators with firm-level data showed the number of zombie firms affects reallocation of capital to firms, thus affecting productivity growth. It also showed that low productivity firms’ productivity growth may be improved by more efficient technology diffusion.

One result of the study is that weak firms survive due to bank forbearance: banks may lack incentive or ability to address non-performing loans and realize losses on their balance sheets. The analysis shows zombie firms are more likely to be connected to unhealthy banks and also that it is harder for healthy firms to access credit in markets congested by zombie firms. Another empirical result stresses the importance of complementary policies: improving the banking system in itself reduces the share of zombie firms, but the effect is greater if insolvency regimes are improved as well. Finally, the study showed policies related to entry and exit complement each other: policies designed to improve entry by reducing administrative burdens on start-ups are only effective in boosting productivity growth in countries where barriers to exit are low.

Ireland noted that as Matthew Bennet mentioned, exit barriers are usually not affected by a particular merger or agreement. The issue is wider than a single market. It affects entire industries or sectors, many of them regulated for different reasons. Competition authorities’ cross domain experience can allow them to pick up on what regulators have done in various sectors and use that as a tool box for other cases. It is better to intervene early than to wait for a crisis. The bail out of Irish banks was subject to conditions related to the disposal of some assets and switching, but this intervention came too late and consumers were left with fewer choices.

The Chair noted that sometimes barriers to entry and barriers to exit do not work the same way and should perhaps be treated differently as in the steel industry, where firms kept entering despite high exit barriers. As a result, competition may be distorted and it is possible that efforts to promote competition may not be as effective as eliminating weak firms would be. All this feeds into decline in productivity growth. He also noted that the discussion analysed different sources of barriers to exit and the intersection of those policies with competition policy and left the question of whether competition authorities should offer their perspectives on these policies as food for thought. The Chair thanked the speakers, in particular for enlightening the audience about the interplay between competition policy and bankruptcy policy.