COMPETITION POLICY RESEARCH CENTER
Fair Trade Commission of Japan

Financial crisis , Regulation and the Future of Antitrust

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Issues to be discussed

Introduction: the response to the financial and real crisis

The causes of the financial crisis

Financial regulation in a time of crisis

Government interventions in the financial sector in a time of crisis

Governement intervention in the real sector in a time of crisis

The role of competition authorities in a time of crisis

Conclusion

The consequences of the financial and real crisis for antitrust: short run, long run

1) How is antitrust going to be affected during the crisis (a period of retrenchement)

1) What is the antitrust world going to look like after the crisis (a return to business as ususal ? The emergence of a new paradigm ?)

Introduction

Saint Vulbas, France February 26 2009:

Speaking to automobile industry executives, President Sarkozy said that :

«he hoped that the Eurpean Commission would understand there are more important things to do than analyze the compatibility of State Aids with competition rules »

The issue

In a time of crisis there is great pressure on governments (with or without economic justification) to intervene to alleviate the severity of the crisis and make the necessary adjustements more politically tolerable (or in certain cases to prevent those disruptive adjustment from taking place)

But the short term measures used to remedy the crisis may have long term toxic effects which will evenually prevent or delay economic recovery. This is particularly the case when as a result of a short term remedial measures the competitive process is durably impaired.

Just like medical doctors consider the side effects of medicine or the possibility of allergic reactions by patients before prescribing a treatment, public policy makers should carefully consider the long term effects of the remedies they implement to remedy the financial and economic crisis.

The origin of the financial crisis

Financial sector, competition, and systemic risk

1) The financial sector is based on trust: hence necessity to avoid financial panic

2) Financial operators are interdependent: hence necessity to prevent the failure of financial institutions which have a systemic importance

3) Role of prudential regulation:

4) Role of competition in banking
   a) Lowering the cost of credit
   b) Financial innovation

Causes of the financial crisis?

-Monetary policy

-Exuberance of markets

-Regulatory failure

-Competition

Too much competition?
Not enough competition ?
Inadequate competition oversight ?

Causes of the financial crisis

- 1990s Growth of developing countries (such as China) through export led market competition, leading to an excess of global intended savings relative to intended capital investment.

-US Monetary policy ⟶ decline in interest rates between 2000 and 2005.

- Hedge funds seek high returns.

- Social policy (extension of mortgage to high risk clients, ever rising price for collateral, risk to be be passed on)

- Risk taking by banks and funds (based on past statistics , rising real estate prices, risk will be passed on): subprime mortgages.

Causes of the financial crisis

- Securitization

- Credit rating (business model, lack of consideration for systemic risk : the risk assessment and the rating is not a function of the global quantity of securitized high risk mortgage)

- Insurance (AIG)

Gaps in the regulation of insurance companies (AIG British subsidiary which insures 450 billions of bad loans is not regulated by the US insurance regulatory authorities, CDS are not regulated, AIG does not create provisions)

- Default

- Mark to market accounting rule

Greenspan on the financial crisis

- From « Shocked disbelief »

To: « Global market competition and integration in goods, services and finance have bought unprecedented gains in material well-being. But the growth path of highly competitive markets is cyclical. And on rare occasion it can break down, with consequences such as those we are currently experiencing. It is now clear that the levels of complexity to which market practitioners tried to push risk-management techniques and products were too much for even the most sophisticate market players to handle properly and prudently ».

Alan Greenspan, Wall Street Journal Thursday March 12 2009

Greenspan on the financial crisis

(….) the appropriate policy response is not to bridle financial intermediation with heavy regulation.That would stifle advances in finance that enhance standards of living.

Remember, prior to the crisis, the US economy exhibited an impressive degree of productivitiy advance. To achieve that with a modest level of combined domestic and foreign borrowed savings was a measure of our financial stystem's pre-crisis success.

Alan Greenspan, Wall Street journal Thursday March 12 2009

Greenspan on regulatory solutuons to the financial crisis

Any new regulation should improve the ability of financial institutions to effectively direct savings into the most productive capital investments.

(….)

Our challenge in the months ahead will be to install a regulatory regime that will ensure responsible risk management on the part of financial institutions, while encouraging them to continue taking the risks necessary and inherent in any successful market economy

Alan Greenspan, Wall Street journal Thursday March 12 2009

Reforming financial regulation

Regulatory proposals in the wake of the financial regulation

-Limiting the ability of financial operators to avoid the constraint of prudential ratios

-Extending the scope of regulation to new instruments

- Extending the scope of regulation to new operators (transparency and hedge funds)

- Extending the scope of regulation to the governance of financial institutions (regulating bonuses of bankers /traders)

-Extending the reach of regulators (international cooperation)

- Regulating Credit rating agencies

-Modifying accounting rules (mark to market)

Recommendations of the G20 Finance Ministers and Central Bank Govs. to the London Summit

- all systemically important financial institutions, markets and instruments are subject to an appropriate degree of regulation and oversight, and that hedge funds or their managers are registered and disclose appropriate information to assess the risks they pose;
- stronger regulation is reinforced by strengthened macro-prudential oversight to prevent the build-up of systemic risk;
- financial regulations dampen rather than amplify economic cycles(…)
- strengthened international cooperation to prevent and resolve crises (…).

We have also agreed to: regulatory oversight, including registration, of all Credit Rating Agencies whose ratings are used for regulatory purposes, and compliance with the International Organisation of Securities Commissions (IOSCO) code; full transparency of exposures to off balance sheet vehicles; the need for improvements in accounting standards, including for provisioning and valuation uncertainty; greater standardisation and resilience of credit derivatives markets; the FSF's sound practice principles for compensation; and the relevant international bodies identify non-cooperative jurisdictions and to develop a tool box of effective counter measures.

Possible toxic effects of regulation

-Ineffective regulations (loopholes, electricity regulation and Enron, financial regulation)

-Regulations which distort incentives in unexpected ways

-Regulations which unnecessarily restrict/ distort competition (telecom regulation after the breakup of ATT)

-Regulations which impair innovation (see Greenspan)

Hence necessary cooperation between sectoral regulators and competition authorities for the design of appropriate regulations

Direct interventions in the financial sector

Other measures to cope with the crisis: in the financial sector

-State aids (including guarantees) , Bail Outs, Recapitalization

-Mergers

-Nationalizations

Possible toxic effects of remedies in the financial sector

-Distorsion of incentive leading operators to deviate from profit maximizing behaviour

-Distortion of competition (aided financial institutions can prevail over possibly more efficient unaided competitors)

- Unnecessary lessening of competition (particularly in the area of mergers)

Importance of competition in the financial sector in a time of crisis

-Complement of stimulus packages (distribution of credit)

-Passing on of decrease in refinancing rates (cheaper credit)

- Financial innovation (allowing savings to be directed into the most productive capital investments).

Those objectives are unlikely to be achieved unless there is a sufficient degree of competition between financial institutions

Governement intervention in the real sector

Financial crisis and the real sector

Sources of difficulties in a time of crisis

-Under-performers (ex the US automobile sector): should they be left hanging in the wind ?

- Collateral victims (well performing firms caught between a credit crunch and sudden precipitous drop in demand): should collateral victims be saved ?

- Firms of systemic importance in the real sector (argument of Carlos Goshn); are there such firms ?

Real sector crisis and governement intervention

Reasons for governement intervention

- Systemic failure:

does it exist in the real economy ? (cf Carlos Gohsn, General Motors on suppliers)

- Political pressure :

stabilization of unemployement and prevention of job losses in the short run.

Real Sector Interventions

-State Aids (Bailouts of General Motors and Chrysler))

-Protectionist measures

- Mergers

Protectionist measures

We commit to fight all forms of protectionism and maintain open trade and investment

Communiqué following the G-20 meeting in the U.K., Sunday March 15 2009

But

- Early in 2009, the US congress adopted a Buy American provision in the economic stimulus package

-The US is preparing to impose antidumping duties on Chinese steel imports

-In 2008 India imposed safeguard measures on steel imports

-In early 2009 France adopted measures to subsidize potential buyers of Airbus planes (5 billion euros) etc…..

-In early 2009 France considered conditioning state aid to the automobile industry on repatriation of plants on French territory.

Possible long term toxic effect from those remedies

- State aids may distort incentives (Effect of the Chrysler Bail-Out in the 80s)?

State aids may be discriminatory and pervert competition (domestic/ international firms; developed/developing countires)

Protectionist measures (antidumping/ Buy american Act/ French automobile plan/ may restrict competition or lead to retaliatory measures and a race to subsidies)

Mergers may lead to unnecessary restrictions of competition

The role of competition authorities in a time of crisis

Role of competition authorities in crisis

1) Help design adequate regulations

2) Help design and/or control rescue packages (particularly: conditions of aids, sunset clauses, rendez vous clauses, evaluation, etc….)

3) Control of protectionist measures (are US and EU competition authorities right to abstain from intervening in antidumping proceedings?)

4) Merger control

5) Control of anticompetitive practices by firms

6) Take up new issues

Interventions of competition authorities in the regulatory process

-Consultation/Advocacy

Ex: US Banking mergers (DOJ and FED simultaneous competition assessments)
But US lack of consultation of FTC on automobile bailout package

-Participation in governmental decision making process

-Ex: Status of Korean KFTC chairman; is there a trade off between independence and influence

-Control of impact of government interventions on competition

-Ex EC State Aid Control, France (binding opinions of competition authority in some cases).

Possible enforcement strategies for competition authorities in the near future

1) Denial: Nothing has happened which should lead competition authorities to do anything differently (the crisis happened because we did not rely enough on unregulated competitive market mechanisms)

2) Panic: The exclusive focus on consumer welfare is untenable in a period characterized by a deep financial and economic crisis calls for more regulation and protectionist policies. We have to go back to the antitrust goals of the 1960's which were more concerned with distributional issues

3) Adjustment: We should keep the same goals and standards but acknowledge that the macroeconomic context in which we are enforcing competition is different from the past and acknowledge that this is going to influence antitrust enforcement.

Possible enforcement adjustments in a time of crisis

-Procedural flexibility (ex week end mergers or bail out plans)

-Case selection (more pressure to take up socially relevant cases in a time of economic depression)

-Interim measures/ preliminary injonctions (increased fragility of some firms)

-Cartel enforcement (likelihood of increased frequency of cartels but increased instability of cartels)

-Potential competition (decrease in the fluidity of reallocation of resources, lower intensity of potential or actual competition due to sharp decline in international trade)

Possible enforcement adjustments in a time of crisis

-Abuse of dominance/monopolization (more concern about ensuring that dominant position do not impair entry, toward a revision of Trinko?)

-Mergers (more frequent use of the failing firm doctrine)

- Merger remedies (possible difficulties to impose divestitures because of paucity of potential buyers hence either longer delays granted for divestiture or shift toward behavioural remedies)

New issues in competition

-Role of transparency in financial markets (how to make financial disclosure laws more consistent with competition laws?)

-Performance in financial markets : (Is there too much focus on prices/ rates and not enough on other dimensions of performance (including stability ?)

-Cooperation and stability in financial markets

-Switching costs and competition in financial markets

Conclusion

Competition is not part of the problem but it is definitely part of the solution.

What we have learned from the crisis is that short run profit maximization (by bankers) combined with excessive risk taking without consideration for long term economic development can have catastrophic results.

This lesson also applies to the remedies used in a period of crisis.

Competition authorities have an important role to play in the coming years.

Thank you for your attention

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