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Executive Summary of the Hearing on Competition and Innovation: A Theoretical Perspective

Annex to the Summary Record of the 140th Meeting of the Competition Committee held on 14-16 June 2023

14-16 June 2023

This Executive Summary by the OECD Secretariat contains the key findings from the discussion of the Hearing on Competition and Innovation: A Theoretical Perspective held during the 140th meeting of the Competition Committee on 14-16 June 2023.

More information related to this discussion can be found at
www.oecd.org/competition/the-relationship-between-competition-and-innovation.htm

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Executive Summary of the Hearing on the Relationship between Competition and Innovation

By the Secretariat[1]

On 14 June 2023, the OECD Competition Committee held a hearing to discuss the theoretical perspective of the relationship between competition and innovation. Considering the background note prepared by the OECD Secretariat, the written contributions, as well as the discussion by the expert panelists, the following key points emerged:

1. There is no single theoretical explanation of the relationship between competition and innovation. Innovation processes work differently in different industries with different technologies, skills, capabilities, and resources.

Different theoretical models have been developed to try to understand the complex relationship between competition and innovation, some with divergent conclusions. There is an extensive series of models that vary across industries; they describe markets with specific characteristics, capture horizontal or vertical relationships between companies, all of them trying to explain the relationship between competition and innovation. There exists literature finding a positive relationship, other finding a negative one and some other finding an inverse-u shaped relationship.

While there is no consensus from a theoretical perspective, key concepts have emerged from the large theoretical discussion as relevant. When markets have proven to be contestable, for example, this feature spurs innovation in such markets. Other considerations such as the degree of differentiation in the market, potential synergies between innovators and the possibility of protecting the innovation through rights have also been considered applicable when examining the relationship between the two variables.

Economists have also developed models to review how market power in particular affects innovation. The outcome of such models largely depends on whether innovations are incremental or radical, on the degree of coordination in the market and on whether one or more firms adopt the innovation.

2. To understand the complex relationship between competition and innovation, it is important to acknowledge the existence of many factors that drive innovation, which might not necessarily relate directly with competition but interact with it and have also an impact on the competitive dynamics of the markets where innovations are taking place.

Innovation does not occur in isolation, but within a broader system that includes competitive dynamics, but also considerations on industrial policy, protection of intellectual property rights, among others. For example, industrial policy can preserve the contestability of markets by reducing knowledge externalities and credit restraint or facilitating the exit of inefficient firms. Similarly, an efficient intellectual property rights system would guarantee innovators the possibility to profit from the commercialisation of their inventions.

[1] This Executive Summary does not necessarily represent the consensus view of the Competition Committee. It does, however, encapsulate key points from the discussion.

Other drivers of innovation include firm size, business models, economies of scale, access to finance, and collaboration. While it is true that much innovation occurs within markets and the economy, innovative ideas also emerge from the public sector where governments grapple with designing innovative public policy. Competition policy alone is often seen as an insufficient driver of innovation, particularly in the way that fiercely competitive markets can, to some extent, dissuade collaboration and reduce the amount of resources firms put towards research and development.

3. The consideration of a dynamic perspective in the analysis is fundamental since not only competition has an impact on innovation, but also successful innovation could lead to evading competition.

Competition needs to be understood in the context of a rapidly changing world where innovation is a key component. From this perspective, static concepts of competition in economic theory and competition law often risk neglecting the role of innovation. Instead, there is a need to consider the relationship between competition and innovation from a dynamic perspective. This implies adjusting the approach competition authorities follow to analyse transactions between competitors or potential anti-competitive conduct.

Among the challenges to evaluate innovation in merger review, for example, are the constraints that competition authorities are subject to when analysing dynamic competition and efficiency factors (i.e., future implications for prices, quantities, and costs in the long run).

Dynamic competition considerations include viewing competition as a dynamic process with innovations generating knowledge, acknowledging the complexity of innovation incentives and effects, and reviewing how changes in innovation and incentives can also impact future competition and, therefore, consumer welfare. In such scenarios, examining a firm’s actual capacity to innovate would influence the assessment of mergers or abuse of dominance cases.

4. Because the relationship between the two variables depends on multiple considerations, the way competition authorities perceived such relationship has an impact on their competition policy and on how they consider innovation in their enforcement activities.

To capture innovation better, competition authorities should have a broader perspective on the dynamics of markets. For example, how established horizontal and vertical structures affect the incentives and ability to innovate, how market power operates in innovative markets, what plans firms have in certain markets for future innovation, what are the capabilities of those firms to innovate and what could be the impact of innovation in the competitive structure of the markets in the future.

Competition authorities should be cautious with the analysis of dynamic capabilities as there is a risk of underenforcement. This may happen when firms use the dynamic capabilities argument and the intensity of innovation in the market to downplay concerns about market concentration, high market shares or abusive practices.

Learning from other fields of study could be useful for competition authorities. Understanding how managerial aspects, regulatory frameworks, and other policies (i.e., trade and industrial) affect decisions to innovate is key to incorporate innovation in the analysis of mergers or firms’ behaviour.