# THE ECONOMIC AND FINANCIAL CRISIS, REGULATION AND COMPETITION

**by**
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The financial crisis and the economic crisis it sparked are raising legitimate questions about the market economy's capacity to promote growth and well-being. While the 1990s and the early 2000s saw competition law acquire growing power to shape our economic activity, it is government intervention and regulation – more intrusive than competition law – on which hopes for economic recovery and a return to prosperity are now pinned.

But we need to qualify the arguments of those who proclaim the death of economic liberalism and the end of competition law as the pre-eminent tool for regulating the functioning of markets, by analysing closely the roots of the crisis, its symptoms and the remedies envisaged, and then looking at the role of competition authorities in a time of crisis and how the crisis will influence the application of competition law. The competition authorities of the OECD member countries engaged in just such an exercise in mid-February 2009 at a meeting of the Organisation's Competition Committee. The remarks that follow are not a summary of these discussions, but rather a commentary on the main themes that were addressed.

Competition and stability of banking and financial markets

It should be noted first of all that financial markets are based on confidence in the strength of banking and financial institutions, and that operators in these markets are interdependent. Such confidence allows banks to lend more than they have received in deposits and to fuel the engine of the economy. When even a limited number of depositors lose confidence in their bank this is liable to set off a widespread panic with regard to that bank, as reflected in a massive run on deposits, and to lead to its failure, or at least to a sharp curtailment in its lending capacity. A bank failure in itself is capable of undermining confidence in the banking and financial system as a whole, potentially leading to its collapse.

Thus, unlike what happens in most goods and services markets, where a firm's failure represents an opportunity for its competitors, the failure of a firm in the banking and financial sector is liable to have systemic effects.

As a consequence, public policy with regard to this sector pursues two objectives: first, to seek efficiency in the sector's provision of banking and financial services, and second, to ensure the stability and security of the sector. Two types of instruments are used to attain these objectives. One is prudential regulation, designed to prevent banks from taking excessive risks. The other is competition law, designed to ensure that there is sufficient stimulus from competition between financial institutions to prompt them to improve the price-quality ratio of financial services and promote innovation, and so contribute to a better allocation of resources in the economy and foster growth.

These dual objectives give rise to two questions, one structural and the other cyclical.

1) One may ask, first of all, whether the two objectives are contradictory. Bankers frequently have doubts about the utility of competition's role in the banking and

financial sector and formulate two types of criticisms regarding competition law. They argue that, insofar as competition implies a decrease in banks' margins, banks are driven to take excessive risks in order to preserve their profits, and that this cannot fail to have consequences for the stability of banking and financial systems. Bankers further maintain that, insofar as competition authorities apply competition law to the banking and financial sector, they should incorporate sector stability as an element of sector performance, rather than limiting their analysis solely to considerations of the cost and pricing of banking and financial services.

The criticism of competition law as applied to the banking sector is unlikely to have much influence on competition authorities unless the arguments of bankers or bank regulators are confirmed by solid theoretical or empirical evidence. From the analytical point of view, however, this argument has weaknesses. Since the purpose of prudential regulation is precisely to prevent banks from taking excessive risks, competition could induce them to take such risks only in the event that prudential regulation failed. Moreover, there is no empirical evidence that those banking sectors that are most vulnerable to competition are more frequently victims of banking panics. If we further refine our analysis, it would seem that there are several reasons to think that excessive fragmentation of the banking sector might be a source of weakness, but that oligopolistic competition would be compatible with greater banking system stability.

As to whether competition authorities do or do not incorporate the stability dimension as an element of economic performance when analysing competition in the banking and financial sector, it must be recognised that bankers have provided no specific evidence to suggest that decisions taken by competition authorities have led to increased instability in any banking sector.

Thus, it does not seem that the application of competition law to the banking sector is inconsistent with the objective of banking system stability.

2) From the economic standpoint, a second question, related to the preceding one, has also been the subject of debate. Isn't the banking crisis evidence of a failure of competition in the banking sector? The answer to this second question is clearly no. The crisis arose and grew, on the one hand, because prudential regulation did not prevent some banks from taking excessive risks and, on the other hand, because the asset valuation method had magnifying effects which weakened the banking sector in a period of rapid decline in the value of financial assets, the result of which was to worsen the systemic risk that the sector was facing[1].

[1] By allowing risk to be dispersed, particularly to unregulated financial markets and unregulated operators such as hedge funds, brokerage firms and investment funds, securitisation dissuaded creditors from undertaking a serious analysis of debtor solvency, since the risk of non-payment was immediately transferred. Having become very complex and lost all traceability, risk was reconcentrated and reintegrated into banking activities. The use of Structured Investment Vehicles (SIVs) made it possible to remove the risky assets from the banks' balance sheets. Lastly, the prudential and accounting rules adopted (particularly the application of International Accounting Standards Board (IASB) standards) had a procyclical effect on financial markets and financial intermediary accounts. When asset prices began to fall, the application of fair value accounting standards (mark-to-market) (IAS 39), and the fulfilment of capital requirements under the Basel II revised international capital framework, led to a decrease in the capital of banks and intermediaries. This decrease had to be offset by capital increases, by asset sales – which contributed to market prices' overreaction to the decline – or by credit restrictions.

Consequences of the financial crisis

Hence, while there is no inconsistency in principle between the objectives of stability and of efficiency of the banking and financial sectors and while in practical terms competition in these sectors does not seem to have played a key role in triggering the crisis, it is nonetheless useful to explore the consequences that this crisis is expected to have for the functioning of the financial and real markets.

The links between the financial market crises and the triggering of a recession in the real economy markets are numerous. We shall mention three as an example.

1) First, as already mentioned, a fall in value of the assets of banks and financial institutions reduces their lending capacity, unless they are refinanced. This in itself has a restrictive effect on firms' investments.

2) Second, a sharp devaluation of stock and real estate assets also has the effect of restricting demand for all those who live on their capital.

3) Third, demand is depressed when economic agents are uncertain of the future and lose confidence in the economic system. Not knowing when the recovery is likely to occur, these actors abstain from non-urgent investments and non-essential consumption. This, in particular, is why the automobile industry has seen a collapse of demand. This sector is characterised by the fact that a replacing a car can, in many cases, be delayed.

As John Fingleton noted recently, an economic crisis may in fact promote vigorous long-term growth in productivity. Unlike what happens in periods of expansion, when inefficient firms may survive and grow, in situations of plummeting demand it is often the least successful enterprises that are the weakest and that face the greatest risk of disappearing. This phenomenon of "creative destruction" is likely to strengthen the production base, promoting innovation and productivity growth in subsequent periods.[2] Even so, and as we shall see further on in drawing the lessons of these events, periods of economic recession may also be those in which competition policies face the greatest dangers.

Thoughts on the role of competition authorities in a crisis period

The first thought is that a huge debate on expanding the regulation of financial markets and sector operators is under way,[3] and that it seems unrealistic to believe that regulation is not going to expand rapidly in the next few years. One of the reasons why politicians have a natural tendency to favour increased regulation is that the crisis has made all economic actors less inclined to take risk, and it seems obvious that more comprehensive and better tailored regulation would help to avert systemic risk without necessarily preventing growth. As Paul Krugman, winner of the 2009 Nobel Prize for economics, recalled recently, the United States

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[2] See John Fingleton, "Competition policy in troubled times", Office of Fair Trading [United Kingdom], 20 January 2009.

[3] For instance, at the opening of the OECD Global Forum on Competition, Dominique Strauss-Kahn [Managing Director of the IMF], said that most of the elements on which one must try to build the future by reshaping financial regulation were known. It was necessary, he said, to extend the perimeter of regulation to financial activities, and not necessarily to institutions, to set up systemic regulators at higher levels, e.g. at regional levels, to ensure that no major parts of the financial sector remained unregulated, to settle the problem of conflicts of interest within the CRAs, and to address the procyclicality of our financial regulations.

emerged from the Great Depression with a tightly regulated and fairly primitive banking system, but one that enabled the United States economy to double its GNP in one generation.[4]

The areas in which such regulation could be adapted vary greatly.

With regard to structures, some suggest revisiting the elimination of sector constraints that allowed the formation of financial groups involved in different activities, such as commercial banking, investment banking, asset management or insurance, because these different businesses have different risk ratios and may give rise to conflicts of interest.

With regard to the scope of regulation, some propose that hedge funds be subject to transparency requirements regarding their financial structure and their links to regulated entities. It is also proposed that they be subject to capital requirements similar to those of banks.

- Concerning financial instruments, there is frequent mention of regulating credit default swaps (CDS), where trading conditions are often opaque. With regard to securitisation, the question is whether it should allow the connection between risk and lender to be completely severed.

- Concerning capital requirements, two types of measures are recommended: prohibiting banks from placing credits in funds not subject to capital requirements, and adjusting asset pricing so as to avoid the procyclical effects seen in the current crisis.

- Concerning incentives, it is proposed that there be oversight of traders' pay rates to prevent their being asymmetrically remunerated for short-term rather than long-term performance.

Lastly, the credit rating agencies have been heavily criticised since the onset of the crisis for having incorrectly estimated the risks that the banks were taking by amassing new financial instrument portfolios. A debate has been launched as to whether or not their economic model, which is based on their being paid by the firms they rate, is likely to induce biases in their assessment of the risks taken by the firms. Proposals are being circulated to regulate them or to create public rating agencies that would be independent of the firms they rate.[5]

However, competition authorities are aware of how imperfect an instrument regulation is and of the risks generated by the use of that instrument.

These adverse effects may have three origins. First, a regulation may be poorly designed and may not contribute to attaining the objectives that warranted its adoption. Second, the regulation may contribute to attaining the objectives assigned to it, but may also introduce a

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4 Paul Krugman, "The Market Mystique", *International Herald Tribune*, 28-29 March 2009.

5 In mid-February 2009, the European Commission agreed to proposals aimed at strengthening oversight of the activities of the credit rating agencies (CRAs) and, in particular, creating a centralised register. The new rules aim to ensure high-quality credit ratings not tainted by the conflicts of interest inherent in the activities of the CRAs, the European executive body explained in a press release. Speaking at a press conference, Charlie McCreevy, European Commissioner for Internal Market and Services, explained that the CRAs would be supervised by European Union entities. He said that he hoped that the European initiative would become the basis for international regulation of CRAs such as Moody's and Standard & Poor's.

distortion in the incentives of economic agents that produces inefficiencies in market mechanisms. Lastly, the regulation may be such as to weaken innovation and competition. The electricity sector in the United States provides an excellent example of a case where regulation may have had adverse effects.

The OECD has long studied the potentially harmful effects of regulations in terms of productivity, growth and innovation, and has made a vigorous effort to promote regulatory reform. This reform consists not of challenging the essentially non-economic objectives that are, in many sectors, the basis for regulation, but of readying procedures for evaluating beforehand the various means of arriving at the desired result, in order to choose the one which least distorts individual incentives and has the weakest anticompetitive effect. Periodic review of regulations to ascertain whether their objectives are still relevant, whether they have been attained and whether the desired result could be attained by more economically effective means is also recommended.

Faced with a new regulatory impetus in the financial sector, we must ensure that the principles emphasised during the OECD's regulatory reform exercises, and the procedures that are now part of good regulatory practices, are applied. It is important to enable the competition authorities to intervene in the regulatory process from the outset in order to establish a competitive assessment of the possible alternatives. There are varying opportunities for the competition authorities to make their voices heard in this area. Some can spontaneously issue opinions on any subject. In other countries, special provisions stipulate that the competition authority must be consulted whenever a regulation liable to restrict competition is being considered. Lastly, in a small number of countries (such as Korea), the head of the competition authority has ministerial status, enabling him to participate in discussions of statutory texts or draft laws within the council of ministers.

The second thought is that, in addition to regulation, the state has many direct means of intervention at its disposal and is under strong pressure to use them in a period of crisis. As Dominique Strauss-Kahn, Managing Director of the International Monetary Fund (IMF), said at the opening session of the OECD Global Forum on Competition in mid-February 2009, the fiscal stimulus will be effective only if the financial system is turned around. This assumes that the banks' balance sheets have been cleaned up and that the banking system has been restructured. It is clear, he added, that a dollar spent nowadays to restructure the financial system is much more effective in restarting growth than a dollar allocated to traditional budgetary outlays. However, he said, we still have a long way to go in that respect.

This means that in the weeks and months ahead, states will intervene by establishing rescue plans for the weakest financial institutions, nationalising some banks de facto, and fostering mergers in the banking sector.

The preparation of such rescue or restructuring plans raises the question of how to limit the risk that these types of government interventions will introduce biases into the incentive system of financial institutions, leading them to take ill-considered risks, or that they will lead to rescuing under-performing banks.

In this regard, it is vital to distinguish among three types of situations:

- Banks or financial institutions whose failure would pose a systemic risk threatening the stability of the financial sector as a whole. An example of this type of situation is

AIG, which insured a very high proportion of the high-risk mortgage loan derivatives in the United States, and whose failure would inevitably heighten the risk for these banks and leave them unable to meet their obligations. Likewise, in November 2008, in approving a state guarantee for the Dexia financial group under the rules of the Consolidated Version of the Treaty Establishing the European Community (EC Treaty), the European Commission recognised that because of the group's size, its market shares and the underlying financial crisis, its potential failure would have created a systemic risk for the Belgian banking sector;

- Banks or financial institutions which are in danger, not because their executives are guilty of mismanagement or because they underestimated the risks to which they were exposed, but because they are victims of the collapse of other banks. One example is Hypo Real Estate Holding AG, a bank that specialises mainly in financing public services and public infrastructure. This company, which is not a deposit bank, and which depends on the interbank market and credit facilities to refinance approximately 50 billion euros per year, was heavily affected by the drying-up of credit after Lehman Brothers filed for bankruptcy;

- Lastly, financial institutions which are neither victims of actions by other banks nor important enough for their failure to pose a systemic problem, but which are in trouble because they took reckless risks or were poorly managed. If we look back at the period of the late 1990s – now long past – the mad, unlimited and unchecked thirst for growth of Crédit Lyonnais (then a public bank), which led to losses of over 100 billion francs, fell within this third category.

The rescue of banks or financial institutions in the first category is necessary because of the external effects that their failure might entail. The rescue of banks or financial institutions in the second category is unlikely to entail an externality for the functioning of financial markets. Lastly, the rescue of banks or financial institutions in the third category has no economic rationale.

Moving now from the financial sector to the real economy, it must be recognised that governments are under intense political pressure to use instruments such as granting ad hoc financial assistance, nationalisation, or allowing struggling operators to be bought out by more robust operators, in order to come to the aid of firms or industries facing difficulties as a result of the sudden fall in demand, and to avoid massive layoffs that are often concentrated in particular geographic regions.

The economic rationale for measures taken by public authorities to rescue whole sections of our industries is decidedly weaker than the rationale for intervention in the financial sector, because in the real sector of the economy there is no risk of a systemic crisis. Unlike what happens in the banking sector, the disappearance of some firms from the market would increase their competitors' chances of recovery.

Yet the authorities are under great political pressure to intervene in the real sector, particularly when the sector concerned is a large employer, the jobs are geographically concentrated or the type of goods produced by the sector is regarded as strategic for the overall development of the economy. "Politicians" cannot be insensitive to the social cost of reallocating resources, especially in a period of generalised economic downturn, and they are tempted to intervene to lessen the shocks caused by the crisis and to make the transitions more socially acceptable.

Lastly, it must be added that in the real economy, in addition to the array of interventionist instruments already mentioned, there are instruments specifically designed to limit international competition, directly or indirectly.

The third observation is that, regardless of its economic or political rationale, recourse to interventionist public policies in the financial sector, as in the real economy sector, raises several types of dangers.

1) The first danger is that these interventions will be ineffective in attaining the objectives sought. In this regard, loans to banks and massive injections of liquidity into the economy have not had the desired effect of restoring credit, not initially, in any case.

2) The second danger is that these interventions will modify the incentives of economic agents in a direction opposite to the one that would guarantee the best economic efficiency. For instance, it is widely recognised that some banks have placed ill-considered (or in any case, underestimated) risk-taking and short-term profit ahead of a management style that is more cautious but better able to ensure the firm's stability and survival. Rescuing such banks evidently sends a signal to the market: if an operator is large enough (and a policy of reckless growth can lead it to become large enough), the state has no choice but to step in and rescue it if necessary. It will be recalled in this connection that the first Paulson plan to rescue banks in the United States was heavily criticised for not imposing drastic conditions on them as a trade-off for the assistance granted. In a way, this amounted to rewarding their inefficiency. Similarly, the question arises whether the plan to rescue the United States automobile industry is likely to encourage inefficiency on the part of sector firms, or whether, on the contrary, it will force them to undertake essential reforms in order to become competitive again. This discussion divided the United States Congress in the last months of the Bush administration. One senses clearly that there is a narrow dividing line between the condoning effect of instruments such as assistance or rescue plans and a potential incentive effect, and that the use of such instruments therefore poses a substantial risk of weakening incentives, one that is liable to entail a non-negligible social cost.

3) The third danger of sector plans is associated with the fact that they can also have adverse effects on the functioning of competition.

Generally speaking, when competition in financial markets is not sufficiently robust, this is liable to have adverse effects on the resolution of the financial crisis itself. As a complement to macroeconomic measures, such as aiding activity and countering household fears, banks must also continue, first, to distribute credit to the economy, and second, to pass on to consumers, through lower interest rates and cheaper credit, the benefits that the banks themselves derive from the lower cost of their own refinancing. But banks will have an incentive to improve credit terms only insofar as they compete effectively with one another in the credit market. Otherwise, if each bank is assured of being able to keep its customers even if it continues to charge high interest rates, it is highly unlikely that lowering the cost of refinancing for the banks will be reflected in credit growth and that it will make a useful contribution to economic recovery. It is therefore necessary to preserve competition in the banking market.

It must also be observed, however, that some of the safeguard measures that have been applied in the banking and financial sector are liable to weaken or hamper the free play of competition in the long run, regardless of their short-term effect. As an example, it may be recalled that when the British Government decided to rescue Northern Bank – a decision nonetheless approved by the European Commission – competitor banks, including Danish banks, filed a complaint, arguing that the newly nationalised bank enjoyed an unfair competitive advantage which could lead to distorting the mechanism of competition. Similarly, insurance companies, particularly French ones, complained about the consequences of the AIG bailout for competition. In particular, they argued that those benefiting from the assistance would, as a result of such assistance, engage in aggressive price and customer recruitment policies to which the unaided competitor companies could not respond on an equal footing. AIG's competitors in the United States point out that it lowered its rates considerably, in some cases by more than 30%, after receiving $173.3 billion in aid.[6]

Thus, short-term remedies which guarantee the immediate survival of some struggling competitors may turn out to be toxic in the long run, by enabling the beneficiaries of such aid to pervert the competitive functioning of markets.

There are two reasons why it is necessary to have the competition authorities review the intervention mechanisms. To begin with, competition authorities are specialists in incentives and the way in which economic actors respond to these incentives. Second, since it is their mission to intervene in a large number of markets, competition authorities offer a better guarantee than sector authorities of not being "co-opted" and therefore of being able to analyse objectively the potential effects of different types of aid on the behaviour of firms.

It is in the European Union that the system of competition control in the context of state aid is the most developed. Its aim is to nip in the bud, i.e., at the time when the assistance is granted, its potentially adverse effects on competition.

In its Communication on "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis",[7] the Commission indicates that Article 87(3)(b) of the EC Treaty, which allows state aid "to remedy a serious disturbance in the economy of a Member State", is available as a legal basis for aid measures undertaken to address this systemic crisis, and that such measures constitute aid granted by way of a general scheme or of ad hoc interventions (e.g. emergency structural interventions and measures to protect third parties, such as creditors). Nevertheless, the Commission adds that it will interpret restrictively, in line with its decision-making practice, what can be considered a serious economic disturbance of a member state's economy; that this provision may not be applied in sectors other than the financial sector in the absence of a comparable risk of immediate impact on the economy of a member state as a whole; that the measures may be taken not on an open-ended basis but only as long as the crisis situation justifies their application; and that they must be reviewed every six months.

In most of the member countries of the European Union, as in the states outside the European Union, the scope of competition law does not include the monitoring of state aid, and no mechanism ensures that the competition authority will be consulted when such aid is granted. Such is the case, for example, in the United States, where, as the Chairman of the Federal

6 "USA Inc: AIG's rivals blame bailout for tilting insurance game", *Wall Street Journal*, 23 March 2009.
7 Communication from the Commission (2008/C 270/02).

Trade Commission (FTC) stated during the discussion in the OECD, the FTC was not consulted on the rescue plan for the automobile industry.

When states are under no legal compulsion to consult the competition authority on the assistance plans envisaged for the financial sector or for sectors of the real economy, the possibility nonetheless remains for the competition authority to intervene if it can render opinions on any subject concerning competition and if it has control over the conditions in which it can make such opinions public. This possibility, which must be utilised to the extent possible, is not, however, as satisfactory as the opportunity for competition authorities to participate in the negotiation of assistance plans. As everyone knows, it is by being present at the crucial moment in the negotiation that the competition authority has the best chances of being heard.

In any case, it is clear that in the exceptional circumstances in which we are living, the institutional model of European competition law and the scope of this law do a better job of ensuring the preservation of competition than the alternative models. One may ask, therefore, whether a discussion will take place in states not members of the European Union as to the need to review their law.

The fourth danger of these interventions, when they take the form of encouraging mergers between firms (as was the case, for example, in the United States banking sector), is that they alter the competitive structure of the sector by weakening it, which leads over time to a weakening of competition. The situation in this area is more satisfactory overall than with regard to the bailout plans or state aid. In most countries, the competition authority is responsible for merger control from the outset, and this is applicable in the financial sectors as in other sectors, so that the competition authority is able to assess the effect of the merger operation being considered and to object to operations whose drawbacks from the standpoint of competition outweigh their advantages from the standpoint of economic growth.

The most important question facing competition authorities in this area is whether their procedures and analytical instruments enable them to respond as rapidly as necessary in situations of acute crisis. Many indeed are the cases in which a decision is due within a few days or a few hours ("weekend mergers"), in an atmosphere of discretion such that it is not always possible to collect information as fully as is usually the case in connection with merger control, and under circumstances of intense political pressure.

The fifth and final danger associated with government intervention by sector has to do with the adoption of protectionist measures designed to lessen the competitive pressure to which domestic firms are subject, i.e. to give a positive advantage to domestic firms at the expense of foreign firms in the same sector.

Control of protectionist practices, which undermine the rules of international trade, is provided for within the framework of the World Trade Organization through an effective dispute settlement system, but the scope of what is prohibited by multilateral trade agreements is limited.

In a recent study,[8] the World Bank recalled the danger that the revival of protectionism represented in both developed and developing countries. The study noted, in particular, that in

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[8] Elisa Gamberoni and Richard Newfarmer, "Trade Protection: Incipient but Worrisome Trends", World Bank, 2 March 2009.

spite of their solemn undertaking on 15 November 2008 not to resort to protectionist measures, 17 of the G20 countries have, since that date, implemented 47 such measures.
In addition to state aid to firms in the automotive sector (the total amount of which in March 2009 came to $48 billion, including $17.4 billion in the United States and the remainder in Canada, the United Kingdom, China, Brazil, Sweden and Italy), protectionist measures have taken various forms: increasing customs tariffs (e.g. in Russia), imposing standards (e.g. in China), imposing geographical restrictions on certain products at points of entry to the country (e.g. in Indonesia), export subsidies (in Europe, China and India), imposing anti-dumping tariffs that are 15 per cent higher than in 2007 (e.g. in India), etc.

Yet competition authorities are rarely consulted when such measures are adopted, even though they obviously have an effect on the intensity of competition in markets and could, in a number of cases, be replaced by economic policy instruments less destructive to the competition system.

Thus, contrary to the proclamations of some, the financial and economic crisis implies renewed activity on the part of competition authorities to defend the mechanism of competition and contain the development of legislative or regulatory initiatives that over time might jeopardise our chances of recovery.

<u>The implementation of competition law in a time of crisis</u>

It must also be recognised that the impact of the financial and economic crisis will be felt in the more traditional realm of implementation of competition law.

In this regard, competition authorities can respond in three possible ways in their efforts to combat anticompetitive practices during a period of financial and real economic crisis:

1) The first attitude consists of denying that the crisis might have any effect on the implementation of competition law. This is the attitude recommended by the authorities, who are concerned with showing that they are not giving in to the panic which characterises our troubled era or to pressure from the political authorities. As much to reassure themselves as to show their determination, they declare that the principle underlying their actions is “business as usual”, and that their duty is to resist the muffled pressure to authorise the crisis cartels and not to succumb to the seductive logic of national champions by letting down their guard on abuse of dominance or by authorising anticompetitive mergers in the name of the needed industrial restructuring.

2) The second attitude consists, on the contrary, of accepting the idea that in a period of crisis, risk aversion and the inability to see into the future complicate the reallocation of resources which the competitive interplay of markets in principle makes possible, and which is necessary to make our economic system effective and the functioning of free markets socially tolerable. The free play of competition without the possibility of a rapid reallocation of resources would then lead to costs that would be difficult to bear for losers of the economic contest and that would be of uncertain benefit to society, at least in the short and medium term. The crisis cartels which would help to manage the transition periods under economically and socially tolerable conditions, and the promotion of national champions which would enable the cartels to grow large

enough be able to face real competition, would then be justified. From this perspective, the implementation of competition law should be more limited in crisis periods than in periods of economic expansion.

3) The third attitude is based on a twofold observation. First, the effective implementation of a law designed to protect the consumer surplus and to enable the reallocation of resources remains the best guarantee of a long-term return to economic efficiency. Second, with the formalist or structural approach to practices or transactions having been gradually abandoned during the 1990s, the implementation of competition law now requires the competition authorities to examine in detail the potential or real effects of the practices and transactions that are referred to them. However, an economic crisis will not always be a neutral context in which to assess the practices or transactions being examined from the standpoint of the rules of competition, of assessing their seriousness, or of remedies capable of addressing the situation. In addition, the context of crisis can also influence the policy and procedures of the competition authorities.

Predicting the way in which the development of the economic crisis is liable to affect the implementation of competition law and the day-to-day practice of the competition authorities is a difficult exercise, in that the crisis is proving to be of such a scope that the only comparison which comes to mind is the crisis of 1929, a period when competition law was still in its infancy. Nevertheless, some clues can be mentioned.

First of all, it is probable that in a period of economic crisis, a larger share of referrals than in the past will come from struggling economic agents, and that their referrals will be accompanied by requests for provisional measures. The refusal to grant a provisional measure, when the referral is fundamentally admissible and the referring firm is economically weak because of the crisis, entails a much greater risk that the referring firm will disappear than if the referring firm was healthy and operating in an expanding market. Thus, the competition authorities will be inclined to ask themselves whether they should change the benchmark they are using to assess the gravity or immediacy of the danger that a potentially anticompetitive practice poses to the referring parties, which are moreover weakened by unfavourable economic conditions.

Second, the situation of economic and financial crisis is liable to diminish their resources. This is particularly likely in countries where the revenues associated with merger notifications represent a substantial share of the competition authority's total resources. But such resource constraints are also liable to be felt in countries where the competition authority is financed by public funds owing to the decrease in tax receipts in a period of economic recession. This implies that the competition authorities will, more than in the past, have to order their priorities and define their referral policy in order to allocate their declining resources to best meet their objectives.

While some authorities (e.g. the Office of Fair Trading in the United Kingdom) have for a number of years applied very elaborate procedures to define and monitor the achievement of their objectives, to define their referral policy, to assess the risks associated with each case being considered for investigation (legal risk, risk of cost overruns, reputational risk, etc.) and to estimate the expected benefits of their activity to society (e.g. in terms of the consumer surplus), many other competition authorities have not adopted such procedures. It can therefore be assumed that the discussion which has already begun about ways for the competition authorities to order their priorities will acquire a certain scope in the months and years ahead.

To the extent that competition authorities are independent institutions and that one of their objectives is to be perceived as fulfilling a useful function for society, it is also likely that in a period of economic crisis they will, more than in the past, choose to tailor their activities to markets which are particularly important for the economically and socially weakest groups.

Third, if we now turn to the issue of anticompetitive practices, the temptation of market sharing and price fixing is stronger in a period of significantly reduced demand, when each of the firms in the market is threatened by bankruptcy, than in a period of economic expansion when they can all increase their turnover simultaneously. At the same time, it may also be assumed that in recession-hit industries, cartels are more unstable than in a period of expansion, particularly in sectors where fixed costs are high in relation to total costs. Given the poor financial health of the cartel's members in a period of economic recession, there is a stronger incentive to betray group decisions. How these two characteristics are likely to combine is difficult to predict. It may of course be assumed that the increased instability of cartels will, by reducing their profitability, serve to slow the increase in the number of cartels, but this effect will not necessarily be perceived by economic agents, at least not at the outset.

From the point of view of deterrence, the expected increase in the number of cartels, at least at the outset, calls for a review of the policy of prosecuting such practices. The competition authorities may want to step up their efforts in this area and to diversify their investigations in order to maintain the probability of detecting and sanctioning cartels at a level comparable to that which prevailed before the crisis. The marginal productivity of the competition authorities in detecting cartels will therefore be crucial. In this regard, it will probably be necessary for the competition authorities to have an ongoing field presence that enables them to set up a competition watch, and to launch investigations on their own initiative; they can no longer be satisfied with waiting for appeals for clemency.

Fourth, the anticompetitive effects of exclusion through vertical restraints, or abuses of dominance by firms, are apt to be greater than in the past. In a phase of economic expansion and abundant credit, potential entrants are – all other things being equal – better able to overcome obstacles placed in the way of their redeployment by firms which fear a new entry into their market than in a period of dwindling demand. In a time of economic and financial crisis, the credit market struggles to finance diversification projects – which have the potential to intensify competition – while lenders have a greater aversion to risk and less ability to predict what the future will bring. Likewise, the very significant fall in international trade is a factor undermining competition. We can therefore expect that the number of cases in which such practices are harshly sanctioned will be higher than in the past.

The concern with ensuring that powerful operators do not hamper the growth of their competitors in the market through exclusionary practices, given the weakness of the mechanisms for reallocating resources, could lead in some countries to a substantial change of attitude on the part of competition authorities towards dominant firms or those in a monopoly situation. In the first place, in countries where abuse of dominance is prohibited, the existence of dominance is appraised in the light of various factors, such as whether or not there are barriers to entry. It may be assumed that competition authorities will consider more frequently than in the past that firms with a substantial market share are also dominant. Moreover, we know that during the 1990s and the early 2000s (in the United States, for example), case-law tended to favour firms with significant market power, notably by significantly limiting cases in which competition law could be used to force such enterprises to provide their competitors with access to infrastructure and by expressing a degree of scepticism regarding the notion of essential infrastructure.[9] This attitude, which is understandable in a world in which resources flow fairly freely between economic sectors, may be more difficult to accept when potential competition is more narrowly limited because of macroeconomic circumstances.

Lastly, one may wonder about the future of merger control in a period of economic and financial crisis. Two thoughts come to mind.

In the first place, it is likely that in a larger number of mergers than in the past, the parties to the operation will argue that the operation should be authorised by invoking the failing firm defence. However, this defence, which in the past has been only rarely invoked and very rarely accepted, has hardly been considered in depth by the competition authorities. They will have to fill this gap and coordinate among themselves so as to define more precisely the concept of a failing firm and the standard of proof in this area. Some members of the OECD Competition Committee have moreover recently emphasised the necessity and urgency of international cooperation in this area.

Moreover, the economic and financial crisis may have implications for the conditions under which proposed mergers with anticompetitive effects may be authorised. We know that, when faced with such proposals, the competition authorities frequently attach conditions (or undertakings) to the merger authorisation aimed at eliminating the anticompetitive effects of the operation. They tend to give preference to structural conditions over behavioural conditions for fear of becoming mired in niggling and burdensome supervision of the entity resulting from the merger. But the fulfilment of these structural conditions, which involves selling some assets in order to reduce the market share of the merged firms or to allow viable competitors to emerge, assumes that potential buyers can be found for the ceded assets. In a world in which financing channels are seriously crippled, it is possible that, more often than in the past, it will be difficult if not impossible to find buyers for these assets. In such cases, the competition authorities will have four options, namely, to:

- prohibit the operation outright;
- authorise it while lengthening the period during which the merged firms can search for a buyer for their assets in the hope that, with the aid of a recovery, it will become easier for the parties to find a buyer;
- decide to impose behavioural conditions;
- authorise the operation without imposing conditions.

None of these solutions is perfect, and the last one, which amounts to relaxing merger control, is certainly the one that is least consistent with the competition authorities' mandate. Extending the deadline for the parties to divest themselves of some assets is not (contrary to how it might appear at first glance) an easy solution to implement, for experience shows that the value of these assets and, in particular, their usefulness in the competition process, deteriorates fairly rapidly as soon as the decision is taken in principle to put them on the market. The rapid devaluation of these assets may be due to the fact that no important strategic decision concerning them can be taken until they are sold, or to the fact that the firm resulting from the merger has an interest in making it difficult for a competitor to make use of

[9] Verizon Communications Inc v. Law Offices of Curtis V. Trinko, LLP, 540US 682 (2004).

the assets and therefore ceases to maintain them as it would if it were going to keep them. In view of these difficulties, it is not out of the question that the competition authorities will, more often than in the past, be compelled to resort to behavioural remedies in the case of anticompetitive mergers.

Conclusion

The avenues that were explored during the two days of discussions among the competition authorities meeting in the OECD Competition Committee are only an initial delineation of the role of competition law and the authorities who implement it in a period of economic crisis.

Nevertheless, these discussions have shown clearly that, in a period of rapid recession, weakening the implementation of competition law is liable to delay the much-needed economic recovery and to raise the already substantial cost of the crisis.

These discussions have also made for a better understanding of what can and should be the areas of intervention of the competition authorities. They can and should play a useful role, in cooperation with the executive branch and the sector authorities, in discussing new types of regulations, to ensure that they do not contain restrictions on competition that are not strictly necessary for attaining the economic or non-economic objectives that justify these regulations. They also can and should participate in the formulation of assistance or rescue plans for struggling firms or sectors to ensure that they do not create distortions of competition in the markets which, by facilitating rent-seeking, would reduce the firms' overall efficiency and complicate efforts to get the real economy moving again. Lastly, the competition authorities can and should be a bulwark against the rise of protectionist measures.

All of this implies, however, that the institutional frameworks in which these authorities operate allow them to intervene in the right place, at the right time, and with the requisite strength of conviction. Yet it is not certain that this condition will always be met. The difficulty stems in part from the fact that, in a period of economic expansion and liberalisation, it is mainly market actors who are responsible for anticompetitive behaviour. It is then crucially important to implement competition law, and it is understandable that in a number of countries (such as France or Spain), emphasis was placed during the 1990s and the early 2000s on setting up an authority that was strong, independent of the executive branch, and tasked with combating firms' anticompetitive practices. In a time of crisis, however, intervention is apt to adversely affect competitive mechanisms in at least as major a fashion, and the role of "competition policy" in influencing government decisions becomes essential. The institutional model of competition, which was chosen during periods of expansion and is well adapted to such periods, then risks becoming a handicap if these authorities are powerless to halt the undermining of their efforts by administrations which, in exercising their intervention or regulatory capacity, create an environment in which fair and efficient competition cannot prosper. At the very least, the current crisis should prompt reflection on the respective roles of competition law and competition policy and on the rehabilitation of the latter function.

In addition to such reflection, the discussion in the OECD has finally enabled competition authorities to realise that, between a rigid stance on the implementation of competition law, which risks making this law incomprehensible and intolerable before its legitimacy has been fully established, and an excessive flexibility that would lead them to renounce the underlying principles of competition law, there is a third way. It consists of taking into account, while implementing the law and respecting its principles, certain economic circumstances characteristic of a crisis period. Competition law must not change in a period of crisis, but its implementation must take account of how macroeconomic conditions influence the free play of competition in the market. That is what will be needed to preserve the law’s relevance.