The Context for UK Competition Policy – Speech to Competition Policy Seminar, 6 December

[Introductory remarks].

I want to talk today about the importance of competition policy. About the benefits of competition and the links to the wider work of the Department of Trade and Industry. The UK has recently undergone major legislative change in the form of the Enterprise Act, which Christopher Clark will talk about in more detail later.

Competition issues seem particularly relevant for you at the moment. I wish you success in your work to amend the antimonopoly act in Japan, introducing a leniency programme and increasing penalties for those violating the law.

The DTI’s ambition is 'prosperity for all'. We work to achieve this by helping people and companies become more productive by promoting enterprise, innovation and creativity. We champion UK business at home and abroad. We invest heavily in world class science and technology. We protect the rights of working people and consumers. And we stand up for fair and open markets in the UK, Europe and the world.

Productivity is the most crucial factor in securing long-term growth in living standards. UK productivity has been consistently lower than that of our major competitors. Along with investment, skills, enterprise and innovation, competition is a key factor in raising productivity.

Let me start by making the case, as I see it, for competition.

Competition is vital in reducing costs for businesses and for consumers - competitive pressures bear down on firms, ensuring they find more efficient ways of producing and delivering goods and services. Making their products cheaper and more desirable.

Its vital in rooting out the staid old practices which protect inefficient companies and act as barriers to stop newer, nimbler, more innovative businesses entering the market. New businesses which can drive up productivity and generate new jobs, new sources of income and new investment.

Ultimately, *continually* competitive markets – which we would argue can only be brought about and sustained by effective competition legislation – are the only route to ensuring that business remains on its toes, keeps innovating, and maintains pressures to keep producing efficiently.

Competition is good for consumers. But as we all know, within markets we can see the success of one, or at best a very small number of, businesses, at the expense of all the others.

What's wrong with that, if it has been achieved through fair competition? In many cases nothing. But in some cases this leads to businesses abusing dominant positions.

This is one area where the need for competition law comes in.

Yes, business is the wealth creator. Yes, business is the generator of quality products. But that's businesses *in competition* with each other. When businesses become dominant, the pressures to improve, to be innovative, to maintain cost and quality can fall away. Market power can be abused. Monopolies lead to companies restricting their output in order to drive up prices and increase their profits. Academic research suggests this could cost the UK economy around one percent of GDP.

Equally, we may find anti-competitive activity without dominant firms. Cartels may form, other anti-competitive practices may prevail. And here again the consumer – and eventually the economy – starts to suffer. OECD research suggests that cartels can raise prices by an average of ten percent.

In 2001 the European Commission concluded that eight companies were guilty of operating a vitamin cartel. They fixed prices for different vitamin products, allocated sales quotas, agreed on and implemented price increases. They kept prices for twelve different vitamins artificially high, by between seventeen and forty-nine percent. This translates to consumers overpaying by seventy-two million US dollars across nine of the affected countries for every year of the cartel, which lasted from 1989 to 1999. Obviously the companies did well from this arrangement but consumers suffered.

UK competition legislation addresses this by criminalising the cartel offence. Those found guilty of dishonestly operating in hardcore cartels can face up to five years in prison.

Investigations by our competition authorities have revealed significant detriment to consumers from a range of anti-competitive activities.

Last year the Competition Commission estimated that excess pricing in the extended warranties market amounted to a detriment to consumers of nearly £150 million per year.

Also last year, mobile phone operators were found to be overcharging by up to forty percent. Correcting this should benefit consumers by up to £700m over four years.

Effective competition legislation ensures that competitive pressures are maintained – ensures that there is a level playing field for companies, ensures that the small players can challenge the big players if they have the right products and skills. Ensures detriment to consumers is minimised. But it won't achieve these results alone.

We commissioned Professor Stephen Davies, a leading UK academic on competition policy, to look at some case studies of how enhanced competition can benefit consumers. I will describe two of these case studies in a minute. But Professor Davies' report emphasised that competition law alone cannot deliver these results. Without a pool of resourceful entrepreneurs to make the running in a newly opened market, the effects of interventions to increase competition would not have been so far reaching.

The report also suggests that competition is about more than just price, it provokes new and innovative ways of doing things. These may be worth far more than lower prices.

Let’s consider two of Professor Davies’ examples.

- **European passenger flights**

First, passenger flights in Europe. The European Commission liberalised EU air routes during the 1990s. Previously, the market was dominated by “flag carrier” airlines, which were not subject to significant competition from other airlines, and therefore had lower incentives to be efficient and innovate than in a competitive market.

As a result of liberalisation a number of low cost carriers emerged, for example, Ryanair and Easyjet. These new entrants operated a very different business model from that of the traditional scheduled carriers. Prices of all fares, in particular economy class fares, have fallen considerably since the liberalisation. Many of these lower fares come from new low cost airlines entering the markets. But existing firms, such as BA have also significantly reduced their prices.

Without liberalisation, low cost airlines would not have been able to grow to their current size; but, equally, it is of huge importance that the entrants brought with them a new business model. Traditional carriers are adopting a number of the business practices associated with low-cost airlines to cut their costs and make their lower fares profitable. What's more, there are now more frequent flights to a larger range of destinations. And fears that safety would be impacted have not materialised.

- **Replica football kits**.

Second, the pricing and availability of replica football kits. In the UK this is a big market. Around two-hundred and fifty million pounds of turnover in 2001. Football supporters are keen to have their team’s latest kit. That kit changes frequently!

Under new legislation the UK's Office of Fair Trading was able to investigate complaints. It found evidence of price fixing and heavy fines were imposed on companies involved. After the investigation, prices of replica kits fell, in some cases by up to a third.

Where does DTI fit in? We have responsibility for competition legislation. Indeed we recently modernised our competitive framework through the Competition and Enterprise Acts. Reforms have created strong competition authorities, free from political interference. Making independent, transparent and expert decisions. Where there is doubt about the conclusions reached, we now have a formal appeals process, through the Competition Appeals Tribunal.

Now we will lead a stronger drive to promote competition and open markets in the European Union, in particular through energy liberalisation and a single market in services.

So how effective is our legislation? We published our second peer review of competition policy regimes this year, comparing the UK with regimes in a range of other countries. KPMG carried out the survey, which summarised the views of businesses, lawyers, economists and competition authorities. It found that the UK competition regime was amongst the best in the world. And that recent changes to our legislation were viewed favourably. It suggests that, whilst it is too early to thoroughly evaluate the effects, we will see more benefits to the changes as the new legislation beds down.

So competition is important. But lets return to how this fits with DTI’s wider work. Prosperity for All is the DTI's overarching aim. A major part of this is raising productivity. Closing the gap with our competitors. Apart from competition, we see four key drivers of productivity:

- Investment
- Innovation

- Skills
- Enterprise

As I’ve already implied, there are many links between these drivers. Enterprise, or entrepreneurship is essential for driving competition and innovation in markets. Competition drives innovation. Skills and investment drive innovation. Competition drives investment.

Let me look at our position on innovation in more depth.

Harvard academic Professor Michael Porter, in his work for the DTI said “To achieve higher prosperity, UK companies will need to upgrade their productivity by competing on more unique and more innovative products and services”. Indeed innovation is one of the main engines of long-term economic growth.

There are two conflicting views on the potential impact of competition on innovation.

One is that increasing competition means that firms' incentives to invest are reduced as they have less to gain from any innovation they make - “ anti-trust discourages innovation…” is a view often expressed by the likes of Bill Gates.

The other temptations is that, faced with increasing competition firms are under pressure to operate efficiently and attract consumers through lower price, higher quality or unique products. This gives firms a strong incentive to conduct research and development and be innovative.

A key question for all policy makers is which of these two effects dominates. Let's look at the evidence. Recent academic work shows that where competition is initially at a low level and then increases we see a significant increase in innovation. Only at very high levels of competition does an increase in competition reduce innovation.

In an assessment of the link between competition and innovation causality is very important. We would argue that increasing competition drives innovation as firms have a greater incentive to innovate to attract new consumers and improve efficiency. But it is also possible that the reverse is true.

Where do we stand on innovation? Although the UK has a number of sectors that lead the world in innovation, including aerospace, pharmaceuticals, biotechnology, financial services - overall performance is only average compared with our international competitors. We are very good at generating ideas.

We are not so good at turning these ideas into successful products, services and processes.

Innovation depends on a range of factors apart from competition and enterprise, including:

- **A firm's ability** to turn knowledge into profitable goods and services. This depends on investments in human and physical capital and the flexibility of a firm's strategy, culture and organisation in the face of change. Central Government funds and delivers skills and education provision.

- **Access to finance** because all investments in new products, services or processes have to be financed in advance of production. The Government influences this by setting the macro-economic framework and through a range of fiscal measures.

- **Sources of new technological knowledge**, such as the Science and Engineering Base, which is largely financed by central Government, and design, play an important role in shaping innovation systems.

- **Customers and suppliers.** Demanding customers and suppliers put pressure on firms to deliver better quality goods and services. Government is a major consumer of goods and services. Government influences innovation through policies which shape innovation systems (including regulation, competition policy, education) or through subsidies to encourage innovation or knowledge transfer.

Developing strong competition and innovation frameworks is key to achieving our aim of prosperity for all.

How does DTI work to achieve this?

- By **Championing Competition**. Working jointly with the competition authorities to promote the competition message across Government. Working to ensure that regulation promotes not restricts competition. Working to ensure that the UK's competition regime is as effective as possible. Empowering consumers to make markets work better. Promoting competition and open markets in Europe and Internationally.

- By **Promoting innovation** –ensuring that intellectual property rights are clear and effective and by encouraging investment and research and development across the UK economy. By ensuring that regulation promotes, not restricts innovation. Changes to the delivery of DTI business support should increase the impact, and clarity, of DTI interventions aimed at increasing innovation by concentrating resources on fewer, more cost effective, activities.

- **Getting business engaged** – consulting with business to understand their requirements and ensuring that, where possible, their concerns are met.

In conclusion, competition is key to the UK's future economic performance. We have a world class framework in place, but our challenge now is to make it work!