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ROUNDTABLE ON EXIT STRATEGIES

-- Note by the Delegation of BIAC --

This note is submitted by the delegation of BIAC to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 16 - 17 June 2010.

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ROUNDTABLE ON EXIT STRATEGIES

-- Note by BIAC --

1. Introduction

1. The Competition Committee of the Business and Industry Advisory Committee (BIAC) to the OECD appreciates the opportunity to submit these comments to the OECD Competition Committee on exit strategies.

2. During the last few years, businesses around the globe experienced one of the worst financial crises in recent memory. The financial crisis precipitated a drop in investor confidence, causing a decline in global stock markets and the devaluation of virtually all traded securities, and a decrease in available capital and liquidity as many affected institutions began to call in loans that otherwise would have made funds available to various operating businesses and industries.

3. Governments around the world were required to respond on an unprecedented scale. Efforts included:

- initiatives to stabilise the banking industry (including bailouts),[1]
- injections of capital through both monetary and fiscal policy, and
- support of other large industries, some of which were already in a weakened state when the crisis began.

4. While the effects of the crisis are certainly still being felt, there have been some promising signs that the economy is beginning to stabilise. As the economic situation improves, measures implemented by governments on an emergency basis will need to be phased out, and incentives to facilitate "exiting" need to be carefully thought out and implemented. These exit strategies will have important implications both for bringing the current crisis to an end and for helping to prevent future ones.

5. Accordingly, with respect to exit strategies, there should be a twofold objective of ensuring: (i) competitive distortions created by emergency measures adopted during the financial crisis are eliminated; and (ii) more lasting policies are set in place to help make the market less prone to future crisis.

6. This paper will discuss the role of competition policy in furthering both of these objectives. In sum, while governments have in recent years had to undertake significant interventions in the marketplace to prevent a further and more drastic collapse of the global financial system, such measures were designed to be temporary. By working in tandem with sector-specific regulation in financial services (so as not to jeopardise financial stability) competition policy can be a valuable tool in helping to shape a post-crisis

[1] Stabilisation efforts included: guaranteeing deposits, buying up “toxic” assets, providing liquidity facilities, recapitalising viable banks and providing aid to weak banks to prevent their failure. Stabilisation efforts also included monetary and fiscal stimulus measures (such as slashing interest rates, quantitative easing, cutting taxes and boosting public spending).

environment free of distortions caused by required government interventions so that the long-term benefits inherent to competitive markets are realised. In like manner, competition policy itself can act as both a stabilising and an innovation-promoting factor that will reduce the risk of a future financial crisis.

2. Responses to the Global Financial Crisis

7. BIAC has submitted two papers to the OECD addressing the role of competition policy in respect of the financial crisis.[2] BIAC has recognised that principles of competition policy need to be co-ordinated with regulatory measures aimed at fostering economic stability.

8. In these papers, BIAC noted that the financial crisis was not caused by failure of or a lapse in competition policy or competition law enforcement. Rather, as several commentators and governments have recognised, irresponsible risk-taking and a lack of proper regulatory oversight by financial sector authorities in various countries in relation to key areas, have been identified as the principal causes of the crisis.

- In a recent speech, EU Commissioner of Competition Joaquín Almunia stated: "The financial crisis demonstrates very clearly how a lack of effective regulation created incentives for financial institutions not to compete on the basis of the best long-term business models. Rather, they were incentivised to pursue excessive risk-taking in order to achieve short-term gains." [3]

9. Government responses to the financial crisis had to be significant and fashioned in a hurry, particularly for those countries that were most directly affected.

- For example, in the period from October 2008 to mid-July 2009, the European Commission approved a large number of guarantee and recapitalisation schemes. The total volume of the approved guarantee measures covered loans amounting to € 2.9 trillion, and the total amount of funds committed to the recapitalisation measures amounted to € 313 billion.[4]

- In the United States, the *Recovery Act* passed by Congress and signed into law by President Barack Obama in February 2009 created a $787 billion recovery package.[5]

10. The rationale for such efforts was to prevent the collapse of banks, which would have produced more serious problems for the wider economy. Unlike failures in other sectors, the failure of one bank can

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2 See BIAC paper presented to the OECD Competition Committee Roundtable on Competition and the Financial Crisis: "The Relationship between Financial Sector Conditions and Competition Policy", February 17-18, 2009 (DAF/COMP (2009)11/ADD1, pages 293-301). See also BIAC paper presented to the OECD Competition Committee Roundtable on Competition, Concentration and Stability in the Banking Sector, February 17, 2010.

3 See Speech of J. Almunia, "Competition v. Regulation: where do the roles of sector specific and competition regulators begin and end?", March 23, 2010, page 4 (source http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/10/121&format=HTML&aged=0&language=EN&guiLanguage=en).

4 See E. Adler, J. Kavanagh and A. Ugryumov, "State Aid to Banks in the Financial Crisis: The Past and the Future", *Journal of European Competition Law & Practice 2010,* Vol. 1, No.1, p. 66.

5 See http://www.recovery.gov/FAQ/Pages/ForCitizens.aspx#whatisrecoveryact.

cause negative repercussions across the industry through direct contagion effects (depositor run, market run, interbank claims, payment system, etc.) and indirect adverse effects on financial and collateral markets.[6]

11. While these efforts may have been necessary to prevent an even greater financial collapse, there was general agreement that such interventions were meant to be temporary and that, once stabilised, normative principles of market-based competition would be allowed to function without distortion.

12. The present question of what are the most appropriate strategies and mechanisms for governments to utilise in phasing out their emergency measures (exit strategies) is fundamentally important.

- For example, exiting too quickly may stifle the economic recovery, while exiting too slowly or in an incomplete fashion can lead to other economic problems (e.g., budgetary crises, inflation, etc.)[7] or longer term economic distortions. In fact the recent financial troubles afflicting Greece indicate that there are likely to be further significant manifestations of the global financial challenge.[8]

- Thus, serious attention needs to be paid as to when the exit should take place and how it should be carried out.

3. The Role of Competition Policy

13. As discussed in BIAC's previous submissions, competition policy had an important role to play during the financial crisis. For example, BIAC noted that:

- Competition policy could work in tandem with sector specific regulation, especially in relation to the financial services sector (e.g., financial regulators could apply their expertise in adapting standards of prudence to the crisis condition while competition authorities could still apply normative competition principles in their review of business conduct and significant acquisitions).

- To the extent that mergers were used as a tool to absorb or rescue a troubled institution, competition law enforcement agencies showed the ability to complete even large and complicated reviews in an expeditious timeframe where the circumstances warranted.

- Effective co-ordination and co-operation among domestic competitive law enforcement agencies were important since an uncoordinated review by any single agency could have prevented or delayed a necessary multinational transaction at a time when expedition was of the essence.

6 See "Bailing out the Banks: Reconciling Stability and Competition", Centre for Economic Policy Research (source: http://www.cepr.org/pubs/other/Bailing_out_the_banks.pdf). See also BIAC paper presented to the OECD Competition Committee Roundtable on Competition, Concentration and Stability in the Banking Sector, February 17, 2010.

7 For example, *The Economist* attributed the following comments to Dominique Strauss-Kahn of the International Monetary Fund: if countries start cutting budgets a year late, they will have an unnecessarily large debt burden. If they tighten too early, and the world economy relapses, the mess will be far bigger, not the least because policymakers will be all but out of ammunition. See "Withdrawing the Drugs", *The Economist,* February 13, 2010.

8 The crisis involving Greece also raises important questions about the impact on global competition resulting from the bailout of a country, as opposed to bailouts applicable to financial or other institutions.

14. Competition policy can also play an important role with respect to a responsible phasing out of emergency government measures that have served their purpose. As Joaquín Almunia recently stated: "In these times of crisis, it is more important than ever to have a voice reminding governments, business and citizens, of the decisive role of competition policy in a successful exit strategy from the crisis."[9]

15. In short, competition policy can be a valuable tool in helping to shape a post-crisis environment that strives to remove distortions caused by required government interventions. In particular, competition policy assists in:

- Withstanding tendencies towards protectionism that may be induced by recent government interventions, by keeping markets open and transparent.
- Ensuring restoration of incentives to responsible risk-taking (not too great and not too little) by businesses in order to promote and foster innovation.
- Generating empirical evidence to guide future policy action and the implementation of solutions.

16. These measures also would reduce the risk of a future financial breakdown.

17. That being said, BIAC recognises that competition policy is not and should not be applied in a vacuum. BIAC agrees with the findings of the OECD secretariat that:

> *"The interface between competition and stability is therefore complex, with the latter taking priority in crises. But as we move through the crisis towards phasing out emergency measures, including divestment of government investments in banks, it will be important to foster corporate structures that enhance both stability and competition. To the extent that this can be accomplished during the crisis phase, the credibility of policy measures will be increased."*[10]

18. As explained in BIAC's previous submissions, markets function most efficiently when they are open and competitive, and there is normally little need for regulation except in situations where a market or sector has certain unique characteristics that make intervention through regulation prudent.[11]

19. With the onset of the financial crisis, much has been said about reforming regulation to limit or prevent future crises. Suggested reforms include: the introduction of macro-prudential regulation, ensuring that regulation takes into consideration potential 'gaming' between regulators and private actors (e.g., either through lobbying efforts or through financial innovation aimed at regulatory arbitrage), and expanding the regulatory umbrella to non-bank financial institutions (such as investment banks or insurance companies).[12] Moreover, globalisation is identified as having "underlined both the current limits

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9 See Speech of J. Almunia, "Cooperation and convergence: competition policy in the 21st century", April 27, 2010, page 5 (source: http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/10/183&format=HTML&aged=0&language=EN&guiLanguage=en).

10 See "Finance, Competition and Governance: Strategies to Phase Out Emergency Measures", OECD Paper prepared for the G20 Meeting in London on April 2, 2009, page 10 (source: http://www.oecd.org/dataoecd/52/23/42538385.pdf).

11 The banking sector (indeed the whole financial services sector) is a prime example of such a sector. Hence, it is one of the most regulated sectors of the economy.

12 See "Bailing out the Banks: Reconciling Stability and Competition", Centre for Economic Policy Research, pages 67 and 68 (source: http://www.cepr.org/pubs/other/Bailing_out_the_banks.pdf).

of, and need for, improvements in international co-operation in banking regulation and supervision", especially given the growth of international banks and the reliance on national supervisors.[13]

20. Whatever reforms to regulation are implemented, competition policy has an important role to play moving forward. Competition policy-makers and financial regulators will need to work together to co-ordinate structures that can enhance both stability and competitiveness in the system. Such co-operation should focus not only on establishing a system that would prevent crises from recurring, but it should also look at correcting market distortions caused by government interventions that retard or impair the innovation and efficiency gains that competition can foster.[14]

21. To this end, competition policy can play a similar role after the crisis as it did during the crisis – e.g. working in tandem with financial services regulators to establish the appropriate balance of regulatory constraints and competition norms in the review of business conduct and significant acquisitions. For example,

- As a means to prevent a financial meltdown and massive contagion, governments aided some fundamentally non-viable banks (e.g., banks that could not cover losses over the business cycle) that were at risk of failing. While, at the time, such efforts may have been important to prevent contagion (given the unique nature of the financial services sector), this is no longer true as the crisis recedes. Post-crisis, policy makers need to recognise that saving individual banks may no longer be necessary to saving the system.

- Competition policy also will have to adapt to the different circumstances that now exist following the financial crisis. Significant restructuring and possible consolidation in many sectors may occur as part of the aftermath of the financial and economic crisis. For example, competition/antitrust regulators will need to be able to make decisions quickly in the case where mergers involving 'failing firms' arise.

22. Such actions will require greater global dialogue and co-operation. As we have seen, financial crises are not confined to geographic borders. Solutions must be found on a global scale. As recognised by Joaquín Almunia "fostering global convergence in our legal and economic analysis is essential to ensuring effectiveness of our enforcement and creating a level playing field for businesses across our jurisdictions."[15]

4. Conclusion

23. Going forward, measures will need to be taken to allow a return to a normal functioning of markets, particularly in the banking sector.[16] The goal should be to ensure a return to the functioning of

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13 *Id,* page 68.

14 *Supra*, note 10, page 10. See also the following quote on page 5: "Many of the bail-out operations for banks have been firm-specific and adversely affect the competitive environment. Such measures can have negative long-term consequences, even if they are not formally inconsistent with established national and EU competition policies or WTO rules."

15 *Supra,* note 9, page 3.

16 For example, Peter Freeman describes the merger of Lloyds/HBoS as being "cleared by the Secretary of State to preserve financial stability, although the OFT had identified competition issues in some markets)". He continues: "[t]here is a continuing need to assess the competitive effects of this merger". See P. Freeman, "Too big to fail, but not too big to be unbundled? Investigating the banks – The importance of Competition", *St. Gallen International Competition Forum,* May 20, 2010, page 6 (source: http://www.competition-commission.org.uk/our_role/speeches/pdf/pjf_st_gallen_20_05_2010.pdf).

normative competition principles and a level playing field for market participants, while at the same time recognising the existence of a different underlying regulatory environment than existed before the financial crisis.[17] In this manner, competition policy itself can act as a stabilising force and provide greater certainty and predictability for businesses.[18]

17 See Speech of J. Almunia, "Europe 2020: for competitive and sustainable industries", dated April 16, 2010, page 3 (source: http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/10/165&format=HTML&aged=0&language=EN&guiLanguage=en).

18 While it is "not the task of competition authorities to take steps to enhance competition which may damage prospects for economic recovery", as Peter Freeman brings out, there are a number of lessons that can be learned from recent events, including the following: financial markets are not necessarily self-correcting; and the rescue measures and accompanying regulation can, themselves, stifle competition; banks are of central importance to economic activity but they are also commercial organisations selling products and services to customers and can enjoy market power which can be exploited in a harmful way; and while, in extreme cases, it may be necessary to override competition law to preserve financial stability, there is no logic in a permanent exemption for banks from competition law. See P. Freeman, "Too big to fail, but not too big to be unbundled? Investigating the banks – The importance of Competition", *St. Gallen International Competition Forum,* May 20, 2010, page 6 (source: http://www.competition-commission.org.uk/our_role/speeches/pdf/pjf_st_gallen_20_05_2010.pdf).