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The Financial Crisis – three lessons for antitrust (II)

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Over the past two years, while the world witnessed the devastating impact of the financial crisis, experts of all kinds have speculated about the root causes thereof and ways to address them so as to prevent the recurrence of a similar meltdown in the future. In the meantime, the role of competition authorities in the management of the crisis has been quite different from one jurisdiction to the other. In the EU, the European Commission has been heavily involved, notably as it ended up coordinating all national bailout plans and other ad hoc rescue measures by means of the EU State aid rules (for an early overview, see here and for the latest report from the front, here). Recurring questions remain, however, as to the precise relation between the crisis and "competition" – as the term is used rather loosely in this context. In a sequence of three short postings, I would like to address three issues related to the financial crisis by means of deliberately "big-picture-op-ed-style" comments and to venture three lessons for antitrust, with the view of eliciting reactions.

This is the second of such postings.

2. Second: to what extent was/will competition law enforcement (be) affected by the financial crisis?

Clearly, the crisis has shaken some of our certainties, assumptions or at least beliefs. Things have changed. We know live in a world where Richard Posner admits openly (here) that capitalism can fail because of a lack of regulation (cheap, but you got the point). We knew there was an Efficiency Paradox (as neatly explained by Eleanor Fox in here); now we realize that capitalism is a system at war with itself… Certainly, the crisis is bound to impact antitrust policy in one way or another, if only by affecting regulators' perceptions about robust, efficient, and self-correcting markets. Could more radical consequences lie ahead?

At the last European Competition Day, the head of a national competition authority shared the view – with a glimpse of guilt – that the confidence of the public in the market mechanism had been hampered, that the crisis caused the market economy to suffer a great loss of credibility and that there was a lot to do to restore that credibility, as if the legitimacy of antitrust had been affected in the same way. The day after, happy coincidence, the EU released the shocking results of an opinion poll – one of the famous Eurobarometer survey – carried over a sample of 25.000 EU citizens

about the perception of its competition policy: citizens overwhelmly (read: including 80% of the French) consider that competition between firms brings about lower prices and greater choice, that cartels and other collusive agreements ought to be prohibited and that competition is a good thing for society in general. Who said that the days of competition policy were over?

But there is more. In Europe, competition law has played a key role in the management of the financial crisis since its inception. Not a single rescue measure and remedial scheme designed by Member States to bail out distressed financial institutions or assist those "sound" banks facing refinancing difficulties, could be implemented without the prior authorization of the Directorate-General for competition. This is because the EU Treaty provides that plans to grant State subsidies – called State aids – must be notified to the European Commission and cannot be implemented prior to having been formally approved, under the threat of being held illegal "per se" and having to be actually paid back. Given the kinds of steps taken by Member States – State guarantees, recapitalization schemes, impaired assets relief measure – and the circumstances – no a single private investor would have had the means or taken the risk to jump in at the time – all those bailout-related measures amounted to State aids. Within days of the collapse of Lehman Brothers, the Commission had reallocated resources and put in the necessary procedures in place to be able to intervene swiftly and provide guidance to Member States so as to avoid a subsidy race, imbalances between countries and distortions of competition. Quite remarkably, Member States backed the Commission's action – not without some healthy sabre-rattling – whereas it basically amounted to give it the power to coordinate their economic policy in the heat of crisis.

In addition, those high times underscored not only the resilience of the EU competition policy but also that protecting competition – the engine of the market economy – enables to address, potentially, a host of ancillary regulatory objectives including, in the particular case of the financial crisis, moral hazard issues. Moral hazard: that asymmetry between risk-taking and risk-bearing that turns firms incentives upside down, or "when they can steal your money and no one is responsible" (…). In effect, by conditioning the authorization of bailout plans to strict eligibility and remuneration requirements, behavioural conditions (including restrictions on the beneficiaries' marketing, dividends, share buyback and other strategic policies, mainly to prevent taxpayer money to serve remunerating capital) and, most importantly, structural obligations (divestitures entailing drastic reductions of balance sheets up to 50%), which are all part of the State aid remedial arsenal, the Commission managed, at least to some extent, to address moral hazard, i.e., to ensure that financial institutions retain/regain the right incentives to orient their businesses toward long-term stability and efficient services to their customers. Hence why Commissioner Almunia puffed out his chest recently and submitted that the EU had been "the only jurisdiction in the world that has explicitly tackled moral-hazard issue" in managing emergency rescue measures (see SPEECH 10/301).

What to draw from the above? First: two years after the financial crisis blew up, competition law is still alive and well and kicking. Second, another simple lesson in antitrust modesty: maybe competition policy is less about engineering efficiency and conjecturing about theoretical "what-ifs", than ensuring that firms remain guided by

the right incentives, rooted in healthy rivalry. The corollary is an acknowledgment that competition policy is in fact a form of economic policy, with great potential to stir firms toward serving the needs of consumers. But there is a third – important – lesson to be derived from the financial crisis: antitrust is a discipline.
To be continued.

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