

Productivity Commission National Competition Policy Analysis Study  
Email – [ncp@pc.gov.au](mailto:ncp@pc.gov.au)

Dear Madam/Sir,

Accord is pleased to provide this brief commentary submission to the Productivity Commission National Competition Policy Analysis Study. For more background on Accord and the industry we represent please refer to Annex 1.

Noted in the Terms of Reference for this consultation is the following:

“Laws and policies at all levels of government – Commonwealth, states and territories, and local – impact the competitiveness of our economy. In this context, the Australian Government is committed to working with states and territories on reforming national competition settings to ensure these challenges are met. At the December 2023 CFFR meeting, Treasurers agreed to progress competition-enhancing reforms by revitalising National Competition Policy.”

We also note that the federal Treasurer has commissioned this study to assess the impact of “reform options proposed by Commonwealth, states and territories as part of the revitalised National Competition Policy”, albeit that the process for developing these is still in progress.

As such, we understand that this is essentially a commissioned study to enable the PC to develop robust methodologies for measuring the impact of NCP reforms but also that such an endeavour requires equally robust consideration of all factors impacting competition and productivity. While it is expected these factors would already be well known to the Commission, and that the final NCP reform targets of Australia’s governments will determine the priority for what is measured, it is equally important that underlying factors such as the impact of regulation on competition be considered.

### **Accord’s specific comments on regulation, competition and productivity**

Since the foundation of Accord as the peak representative body for our industry in 2005, every survey of business pressures we have taken of our member businesses has highlighted overly complex regulation as a barrier to innovation, investment and new product entry. And based on non-member business contact regarding the potential entry of new ventures into the Australian market, overly complex regulation also acts as barrier to new business entry.

This submission provides some information that may assist the Commission in integrating the impacts of regulation into its approach for developing an economy-wide methodology and framework.

The Business Council of Australia’s “*Seize the Moment – A plan to secure Australia’s economic future*” report was released in August last year and highlighted the ongoing complexity of regulation across Australian jurisdictions: “*The patchwork of regulation across the nation discourages investment and is a barrier for companies to expand and trade across state lines or overseas.*”

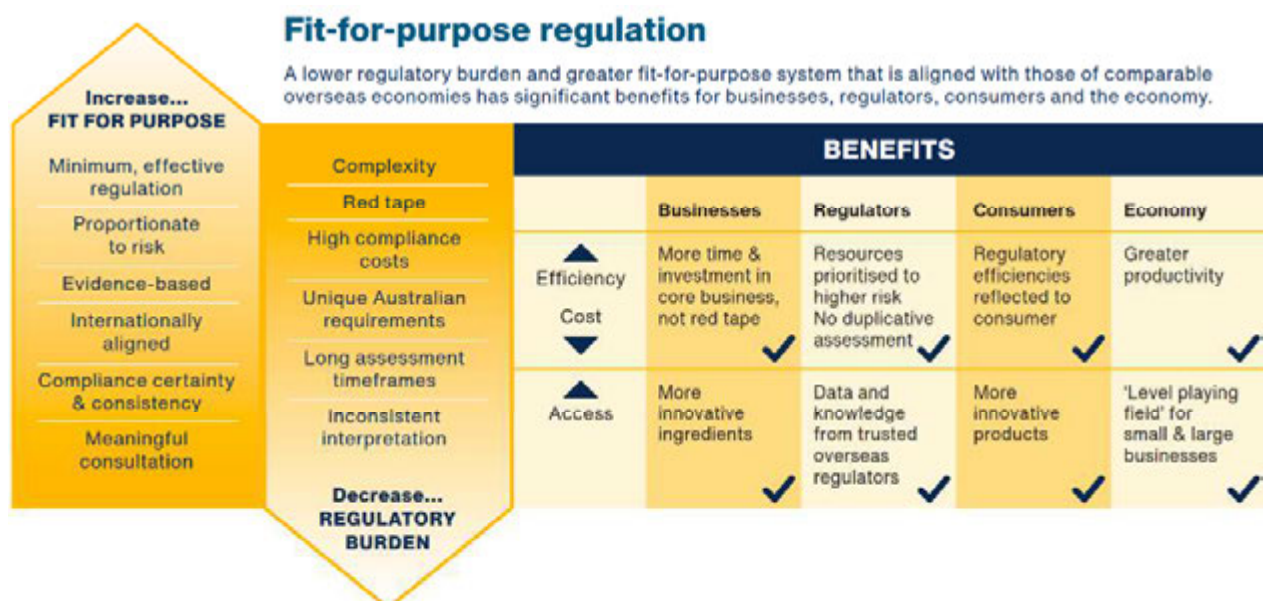
In the specific case of Accord’s industry sector, the 2008 Productivity Commission (PC) Study of Chemicals and Plastics Regulation found that: *“While the regulatory framework has been reasonably effective in achieving public health, workplace safety, environment protection and national security goals, there are many inefficiencies. Governments have regulated chemicals in different ways, even though the hazards and risks they pose vary little across the country, and this has resulted in unnecessary complexity under our federal system.”*

Arising from the long-running “reform” process started by the then government’s response to this PC Study, one of the measures undertaken was to update the overarching chemicals introduction legislation with a new law, the *Industrial Chemicals Act 2019*. While this updated legislation received industry support as simpler and less complex than what it replaced, the actual requirements facing firms under the subordinate Rules and Guidelines have remained overly complex in administration and enforcement and are often out of step with international best practice, especially for regulation of globally traded cosmetic and personal care products.

For this reason, a key strategic goal of Accord as a peak body is to work with governments and other stakeholders to foster greater industry productivity and innovation via simpler regulation—devoid of unnecessary red tape.

Our key proposition on this is that governments need to regularly ask the following: *“Is the regulation fit-for-purpose?”* In this regard, the concept of fit-for-purpose regulation is two-sided and effective regulation must of course protect the public, workers and the environment from unsafe products and technologies. On this front, and based on Accord’s decades-long experience, Australia’s various regulatory frameworks generally work well. Overall, in the case of our industry, consumer protection is being satisfactorily achieved.

But there is a flip side to all this. And this relates to the question of whether Australia’s existing regulatory approaches are truly fit-for-purpose. Technologies, systems, products and markets are constantly evolving but all too often regulations and regulatory schemes remain static, with unnecessary duplications across Australian jurisdictions remaining firmly entrenched. As a guide to the elements of fit-for-purpose regulation, Accord has developed the following pictorial:



It is our hope that the proposed revitalisation of the NCP will prioritise a goal of making Australian regulatory approaches more fit-for-purpose.

Noting that this study will be evidence-based and focus on economic modelling in relation to competition, we draw the Commission's attention to a detailed study undertaken by the UK Competition and Markets Authority titled "*Regulation and Competition: A review of the evidence*". This study is attached as Annex 2.

In this study, the CMA stated that "*our starting point for this report is that effective competition is a means of improving outcomes for consumers: lower prices, better quality, new products and services. At same time, regulation plays an important role in helping government secure its various policy objectives e.g. protecting consumers and the environment and promoting competition and economic growth. **There should thus be a focus on the process for designing and implementing "better regulation", taking into account the impact on competition and measuring the outcomes of regulatory interventions.***" [our bolding]

There is a wealth of information in this study. Our assessment is that this report delves deeply into the question of how regulation impacts competition and therefore may be a useful resource for the Commission's study.

We thank the Commission for this opportunity to share our comments on the study it is undertaking and wish those engaged in the study all best in their deliberations.

Yours sincerely,

<Unsigned for electronic transmission>

Craig Brock  
**Policy & Public Affairs Director**

22 May 2024

Attachments: Annex 1 – Accord member list; Annex 2 – "*Regulation and Competition: A review of the evidence*", UK CMA, Jan 2020.

## *Members*

### **Consumer and Personal Care**

Advanced Skin Technology Pty Ltd	L'OCCITANE Australia Pty Ltd
Aesop	L'Oréal Australia Pty Ltd
Amway of Australia Pty Ltd	LVMH Perfumes and Cosmetics
Beiersdorf Australia Ltd	MECCA Brands
Chanel Australia	Muk Haircare Pty Ltd
Church & Dwight (Australia) Pty Ltd	Natural Australian Kulture Pty Ltd
Clarins Group/Trimex Pty Ltd	Nutrimetics Australia
Clorox Australia Pty Ltd	Panamex Group
Colgate-Palmolive Pty Ltd	Pierre Fabre Australia Pty Ltd
Combe Asia-Pacific Pty Ltd	Procter & Gamble Australia Pty Ltd
Cosimer Pty Ltd	Puig Oceania Pty Ltd
Coty Australia Pty Limited	PZ Cussons Australia Pty Ltd
De Lorenzo Hair & Cosmetic Research Pty Ltd	RATIONALE
Edgewell Personal Care	Reckitt
Estée Lauder Australia	Revlon & Elizabeth Arden Australia
Frostbland Pty Ltd	Sabrands
Hairjamm Pty Ltd	SC Johnson & Son Pty Ltd
Haleon	Shiseido Asia Pacific Pte Ltd
Helios Health & Beauty Pty Ltd	Supergoop!
Inglot Cosmetics Pty Ltd	Ultraceuticals
Jurlique International Pty Ltd	Unilever Australia Ltd
Kao Corporation	Vanity Group
Kenvue	Vitality Brands Worldwide
Keune Australia	Weleda Australia Pty Ltd
Kimberly-Clark Australia	
La Prairie Group	

### **Commercial/Hygiene & Specialty Products**

Albright & Wilson (Aust) Ltd	Mera Chemicals
A S Harrison & Co Pty Ltd	Native Oils Australia
BP Castrol Australia Pty Ltd	Novozymes Australia Pty Ltd
Brenntag Australia Pty Ltd	Nowchem
Castle Chemicals Pty Ltd	Peerless JAL Pty Ltd
Challenge Chemicals	Recochem Inc
Crisp Solutions	SC Johnson Professional
Dominant (Australia) Pty Ltd	Scentral Flavours & Fragrances
Dow Chemical (Australia) Pty Ltd	Schulke Australia Pty Ltd
Ecolab Pty Limited	Solvay Interox Pty Ltd
Ensign Laboratories	Sopura Australia Pty Ltd
Freudenberg Household Products Pty Ltd	Symbio Australia Pty Ltd
Givaudan Australia Pty Ltd	Thor Specialties Pty Limited
Indorama Ventures Oxides Australia Pty Limited	True Brands
Inspired Brands Pty Ltd	Whiteley Corporation Pty Ltd
Lab 6 Pty Ltd	

## **Associate Members**

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Active Display Group  
Ident Pty Ltd  
Look Print

### **Legal and Business Management**

FCB Lawyers  
HWL Ebsworth Lawyers  
K&L Gates

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Competitive Advantage  
Davoren Environmental Pty Ltd  
Delphic HSE  
Engel, Hellyer & Partners Pty Ltd  
International Cosmetics & Regulatory Specialists LLC  
Purvis Regulatory Consulting  
Quality Matters Safety Matters  
Ramboll Australia Pty Ltd  
Seren Consulting Pty Ltd  
Skincare Business Foundations  
Sue Akeroyd & Associates  
Tudor Chem Pty Ltd  
UL International Australia Pty Ltd

### **Specialist Laboratories and Testing**

D.Lab Solutions Pty Ltd  
Eurofins ams Laboratories Pty Ltd  
Eurofins | Dermatest Pty Ltd  
pH Factor

*April 2024*

# Regulation and Competition

A Review of the Evidence

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# 1. Executive Summary

## Background

- 1.1 In the Spring Statement in March 2019, the Chancellor asked the CMA to carry out a review to assess how regulation affects competition in the UK business environment.
- 1.2 The purpose of this report is to summarise existing evidence about the impact of regulation on competition both in terms of the academic research and the way in which regulation is designed and implemented in practice. It also provides a number of practical recommendations for policymakers to support them in developing regulation.
- 1.3 It is well established that effective competition is a key mechanism for improving outcomes for consumers. It leads to lower prices and better quality for existing products and services, and it promotes innovation in new products and services. There is a concern that regulation can have the effect of stifling competition, and thereby deprive customers of these benefits, for example through raising barriers to entry.
- 1.4 At the same time, different forms of regulation have an important role to play in supporting competition, for example by providing the legal and economic frameworks within which competition takes place. Regulation also helps government and other policymakers secure other policy objectives in addition to promoting economic growth. For example, there are regulatory frameworks to protect consumers from mis-selling; to secure health and safety in the workplace; and to safeguard the environment. It is therefore important to take into account the benefits as well as the costs when considering the impact of regulation.
- 1.5 As a starting point, evidence from international indicators show that the UK is already a highly competitive economy, with a world-leading regulatory environment which includes processes to assess the way in which regulations are designed, implemented and reviewed:
  - (a) The World Bank's 2019 Ease of Doing Business Survey ranks the UK as 9th out of 190 economies;
  - (b) The World Economic Forum's 2017–18 Global Competitiveness Index ranked the UK as having the 8th most competitive economy out of 137;
  - (c) The OECD's Regulatory Policy Outlook ranks the regulatory practices of 38 countries across a number of categories. In 2018 the UK was ranked

1st for regulatory impact assessment and 2nd for ex-post evaluation. It was ranked 1st for stakeholder engagement on primary legislation and 5th in terms of subordinate legislation.

- 1.6 In practice, competition and regulation are not mutually exclusive. In order to get the appropriate balance between the two, i.e. to ensure that the level of regulation is proportionate and does not impose any unnecessary restrictions on competition beyond securing specific policy objectives, it is important that there is an on-going focus on the process of designing and implementing “better regulation” across government and the public sector more generally.
- 1.7 The process of reviewing and evaluating regulatory decisions to learn from experience and to improve the quality of regulation should be a key aspect of any government intervention in the operation of markets. This becomes even more important as government departments and regulators at all levels increasingly have to deal with new technologies and fast-moving markets, where the consequences of regulatory decisions are inherently more uncertain.

## **Our approach and findings**

- 1.8 In this report we first examine evidence from the academic literature, before then considering evidence from the design and implementation of regulation in practice.

### ***Evidence from the academic literature***

- 1.9 As part of the literature review we have looked at:
  - (a) Key studies summarising the relevant academic literature on the impact of regulation on competition (this includes studies from a range of countries, with a focus on OECD countries);
  - (b) Academic literature published since 2015 (when the CMA published its work looking at competition and productivity), with a focus on research looking at the impact of specific forms of regulation on competition (as above, we focused on studies undertaken in OECD countries); and
  - (c) OECD studies and reports looking at the impact of regulation.
- 1.10 Based on this evidence we have identified a number of high-level findings.
- 1.11 First, greater regulation is – on average – associated with less competition. For instance, countries with lower levels of product market regulation tend to have more competitive markets and enjoy higher rates of productivity and

economic growth. A number of recent studies have also identified that product and labour market regulation in the aggregate can lead to a distortion in the allocation of resources between firms and between sectors and can thus reduce productivity. However, there are no hard and fast rules. The academic research has identified that the specific impact of regulation on competition will depend on both the form of regulation and the way in which it is implemented.

- 1.12 Second, there is no clear evidence in the literature on the appropriateness of the current overall balance between competition and regulation in the UK. Some studies focus narrowly on examining individual regulations, and therefore do not shed light on this question of overall balance. Other studies look more broadly, as discussed above, but to do so they rely on simple high-level indices of economic outcomes, which will not capture many of the possible wider benefits of regulation, such as protecting the environment or improving health and safety.
- 1.13 Third, much of the harm to competition comes from regulation that creates or raises barriers to entry. By restricting innovation and market disruption, such regulation can have significant negative effects. A large number of studies have found that barriers to entry can come in a wide range of forms, not just absolute restrictions on the number of firms in a market, but also through other aspects of product market regulation, such as excessive compliance or administrative costs, which can have the effect of making entry more difficult or less attractive e.g. excessive compliance or administrative costs.
- 1.14 Fourth, the proper design of regulation can substantially reduce the negative impacts on competition. The research finds that regulation can be used to incentivise innovation in a sector but, as with regulation and competition, the form of regulation can have an important influence on the type of innovation in a sector.
- 1.15 Fifth, the evidence from the research specifically points to the need to guard against regulations which serve firms with vested interests – such as incumbent firms – and which have a disproportionate impact on smaller firms, at the expense of the economy at large. The evidence also indicates that where policymakers and regulators do not establish and maintain channels of communication with new entrants and firms with new technologies or different business models, there is significant scope for poorly designed regulation that harms competition.
- 1.16 Finally, in dynamic markets more flexible forms of regulation can reduce the risk of deterring innovation, and therefore harming competition. Such approaches can include the use of sunset clauses for new regulation which

are triggered after a fixed period of time or once certain criteria have been met. There can also be greater experimentation about different approaches to regulation.

### ***Evidence from the design and implementation of regulation***

- 1.17 Following on from our review of the academic research, we have also reviewed the practical guidance that is available to policymakers when considering introducing new regulation or modifying existing regulation. We have focused our review on whether the guidance includes information for policymakers on: (i) evaluating the impact of new regulation on competition and innovation; and (ii) reviewing existing regulation to evaluate whether the regulation worked in terms of delivering its primary objective and what the impact on competition was in practice. Unless otherwise specified, the guidance and processes we discuss apply to policymakers in central government departments, agencies and sector regulators (which we refer to as 'Whitehall' for the purposes of this report). We have also reviewed some of the guidance and processes which apply in the Devolved Administrations and have clearly stated when this is the case.
- 1.18 We have found that, in practical terms, there are already a number of different guidance documents which are available to policymakers to support them in developing better regulation. These documents clearly identify the need to take into account the impact on competition when considering modifying existing regulation or introducing new regulation. We have also confirmed that there are processes in place to evaluate and review new regulations.
- 1.19 For this report we have not carried out a review of the extent to which the impact on competition is systematically considered as part of the process of developing or reviewing regulations in practice. Rather, we have drawn on evidence from our experience of our own reviews of measures to address competition issues (e.g. most recently in the context of reviewing merger remedies) and have considered a number of case studies of different forms of regulation in the UK.
- 1.20 Overall, the evidence suggests that there is sometimes insufficient analysis of the impact of regulation on competition. It is important to clarify that in reaching this conclusion we do not mean to imply that we would expect there to be a detailed quantification of the impact on competition or innovation in every case – we recognise that this can be challenging and may not be relevant. Equally, we do not mean to suggest that competition considerations should always outweigh other policy considerations, some of which can be critical.

- 1.21 However, the evidence makes clear that there is scope for the impact of regulation on competition to be better incorporated into the Regulatory Impact Assessment process. In particular, we consider that there is insufficient prominence given to the impact of proposed regulation on dynamic competition and the process of innovation in the template used by government officials to produce Regulatory Impact Assessments. In cases where competition is not sufficiently considered, there is a higher risk that a regulatory measure could have major unintended impacts on competition and innovation in a market.
- 1.22 Moreover, this would provide a better baseline against which ex post evaluations of the impact of regulation can take place and subsequent regulatory interventions can be improved. Our experience of reviewing remedies to address competition issues points to the importance of keeping regulatory interventions under review to ensure that they can be adapted or lifted as markets develop.

## **Recommendations**

- 1.23 Having reviewed the evidence and reached the conclusions outlined above, we now set out a number of proposals and recommendations. These are aimed at ensuring that the impact of regulation on competition is thoroughly considered, and at promoting a regulatory environment in the UK which supports innovation and market disruption, while being conscious of the broader policy issues that regulation is used to address.
- 1.24 The key principle behind all of our recommendations, is that there should be an increased focus on competition and innovation as part of the process of developing, assessing and evaluating regulatory interventions. This follows directly from our findings above, around the potentially large risks to competition that poorly designed regulation can raise, and the limitations in the way competition is sometimes currently considered as part of the policy development process.
- 1.25 Importantly, this process should consider not just price effects but also consider other dimensions of competition, such as service quality and innovation. Whilst price effects are important, dynamic effects around innovation are likely to be more important in aggregate. Dynamic competition occurs when existing market participants face competitive pressure from a new product, technology or business model. Such competitive pressure forces firms to continue to innovate, to introduce new products and new technologies. For instance, in the UK, Public Service Broadcasters have faced an increasing competitive challenge from video streaming services (such as Netflix, Now TV, Amazon Prime etc) for viewers' attention. They have

responded by launching their own Video on Demand services (e.g. iPlayer, ITV Hub, All4, My5 and, most recently, BritBox) and offering those services across a range of fixed and mobile platforms.

- 1.26 Even if policymakers were ultimately to pursue regulation in spite of competition risks, perhaps because of the importance of broader policy concerns, such analysis could still help inform the design of the policy so as to minimise any negative impacts on competition.
- 1.27 Our recommendations cover three areas:
- (a) **Recommendation 1:** Develop regulation that supports innovation and disruption;
  - (b) **Recommendation 2:** Update the guidance for assessing the impact of regulation; and
  - (c) **Recommendation 3:** Enhance the oversight of Regulatory Impact Assessments.
- 1.28 Based on our review of the recent academic research, we have also identified areas where further research would be useful. Firstly, there should be more empirical research into the impact of specific types of regulation – as opposed to the impact of regulation in general. Second, there should also be more research around how regulation can support and promote innovation. Our review of the literature in this area suggests that most of the recent research has been focused on environmental regulation and it would be useful to expand this to other policy areas. Finally, there should be more research into the overall balance of regulation and the burden of regulation on firms.

***Recommendation 1: Develop regulation that supports innovation and disruption***

- 1.29 The rate of technical change is accelerating and there has been significant disruption to traditional markets and business models. As highlighted in the Government's recent white paper, *'Regulation for the Fourth Industrial Revolution'*, it is vital that the UK's regulatory system keeps pace with technological innovation, and innovation more widely, and supports the thriving start-up environment. Evidence shows that there are potentially large impacts on innovation from regulation which creates barriers to entry and from regulation which is too rigid and focused on incumbents. Therefore, it is critical that policymakers and regulators understand and take into account how regulatory measures affect new entrants and innovation.

- 1.30 To that end, we are making a series of recommendations aimed at ensuring that policymakers and regulators put innovation and competition at the heart of the process of developing regulation.
- 1.31 Policymakers and regulators should avoid regulation which favours incumbents or firms with specific business models, or that disproportionately harms smaller scale businesses in a sector. As highlighted in our literature review, in mature markets, regulations which are skewed towards larger incumbents can lead to lower levels of innovation, higher prices and a resulting loss of consumer welfare. Policymakers and regulators should look for ways to accommodate new services and business models. The development of “peer to peer” businesses such as Airbnb, Deliveroo, and a number of ride-sharing transport services such as Uber demonstrates that businesses making use of new technologies and new business models can bring in new customers, expand the size of the market and stimulate competition. But such developments will challenge existing regulatory approaches and the assumptions behind those approaches and policymakers and regulators need to adapt the regulatory framework to accommodate such developments.
- 1.32 Policymakers and regulators should carry out strategic, forward-looking reviews of regulation. These should seek to evaluate the external factors that could have an important impact on how markets evolve in the future; to identify potential sources of disruption whether from inside or outside of those markets; and, assess how regulation might need to change and adapt to accommodate such changes.
- 1.33 Policymakers and regulators should also make greater effort to engage with a wider range of market and industry participants, especially smaller scale firms, so that they better understand the immediate issues facing different types of firms. This will put them in a better position to evaluate the challenges involved in stimulating effective competition and promoting innovation. There is evidence to suggest that the way regulation affects smaller firms is different to the way it affects large firms, and policymakers and regulators should seek to understand both before implementing regulation. Our literature review identifies the risk that only large incumbents have the necessary resources to engage consistently and effectively with regulatory processes. As a result, policymakers and regulators need to make sure that the development of regulation is not unduly influenced by this particular group of stakeholders and ends up favouring them or their specific business models.
- 1.34 Policymakers and regulators should make greater use of reviews and “sunset clauses” as a means of promoting more innovation-friendly regulation. A ‘sunset clause’ in a statute, regulation or legislation provides for that piece of

law or regulation to be automatically repealed once a period has passed, or certain criteria have been met. In respect of the remedies it imposes following market investigations, the CMA has already changed its own guidance to commit more clearly to considering the use of sunset clauses and to reviewing the continuing need for remedies, with a view to ensuring that remedies do not remain in force where they are no longer necessary to achieve the purposes for which they were imposed.

- 1.35 It is also important that when developing options for regulatory interventions, policymakers and regulators consider more flexible forms of regulation to ensure that regulation is proportionate and not unduly restrictive e.g.
- (a) Principles-based regulation: this approach entails moving away from a reliance on detailed, prescriptive rules and relies instead on high-level, broadly stated principles to set the standards by which regulated firms must conduct business. This leaves firms with the flexibility to determine how they comply with those principles.
  - (b) Codes of conduct: a form of regulation that applies only to firms in an industry that satisfy certain criteria. The code of conduct will set certain restrictions on the behaviour of these firms, for example how they must treat their suppliers; but it will give the regulated firms some discretion in how they comply with the code. A code can also be changed with industry agreement as circumstances change. The Report of the Digital Competition Expert Panel, *'Unlocking Digital Competition'* identified a code of conduct for firms with Strategic Market Status as an approach that would set up predictable rules in advance but would also allow competition and innovation to thrive in the digital space.
  - (c) Participative regulation: regulation in which there is a greater degree of engagement between firms and the regulator in a market, with firms making formal proposals to the regulator e.g. in relation to the introduction of new services or products. This can be particularly helpful for new entrants wanting to bring products to a market, particularly if the regulator can then forbear from regulating, until there is a better sense of whether intervention is needed / what form that intervention should take.
- 1.36 Policymakers should also consider making greater use of regulatory “sandboxes” to trial new regulatory approaches. A regulatory sandbox allows businesses to trial new products, services or business models in a live, real-world environment and with real consumers, without some of the usual rules and regulations applying.



- 1.37 In the UK, the Financial Conduct Authority and Ofgem, two sector regulators, are already making use of regulatory sandboxes to facilitate small, temporary trials which can help the regulator during future policy development. Early indications from the Financial Conduct Authority suggest that this innovative approach to regulatory oversight is enabling new products to be tested, reducing the time and cost of getting new ideas to market, improving access to finance for innovators and ensuring appropriate safeguards are built into new products and services. For instance, this process has enabled firms to test different applications of Distributed Ledger Technology (“DLT”), a specific version of which is blockchain. At the same time, it has allowed the Financial Conduct Authority to observe more closely the potential risks this technology may present and to feed into these tests to ensure appropriate safeguards are in place and potential consumer detriment is minimised.
- 1.38 Finally, policymakers and regulators need to be particularly cautious about imposing regulation that creates significant barriers to entry, substantially raises the costs of production for some firms relative to others or creates restrictive licensing regimes. They should consider such forms of regulation only after a detailed evaluation of the impact on competition. The evidence from the literature review and work carried out by the OECD indicates that regulation which creates significant barriers to entry can have the most significant impact on competition. In England and Wales, as part of the CMA’s Legal Services Market Study, we identified the concern that the existing approach to regulation, which focuses on professional qualifications (what we called ‘title-based model of regulation’), was not sufficiently flexible to apply proportionate, risk-based regulation reflecting differences across legal services areas and over time. As a result, we recommended that the Ministry of Justice to undertake a review of the current regulatory framework for legal services.

***Recommendation 2: Update the guidance for assessing the impact of regulation***

- 1.39 There is already a substantial body of guidance together with related templates and processes in place to support policymakers in assessing the impact of regulations in general. Based on our review of the guidance and templates, as well as the case studies we have looked at, we have identified a number of key areas where the guidance and processes currently in place could be brought up to date to ensure that the impact on competition is properly taken into account.
- 1.40 We propose that the Government’s Regulatory Impact Assessment template should be updated to incorporate a specific “Competition and Innovation”

section which requires officials to briefly summarise how the proposed regulation is expected to impact on competition and innovation. At present, the Regulatory Impact Assessment template does not refer to the impact on competition at all, although the main body of the Regulatory Impact Assessment will sometimes include a competition impact assessment.

- 1.41 The existing CMA Competition Impact Assessment guidelines include a 4-question checklist to support policymakers. We will enhance this check-list to provide more practical guidance for policymakers to help them recognise where there could be an impact on competition and/or innovation at an early stage of developing proposals. Providing examples of how the four high-level issues can be broken down into a series of sub-questions will make the checklist more relevant and easier to implement in a practical way.
- 1.42 The Better Regulation Executive, and the Devolved Administrations who do not already do so, should update their guidance to refer to the CMA's Competition Impact Assessment guidelines, and their purpose in assisting policymakers to assess the impact of their proposals on competition. They should also note that, in more complex cases, policymakers can seek expert advice from the CMA's Advocacy team ([advocacy@cma.gov.uk](mailto:advocacy@cma.gov.uk)) or, for the devolved administrations, their local CMA offices.
- 1.43 Sector regulators should review their approach to Regulatory Impact Assessments to ensure that their policies are up to date and in line with "best practice". We note that in many cases, the main economic regulators do have in place published documents which set out how they will assess the impact of regulation on competition in line with their statutory duties. However, in some cases that guidance needs to be updated and there is greater scope for sharing examples of best practice.

### ***Recommendation 3: Enhance the scrutiny of Regulatory Impact Assessments***

- 1.44 Our experience of the benefits of ex post evaluations and the case study evidence clearly points to the importance of evaluating market interventions through Post Implementation Reviews, and of these focussing on competition impacts. The Better Regulation Executive, and relevant teams in the Devolved Administrations, can assist policymakers and regulators across government in completing Post Implementation Reviews and has guidance in place in this area.
- 1.45 In order to be able to effectively carry out Post Implementation Reviews, it is critical that policymakers and regulators set out clear statements at the outset about the expected impact on competition and innovation of specific measures. They also need to put in place monitoring and evaluation plans,

which show how the impact on competition and innovation will be measured once the regulation has been implemented.

- 1.46 We consider that Post Implementation Reviews are likely to be particularly important and should be carried out where:
- (a) The measure affects fast-moving markets or ones in which there has been significant technological innovation, so that there is a risk that the regulatory measure has become obsolete or is now mis-specified. Markets that are affected by technological change, automation, changing business models and practices are likely to be relevant here;
  - (b) There was a lack of firm evidence to inform the assessment of the impact on competition and innovation in the Regulatory Impact Assessment and/or there were clear prior concerns about the effect of the regulation on competition and innovation. In this case, carrying out a Post Implementation Review would allow policymakers and/or regulators to understand whether any negative impacts on competition are outweighed by other benefits of the regulation, or to consider whether the same objectives could be achieved through another means, and with less impact on competition in a specific market;
  - (c) The measure is behavioural in focus. With interventions designed to bring about behavioural change – particularly in fast-moving markets – there is the need to monitor and review to ensure they remain effective and do not distort competition. Both firm and consumer behaviour can change over time: firms can find ways to circumvent regulation and consumers can revert to being less engaged.
- 1.47 There is already a process in place for the Regulatory Policy Committee to review both Regulatory Impact Assessments, and Post Implementation Reviews. Evidence from the case studies suggests that there should be a greater focus as part of this process on the impact on competition and innovation, for example by:
- (a) The Regulatory Policy Committee being able to offer a qualified opinion on any Regulatory Impact Assessment that does not appropriately consider the impact on competition or innovation. This could range from the Regulatory Policy Committee commenting on the quality of the Competition Impact Assessment, up to affecting directly the rating given to the Regulatory Impact Assessment overall;
  - (b) The Regulatory Policy Committee developing case studies of good practice in relation to the assessment of competition in Regulatory Impact Assessments and Post Implementation Reviews;

- (c) Expanding the best practice training provided by the Better Regulation Executive and the Regulatory Policy Committee in relation to Regulatory Impact Assessments and Post Implementation Reviews to include a more detailed consideration of competition and innovation. The CMA would be happy to work with the Better Regulation Executive and the Regulatory Policy Committee to devise such training;
- (d) Continued cooperation between the CMA, the Better Regulation Executive and the Regulatory Policy Committee to promote competition in the policy making process.

## 2. Introduction and Policy Context

### Introduction

- 2.1 In the Spring Statement in March 2019, the Chancellor asked the CMA to carry out a review to assess how regulation affects competition in the UK business environment.
- 2.2 Competition and regulation are sometimes portrayed as mutually exclusive. For instance, either you can have competition policy to promote competition or you have regulatory policy to replicate the operation of competitive markets. In fact, competition and regulatory policy are more often than not complementary and there can be significant benefits from an approach which combines both.<sup>1</sup>
- 2.3 The real issue in terms of the interplay of regulation and competition is one of balance: how to design and implement regulation that complements / supports competition and does not adversely affect incentives on firms to compete both in the short and long-run?
- 2.4 Our starting point for this report is that effective competition is a means of improving outcomes for consumers: lower prices, better quality, new products and services. At same time, regulation plays an important role in helping government secure its various policy objectives e.g. protecting consumers and the environment and promoting competition and economic growth. There should thus be a focus on the process for designing and implementing “better regulation”, taking into account the impact on competition and measuring the outcomes of regulatory interventions.

### Policy context

- 2.5 The complexity of the relationship between regulation and competition is not a particularly new or revolutionary idea.
- 2.6 There has been over 20 years of work at an international level looking at ways to improve the way in which regulation is designed and implemented and seeking to disseminate best practice this area.

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<sup>1</sup> In the [keynote speech](#) at the annual Fordham Competition Law Institute in 2018, the Chief Executive of the CMA made the point that a dual approach (regulatory oversight and competition enforcement) was key to fostering dynamic competition and for dealing with new and fast-moving markets.

- 2.7 International indicators highlight that the UK is a highly competitive economy, with a world-leading regulatory environment and processes in place to assess the way in which regulations are designed, implemented and reviewed:
- (a) The World Bank's 2019 Ease of Doing Business Survey ranks the UK as 9th out of 190 economies;
  - (b) The World Economic Forum's 2017–18 Global Competitiveness Index ranked the UK as having the 8th most competitive economy out of 137;
  - (c) The OECD's Regulatory Policy Outlook ranks the regulatory practices of 38 countries across a number of categories. In 2018 the UK was ranked 1st for regulatory impact assessment and 2<sup>nd</sup> for ex-post evaluation. It was ranked 1<sup>st</sup> for stakeholder engagement on primary legislation and 5<sup>th</sup> in terms of subordinate legislation.
- 2.8 However, the on-going debate about the interaction of competition and regulation is particularly relevant at this point in time for a number of reasons. These include:
- (a) The importance of taking into account the increasing rate of innovation and the increasing disruption of traditional markets and business models;
  - (b) The growth of new digital markets and the on-going debate about the appropriate regulatory approach to these new markets;<sup>2</sup>
  - (c) The need to protect vulnerable consumers with the recognition that competition does not always work well for users that struggle to engage with the choices available to them; and,
  - (d) The development of new approaches to regulation which means that policymakers have a wider range of regulatory tools available to them.

## **The importance of innovation and disruption**

- 2.9 The rate of technical change is accelerating and there has been significant disruption to traditional markets and traditional business models as well as the creation of new businesses and services.

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<sup>2</sup> See the *'Unlocking digital competition, Report of the Digital Competition Expert Panel'* report, March 2019; the European Commission Report *'Competition Policy for the Digital Era'*; and the Stigler Center for the Study of the Economy and the State (at Chicago Booth) report *'Stigler Committee on Digital Platforms'*.

- 2.10 The recent Government White Paper, *Regulation for the Fourth Industrial Revolution*<sup>3</sup>, refers to a Fourth Industrial Revolution in terms of scale, speed and complexity that is “unprecedented” and that it is characterised by a “fusion of technologies ... that is blurring the lines between the physical, digital and biological worlds.” The White Paper states that these changes “will disrupt nearly every industry in every country, creating new opportunities and challenges for people, places and businesses.”
- 2.11 The White Paper also refers to the UK’s regulatory system as a national asset and that the UK is ranked 9th among 190 economies for the ease of doing business<sup>4</sup>. It states that the quality of our regulatory practices have been given the highest overall country score by the OECD<sup>5</sup>.
- 2.12 Against this backdrop, key issues include how to ensure that existing regulatory structures are flexible enough to accommodate this technical change and do not inadvertently restrict new sources or forms of competition and prevent new innovations<sup>6</sup> coming to the market.
- 2.13 A particular issue we want to look at in this report is the potential impact of regulation on competition in markets which are particularly susceptible to (technological) disruption and to consider whether existing rules are designed to deal with new business models. This is because the gains from competition in these new markets are likely to be significant but equally the challenges facing authorities / regulators are also the greatest.

## **The rapid growth of digital markets**

- 2.14 At the same time, there is an on-going debate – at both a national and international level - about the appropriate regulatory approach to digital markets. This debate is focused in part on how to promote competition and on the role of ex ante regulation. There have been a number of reports<sup>7</sup> which have identified issues in markets dominated by large digital platforms and have concluded that these markets are unlikely to self-correct. As a result, at the very least competition policy needs to be adapted / updated to properly

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<sup>3</sup> See the Government's White Paper, '*Regulation for the Fourth Industrial Revolution*', June 2019. CP 111.

<sup>4</sup> Regulation for the Fourth Industrial Revolution, (2019).

<sup>5</sup> OECD (2018); OECD *Regulatory Policy Outlook 2018*.

<sup>6</sup> The UK ranks in the top five in the *Global Innovation Index*. Cornell University, INSEAD and the World Intellectual Property Organization (2019).

<sup>7</sup> In addition to the reports listed in footnote 2, there are also: The University of Chicago Booth School of Business. *Committee for the Study of Digital Platforms: Market Structure and Antitrust Subcommittee Report*, May 2019; and the Australian Competition & Consumer Commission's report, *Digital platforms inquiry – final report*, June 2019.

capture these developments and to reflect the fact that some form of regulation may be required in these markets.

- 2.15 In the UK, the Furman report<sup>8</sup> proposed a Digital Markets Unit (“DMU”) which would have a remit to develop ex-ante regulatory tools and frameworks to support greater competition and consumer choice in digital markets. In particular, the Furman report proposed that the DMU would develop a code of competitive conduct to be applied to particularly powerful companies (those deemed to have ‘strategic market status’). The DMU would also be charged with enabling greater personal data mobility and systems with open standards where these tools will increase competition and consumer choice. And finally, the DMU would advance data openness to tackle what is perceived to be a key barrier to entry in digital markets.

## **The need to protect vulnerable consumers**

- 2.16 While there is a debate about ensuring that regulation does not impact on competition and about how regulation can be used to support competition, there is also an on-going discussion about the extent to which effective competition is sufficient to effectively protect the interests of vulnerable consumers, (including the elderly and those on lower incomes), particularly in relation to utility, communications and financial markets. In this context, there is a debate about whether more regulation is in fact needed to protect those consumers and to guard against new forms of consumer detriment.
- 2.17 In its response to a “super complaint” from the consumer organisation Citizens Advice, in December 2018 the CMA recognised that many services were paid for through automatically renewed or rolled over contracts.<sup>9</sup> While convenient for consumers, this could increase the risk that customers who got rolled over year after year, ended up paying a “loyalty penalty”. The CMA found that this loyalty penalty could be significant and had an impact on many people, including those who could least afford it. As a result, consumers felt ripped off, let down and frustrated. Existing estimates suggest this penalty could be around £4 billion in total across the five markets the CMA looked at (mobile; broadband; cash savings; home insurance and mortgages).
- 2.18 The CMA recognised that in the past, not enough had been done by CMA and regulators and that there now needed to be a step-change to tackle these problems more effectively. The CMA concluded that there needs to be a focus

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<sup>8</sup> *Unlocking digital competition* (March 2019).

<sup>9</sup> Competition and Markets Authority. *Tackling the loyalty penalty*. Response to a super-complaint made by Citizens Advice on 28 September 2018, 19 December 2018.



on not only giving better support to consumers; but also on getting tough on harmful business practices and using targeted pricing interventions to protect those who suffer most, particularly those who are vulnerable.

## **The development of new forms of intervention in markets**

- 2.19 Developments and insights from the field of behavioural economics / behavioural insights have expanded the regulatory “toolkit” available to competition authorities and sector regulators both in terms of analysing issues around market failure (e.g. understanding how consumers actually behave in the real world) and in designing remedies to address those issues more effectively.
- 2.20 This means that the range of potential regulatory interventions has increased and that competition authorities and sector regulators can be more sophisticated about the way in which they intervene in markets. At the same time, it will be important to capture and share best practice on ‘nudge’ remedies that have been tested and shown to work or, as importantly, not to work. In some cases, it is possible that that some remedies could be rolled out across markets and potentially strengthened.
- 2.21 A key lesson of these developments is the importance of trialling and testing interventions, to find out what works. The importance of exposing potential remedies to trialling and testing can be seen in the history of attempts by regulators to encourage customers to engage: early engagement measures that had not been tested have been found to be somewhat limited in their impact.<sup>10</sup> At the same time, testing can take a variety of forms, from qualitative research and focus groups, to the so called ‘gold standard’ of randomised controlled trials (RCTs). Whatever form it takes, greater use of testing is now considered to be fundamental to effective remedy design. Repeated testing and evaluation are also important, in order to establish whether a measure worked in practice, and to identify any interventions that may have worked initially but then stopped working once consumers became habituated.
- 2.22 For purposes of this report we consider regulation in its broadest sense. That is, rules set out in legislation and the processes used to enforce them and this encompasses regulation at a central, national and local government level and also includes economic sector regulators.

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<sup>10</sup> Amelia Fletcher, Centre for Competition Policy University of East Anglia, *The role of demand-side remedies in driving effective competition: a review for Which?*, November 2016,

## Report structure

- 2.23 In Section 3 we start with an overview of a high-level framework for considering the impact of regulation on competition and briefly set out the various mechanisms by which regulation can restrict competition. We do draw attention to the fact that in certain circumstances, regulation can be also be used to promote competition.
- 2.24 In Section 4 we present work by the CMA and others which summarises the established view in the academic research about the impact of regulation on competition. We then move on to review recent academic research into three specific areas relating to the interaction between regulation and competition: regulation and barriers to entry; regulation and its impact on innovation through its impact on competition; and the development of effective regulation.
- 2.25 In Section 5 we move on to consider what practical guidance / advice is available to policymakers to help them assess the impact of regulation on competition. We also consider what processes are in place to check / validate the assessment of the impact of new regulations (or changes to existing regulation) on competition. While we have not been able to systematically assess the extent to which considerations about competition (and potential follow-on effects on innovation) are built into the evaluation of policy recommendations from an early stage, we have considered a number of case studies which help to illustrate the processes by which regulation is developed, assessed and reviewed in the UK.
- 2.26 In Section 6, we then consider alternative forms of regulation which have been put forward recently, such as codes of conduct and regulatory sandboxes.
- 2.27 Finally, in Section 7 we put forward recommendations for strengthening the existing processes for assessing the impact of regulation on competition and ensuring that regulation can support competition and innovation.

### 3. Regulation and Competition: Overview

#### Introduction

- 3.1 Competition can be defined as a process of rivalry between suppliers that takes place either in or for the market. Firms compete to attract customers by offering lower prices, higher quality products and services or more innovative products and services. When competition is working effectively, the market will send clear messages to firms (for example in the form of prices they can charge and the profits they earn) about which goods and services consumers want to buy. Efficient firms offering the products consumers want at low prices and/or high quality will prosper – and inefficient firms will not.<sup>11</sup>
- 3.2 For markets to work well, consumers also need to be active and engage with the choices offered to them and to make well-informed and rational consumption decisions. If consumers do not readily search out and switch to the best deals, then this can weaken competition and firms offering better deals will only win a proportion of those customers who would rightly prefer their deals. That in turn will reduce the disciplining effect that consumers have on supplier behaviour and limit the competitive incentives on firms to offer better deals.
- 3.3 Regulation consists of the rules set out in legislation and the processes used to enforce them<sup>12</sup> and it is important to the functioning of competitive markets. For instance, following the OECD<sup>13</sup>, well-functioning markets require:
- (a) A sound legal and judicial infrastructure;
  - (b) An effective competition regime;
  - (c) Competition-friendly product market regulation; and,
  - (d) An efficient insolvency regime.
- 3.4 In addition, as well as promoting competition and economic growth, governments can intervene in markets for a range of economic and other public policy reasons: e.g. addressing market failures due to externalities and the existence of public goods; protecting consumers and the environment; safeguarding the health and safety of workers etc.

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<sup>11</sup> For example, see Vickers (1995).

<sup>12</sup> Regulation for the Fourth Industrial Revolution (2019).

<sup>13</sup> OECD [Indicators of product market regulation](#), [Accessed on 5<sup>th</sup> July 2019].

3.5 The result is that there can be a range of political and other interests involved in the design of regulation and, although policy-making per se is not the focus of this report, it is important to be aware of the main theories as to how regulations are formed and the possibility of regulatory failure.

## **Approaches to regulation**

3.6 The public interest theory assumes that regulation serves the interests of consumers by restricting harmful actions of businesses. The main focus of regulation under this theory is to address market imperfections / market failures and tends to assume that the bodies formulating regulations act benevolently and have sufficient information and enforcement powers to effectively promote the public interest and to maximise social welfare.

3.7 In contrast to the public interest theory, private interest theories of regulation assume that those formulating regulation do not have sufficient information about costs, demand, quality and other dimensions of firm behaviour and that all economic agents pursue their own self-interest which may or may not include elements of the public interest. As a result, they can only promote the public interest imperfectly when designing and implementing regulations.

3.8 Under these theories of regulation, the pursuit of self-interest means that legislators / politicians will make decisions that maximise their chance of re-election, officials will further their own career interests, regulatory agencies seek to extend their remit/empire build etc. The differences in the objectives of economic agents and the costs associated with the imbalance in information between the different parties, means that decision-makers can also be influenced by various special interest groups.

3.9 One prediction of this set of theories is that established firms seek to turn regulatory provisions to their advantage to restrict competition in a market e.g. by promoting licensing or other regulatory restrictions on entry to raise barriers to entry for new entrants. Under this approach, the informational advantage enjoyed by existing businesses over the regulators enables them to influence the design of the regulatory framework.

3.10 It is difficult to test empirically which theory of regulation may be more relevant, but there is some evidence in the available literature<sup>14</sup> to support

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<sup>14</sup> [Regulation and Competition – A literature review](#). Report 0218 (2017). Swedish Agency for Economic and Regional Growth.

private interest theories of regulation to a greater extent than public interest theories.

## **Regulatory failure**

- 3.11 There is a risk of “regulatory failure” with all forms of regulation i.e. the risk that the intervention designed to address a problem in a market can impose higher costs than the problem it was designed to address.
- 3.12 Regulatory failure can arise for a number of different reasons, including:
- (a) Analytical failure: the analysis of the underlying issue or situation was misplaced or incorrect;
  - (b) Design failure: the design of the regulation was not appropriate to address the problem or issue that had been identified; and,
  - (c) Implementation failure: the way in which the regulation was implemented was insufficient to address the problem or issue (e.g. the legal basis was incorrect; a regulator did not devote sufficient resources to implementing and monitoring the regulation, or the behaviour of consumers changed subsequently).
- 3.13 The risk of regulatory failure points to the need for policymakers to be alive to the possibility of unintended consequences from introducing new regulations or changing existing regulations. It also points to the need to monitor and review the effect of particular interventions to ensure that they remain relevant and effective.

## **How does regulation affect competition?**

- 3.14 Regulation can affect the competitive process (i.e. how firms compete with one another) and / or market outcomes (e.g. limits on the prices that can be charged to consumers). The former relates to the supply-side of a market (i.e. how firms compete with one another), whilst the latter relates to the demand-side (i.e. how active consumers are in responding to products and services offered to them).
- 3.15 The four main ways in which a regulatory measure might be expected to have an impact on competition are through:
- (a) Limiting the number or range of firms in a market;
  - (b) Restricting the ability of firms to compete;

(c) Reducing the incentives on firms to compete;

(d) Limiting the choices and information available to consumers.

- 3.16 The first three mechanisms listed above relate to the supply-side of the market.
- 3.17 New entrants face many challenges in breaking into a market that arise naturally as the result of operating a business: e.g. sourcing raw materials, setting up distribution networks, winning new customers. At the same time, there can be administrative requirements that those firms have to comply with e.g. having a licence to operate or to conform to certain technical standards in order to be able to carry on with their business. Where these apply equally to all undertakings, such as health and safety regulations, they might not affect the cost for new entrants any more than they affect the cost for incumbents. However, regulation can lead to entry barriers when it does not apply equally to all undertakings.
- 3.18 Regulatory measures which impose administrative requirements that go further than necessary to secure particular policy outcomes will create artificial barriers to entry. Regulation which increases the administrative costs of market entry can have a particularly negative impact on the market entry of small firms as these firms are less likely to be able to manage high administrative costs.
- 3.19 This will in turn deter otherwise successful businesses from entering a market and will typically have negative outcomes for consumers. Competition acts as a disciplining device and places pressure on firms to become more efficient. However, having fewer firms will mean less competition which in turn will help to protect inefficient firms and distort incentives to invest and innovate. As a result, consumers will be faced with less choice, higher prices and worse service than would have otherwise been the case.
- 3.20 Regulatory measures which restrict the ability of firms to compete in a market or limit the incentives to compete (e.g. by limiting the ability to set prices or limiting the freedom of firms to advertise or market their services) will have the same negative impact on competition and so lead to worse consumer outcomes.
- 3.21 The fourth mechanism listed above relates to the demand-side of the market. It is well accepted that consumers need to be able to access, assess and act on information for competition in markets to work well. That is, consumers need to engage actively with the choices that are offered to them. If consumers are not active and do not readily search out and switch to better deals, then this can weaken competition. That is, a firm which offers

consumers a better deal will only win a proportion of those consumers that would actually prefer the deal that the firm is offering. This will limit the competitive incentives on that firm to make such an offer and can result in distorted incentives on firms to compete on other less relevant but more prominent product characteristics. For instance, in insurance markets there is the concern that insurers have focused on competing on headline prices and have reduced levels of cover / increased the excesses on policies.

- 3.22 Regulatory measures which affect the amount of information that is available to consumers or the choices they can make will therefore have a negative effect on the competitive process.
- 3.23 More recently, there has been a greater recognition that as well as having an impact on competition between existing firms in a market (i.e. in terms of static competition), regulation can have an important impact on dynamic competition and innovation in a market and that this can have significant long-term consequences. Dynamic competition occurs when existing market participants face competitive pressure from a new product, technology or business model. Such competitive pressure forces firms to continue to innovate, to introduce new products and new technologies. For instance, in the UK, Public Service Broadcasters have faced an increasing competitive challenge from video streaming services (such as Netflix, Now TV, Amazon Prime etc) for viewers' attention. They have responded by launching their own Video on Demand services (e.g. iPlayer, ITV Hub, All4, My5 and, most recently, BritBox) and offering those services across a range of fixed and mobile platforms.
- 3.24 There is a strong argument that dynamic competition can result in the greatest increases in consumer welfare.<sup>15</sup> As a result, the impact that regulation has on dynamic competition could be even more significant than the impact on static competition, and therefore is something that policymakers and regulators should take into account.

## **Regulation to support competition**

- 3.25 While regulation is sometimes viewed as an alternative to competition, or indeed even as a barrier to competition, appropriately designed and implemented regulation can assist in the promotion of competition.

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<sup>15</sup> [Dynamic Competition, Online Platforms, and Regulatory Policy](#). Statement of Jerry Ellig, PhD (Senior Research Fellow Mercatus Center at George Mason University) submitted to the House of Lords Select Committee on the European Union, EU Internal Market Sub-Committee Call for Evidence: Online Platforms and the EU Digital Single Market; 9 December 2015 [accessed 6 November 2019].

- 3.26 The CMA's experience with the implementation of Open Banking is an example of a regulatory remedy that was designed to ensure that customers benefitted from technological advances and that new entrants and smaller providers in the UK retail banking sector were able to compete more fairly.

### ***Case Study 1: Open Banking***

In August 2016, the CMA published its final report following its investigation into the supply of retail banking services to personal current account (PCA) customers and to small and medium-sized enterprises (SMEs) (retail banking market). The CMA found that older and larger banks did not have to work hard enough to win and retain customers and that it was difficult for new and smaller banks to grow. To address these issues the CMA proposed a number of remedies including Open Banking, which enables customers and small and medium-sized businesses to share their current account information securely with other third-party providers from January 2018.

Central to the CMA's open banking remedy were measures to require the largest banks in Great Britain and Northern Ireland to adopt and maintain common API standards through which they would share data with other providers and with third party service providers including Price Comparison Websites ("PCWs"), account information service providers (AISPs) and payment initiation service providers (PISPs).

The CMA's final report stated that: "Of all the measures we have considered as part of this investigation, the timely development and implementation of an open API banking standard has the greatest potential to transform competition in retail banking markets. We believe that it will significantly increase competition between banks, by making it much easier for both personal customers and SMEs to compare what is offered by different banks and by paving the way to the development of new business models offering innovative services to customers."

While it is very early to assess the impact of open banking in practice, in January 2019, Imran Gulamhuseinwala OBE, trustee of the Open Banking Implementation Entity (OBIE) said: "They [the banks] have worked hard to implement the Standards despite many challenges and an ambitious timescale. Yet already we have seen some impressive early signs of new technologies powered by Open Banking – even though we are only mid-way through our roadmap with lots more to come."

We consider that the Open Banking example highlights the fact that regulation can help to promote the adoption of measures to open up markets and promote competition by making use of new technologies in designing market interventions i.e. working with the grain of industry developments.



## 4. The Impact of Regulation on Competition: Academic Research

### Introduction and approach

- 4.1 As indicated in the Introduction, there has been a considerable amount of interest in the relationship between regulation and competition and the issue of the impact of regulation on competition and on economic growth at an aggregate level.
- 4.2 For the purposes of this report we have looked at existing reviews of the well-established literature in relation to regulation and competition. We have then supplemented this by carrying out a survey of the recent academic literature in relation to competition, regulation and innovation. We examined the recent research to check our understanding of the position reached in previous reviews and to establish whether there have been any significant theoretical or empirical developments that would change that understanding.
- 4.3 We have also looked at the recent academic research on the impact of specific types of regulation. As a result of our literature review, we found that there were three key areas that were particularly relevant to the debate about regulation, competition and innovation where academic research has been most intense. These three areas are: the role of barriers to entry; the link between regulation and innovation; and the design and implementation of effective regulation.

### Summary of existing reviews

- 4.4 There are a number of reports which have already summarised the academic consensus on the relationship between regulation, competition and economic growth. A key determinant in economic growth is increasing productivity (i.e. achieving a higher level of output from a fixed amount of input) and, given that there is a positive relationship between competition and productivity, regulation which has a negative impact on competition is more likely to also have a negative impact on economic growth.
- 4.5 Below we summarise the findings of three reports which we consider together effectively synthesise the academic literature:
- (a) The impact of regulation on growth (Frontier Economics 2012);
  - (b) Productivity and Competition: a summary of the evidence (CMA 2015);
- and,

- (c) Regulation and Competition – A literature review. The Swedish Agency for Economic and Regional Growth (2017).
- 4.6 The 2012 Frontier Economics report, which was prepared for the then Department of Business, Innovation and Skills, consists of a literature review focused on product and labour market regulations. Frontier’s approach involved developing a long list of 94 articles that were then filtered to a short list of 36 articles.
- 4.7 In terms of the literature reviewed, the report notes that much of it did not deal with the impact of regulation on growth directly, but instead tended to focus on the impact of regulation on drivers of growth: labour productivity, investment, innovation and total factor productivity.
- 4.8 The report also considered aggregate measures of regulation (e.g. OECD indicators, World Bank Doing Business ranking and the Fraser Institute of Economic Freedom Index) and noted that none of these measures captured issues of regulatory design or the quality of regulations.
- 4.9 The main findings of this report were that the relationship between regulation and growth can be positive or negative depending on the type of regulation. The report noted that the strength of the evidence varied according to the type of regulation being assessed.
- 4.10 Product market regulation was the area where the theoretical mechanisms and the empirical evidence were the most conclusive. The key channel by which product market regulations affected growth was by creating barriers to entry and therefore affecting the level of competition in markets. The report found that the most robust empirical evidence indicated that:
- (a) Increasing administrative costs of market entry could have a significant negative impact on productivity growth. This impact can be particularly strong for small firms, who are likely to be more credit constrained;
  - (b) A reduction in product market regulation would have a positive impact on competition which would increase innovation and therefore productivity; and
  - (c) Regulation in upstream markets can have a significant negative impact on downstream market productivity.
- 4.11 The report notes that labour market regulation is the other important area that can influence growth. However, it is not clear whether labour market regulation has a net positive or negative impact on growth. It is suggested that

Employment Protection legislation may have a stronger impact on SMEs as they are less able to substitute capital for labour due to credit constraints.

- 4.12 In 2015, the CMA produced a report summarising the theoretical and empirical evidence on the relationship between competition and productivity.<sup>16</sup> The report reviewed the academic literature and established that there was a strong body of empirical evidence showing that competition can drive greater productivity. It also considered the mechanisms by which competition might lead to higher productivity. Over ninety academic articles, reports and policy documents were reviewed for the purpose of this study.
- 4.13 Although the study was focused on the relationship between competition and productivity growth across sectors, it also found that cross-country studies suggested that countries with lower levels of product market regulation - which in turn enabled stronger competition - tended to have higher levels of productivity growth.
- 4.14 The report also found that there was an extensive literature examining the impact on productivity of changes in competition over time including as a result of de-regulation. Those studies showed generally strong positive effects on productivity in sectors where de-regulation has occurred, including transport and utilities.
- 4.15 Finally, a 2017 report from the Swedish Agency for Economic and Regional Growth<sup>17</sup> provides an overview of the research on the impact of regulation on competition. This report reviewed over 50 articles, reports and policy documents for the purpose of the study.
- 4.16 Based on the literature reviewed, the report reached the following high-level conclusions:
- (a) Rules and regulations are a pre-condition for the functioning of markets and enabling competition;
  - (b) Regulation can impact negatively on competition in several ways e.g. limiting the number of suppliers, limiting the incentives or ability of firms to compete;

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<sup>16</sup> [Productivity and competition: a summary of the evidence](#), Competition and Markets Authority, 9 July 2015.

<sup>17</sup> Regulation and Competition – A literature review (2017).

- (c) Regulation which creates entry barriers or burdensome labour market regulation was highlighted in the literature as particularly problematic in terms of hindering effective competition;
- (d) Other examples of regulations which can adversely impact competition include: price regulations; restrictions on marketing activities; the introduction of self-regulatory regimes (encouraging cartel-like behaviour); requirements on firms to publish certain information;
- (e) Although there has been extensive research into the impact of labour market regulation on competition and business activity, the empirical evidence is ambiguous. On the one hand heavy labour market regulation can hamper firm entry or discourage firms from expanding. On the other, a flexible labour market with few restrictions on hiring and firing may adversely impact employee behaviour by discouraging them from investing in developing their skills; and
- (f) Governments have recently tended to focus on reducing the regulatory burden on businesses in terms of administration and direct compliance costs of regulation. However, the indirect effects of regulation can be significant (e.g. where it inhibits competition and the formation of new firms) and need to be taken into account when governments propose new or amended rules.

## **Academic research since 2015**

- 4.17 In this section we have conducted our own review of academic research published since 2015 – this is intended to pick up research carried out since the CMA’s report on Productivity and Competition.
- 4.18 The first part of this section looks at recent academic research on the aggregate impact of regulation on competition. We then examine academic research on three specific issues: the role of barriers to entry; the link between regulation and innovation; and the development of effective regulation.
- 4.19 An independent academic, Dr. Peter Ormosi of the University of East Anglia, reviewed the methodology we developed to identify relevant academic literature. He also reviewed the list of articles we short-listed for inclusion in our literature review (see Annex B for more detail on the methodology and its outputs).
- 4.20 As part of his review, Dr. Ormosi suggested additional articles we could include in our short-list. Following a discussion with Dr. Ormosi, and based on

our own consideration of relevance, we added a number of the articles he suggested to our literature review. Dr. Ormosi also reviewed our write-up of the findings based on the literature review, and the conclusions we drew based on it. He was content that the conclusions we have drawn are well founded in the literature.

### ***The aggregate impact of regulation on competition***

- 4.21 Research since 2015 confirms the findings of previous research which looked at the relationship between regulation and competition at the aggregate level. That is, the research looks at the links between aggregate indices of regulation, such as the OECD product market regulation index, and macroeconomic variables such as productivity, rather than looking at the links between specific forms of regulation and competition.
- 4.22 Much of the research appears to study the impact regulation can have on competition as an intermediate step to considering the impact of regulation on productivity and investment. A number of papers in this area also point to the fact that excessive regulation can result in a mis-allocation of resources.
- 4.23 Cette et al (2016) compared 18 industries across 14 OECD countries to see how regulation in product and labour markets impacted the level of productivity using OECD indicators of product and labour market regulation. They take into account both the direct impact of product market regulations on productivity in regulated industries as well as the indirect knock-on impact onto other industries at other stages of the supply chain and the impact of labour market regulations. They find that firms can take advantage of the market power induced by high levels of product market regulation to charge higher production prices which can be passed along the production chain.
- 4.24 They also modelled a scenario in which product and labour market regulation were reduced to the average level of regulation of the three lightest regulated of the 14 countries in the study and found that reducing product and labour market regulations to this level could lead to an increase in productivity by, on average, 4.4%. These gains vary between countries and given the less restrictive state of regulation in the UK, a smaller estimated gain of 1.1% was observed.
- 4.25 Product and labour market restrictions can result in distortions in the allocation of resources. Égert (2016) compares levels of regulation of firms and innovation intensity between 34 OECD countries over the past 30 years to understand the impact of these variables on the productivity of firms. He finds that differences in the level of regulation mostly explain variations in firm productivity through distorting capital and labour allocations. The level of

regulation is also found to have an impact on the level of productivity across industries, as regulation is found to be associated with lower levels of R&D<sup>18</sup>.

- 4.26 In competitive markets, profits which deviate from the “normal level” should not persist for extended periods. That is, if there is unrestricted entry and exit to markets, then the process of competition should drive profits down to competitive levels. However, this dynamic process can be influenced by regulations that temporarily or permanently impede competition. Eklund and Lappi (2018) use firm-level data across 30 OECD countries over 15 years to study how product market regulations – as measured by OECD indicators – affect competition and the level of economic rent. They show that regulation leads to long-run persistently high rents, from which they infer that there must be some limitations to competition.

### ***The impact of regulation on barriers to entry***

- 4.27 Our review of the academic research confirms the findings of previous studies that barriers to entry are one of the most important inhibitors to competition and of well-functioning markets. The evidence set out below indicates that they have the potential to have a major impact on competition both in terms of when regulation creates absolute barriers to entry but also when regulation imposes high administrative or compliance costs on new or potential entrants. The evidence also suggests that there is a case for policymakers pro-actively to identify and reduce / remove regulatory barriers to entry where possible.
- 4.28 In its Competition Impact Assessment Toolkit (2015) the OECD produced a database of more than 300 research studies of the impact of pro-competitive regulatory reform (mainly in OECD countries) which gave a ‘rule of thumb’ estimate of the price effect of introducing a regulatory restriction that impacts on competition.
- 4.29 The OECD database finds that the average price change from removing a restriction on competition is 19 per cent. This suggests that moving towards more competitive outcomes can reduce prices by 19 per cent *on average*<sup>19</sup>. However, the database also suggests that removing regulation which impose

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<sup>18</sup> As with Clette et al, Égert finds a negative relationship between regulation and both labour and product market productivity. He suggests that co-ordinating product and labour market reforms may increase productivity to a greater extent than implementing just one type of reform or the other. He also suggests that having strong institutional arrangements and a business-friendly environment can improve productivity.

<sup>19</sup> See Table 5. Competition Impact Assessment: Part 2 guidelines (CMA50) (2015). It is important to note that the figures quoted here are mean figures rather than median figures and so could have been inflated by a few large results.

barriers to entry in general could reduce prices by 20 per cent (based on 111 studies) and within that, removing restrictions which establish a license, permit or authorization process as a requirement of operation could reduce prices by 23 per cent (based on 55 studies)<sup>20</sup>.

- 4.30 The finding that there are potential benefits of reducing barriers to entry for new firms in terms of a reduction in prices continues to be replicated in other studies. This is seen in Bagchi and Sivadasan (2017) where they analyse the impact on price from threat of entry following regulatory reform across 19 states in the US. Lower barriers to entry resulted in a 5.5% to 6.8% reduction in prices. At the same time, they also found little or no change in quality following the reforms.
- 4.31 In the case of the airline sector, Guiomard (2017) analysed the relationship between airport slot regulation and aviation competition using the application of the EU slot rules at Dublin airport as a case study. He finds that the administrative slot controls actually act as a barrier to entry and that incumbent airlines have the incentive to resist investments in new airport capacity because this would increase the number of slots and possibly lower their market power. Indeed, the paper finds that airlines actually lobby to preserve the grandfather principle and to avoid relaxation of administrative slot rules. The paper reports previous studies which estimate the potential gains from a transition from grandfathered to auctioned slots as being equal to 24 million more passengers per year and €31bn more of consumer welfare.
- 4.32 The case of regulatory barriers has been more generally explored by Bailey and Thomas's (2017) study of the impact of regulation in 215 different industries in the US. Their study showed that more-regulated industries experienced fewer new firm births and slower employment growth. They also found that that large firms were less likely to exit a heavily regulated industry than small firms.
- 4.33 However, absolute barriers to entry may not be the only hurdle for firms trying to enter a market. In their paper Fan and Xiao (2015) looked at the slower than expected entry into the telephone market in the USA following the abolition of the regulated monopolies. They analysed actual entry and also the level of interest from potential entrants to telephone markets using information about the timing of applications for certification as a means of assessing the level of interest in entering specific markets. They found that a key reason for the slower than expected entry was the fact that the high cost of the

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<sup>20</sup> See p.131, Annex 2. OECD (2017) *Competition Assessment Toolkit: Volume 3. Operational Manual*. See also caveat in Footnote 18 (above).

administrative process for certification imposed a barrier to entry. The high administrative cost deterred a number of potential entrants from entering because the costs were such that potential entrants did not then expect to be compensated by the levels of profit in the de-regulated markets.

- 4.34 The impact of entry restrictions created by state certification processes is also something studied by Ohsfeldt & Li (2018) in the context of the health sector in the US. They compared the impact on the quality of home health agencies (“HHA”) in states with certificate-of-need (“CON”) programmes with those in states without such restrictions on entry. They find that HHAs in states with CON programmes were less likely to have “High” quality ratings, and more likely to have Medium quality ratings, compared to HHAs in states without the CON restrictions on entry.
- 4.35 Barriers to entry can also arise from regulation that is imposed to protect consumers. In a theoretical paper, Campbell et al (2015) look at the case of consumer data privacy regulation. They build a model which demonstrated that the requirements that were placed on companies to protect consumers would disproportionately affect smaller businesses. In their paper they show that larger firms who were more likely to offer a suite of services would face a relatively smaller cost from asking for consent from a consumer relative to the benefit they offer, compared with a new and smaller entrant who might offer only a single service. This would make it more difficult for a new and smaller firm to enter into the market and attract users.
- 4.36 The OECD database – referred to above – also suggests that removing regulatory measures which significantly raised the costs of production for some suppliers relative to others (especially by treating incumbents differently from new entrants) has the potential to stimulate competition and reduce prices. The OECD database indicates that moving to a pro-competitive outcome could reduce price by 39 per cent on average (although this finding was based on just two studies).
- 4.37 At the same time, there are cases where regulation can help to overcome situations where barriers to entry might arise in an unregulated market. Albalade and Perdiguero (2015) compared the situation between fuel stations on privately run toll roads and on regulated motorways in Spain. Their analysis found that the regulation of motorways meant that authorities could stop motorways from restricting the number of petrol stations in contrast to the situation on privately owned toll roads.



## ***The impact of regulation on innovation***

- 4.38 As well as highlighting the risk that regulation (in its broadest sense) can impede innovation, evidence from the academic research indicates that – as with the impact on competition – different types of regulation can impact on innovation in different ways.
- 4.39 The research identifies some of the mechanisms through which regulation can stifle innovation through deterring disruptive technologies or business models. In this section we discuss three broad issues and the links between them:
- (a) The costs of complying with regulation: high compliance costs tend to reduce the incentives as well as the funds available for research and development;
  - (b) The importance of the overall approach to innovation and ensuring that the regulatory approach is appropriate. There is a risk that seeking to extend existing regulation to disruptive entrants – particularly at the instigation of incumbent firms) can stifle that innovation; and,
  - (c) There should be a proper evaluation of what the appropriate regulatory framework should be to deal with new technologies rather than some automatic levelling up process of existing regulation.
- 4.40 In the same way that high compliance costs can reduce the incentive on new firms to enter a market, high compliance costs also divert resources away from research and make innovation less likely for firms already in a market. Kramer and Wrihston (2016) found that regulation which imposes a compliance burden stifled innovation while regulation that reduced the burden of compliance incentivised innovation.
- 4.41 Kramer and Wrihston (2016) also explored how the US government has influenced innovation. They noted that the primary mechanism by which regulation can have an impact on stifling innovation is by diverting funds away from R&D through high compliance costs on firms. They argued that in order for regulation to stimulate innovation, it must minimise compliance costs and regulators must ensure that firms have a clear understanding of what is necessary to comply with future regulation. Flexible and well-informed regulatory decisions would mean that firms were better placed to reduce their commercial risks.
- 4.42 Following on from earlier empirical research which established that regulations that were focused on product or compliance regulation tended to

deter innovation<sup>21</sup>, Blind et al (2017) compared the impact of formal standards versus regulation on firms' innovation efficiency. They found that formal standards and regulation had different effects, depending on the extent of market uncertainty. Their results – based on the German Community Innovation Survey (CIS) – showed that in mature markets (i.e. where there was less technological uncertainty), a few key firms were able to influence the design of standards for the market. This in turn tended to lead to higher costs for all other firms and lower levels of innovation. Conversely, where there was a high degree of market uncertainty, formal standards could lead to higher levels of innovation efficiency compared to regulations.

- 4.43 While regulation can be a barrier for introducing new technologies, it can also play an important role in creating incentives for firms to innovate. In their review of the literature concerning environmental policy instruments and eco-innovation, Sanchez and Deza (2015) offer a meta review of 40 previous studies, from which they conclude that firms' willingness to invest in innovation can be influenced by expectations about the likely direction of future regulation. For example, where standards are expected to increase in the future, this can create an incentive for firms to innovate to maintain their competitive position under the new regulation. They report that empirical studies suggest that the market-based instruments (e.g. creating a market for tradable emission permits) tend to result in more incremental innovation and diffusion of existing technologies rather than radical innovation. They suggest that instruments which are based on changing incentives need to be complemented with strict controls to be more effective.
- 4.44 Cecere and Corrocher (2016) also considered the impact of the strictness of environmental regulations on innovation in relation to waste management. They found that the stringency of regulation positively influenced the probability of innovation in waste recycling but this effect was non-linear: i.e. that there was an optimal level of regulation in respect of innovation. They argued that the optimal level of regulation should be focused on outcomes to allow flexibility in respect of the production and distribution and that regulatory processes should be stable and predictable.
- 4.45 There is also a risk that regulation intended for a specific, non-competition related purpose can have the effect of deterring innovation by preventing firms from rolling out new products or services. In the case of the Canadian regulatory framework for environmental innovation, Bak (2017) found that

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<sup>21</sup> Blind, K. *The influence of regulations on innovation: A quantitative assessment for OECD countries*. Research Policy 41 (2012) p.391– 400. This research also found that regulation that focused on developing frameworks that encouraged competitiveness had a positive impact on innovation

regulation constrained “clean technology” start-ups from deploying their products. A key impediment to the growth of these new firms was the lack of ability to influence and intervene with regulators in relation to new environmental rules which were critical to the success of these firms’ products in the market.

- 4.46 Innovation is not just about the introduction of new technologies or scientific breakthroughs; there can also be innovation in business models. In terms of dealing with new technologies or business models, there can be a difficulty for policymakers and regulators in keeping up with the pace of innovation. Ranchordás (2015) argued that regulators are often limited by procedural requirements and the need for there to be a degree of stability in the regulatory framework over time. In addition, regulators are now facing having to deal with complex innovations in different fields of emerging technologies and innovations that challenge existing regulatory business models (e.g. Airbnb, Uber). These problems could be compounded by a lack of information available to regulators.
- 4.47 Stallibrass and Fingleton (2016) argue that regulators should seek to accommodate the development of “peer to peer” businesses such as Airbnb and Uber. They find that such businesses can expand the size of the market, as the new firms bring in new products, assets and suppliers to an industry, serve new customers and so stimulate competition. This can challenge regulatory tools which are designed to govern traditional business models and also challenge the assumptions behind traditional regulations. For instance, they may reveal that consumers are happy with alternatives to the traditional regulated products and services.
- 4.48 A number of papers have examined the impact that Uber has had on the regulation of taxi markets.
- 4.49 The regulation of taxi markets is typically presented as involving measures to protect consumers whether in the form of controls on: the level of prices, the quality of services, the safety of passengers etc. They can, however, also have the effect of restricting entry. If a firm - such as Uber – with a new technology is able to enter a market and is not subject to these controls, then it is able to improve consumer welfare and gain a competitive advantage over others in the market (Harding et al (2016)).
- 4.50 In response to pressure from existing, regulated taxi firms, municipalities have often responded by trying to enforce existing taxi regulations against firms making use of riding-sharing technology. In this context, municipal level regulation is often narrowly focused on a particular issue rather than taking into account how the rules could adapt to take into account competition

factors. When the municipality of Toronto was not able to extend regulation to Uber to prevent market entry, it was forced to change policy. In a relatively short period of time, the City of Toronto moved from a system of limiting and highly regulating taxis, to opening its ground transportation system up to private transportation companies. (Brail (2018)).

4.51 Some of these issues are also picked up in the next section.

### ***The development of effective regulation***

4.52 A number of articles examine the impact the regulatory process i.e. the way in which regulation is formed, can have on competition and innovation. The evidence from the academic research is that the processes involved in the design of regulation can have a significant impact on the outcomes for competition and innovation. In this section we consider three important themes that can influence the development of effective regulation: (i) the information that is available to those developing regulation; (ii) the external factors which can influence regulation; and (iii) the costs to firms of engaging with the regulatory process.

4.53 The first idea is the straight-forward concern that regulators do not always have sufficient information available to them to make well-informed decisions. Cicala et al (2015) looked at changes in the operation of energy providers following deregulation in America. They found that the regulator allowed for the recovery of investment costs by coal burning energy providers at a higher rate than the cost of capital whereas this did not happen for (deregulated) natural gas energy providers. They found that this issue arose because of the inability of the regulator to observe directly the operating costs for coal burning energy providers.

4.54 Secondly, regulators and policy-makers can also be subject to lobbying and regulatory capture. In the case above, Cicala et al (2015) had found that part of the problem was that the regulator had been successfully lobbied by the state coal producers to require coal burning energy producers to purchase more expensive “in-state” coal.

4.55 More generally, a concern that arises across a number of different sectors is that incumbent firms are better positioned to engage with regulatory processes and actively lobby regulators and policymakers for changes that work to their benefit and at the same time make it more difficult for new firms to enter and to innovate.

4.56 In the Uber case referred to above, the regulator for the taxi industry in Toronto faced pressure from taxi firms to enforce existing taxi regulations

against Uber (Brail (2018) and this ultimately had to be resolved through a court process. It can also be the case that a regulator responds to petitioning by incumbent firms and introduces regulation which has the effect of restricting competition from new entrants such as in Tarullo (2019) where new regulation protected incumbent banks. The Bailey and Thomas (2017) study into barriers to entry (referred to above) also suggested that large firms lobbied government officials to increase regulations to raise their smaller rivals' costs.

- 4.57 External factors can also include changes to government policy. Littlechild (2019) sets out the history of the development of regulation of GB retail energy markets over the period 2008-2016. He contrasts the approach of minimum intervention from privatisation up to the later 1990s with - what he argues - is increasing pressure from governments on the regulator, Ofgem, to take action to address not only concerns about: rising energy prices and vulnerable consumers but also a shift in policy towards an emphasis on renewable energy sources.
- 4.58 Finally, in addition to direct attempts to influence regulatory processes, there is research which identifies that the larger incumbent firms typically have the resources to dedicate to engaging with regulators and regulatory processes (e.g. consultations about changes to existing regulations) whereas smaller firms may not have the same resources to devote to these activities. For instance, McNally et al (2018) point to a lack of participation on the part of smaller ISPs in the development of policies that directly affected them in relation to the provision of broadband services in remote and rural areas and indeed a lack of understanding of various policy mechanisms.
- 4.59 In terms of the implications for design and implementation of remedies, there is a recognition that regulation needs to be flexible and adaptable to be able to deal with changing market circumstances. Picking up from his findings that regulation struggles to keep pace with innovation, Ranchordás (2015) suggests that there is more scope to make use of sunset clauses (e.g. having a specific end date for regulations) and experimental legislation (e.g. testing new regulations on a small-scale basis). These innovation-friendly approaches to regulation enable the regulatory framework to adapt in a responsible way while at the same time allowing the removal of regulation that has become obsolete. They also create scope for regulatory flexibility and learning. In particular, experimenting with laws can be particularly useful in terms of gathering more information about how markets react to innovative products and better information is likely to improve the quality of regulation as more information becomes available.

## Conclusions

- 4.60 Having reviewed recent academic literature and studies on the topic of regulation, competition and innovation, we have identified a number of high-level conclusions and identified some areas in which we think further research would be useful.
- 4.61 First, greater regulation is - on average – associated with lower competition. For instance, countries with lower levels of product market regulation tend to have more competitive markets and enjoy higher rates of productivity growth. A number of recent studies have also identified that product and labour regulation in the aggregate can lead to a distortion in the allocation of resources between firms and between sectors and can thus reduce productivity. However, there are no hard and fast rules. The academic research has identified that the specific impact of regulation on competition will depend on both the form of regulation and way in which it is implemented.
- 4.62 Second, there is no clear evidence on the overall balance between competition and regulation in different countries. That is, studies either focus on individual regulations or look more broadly using high-level indices of product market regulation and do not seek to capture wider benefits of regulation.
- 4.63 Third, much of the harm to competition comes from regulation that creates or raises barriers to entry. This can restrict innovation and market disruptors and can have significant effects. A large number of studies have found that barriers to entry can come in a wide range of forms, not just absolute barriers to entry (e.g. in the form of restrictions on the number of firms in a market) but also through other aspects of product market regulation which can have the effect of raising barriers to entry e.g. excessive compliance or administrative costs.
- 4.64 Fourth, the proper design of regulation can substantially reduce the negative impacts on competition. The research finds regulation can be used to incentivise innovation in a sector but, as with regulation and competition, the form of regulation can have an important influence on the type of innovation in a sector. The evidence from the research specifically points to the need to guard against regulations which disproportionately favour incumbent firms and which have a disproportionate impact on smaller firms. The evidence also indicates that where policymakers and regulators do not establish and maintain channels of communication with new entrants and firms with new technologies or different business models, this can lead to poorly designed regulation that harms competition.

- 4.65 Fifth, in dynamic markets more flexible forms of regulation can reduce the risk of deterring innovation, and therefore harming competition. Such approaches can include the use of sunset clauses for new regulation which is triggered after a fixed period of time or once certain criteria have been met. There can also be greater experimentation about different approaches to regulation.
- 4.66 Finally, there remain important gaps in the existing knowledge which creates scope for further research. As noted above, academic research does not consider the benefits of regulation in terms of broader public policy concerns (e.g. in relation to safety, crime, etc.). There is thus little evidence about the appropriateness of the overall balance of regulation or the burden of regulation on firms.
- 4.67 We also consider that there is scope for more targeted, empirical research about the impact of specific types of regulation. We would encourage expanding research into how regulation directly affects the ability for firms to compete in the market.
- 4.68 We note that the academic research does not typically comment on empirical issues around regulatory design or the quality of regulation. Again, this is likely to be an important issue when it comes to considering what constitutes best practice in relation to developing regulation.

## 5. The Design and Implementation of Regulatory Policy

- 5.1 In this section, we review the processes and guidance used by government departments, agencies and sector regulators in the UK to assess and evaluate regulatory policy. As part of this, we have reviewed the CMA's own Competition Impact Assessment guidelines and considered the extent to which they may need to be updated to make them more accessible to officials carrying out Regulatory Impact Assessments (RIAs). We use a series of case studies to illustrate how the guidance and tools available are used in practice by policymakers.
- 5.2 Impact assessment guidance and processes in the Devolved Administrations are generally separate from that which is in place for central government departments, agencies and sector regulators which for convenience we refer to as "Whitehall" for the purposes of this report. Most of this section refers to guidance and processes which apply to Whitehall only, unless clearly stated otherwise. We have also undertaken a high-level review of the guidance and processes in place in the Devolved Administrations (see later in this section).
- 5.3 To support the design of better regulation over the last 20 to 30 years, the OECD has put considerable effort into developing and disseminating guidance on "best practice" in relation to regulatory policy. At the national level, successive governments in the UK have looked to develop tools to improve regulatory design and RIAs have emerged as a key tool in this process.
- 5.4 The RIA can be viewed as both a tool and decision process for informing political decision makers on whether and how to regulate to achieve public policy goals (OECD 2012). That is, it provides a rigorous approach to identify and assess the expected costs and benefits of a measure and at the same time it helps to develop a better understanding of the likely impact of different options to help guide decision-makers.
- 5.5 However, it is striking that in a recent report, the OECD has cautioned that RIAs have become over-procedural and are frequently not applied to the most significant laws and regulations (Deighton-Smith et al (2016)). The OECD points to research which has identified a general tendency to use RIAs as a legitimisation tool rather than as an informative assessment in support of decision-making. The OECD has also noted (OECD 2015) that "countries tend to adopt a procedural approach to regulatory policy and use its tools (RIA, stakeholder engagement and ex post evaluation) strictly in an administrative fashion, after policies and regulatory decisions have been made".



- 5.6 As indicated in the Introduction section (section 2), there is no suggestion that the UK is guilty of falling into this trap – the UK achieves a high ranking in terms of both its processes and institutions for evaluating regulatory policy. However, the observations by the OECD suggest that it is important to be alive to such possibilities and to keep regulatory decision-making processes under review. We consider that this is likely to be particularly important at a time when: new technologies and new business models threaten to disrupt existing markets; there is a need to avoid stifling innovation and new entry; and regulation needs to respond to these changing circumstances.
- 5.7 Given the time available, we have not carried out a systematic review of how policymakers across government develop or review regulation to consider the impact on competition (both in terms of static and dynamic competition). That is, we have not made an assessment of the extent to which policymakers follow the guidance available, and to what extent this results in good outcomes. Instead, we have drawn on our experience and knowledge of regulation in a number of different areas to develop a series of case studies that we consider illustrate some important points to be considered in the way in which regulation is developed and reviewed. These case studies cover examples from central government, sector regulators, devolved government and regional administration.
- 5.8 The rest of this section provides an overview of the following inter-related documents available to policymakers which provide guidance<sup>22</sup> on how to assess the impact of regulatory proposals:
- (a) HMT Green Book;
  - (b) Better Regulation Framework Guidance;
  - (c) Regulatory Policy Guidance;
  - (d) CMA Competition Impact Assessment guidelines;
- 5.9 We then discuss the duties and processes of the sector regulators, and the Devolved Administrations.
- 5.10 There are also a series of processes in place to verify those assessments. We briefly summarise those processes in the second half of this section.

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<sup>22</sup> While a number of these documents are described as ‘guidance’, the guidance may be something that policymakers need to comply with depending on the type of policy being developed. For example, the Better Regulation Framework is something that policymakers developing or implementing policies that will regulate or deregulate business or civil society organisations need to comply with.

## Overview of guidance for regulatory impact assessments<sup>23</sup>

### ***HMT Green Book***

- 5.11 The main government guidance on how to appraise and monitor policies, programmes and projects is the HM Treasury Green Book (2018) (“The Green Book”). The Green Book gives guidance on how to appraise policies, programmes and projects and how to design and use monitoring and evaluation processes before, during and after the implementation of a policy. The scope of the Green Book is wide, covering both proposals concerning public spending and changes to regulations. It provides guidance, methods and tools to appraise and evaluate policies in an objective way, including RIAs.<sup>24</sup>
- 5.12 The Green Book does specifically include references to competition and competition effects. For instance, it points out the potential impact of public policies on product market competition, and in turn on productivity. The Green Book states that where competition effects are deemed to be relevant, they need to be considered when evaluating different policy options and refers directly to the CMA’s Competition Impact Assessment guidelines (see below).

### ***Better Regulation Framework***

- 5.13 The Better Regulation Executive (“BRE”) is a unit within BEIS which leads the regulatory reform agenda across government. The BRE supports departments and regulators in considering how to design and deliver regulation. Some parts of the better regulation framework are enshrined in the Small Business, Enterprise and Employment Act 2015, principally the Business Impact Target and Post Implementation Reviews.
- 5.14 The better regulation framework requires the evidence base for significant domestic regulatory decisions to be subject to independent scrutiny by the Regulatory Policy Committee (RPC) who publish an opinion on regulatory measures (see below).

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<sup>23</sup> There is also the Cabinet Office Guidance to Legislation which sets out the procedural aspects to be followed by departments and policy officials in preparing primary legislation and taking it through the Parliament. The guidance does refer to competition effects and states that any proposal which might affect competition in certain markets should be discussed with the CMA advocacy team, which has the power to advise informally or give formal recommendations on the impact of legislative proposals on competition. The guidance also points out the existence of a Competition Policy team at BEIS which can answer any relevant queries. As the main focus is on procedural issues, we do not discuss it any further in this report.

<sup>24</sup> The Green Book applies across the UK (including the Devolved Administrations).

- 5.15 The Better Regulation Framework Guidance (“BRFG”) is aimed primarily at central government departments. It explains how to comply with the requirements of the BRF. The BRDG explains how departments can comply with the better regulation principles of robust evidence, transparency and proportionality in their policy making cycles. It contains specific guidance in relation to RIAs and Post Implementation Reviews (PIRs)<sup>25</sup>.
- 5.16 The BRFG cross refers to the Green Book as the main analytical and methodological framework to implement RIAs and PIRs. The BRFG does recognize the possibility of competition effects stemming from changes in regulation. However, we note that there is no direct reference in the main BRFG document to the need to consider adverse effects on competition that may arise from a proposed regulation. We also note that although the CMA’s Competition Impact Assessment guidelines are referenced in Annex 2 to the document, the BRFG describes this as sitting “outside the better regulation framework”.
- 5.17 We also note that the main government RIA template<sup>26</sup> - which policymakers need to complete in order to obtain sign off at ministerial level for qualifying measures - does not explicitly refer to either the impact on competition or innovation. We note that it does require consideration of alternative policy options, including alternatives to regulation.

### ***Regulatory Policy Committee Guidance***

- 5.18 The Regulatory Policy Committee (“RPC”) was established to provide external, independent scrutiny of new regulations through the government decision-making process. The RPC scrutinises the quality of evidence and analysis used to inform regulatory proposals and provides an RPC opinion to inform the decisions of ministers as to whether they should proceed with the proposal.
- 5.19 As part of its review function (which is discussed in more detail below), the RPC has developed guidance to assist policymakers in compiling their RIAs. The RPC guidance does point to the need for considering potential anti-competitive effects of both regulation and self-regulation, such as those favouring incumbents at a cost to new entrants. It also provides guidance on proportionality when considering the impacts of a policy. The RPC website also has a section on case histories, which provide practical guidance, with

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<sup>25</sup> The guidance also relates to Business Impact Target (“BIT”) which focuses on identifying the direct costs of regulation on businesses.

<sup>26</sup> [Regulatory impact assessment template for government policies](#) (accessed 8 August 2019).

case study examples, of how the better regulation framework has been applied by the committee.

5.20 However, not all regulatory proposals fall to be considered by the RPC. There are a series of exemptions depending on the nature of the regulatory proposal and the estimated net direct cost to businesses<sup>27</sup>. It is also the case that the default position is to exempt small and micro-businesses<sup>28</sup> from the requirements of new regulatory proposals.

5.21 We also note that there is no formal requirement for the RPC to check the presence and quality of a competition impact assessment in RIAs and so the RPC could not give a 'red rating' on an RIA on the basis that it did not consider the impact on competition.<sup>29</sup>

### ***CMA Competition Impact Assessment guidelines***

5.22 The CMA itself has published guidance to support policymakers in assessing the impact of their proposals on competition. This guidance replaces an earlier version published by the Office of Fair Trading in 2007 and explicitly refers to the need for it to be read in conjunction with the BRE's Better Regulation Framework Manual and the Green Book.

5.23 The CMA guidelines include a two-stage process for assessing the impact of a proposal or regulatory intervention on competition: an initial "screening" process and a more in-depth competition assessment:

(a) ***Stage I: Initial screening*** – in this stage policymakers should identify the purpose of the measures being considered and go through the four screening questions on the CMA's Competition Checklist (see Table 1 below). If the answer to any of these questions is 'yes', policymakers should move to undertake an in-depth assessment of the likely impact.

(b) ***Stage II: In-depth competition assessment*** – should policymakers establish that an in-depth competition assessment is required then they will then need to identify the affected market(s), establish a baseline and conduct an assessment of the likely impact the policy will have on the

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<sup>27</sup> For instance, there is a distinction between qualifying regulatory proposals and non-qualifying regulatory proposals. Furthermore, qualifying regulatory proposals where the Equivalent Annual Net Direct Cost to Business ("EANDCB) is estimated to be + /- £5m are not subject to RPC scrutiny.

<sup>28</sup> A small business is defined in terms of having 10-49 employees. A micro-business is one that has 1-9 employees.

<sup>29</sup> For final stage Impact Assessments, the RPC issues either 'red' rating (ie not fit for purpose) or a 'green' rating (ie fit for purpose).

market compared to the baseline. The guidance provides detail on how to conduct this kind of assessment.

**Table 1: CMA Competition Checklist**

<b>1</b>	Will the measure directly or indirectly limit the number or range of suppliers in the market?
<b>2</b>	Will the measure limit the ability of suppliers to compete?
<b>3</b>	Will the measure limit suppliers' incentives to compete vigorously?
<b>4</b>	Will the measure limit the choices or information available to consumers?

***Duties of sector regulators***

5.24 Regulation is not only something which originates in central government departments: there is a wide range of regulatory bodies across many different areas of the economy and the Devolved Administrations.

5.25 In particular, there are a number of sector regulators in the UK, also often referred to as economic regulators. These regulators are responsible for important sectors of the economy including transport, utilities, communications and financial services. The various services that are regulated in the UK – including utilities like gas, electricity and water, or financial services such as banking and insurance – were estimated to account for around 25% of UK GDP in 2016.<sup>30</sup>

5.26 While all the sector regulators have different organisational status and structures, they generally derive their objectives from a set of statutory duties, which vary by regulator. These statutory duties tend to relate to issues specific to the sector being regulated, but also cross-sectoral issues and common problems that must be addressed, for example promoting competition or protecting consumers.

5.27 A high-level overview of the position in relation to the promotion of competition for each of the main economic, sector regulators is set out in annex A. In summary, most of these sector regulators either have an explicit duty to promote competition in their sector or have a strategic objective in relation to competition or associated outcomes (e.g. a duty to promote economic growth<sup>31</sup>).

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<sup>30</sup> Speech given by Andrea Coscelli, CMA Acting Chief Executive, at the Utility Week Congress in Birmingham, 18 October 2016: [Andrea Coscelli: our work in the regulated sectors](#).

<sup>31</sup> We note that the utility regulators - Ofwat, Ofgem and Ofcom - are exempt from the economic growth duty. [p.22 Regulation for the Fourth Industrial Revolution. CP111. BEIS (June 2019)]

- 5.28 As part of the process for introducing new rules and regulations, the main sector regulators prepare RIAs as required under the Enterprise Act (2016) although the Financial Conduct Authority ('the FCA') typically assesses the impact of its proposals using Cost Benefit Analysis and periodically prepares impact assessments of provisions as required by the Enterprise Act.
- 5.29 Although they are required to carry out RIAs under the Enterprise Act (2016), the sector regulators do not necessarily all follow the same process for complying with this requirement. For instance, the ORR has stated that it has adopted the government's impact assessment process whereas other regulators have their own published guidance for stakeholders as to how they will carry out the RIA process (e.g. Ofgem, Ofcom)<sup>32</sup>. In its guidance Ofcom also states that it expects to carry out Impact Assessments in relation to the 'great majority' of its policy decisions, not just the 'important' policy decisions as required by Section 7 of the Communications Act 2003. It is not clear the extent to which innovation is a consideration in the RIA processes used by regulators.

### *Case Study 2*

- 5.30 We have identified the Financial Services Authority's ('the FSA') Mortgage Market Review as a case study of a sector regulator developing regulation to address a specific policy objective, and of considering competition impacts as part of the policy development process. The case study covers the complete lifecycle of the development, implementation and review of regulation. We consider that it provides an interesting example of a situation in which there was an assessment of the impact on new regulation on competition (a cost benefit analysis (CBA) was carried out) but a subsequent review identified that the regulation was perceived to be having an adverse impact on competition and innovation and the regulation was removed.<sup>33</sup>

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<sup>32</sup> We note that Ofgem is currently in the process of updating the guidance it published in 2016 whereas Ofcom's guidance has been in place since 2005.

<sup>33</sup> Over the course of the MMR and its implementation, the FSA was abolished and replaced by the FCA. However, we note that although the FSA did not have a statutory duty in relation to competition, it had adopted regulatory principles which included (i) the need to consider proportionality and (ii) to minimise the adverse effect on competition. As part of this, considerations about competition and innovation were supposed to be a key part of the CBA work.

## **Case Study 2: FSA Mortgage Market Review**

The FSA's<sup>34</sup> Mortgage Market Review (MMR)<sup>35</sup> was in part a response to the financial crisis, and the poor lending practices that occurred in the run-up to it. The aim of the review was to ensure the continued provision of mortgage credit for borrowers who could afford it, while at the same time preventing the re-emergence of poor lending practice which led to customer detriment. The MMR made proposals in a wide range of policy areas, including: responsible lending, distribution, disclosure, arrears management, non-deposit taking mortgage lenders etc. We have not reviewed the competition analysis undertaken in relation to all the policy areas. Instead, we have focused on one of the areas which was subsequently highlighted as part of the FCA's Mortgage Market Study in 2016.

To inform its package of proposals, the FSA undertook a cost-benefit analysis, which was published alongside its proposals.<sup>36</sup> The CBA included a section on competition impacts, which looked at the possible impacts of the different proposals put forward in the MMR. The CBA found that most of the proposals were unlikely to have a material adverse effect on competition or lead to profound changes in the market. The CBA did acknowledge some areas where the new rules could lead to higher barriers to entry in the market (e.g. for non-bank lenders) but did not explore these in depth. The CBA also did not consider innovation in detail. Most of the MMR reforms were implemented in 2014<sup>37</sup>, and significantly changed the regulatory regime for mortgages.

In December 2016, the FCA launched the Mortgages Market Study<sup>38</sup>, the purpose of which was to investigate whether competition was working well in the mortgage sector in general. The final report from the Mortgages Market Study was published in March 2019. One of the findings of the market study, was that there was a perception within the mortgage market that some of the rules imposed through the MMR were acting as a barrier to innovation. For example, to avoid inadvertently breaching the FCA's rules, lenders and intermediaries were not developing tools to sell via execution-only channels (i.e. without advice). These perceived barriers appeared to restrict lenders' and (new and existing) intermediaries' ability to innovate to meet consumer demands for information and guidance in a non-advised, digital environment. The FCA committed to identifying changes to mortgage advice rules and guidance to help remove potential barriers to innovation.

### **Observations**

This case study illustrates several important points. Firstly, it highlights the fact that even in cases where competition is explicitly considered as part of the CBA/RIA process, technological change can occur after a regulatory measure has been implemented and impact the way competition or innovation operates in that market. The cost-benefit analysis which accompanied the FSA's distribution proposals (i.e. on advised and non-advised sales), concluded that the proposals were unlikely to have a material impact on competition in this market. The CBA did not however consider innovation (i.e. dynamic competition) in detail. In practice, the way the market interpreted these new regulations acted as a barrier to innovation in a market where significant technological change occurred.

Secondly, this case study highlights the importance of keeping regulation under review and the importance of post implementation reviews, particularly if there may be some uncertainty when the original regulations are drawn up. While the FCA's market study was not specifically looking at the proposals introduced as part of the MMR (rather it was looking at

the mortgage sector more generally), it identified that some of the rules introduced through the MMR were having an adverse impact on innovation. The FCA took steps to address those issues (acknowledging that some of them relate to perceived barriers to innovation). In a market where there has been significant technological change, such as the mortgage market, it is important to keep regulation under review (even when a substantial period of time has not elapsed), as the FCA has done.

### ***Devolved Administrations***

- 5.31 The processes and requirements in the devolved administrations have some similarities but also a number of important differences. They all have internal systems for regulatory impact assessment with similar guiding principles for appraisal and evaluation. These include similar guidelines on what kind of government measures require economic impact assessment and on the types of analysis that are required (e.g. economic costs/benefits to business and government, wider social or environmental costs/benefits, etc.). However, the procedures for RIAs in the devolved administrations do not include the same element of independent scrutiny as provided by the RPC.
- 5.32 For the UK as a whole, guidance is provided through the HMT Green Book and the better regulation framework guidance. The devolved administrations on the other hand have their own guidance which is supplemental to the Green Book. Impact assessment processes in the Devolved Administrations differ from what is in place for central government departments, agencies and sector regulators.
- 5.33 In this report, we have not sought to undertake a systematic survey of what these differences are and what impact they may have. However, we have provided a high-level overview of the practices currently in place in Scotland, Northern Ireland and Wales in relation to regulatory impact assessments. We have also looked at an example and case study based on the Scottish Business and Regulatory Impact Assessment (BRIA) process.

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<sup>34</sup> The FSA was the regulator for the financial services industry until 2013, when it was restructured into the FCA and the Prudential Regulation Authority.

<sup>35</sup> The final rules were set out in a policy statement, following a number of consultations and working papers (the first one published in October 2009): [Mortgage Market Review Feedback on CP11/31 and final rules](#), October 2012.

<sup>36</sup> Annex 1 to the [proposed package of proposals](#). The FCA also commissioned two reports from consultancy Oxera, which looked at the compliance costs and indirect costs associated with MMR reforms (as set out in CP10/16 and CP10/28).

<sup>37</sup> To note that many of the reforms, like the arrears changes, were implemented ahead of this (see Mortgage Arrears Instrument FSA 2010/22 which came into force on 25 June 2010).

<sup>38</sup> Documents relating to the Mortgages Market Study are available [here](#).



## *Scottish Government*

- 5.34 The Scottish Government better regulation model is based on 5 principles; proportionate, consistent, accountable, transparent, targeted only where needed. These principles apply to all regulation whether it be voluntary or statutory.
- 5.35 Better regulation in the SG is supported by a range of measures including the Regulatory Reform (Scotland) Act 2014, the main purpose of which is to further improve the way regulation in Scotland is developed and applied and deliver consistent and proportionate regulation. The Act includes provisions that support the Scottish regulators' strategic code of practice, which describes how regulators should apply regulatory principles and good practice to contribute towards sustainable economic growth.
- 5.36 The Scottish Government's BRIA process broadly follows that for a RIA. That is, it is used to analyse the cost and benefits to businesses and the third sector of any proposed legislation or regulation. All proposals which may have an impact on business or the third sector should be accompanied by a BRIA, and each directorate in the Scottish Government is responsible for their own BRIA quality monitoring.
- 5.37 To assist policymakers there is: BRIA general guidance; a list of best practice examples; and, a template available on the Scottish Government's website for the completion of a BRIA. The template includes a "Competition Assessment" box which must include analysis and evidence on whether the proposal will have an effect on competition. There is also a reference to the CMA Competition Impact Assessment guidelines.
- 5.38 In addition, the Regulatory Review Group ("RRG") has an oversight function in relation to BRIAs. The RRG was set up in December 2004 to help Scottish Ministers improve the regulatory environment for businesses. It works with policy makers to promote better regulation and sustainable economic growth. The CMA has a place on the RRG in an observer capacity.

## *Northern Ireland*

- 5.39 While NI does not currently follow a Better Regulation Framework, they do provide Better Regulation and RIA guidance.
- 5.40 The Department of the Economy of the Northern Ireland Government has published guidance for staff in Departments, Executive Agencies and other public bodies on when and how to implement RIAs of policies that may impact the wider business community in Northern Ireland.

5.41 There is a reference in the guidance to considering the wider impact of policies, including the impact on competition within the marketplace. The guidance is complemented by a RIA template, which implicitly includes competition among the “wider effects” of the policy to be considered in the assessment. The guidance does not however refer to the CMA’s Competition Impact Assessment guidelines (as part of the list of other guidance/resources available).

### *Welsh Government*

5.42 The Welsh Government has a dispersed approach to regulation, with no central responsibility in the way that Northern Ireland and Scotland have, so there is no single “regulatory framework” in existence. Each minister is responsible for regulatory activity in their portfolio area.

5.43 A Regulatory Impact Assessment (RIA) is needed whenever changes to the law are being considered by Welsh Government and where costs or benefits could accrue. The broad methodological approach taken in Wales is similar to that followed elsewhere in the UK and is consistent with the HM Treasury Green Book. However, the approach and presentation of the analysis has been adapted to reflect Wales’ specific legislative requirements, the National Assembly for Wales’ Standing Order requirements, the Welsh Ministers’ RIA Code and recommendations made following various Committee inquiries.

5.44 The Welsh Government has published a “regulatory impact assessment code for subordinate legislation” for Ministers. This code outlines the policy on carrying out regulatory impact assessments in relation to relevant subordinate legislation<sup>39</sup>. We note that the code has not been updated since 2009.

### *Case Study 3*

5.45 Our case study in this area looks at the BRIA undertaken for the Deposit Return Scheme for drink containers for businesses in Scotland. It considers the BRIA published by the Scottish Government as well as the interaction with the relevant Whitehall departments and the CMA itself.

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<sup>39</sup> [Welsh Ministers Regulatory Impact Assessment Code for Subordinate Legislation](#). First published 20 October 2009.

### **Case Study 3: Scottish drink container Deposit Return Scheme**

A Deposit Return Scheme (“DRS”) is a means of encouraging more people to recycle drinks containers such as bottles and cans. It involves the levy of a small deposit on certain products with the money then being paid back to the customer on the return of the empty containers. The concept has been around for a number of years and has already been adopted in a number of European countries (e.g. Denmark, Sweden and Germany).

The UK government and devolved administrations in Scotland, Wales and Northern Ireland are exploring the feasibility of introducing Deposit Return Schemes (“DRS”) as a means of incentivising producers to take more responsibility for the environmental impact of packaging waste and to increase recycling rates. Although waste policy is a devolved responsibility and the Scottish, Welsh and Northern Ireland Administrations can decide policy separately, the UK government has signalled that it wants to ensure as far as possible that there is a coherent UK-wide system.

The Scottish government has been leading the way in this area with the introduction of a DRS and has already consulted on key aspects of such a scheme for Scotland. As part of its 2019-2020 Programme for Government, the Scottish Government has outlined plans for a new Circular Economy Bill and has stated its intention to have a DRS in operation by 2021.<sup>40</sup> Proposals for England, Wales and Northern Ireland are not as fully developed and there is likely to be a further formal consultation on specific regulatory measures in early 2020. Both the Scottish government and Defra have produced separate impact assessments in respect of the proposals for a DRS in Scotland and England, Wales and Northern Ireland respectively.

The Scottish government produced a Business and Regulatory Impact Assessment (“BRIA”) which included a specific Competition Assessment section examining the potential economic impacts of introducing a DRS on the Scottish drinks industry, retail businesses and consumers in some detail. The BRIA explicitly referred to the CMA’s Competition Impact Assessment guidelines as providing assistance in identifying the markets that might be affected by a new policy.

Defra has also produced a RIA for its initial proposals. Like the BRIA it referenced the impact on competition between drinks producers but in terms of competition between drinks producers tending to constrain the extent to which they could pass through the costs of the scheme to consumers.

In early discussions between Defra and HMT it was suggested that DRS proposals for England and Wales may have competition impacts related to collected recyclable material. In subsequent discussions between Defra and the CMA, it has become apparent that the initial Defra analysis was focused on the costs of administering the scheme and had overlooked the potential competition impact if the scheme administrator were also to operate in markets for recycling the material collected by the scheme. That is, whether the administrator would - in effect - be granted exclusive access to the material for recycling collected by the scheme and the impact that could have on competition. The partial BRIA for a DRS in Scotland had also overlooked this as a potential issue.

These issues are now taken into account as proposals for the operation of the respective schemes are being refined.

#### **Observations**

When considering the impact on competition, there is the need to consider the impact on competition at different points in the industry supply chain and not just on the parties that are the immediate focus of the regulation.

The CMA Competition Impact Assessment guidelines provide a useful checklist in terms of starting to think about the impact of regulation on competition and whether a more detailed assessment is needed. However, as indicated above, there is the need to guard against adopting too narrow a starting point and there is the need to consider potential competition impacts more broadly.

The CMA can play an important role in providing an external, independent perspective on proposals for regulation and early engagement with the CMA can help identify potential issues that policymakers may have initially overlooked.

## **Processes for reviewing regulatory impact assessments**

### ***The Role of the CMA in advising policymakers when developing regulation***

- 5.46 As indicated above, the CMA has published guidance to support policymakers in assessing the impact of their proposals on competition. This guidance sets out a two-stage process for assessing the impact of a proposal or regulatory intervention on competition.
- 5.47 The Cabinet Office Guide to Making Legislation asks policymakers to contact the CMA via a specific email address for any legislative proposal that might affect competition in markets.
- 5.48 This has not systematically been used by departmental officials to engage with the CMA. Through other channels, the CMA has, however, been in contact with government departments to discuss and offer advice on primary legislation as it is being developed: examples include the Energy Bill, the Higher Education and Research Bill and the Buses Bill.
- 5.49 Departments have also approached the CMA to discuss other policy initiatives and regulatory proposals that have a bearing on competition, such as measures to tackle obesity, the regulation of private hire vehicles, and the National Lottery.
- 5.50 The SBEEA also gave the CMA a new power, to use at its discretion, to make and publish written recommendations to ministers on the impact of proposals for legislation on competition within any UK market(s) for goods or services. Early consideration of the competition implications of a policy may help to

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<sup>40</sup> Scottish Government. [Protecting Scotland's Future: the Government's Programme for Scotland 2019-2020](#). 3 September 2019.

mitigate the risk that the CMA raises concerns about a policy once the proposal becomes draft legislation.

- 5.51 Having looked at our guidance again, and in light of our experience with the Advocacy email address, we believe that the checklist is a useful tool for policymakers but could be made more accessible and easier to put into practice, particularly for policymakers who are not as familiar with competition policy.
- 5.52 Specifically, we think that the checklist provided in step 1, the initial screening stage, could be expanded to provide examples of the kinds of impacts that might be observed in each area, as well as expanded to include a more explicit consideration of innovation. This is in order to allow policymakers to identify where a competition impact assessment should be undertaken at an early stage in the process of developing regulatory options.

#### *Case Study 4*

- 5.53 An example of where there was scope for policymakers to engage with the CMA as part of the process of developing regulatory options is in relation to TfL's proposed changes to the licensing of private hire vehicles in London in 2015. This is particularly the case in light of the changes and disruption happening in the private hire vehicle market at the time (with the entry of players like Uber).
- 5.54 While reviewing the existing regulations was clearly important in terms of passenger safety, the CMA felt at the time that some of the TfL proposals went beyond that objective and were potentially harmful to competition.

#### ***Case Study 4: TfL Proposals for Private Hire Vehicles***

In 2015, TfL launched a review of regulations relating to the licensing of private hire vehicles in London, in response to developments in the private hire industry, including the emergence of new technologies (and with that services such as Uber) and changes to the ways people engage and use private hire vehicles.

In September 2015, TfL published a consultation setting out a package of 25 detailed proposals.<sup>41</sup> According to the TfL consultation, the main purpose of these proposals was to improve passenger service and safety. TfL also commissioned an independent consultant to undertake an Integrated Impact Assessment (IIA) of the proposals.<sup>42</sup> The IIA considered the health, equality, environmental, business and economic impact of the proposals. The IIA was published in January 2016. While the IIA did not include a specific section on competition impacts, it did acknowledge that some of the proposals could affect future competition in the sector. The consideration of competition impacts in the IIA was not systematic or structured.

In December 2015, the CMA submitted a response to TfL's consultation, expressing concerns about some of the proposals. The response acknowledged that private hire vehicle passengers need to be protected, and appropriate legislation is required to do so. However, the CMA was concerned that some of TfL's proposals went beyond what is necessary to protect passengers, and could have an overall detrimental impact on consumers, through reduced competition. The CMA identified a number of specific proposals that it had concerns about but stressed that a competition impact assessment could be undertaken for all of the proposals.<sup>43</sup>

In March 2016, TfL set out the final list of changes to the regulations which was approved by its board. Some of the recommendations the CMA had opposed were dropped (e.g. the 5-minute wait requirement), while others were modified (e.g. operators required to notify TfL of changes to operating models, and requirement to provide an estimate of the fare).

#### ***Observations***

This case study highlights the fact that a proper consideration of competition issues does not prevent public authorities from pursuing relevant public policy goals (in this case passenger safety). In fact, a proper consideration of competition issues can help to address the issue of proportionality in considering the impact of new regulation i.e. what regulation is strictly needed to achieve a public policy objective, while at the same time identifying areas where proposed regulation is disproportionate – thus adding to the regulatory burden - and likely to harm consumers.

At the same time, we also consider that this example illustrates the role the CMA can play in terms of advising public authorities about the role of competition. The CMA had experience both of competition issues relating to the regulation of taxis and private vehicle hire as well as on consumer protection matters.

The CMA's experience of different types of competition issues in different sectors of the economy is a resource which other public authorities can draw on when it comes to considering introducing or changing regulation.

## **Review by the RPC**

- 5.55 Although there has been a focus on “better regulation” and the use of RIAs in the UK since the late 1980s, an independent body - the RPC - was only set up and given a specific role in terms of scrutinising the evidence base for these Impact Assessments in the late 2000s. The RPC is responsible for the verification of both RIAs and PIRs subject to certain criteria (e.g. ones subject to statutory review clauses or if the scale of impact is above a certain threshold).
- 5.56 We note that since the coalition government of 2010, there has been a specific focus on reducing the regulatory burden on business, with a specific target of reducing the impact of regulation on business (the “Business Impact Target” or “BIT”) by a specified amount each parliament. A number of types of regulatory provisions are exempt from the BIT, including those which are deemed to have a pro-competitive impact.
- 5.57 In terms of PIRs, the RPC will undertake a review of the quality of the evidence base and analytical elements of the PIR and all reports setting out the conclusions of a statutory review require RPC clearance before publication. Departments must publish both statutory and non-statutory PIRs.

## **Post implementation review**

- 5.58 A PIR is the process of reviewing a regulation or policy after it has been implemented and operational for some time. A PIR looks at whether the objectives of the regulation were achieved, whether they are still relevant and if they could be achieved in a less burdensome way.<sup>44</sup>
- 5.59 Evaluating the impact and delivery of interventions is an important but often overlooked aspect of public policy. Evaluations help policy-makers understand what worked well and what has been less successful. They provide a basis for continuous improvement and can drive legislative reform and policy development, as well as informing future interventions.

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<sup>41</sup> TfL Private Hire Regulations review: [Consultation Report](#). September 2015.

<sup>42</sup> TfL Private Hire Vehicles Regulation Proposals: [Integrated Impact Assessment](#). January 2016.

<sup>43</sup> The proposals the CMA was most concerned about were: (a) 2 (5 minute wait requirement); (b) 3 (approval for changes to operating models); (c) 8 (prohibition of displays of vehicle availability); (d) 10 (requirement to specify the fare in advance); and (d) 15 (drivers to only work for one operator at a time).

<sup>44</sup> The Magenta Book is the principal source of guidance for policymakers and analysts in central government on conducting an evaluation. The Green Book also provides guidance on the economic principles that should be applied to both appraisal and evaluation.

- 5.60 The SBEEA now requires the inclusion of a statutory review clause in secondary legislation regulating business or voluntary/community bodies, or a statement on why a review clause is not appropriate. The inclusion of a review clause requires policy officials to undertake a PIR in line with the legislative timetable specified and reviews should normally be completed within five years of the regulatory measure coming into force.
- 5.61 The BRE has published guidance on PIRs<sup>45</sup>. This guidance stresses that monitoring and evaluation should be built in at the start of the policy development process to monitor specific elements of the policy. This would enable departments to produce higher quality PIRs, by ensuring they can collect the data they require for the evaluation throughout the life of the policy. Good practice is to set out monitoring and evaluation plans in the RIA accompanying the original proposal.
- 5.62 The CMA has an established programme of evaluating its merger remedies and other interventions like market studies (our evaluations programme and remedies reviews). It also has systematically reviewed the “backbook” of existing merger remedies inherited from its predecessor bodies. The aim of this work has been to remove measures which were no longer necessary or indeed were restricting or distorting competition. As part of this process, the CMA reviewed 99 merger remedies and removed 72 of them i.e. nearly 75%.
- 5.63 The process has highlighted important lessons for the design of interventions to protect competition which it believes will also be relevant to Post Implementation Reviews. These include:
- (a) The need to put addressing likely consumer harm at the forefront of decisions about interventions. Where there is a risk that an intervention will not be fully effective, that risk is ultimately borne by consumers.
  - (b) Behavioural interventions tend to be higher risk, more complex and resource-intensive to design. There is then the risk that behavioural interventions become mis-specified over time and may only be effective in a narrow set of circumstances over a limited time period. For instance, they might only work in a technologically mature sector with an established and well-resourced regulatory regime.
- 5.64 The PIR process does not apply in Scotland and Northern Ireland. The Welsh Government does carry out some form of post-implementation review.

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<sup>45</sup> Department for Business, Energy & Industrial Strategy, [Producing Post-Implementation Reviews \(PIR\): Principles of Best Practice](#), July 2018.



### *Case Study 5*

- 5.65 In the case study below, we look at Ofgem's 2010 Retail Market Review, and the measures implemented following that review, particularly around energy tariff simplification. This case study illustrates the importance of keeping regulation under review.

### ***Case Study 5: Ofgem's Retail Market Review***

The supply of electricity and gas is heavily regulated, and the form that regulation takes has a profound effect on the shape of competition in retail energy markets.

In 2010, Ofgem launched a Retail Market Review ("RMR"), due to concerns that retail energy markets were not working effectively for customers. The stated purpose of the RMR was to promote customer engagement in energy markets to improve the competitive constraint on supplier pricing and other behaviours. In 2013 Ofgem proposed a series of measures which included: a) the ban on complex tariffs; (b) a maximum limit on the number of tariffs that suppliers are able to offer at any point in time; and (c) the simplification of cash discounts.

These measures clearly restricted the behaviour of suppliers but at the same time limited the choices available to consumers. In 2014, after consultation with the OFT and the CMA, Ofgem referred the energy market in Great Britain to the CMA.

The CMA's market investigation concluded that certain aspects of the 'simpler choices' component of the RMR rules (including the ban on complex tariffs, the maximum limit on the number of tariffs that suppliers are able to offer at any point in time, and the simplification of cash discounts) were limiting competition (i.e. giving rise to an Adverse Effect on Competition) in the domestic retail supply of electricity and gas in Great Britain.

The CMA found that there were few, if any signs that customer engagement had improved either in terms of direct customer activity (e.g. switching, shopping around) or their experience and perception (e.g. views on tariff complexity). The CMA also found that the 'simpler choices' features in fact reduced retail suppliers' ability to compete and innovate in designing tariff structures to meet customer demand, over the long term, and softened competition between Price Comparison Websites. For instance, the CMA found that the four-tariff rule limited the ability of suppliers to compete and innovate and provide products which may be beneficial to customers and competition. This was a particular concern over the longer term, as RMR rules could potentially stifle innovation around smart meters. The CMA also noted that some innovative tariffs had been withdrawn following the introduction of the RMR rules.

The CMA recommended the removal of the conditions in respect of: the ban on complex tariff structures; the four-tariff rule; and, the restrictions on the offer of discounts.

The CMA also expressed concern about the structure and governance of the regulatory framework including the design of decision-making processes – these processes increased the risk of policies being developed that were not in customers' interests and inhibited the development of policies that could promote competition.

#### ***Observations***

When considering regulations to promote competition there is a need to consider not just immediate, static effects (e.g. the impact on price) but also longer-term dynamic effects – particularly there is the need to consider the impact on incentives to innovate.

When considering remedies that are intended to have a behavioural effect, there is a need to trial and test those remedies systematically. For instance, at the time, concerns were expressed by stakeholders that Ofgem's research did not actually indicate that tariff

complexity was a factor which prevented switching or that reducing the number of choices for each customer was going to increase activity significantly. Trialling the proposed remedies may have high-lighted this issue.

The CMA's report highlighted the importance of the decision-making process itself and the need to ensure that policy trade-offs are articulated clearly and explicitly.

This case study also illustrates the importance of reviewing regulations after they have been introduced (for example through a PIR, but in this case through a CMA market investigation). Ex-post reviews allow policymakers to understand whether the regulations are achieving their stated objectives. This is particularly important when the original regulation seeks to address consumer behaviour, and where there was no testing before its introduction.

## Conclusions

- 5.66 As set out above, it is clear that there are processes and guidance in place to support the overall assessment of the impact of new regulations or changes to existing regulations. Based on our review of the guidance available, and evidence from our case studies, we have identified a number of conclusions on which we have based a number of recommendations (see next section).
- 5.67 Firstly, as part of the process of impact assessing new regulations (or changes to existing regulations), the extent to which there is a consideration of the impact on competition and innovation appears to vary. It is important to clarify that we do not mean to imply that we would expect there to be a detailed quantification of the impact on competition or innovation in every case. We recognise that this can be challenging and may not be relevant. However, our own experience e.g. of engagement with the CMA via the specific email address set out in the “The Cabinet Office Guide to Making Legislation”, suggests that there is scope for more engagement and consideration of these issues between different parts of Whitehall. There is also potentially scope for greater engagement between the Devolved Administrations, the CMA and Whitehall on regulation and competition matters.
- 5.68 Secondly, in a number of instances (such as with the RIA template) there may not actually be an explicit requirement to consider the impact on competition of regulatory proposals. As a result, there a risk that the assessment of the impact on competition may not be “front of mind” for officials working on regulatory policy (and therefore only brought in late in the day) or may not be systematically assessed.
- 5.69 We consider that the guidance should be updated to explicitly refer to impacts on competition and innovation, as set out in the recommendations chapter.

5.70 Third, the evidence suggests that even where the impact on competition is taken into account, there is a risk that it has a narrow focus on static competition effects (e.g. on the impact on price) and that other aspects of the competitive process (e.g. the impact on quality and innovation through dynamic competition) are not properly assessed.

## 6. Alternative Approaches to Regulation

- 6.1 Although effective competition is a means for improving outcomes for consumers in terms of lower prices, better quality and new services, there can be circumstances in which some form of regulation to promote competition may be necessary.
- 6.2 Based on our own experience<sup>46</sup>, the case studies we have looked at in this report, and discussions with the BRE and RPC, we have identified that regulation can pose a particular challenge when it comes to fast-moving markets or markets in which there is disruption. Specifically, it can be difficult for policymakers to ensure that in these kinds of markets, regulation is proportionate, contains the necessary safeguards but at the same time does not hinder innovation.
- 6.3 There is a general sense that regulation can struggle to cope with changing markets and innovation.<sup>47</sup> In general terms, we note that principles-based regulation can help to promote more innovation-friendly regulation. This approach entails moving away from a reliance on detailed, prescriptive rules and instead relying on high-level, broadly stated principles to set the standards by which regulated firms must conduct business. As a result, this approach leaves firms with the flexibility to determine how they comply with those principles.
- 6.4 We have earlier referred to the CMA's experience with Open Banking which has demonstrated how regulation which puts consumers in control of their data can enable the development of innovative services. Here we provide an overview of three other regulatory approaches which could enable regulation to be made more responsive and better able to adapt to new challenges compared to detailed rules or rigid prohibitions on types of behaviour. The three approaches are:
- (a) Codes of conduct;
  - (b) More flexible approaches to regulation e.g. regulatory sandboxes; and,
  - (c) Participative Regulation / Business Review letters.

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<sup>46</sup> For example, as part enforcing merger policy and conducting Market Studies.

<sup>47</sup> For example, in England and Wales, as part of the CMA's Legal Services Market Study, we identified the concern that the existing approach to regulation, which focuses on professional qualifications, was not sufficiently flexible to apply proportionate, risk-based regulation reflecting differences across legal services areas and over time.

- 6.5 We also note that regulatory reviews and sunset clauses can be a means of promoting more innovation-friendly regulation.<sup>48</sup> The CMA has changed its own guidance to commit more clearly to considering the use of sunset clauses and to reviewing the continuing need for remedies (in respect of the remedies it imposes following market investigations)<sup>49</sup>. This is in order to ensure that remedies do not remain in force where they are no longer necessary to achieve the purposes for which they were imposed.
- 6.6 We do not discuss sunset causes further in this section.

## Codes of Conduct

- 6.7 Codes of conduct are a tool which has been used by competition authorities and regulators to complement existing competition and regulatory frameworks and to help to promote competition in a market. Codes of conduct set out a set of high-level principles for firms' behaviour that help to define the boundaries of anti-competitive conduct. They typically apply to the larger firms in a market. Setting out the high-level principles that should apply to firms' behaviour helps to give all firms in a market greater clarity on the rules that should be followed as well as providing for on-going flexibility to be updated as markets and practices change. Where disputes arise, a code of conduct can also help to resolve those disputes and enforce solutions more rapidly.
- 6.8 Codes of conduct can be used at both a UK-wide level and at the level of Devolved Administrations. For instance, at a UK level, there is the Groceries Supply Code of Practice which we discuss in more detail in the case study below. There is also a Code of Practice for property management companies in Wales which was announced by the Welsh Government as part of its written statement on leasehold reform.<sup>50</sup>

### *Case Study 6*

- 6.9 The Groceries Supply Code of Practice was proposed by the Competition Commission as a result of its 2008 groceries market investigation.

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<sup>48</sup> A 'sunset clause' in a statute, regulation or legislation provides for that piece of law or regulation to be automatically repealed once a period has passed, or certain criteria have been met.

<sup>49</sup> CMA, [Market Studies and Market Investigations: Supplemental guidance on the CMA's Approach](#). January 2014 (revised July 2017).

<sup>50</sup> Welsh Government. [Written Statement – Leasehold Reform in Wales](#). 6 March 2018 [accessed 5 November 2019].

### ***Case Study 6: Groceries Supply Code of Practice***

The Groceries Supply Code of Practice (GSCOP) is a legally binding code imposed on certain supermarkets. It was proposed by the Competition Commission in order to address the adverse effects on competition found in relation to supply chain practices in the groceries market investigation (2008).

Retailers are obliged to train staff, appoint an in-house compliance officer and to issue an annual report on their compliance with the code. There is also a substantial list of obligations that retailers must comply with when it comes to their supplier relationships. These include ensuring that supply terms are recorded in writing, that the full terms are agreed at the beginning of the relationship and that appropriate contacts (head buyers) are identified from the outset.

The Competition Commission also sought undertakings from grocery retailers to set up an Ombudsman to monitor and enforce compliance with the GSCOP. Industry however failed to do so, which led the CC to recommend that the then Department of Business, Innovation & Skills (BIS) set up a Groceries Code Adjudicator.

The Groceries Code Adjudicator (GCA) was created by the Groceries Code Adjudicator Act 2013, following concerns about unfair competition practices and abuses of power in the groceries market. The role of the Groceries Code Adjudicator is to ensure that 13 "designated" or "regulated" retailers comply with the Groceries Supply Code of Practice and treat their direct suppliers lawfully and fairly.

An impact assessment was undertaken for the establishment of the Groceries Code Adjudicator. This included a competition assessment. Unsurprisingly given the nature of the proposal, the IA did not find that the introduction of the Adjudicator would have an adverse effect on competition.

A statutory review into the functioning of the Groceries Code Adjudicator between 2013 and 2016 was published in July 2017. The review found that the GCA had been effective in exercising its powers and enforcing the code. During the period covered by the Review the GCA carried out one investigation but, in addition, it also concluded two arbitrations and two more were on-going at the end of the period. There has been some criticism that the GCA has not carried out more investigations, but the review noted that the GCA had chosen to adopt a collaborative approach to deliver increased compliance rather than a rapid escalation to formal measures. The review also commented that this approach involved a high level of engagement with the large retailers and that there was an increased awareness of the Code in the sector. The fact that the Adjudicator did not need to exercise its formal powers could also be seen as an indication of the deterrent effect of having an expert body overseeing the Code.

#### ***Observations***

The experience with the Groceries Supply Code of Practice points to the fact that there can be alternative forms of regulation other than specific rules and regulations and that these approaches are likely to be more flexible and responsive in the long-term. At the same time, the experience with the GSCOP also points to the benefit of having a body to stand behind the Code to ensure that it is followed and adhered to.

We note that Codes of Conduct and Adjudicators have also been used in a range of other contexts including:

- a) Overseeing merger undertakings: The Contracts Rights Renewal (“CRR”) Adjudicator in relation to ITV plc; and the Broadcast Transmission Services Adjudicator in relation to Arqiva.
- b) Commissioning of programming from independent producers: a Code of Conduct is a key part of the arrangements for commissioning programming for TV and radio by Public Service Broadcasters (“PSB”s - BBC, ITV, Channel 4, Channel 5 and S4C).

In the case of the PSB’s Code of Conduct, each PSB is required to have in place their own code of conduct with Ofcom – as the sector regulator – producing high-level guidance setting out high-level principles as to what the Code needs to contain.

## More flexible approaches to regulation

- 6.10 The concept of a “sandbox” for testing ideas comes from software development. It is a testing environment that enables software or programmes to be operated in isolation and used for independent evaluation, monitoring or testing. In 2016, the FCA created the world’s first “regulatory sandbox”. This is an arrangement in which parts of the usual regulatory framework are temporarily suspended to give firms the opportunity to work with the regulator to trial innovative products, services and business models with consumers. It offers firms the ability to carry out trials in a controlled environment without immediately incurring all the normal regulatory consequences of engaging in the activity in question.
- 6.11 The “sandbox” approach also gives regulators the opportunity to identify appropriate consumer protection safeguards to build into new products and services.
- 6.12 Early indications suggest that that this innovative approach to regulatory oversight is enabling new products to be tested, reducing the time and cost of getting new ideas to market, improving access to finance for innovators and ensuring appropriate safeguards are built into new products and services<sup>51</sup>.
- 6.13 Since its establishment, the sandbox has received more than three times as many applications than places available which indicates a significant demand

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<sup>51</sup> In the first year, 90% of firms progressed towards wider market launch and 40% received investment during or following their sandbox tests. Source: Regulation for the Fourth Industrial Revolution (2019).



for this sort of regulatory initiative. Access to the sandbox has helped reduce the time and cost of getting innovative ideas to market.<sup>52</sup>

- 6.14 The idea of the regulatory sandbox has recently been extended to energy markets<sup>53</sup> by Ofgem. In this instance, the sandbox allows firms to run a trial where some regulations have been removed on a temporary basis. The trial is expected to run for a set period of time with a limited number of customers and includes explicit learning objectives to test the viability of the model. At the end of the trial, regulations will apply as normal. The firm conducting the trial will report what it has learnt and Ofgem will consider the results during future policy development.
- 6.15 In a similar vein, faced with a significant increase in the demand for spectrum, driven by both existing and new services and applications, Ofcom has experimented with the use of both unlicensed spectrum and, more recently, shared access to spectrum to promote innovation in the development of new wireless services<sup>54</sup> as part of a programme of spectrum liberalisation.
- 6.16 Traditionally, spectrum licences had specified, often in considerable detail, the use to which spectrum could be put and the means by which that spectrum can be exploited – including for example details of the service that could be offered and the technology that was allowed to be deployed. Spectrum liberalisation has involved the reduction or removal of these restrictions. More sophisticated technologies have allowed greater and more intense spectrum sharing and this in turn has required more flexible approach to authorising the use of spectrum. Ofcom is exploring and, where appropriate, implementing new forms of spectrum sharing and extend sharing across new spectrum bands.

## **Participative regulation / Business review letters**

- 6.17 More recently, Jean Tirole has put forward the concept of “participative regulation”<sup>55</sup>. Although there is little in the way of detail on how this might work in practice, the basic idea of this approach is that there is greater engagement between regulators and the industries that they regulate. A firm or firms would make specific proposals to the regulator – setting them down formally – and the regulator would in turn respond to set out its views on the

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<sup>52</sup> For instance, this process has enabled firms to test different applications of Distributed Ledger Technology (“DLT”), a specific version of which is blockchain.

<sup>53</sup> Ofgem, *‘What is a regulatory sandbox?’*, September 2018.

<sup>54</sup> Ofcom, *A framework for spectrum sharing*, 14 April 2016.

<sup>55</sup> EU Conference: *Shaping competition policy in the era of digitisation*. January 2019.

proposal (or proposals) based on the accuracy of the information and representations presented by the firm.

- 6.18 Through this process, the regulator is able to elicit information about the plans or proposals of the firms it regulates. It also enables regulators to respond in a more flexible way where there are perhaps “grey” areas as to how regulations might be applied to new technologies / new services. In return for setting out their proposals, if acceptable, firms would benefit from reduced legal uncertainty. At the same time, the regulator is not fettering its discretion: they would retain the ability to investigate the business practices at a later stage if new information emerges or if complaints were made.
- 6.19 One further aspect of this approach is that the regulator would be able to develop guidance based on their experience over time and which could be shared with the rest of the industry.
- 6.20 In the US, we note that the DOJ has historically made use of a “business review procedure”<sup>56</sup> in situations where a firm or business organisation is concerned about the legality of a business practice under antitrust laws. Under this approach, a firm requests a statement from the DOJ about its current enforcement intentions with respect to a specific business conduct. The DoJ does not have to accept the request or can decline to state its enforcement intentions but it can also choose to indicate that it does not currently intend to bring enforcement action (as at the date of the letter). The fact that the business review letter is made public then allows other firms to factor that interpretation of the existing legislation into their own plans.
- 6.21 Although the DoJ reserves the right to take action, it has noted that where it has stated an intention not to pursue enforcement action, it has not subsequently brought a criminal action if there was full disclosure at the time the business review request was presented to the DoJ.

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<sup>56</sup> US Department of Justice, [Introduction to Antitrust Division Business Reviews](#).

## 7. Conclusions and Recommendations

- 7.1 Having reviewed the evidence and reached the conclusions set out in the previous sections, we are setting out proposals and recommendations which are aimed at ensuring that the impact of regulation on competition and innovation is thoroughly considered; and at promoting a regulatory environment in the UK which supports disruption and innovation in markets, while being conscious of the broader policy issues that regulation is used to address.
- 7.2 The key principle behind our recommendations is that there should be an increased focus on competition and innovation as part of the process of developing, assessing and evaluating regulatory interventions. This follows directly from our findings around the potentially large risks to competition that poorly designed regulation can raise, and the limitations in the way competition is sometimes currently considered as part of the policy development process.
- 7.3 Importantly, this process should consider not just price effects but also consider other dimensions of competition, such as service quality and innovation. Whilst price effects are important, dynamic effects around innovation can be more important in aggregate. Dynamic competition occurs when existing market participants face competitive pressure from a new product, technology or business model. Such competitive pressure forces firms to continue to innovate, to introduce new products and new technologies. For instance, in the UK, Public Service Broadcasters have faced an increasing competitive challenge from video streaming services (such as Netflix, Now TV, Amazon Prime etc) for viewers' attention. They have responded by launching their own Video on Demand services (e.g. iPlayer, ITV Hub, All4, My5 and, most recently, BritBox) and offering those services across a range of fixed and mobile platforms.
- 7.4 Even if policymakers were ultimately to pursue regulation in spite of competition risks, perhaps because of the importance of broader policy concerns, such analysis could still help inform the design of the policy so as to minimise any negative impacts on competition.
- 7.5 Our recommendations cover three areas:
- (a) **Recommendation 1:** Develop regulation that supports innovation and disruption;
  - (b) **Recommendation 2:** Update the guidance for assessing the impact of regulation; and

(c) **Recommendation 3:** Enhance the oversight of Regulatory Impact Assessments.

7.6 We are also setting out areas in which we think further empirical research is necessary in order to gain a better understanding of the impacts of specific types of regulations on competition and innovation,

## **Recommendation 1: Develop regulation that supports innovation and disruption**

7.7 The rate of technical change is accelerating and there has been significant disruption to traditional markets and business models. As highlighted in the Government's recent white paper, *'Regulation for the Fourth Industrial Revolution'*, it is vital that the UK's regulatory system keeps pace with technological innovation, and innovation more widely, and supports the thriving start-up environment. Evidence shows that there are potentially large impacts on innovation from regulation which creates barriers to entry and from regulation which is too rigid and focused on incumbents. Therefore, it is critical that policymakers and regulators understand and take into account how regulatory measures affect new entrants and innovation.

7.8 To that end, we are making a series of recommendations aimed at ensuring that policymakers and regulators put innovation and competition at the heart of the process of developing regulation.

7.9 Policymakers and regulators should avoid regulation which favours incumbents or firms with specific business models, or that disproportionately harms smaller scale businesses in a sector. As highlighted in our literature review, in mature markets regulations which are skewed towards larger incumbents can lead to lower levels of innovation, higher prices and a resulting loss of consumer welfare. Policymakers and regulators should look for ways to accommodate new services and business models. The development of "peer to peer" businesses such as Airbnb, Deliveroo, and a number of ride-sharing transport services such as Uber demonstrates that businesses making use of new technologies and new business models can bring in new customers, expand the size of the market and stimulate competition. But such developments will challenge existing regulatory approaches and the assumptions behind those approaches and policymakers and regulators need to adapt the regulatory framework to accommodate such developments.

7.10 Policymakers and regulators should carry out strategic, forward-looking reviews of regulation. These should seek to evaluate the external factors that could have an important impact on how markets evolve in the future; to

identify potential sources of disruption whether from inside or outside of those markets; and, assess how regulation might need to change and adapt to accommodate such changes.

- 7.11 Policymakers and regulators should also make greater effort to engage with a wider range of market and industry participants, especially smaller scale firms, so that they better understand the immediate issues facing different types of firms. This will put them in a better position to evaluate the challenges involved in stimulating effective competition and promoting innovation. There is evidence to suggest that the way regulation affects smaller firms is different to the way it affects large firms, and policymakers and regulators should seek to understand both before implementing regulation. Our literature review identifies the risk that only large incumbents have the necessary resources to engage consistently and effectively with regulatory processes. As a result, policymakers and regulators need to make sure that the development of regulation is not unduly influenced by this particular group of stakeholders and ends up favouring them or their specific business models.
- 7.12 Policymakers and regulators should make greater use of reviews and “sunset clauses” as a means of promoting more innovation-friendly regulation. A ‘sunset clause’ in a statute, regulation or legislation provides for that piece of law or regulation to be automatically repealed once a period has passed, or certain criteria have been met. In respect of the remedies it imposes following market investigations, the CMA has already changed its own guidance to commit more clearly to considering the use of sunset clauses and to reviewing the continuing need for remedies, with a view to ensuring that remedies do not remain in force where they are no longer necessary to achieve the purposes for which they were imposed.
- 7.13 It is also important that when developing options for regulatory interventions, policymakers and regulators consider more flexible forms of regulation to ensure that regulation is proportionate and not unduly restrictive e.g.
- (a) Principles-based regulation: this approach entails moving away from a reliance on detailed, prescriptive rules and relies instead on high-level, broadly stated principles to set the standards by which regulated firms must conduct business. This leaves firms with the flexibility to determine how they comply with those principles.
  - (b) Codes of conduct: a form of regulation that applies only to firms in an industry that satisfy certain criteria. The code of conduct will set certain restrictions on the behaviour of these firms, for example how they must treat their suppliers; but it will give the regulated firms some discretion in how they comply with the code. A code can also be changed with industry

agreement as circumstances change. The Report of the Digital Competition Expert Panel, *'Unlocking Digital Competition'* identified a code of conduct for firms with Strategic Market Status as an approach that would set up predictable rules in advance but would also allow competition and innovation to thrive.

(c) Participative regulation: regulation in which there is a greater degree of engagement between firms and the regulator in a market, with firms making formal proposals to the regulator e.g. in relation to the introduction of new services or products. This can be particularly helpful for new entrants wanting to bring products to a market, particularly if the regulator can then forbear from regulating, until there is a better sense of whether intervention is needed / what form that intervention should take.

- 7.14 Policymakers should also consider making greater use of regulatory “sandboxes” to trial new regulatory approaches. A regulatory sandbox allows businesses to trial new products, services or business models in a live, real-world environment and with real consumers, without some of the usual rules and regulations applying.
- 7.15 In the UK, the Financial Conduct Authority and Ofgem, two sector regulators, are already making use of regulatory sandboxes to facilitate small, temporary trials which can help the regulator during future policy development. Early indications from the Financial Conduct Authority suggest that this innovative approach to regulatory oversight is enabling new products to be tested, reducing the time and cost of getting new ideas to market, improving access to finance for innovators and ensuring appropriate safeguards are built into new products and services.
- 7.16 Finally, policymakers and regulators need to be particularly cautious about imposing regulation that creates significant barriers to entry, substantially raises the costs of production for some firms relative to others or creates restrictive licensing regimes. They should consider such forms of regulation only after a detailed evaluation of the impact on competition. The evidence from the literature review and in particular, work carried out by the OECD indicates that regulation which creates significant barriers to entry can have the most significant impact on competition. In England and Wales, as part of the CMA’s Legal Services Market Study, we identified the concern that the existing approach to regulation, which focuses on professional qualifications, was not sufficiently flexible to apply proportionate, risk-based regulation reflecting differences across legal services areas and over time. As a result, we recommended that the Ministry of Justice to undertake a review of the current regulatory framework for legal services.

## **Recommendation 2: Update the guidance for assessing the impact of regulation**

7.17 There is already a substantial body of guidance together with related templates and processes in place to support policymakers in assessing the impact of regulations in general. Based on our review of the guidance and templates, as well as the case studies we have looked at, we have identified a number of key areas where the guidance and processes currently in place could be brought up to date to ensure that the impact on competition is properly taken into account.

7.18 We propose that the guidance for assessing the impact of regulation on competition be updated to be more integrated and consistent:

- The BRE should update its guidance to explicitly refer to the CMA's Competition Impact Assessment guidelines to champion the consideration of competition in the Regulatory Impact Assessment process;
- The Government's RIA template should be updated to incorporate a specific "Competition and Innovation" section which requires officials to report on the impact of the proposed regulation on competition;
- A link to the CMA's Competition Impact Assessment guidelines should be included on the RPC's website under the "guidance" or "useful link" sections;
- The existing CMA Competition Impact Assessment guidelines include a 4-question checklist to support policymakers. We are enhancing this checklist to provide more detailed guidance for policymakers when considering the impact of their proposals (see table 2 below);
- The RIA template should include the CMA's enhanced check-list, to help policymakers identify specific impacts on competition that could arise from the regulatory interventions they are considering;
- Sector regulators should review their approach to RIAs to ensure that their policies are up to date and in line with "best practice".

7.19 The existing CMA Competition Impact Assessment guidelines include a 4-question checklist to support policymakers. We will enhance this check-list to provide more practical guidance for policymakers to help them recognise where there could be an impact on competition and/or innovation at an early stage of developing proposals. Providing examples of how the four high-level issues can be broken down into a series of sub-questions will make the checklist more relevant and easier to implement in a practical way. We have

included illustrative screening questions under each of the four questions on our checklist in the table below.

- 7.20 In addition, we think there is scope to add a fifth question to the check-list to encourage policymakers and regulators to consider the impact of their proposals on markets where there has been significant change in terms of business models or processes. Examples of questions which could be included under this fifth question are:
- (a) Is there a history of significant technological change or disruption in this area in the last 5-10 years?
  - (b) Is there the prospect of significant technological change or disruption in the next 1-3 years?
  - (c) Is the policymaker aware of firms arguing that existing regulation constrains the deployment of new technology or prevents it operating a particular business model?
- 7.21 We consider that there is scope for more engagement and consideration of the competition issues between different parts of Whitehall. There is also potentially scope for more engagement between the Devolved Administrations, the CMA and Whitehall on regulation and competition matters. The Better Regulation Executive, and the Devolved Administrations who do not already do so, should update their guidance to refer to the CMA's Competition Impact Assessment guidelines, and their purpose in assisting policymakers to assess the impact of their proposals on competition. They should also note that, in more complex cases, policymakers can seek expert advice from the CMA's Advocacy team ([advocacy@cma.gov.uk](mailto:advocacy@cma.gov.uk)) or, for the devolved administrations, their local CMA offices.
- 7.22 Sector regulators should review their approach to Regulatory Impact Assessments to ensure that their policies are up to date and in line with "best practice". We note that in many cases, the main economic regulators do have in place published documents which set out how they will assess the impact of regulation on competition in line with their statutory duties. However, in some cases that guidance needs to be updated and there is greater scope for sharing examples of best practice.



**Table 2: CMA CIA Guidelines – Illustrative Stage 1 Screening Questions**

An assessment of the impact on competition should be carried out if the answer is “Yes” to any of these screening questions.	
SCREENING QUESTION	Examples of sub-questions
1. Does the measure limit the number of suppliers?	<p><u>Does the measure:</u></p> <ul style="list-style-type: none"> <li>• Give exclusive rights to a firm to provide a product or service?</li> <li>• Require firms to go through a licensing or authorisation process to be able to operate?</li> <li>• Limit the ability of some suppliers to provide the good or service?</li> <li>• Impose additional costs for a new firm wanting to offer goods or services?</li> <li>• Impose any sort of geographical restrictions for firms e.g. in terms of supply goods or sourcing workers.</li> </ul>
2. Does the measure limit the ability of suppliers to compete?	<p><u>Does the measure:</u></p> <ul style="list-style-type: none"> <li>• Limit firms’ ability to set prices for goods or services?</li> <li>• Limit firms’ freedom to advertise or market their goods or services</li> <li>• Sets standards for product quality that are likely to put some firms at an advantage over others?</li> <li>• Significantly raise the costs of production for some firms relative to others (especially if existing firms are treated differently from new entrants)</li> </ul>
3. Does the measure limit the incentives of suppliers to compete vigorously?	<p><u>Does the measure</u></p> <ul style="list-style-type: none"> <li>• Create a self-regulatory or co-regulatory regime?</li> <li>• Require or encourage information on supplier outputs, prices, sales or costs to be made public or published?</li> <li>• Exempt the activity of a particular industry, or group of suppliers, from the operation of general competition law?</li> </ul>
4. Does the measure limit the choices or information available to consumers?	<p><u>Does the measure:</u></p> <ul style="list-style-type: none"> <li>• Limit the ability of consumers to decide which firm they can purchase from?</li> <li>• Significantly change the information required by buyers to be able to shop around?</li> <li>• Reduce the ability of customers to switch between firms by increasing the explicit or implicit costs of changing suppliers?</li> </ul>

### **Recommendation 3: Enhance the scrutiny of Regulatory Impact Assessments**

7.23 Our experience of the benefits of ex post evaluations and the case study evidence clearly points to the importance of evaluating market interventions through Post Implementation Reviews, and of these focussing on competition impacts. The Better Regulation Executive, and relevant teams in the Devolved

Administrations, can assist policymakers and regulators across government in completing Post Implementation Reviews and has guidance in place in this area.

- 7.24 In order to be able effectively to carry out Post Implementation Reviews, it is critical that policymakers and regulators set out clear statements at the outset about the expected impact on competition and innovation of specific measures. They also need to put in place monitoring and evaluation plans, which show how the impact on competition and innovation will be measured once the regulation has been implemented.
- 7.25 We consider that Post Implementation Reviews are likely to be particularly important and should be carried out where:
- (a) The measure affects fast-moving markets or ones in which there has been significant technological innovation, so that there is a risk that the regulatory measure has become obsolete or is now mis-specified. Markets that are affected by technological change, automation, changing business models and practices are likely to be relevant here;
  - (b) There was a lack of firm evidence to inform the assessment of the impact on competition and innovation in the Regulatory Impact Assessment and/or there were clear prior concerns about the effect of the regulation on competition and innovation. In this case, carrying out a Post Implementation Review would allow policymakers and/or regulators to understand whether any negative impacts on competition are outweighed by other benefits of the regulation, or to consider whether the same objectives could be achieved through another means, and with less impact on competition in a specific market;
  - (c) The measure is behavioural in focus. With interventions designed to bring about behavioural change – particularly in fast-moving markets – there is the need to monitor and review to ensure they remain effective and do not distort competition. Both firm and consumer behaviour can change over time: firms can find ways to circumvent regulation and consumers can revert to being less engaged.
- 7.26 There is already a process in place for the Regulatory Policy Committee to review both Regulatory Impact Assessments, and Post Implementation Reviews. Evidence from the case studies suggests that there should be a greater focus as part of this process on the impact on competition and innovation, for example by:
- (a) The Regulatory Policy Committee being able to offer a qualified opinion on any Regulatory Impact Assessment that does not appropriately

consider the impact on competition or innovation. This could range from the Regulatory Policy Committee commenting on the quality of the Competition Impact Assessment, up to directly affecting the rating given to the Regulatory Impact Assessment overall;

- (b) The Regulatory Policy Committee developing case studies of good practice in relation to the assessment of competition in Regulatory Impact Assessments and Post Implementation Reviews;
- (c) Expanding the best practice training provided by the Better Regulation Executive and the Regulatory Policy Committee in relation to Regulatory Impact Assessments and Post Implementation Reviews to include a more detailed consideration of competition and innovation. The CMA would be happy to work with the Better Regulation Executive and the Regulatory Policy Committee to devise such training;
- (d) Continued cooperation between the CMA, the Better Regulation Executive and the Regulatory Policy Committee to promote competition in the policy making process.

## **Further research is needed on the impact of regulation on competition**

- 7.27 Based on our review of the recent academic research, we have also identified areas where further research would be useful (i.e. gaps in the existing academic literature).
- 7.28 We note that academic research does not consider the benefits of regulation in terms of broader public policy concerns (e.g. in relation to safety, crime, etc.). There is thus little evidence about the appropriateness of the overall balance of regulation or the burden of regulation on firms. This is an area where more targeted research could be warranted, including work to develop appropriate methodologies for considering this question.
- 7.29 We also consider that there is scope for more targeted, empirical research about the impact of specific types of regulation. We would encourage expanding research into how regulation directly affects the ability for firms to compete in the market.
- 7.30 We also think there should more research around how regulation can support and promote innovation. Our review of the literature in this area suggests that most of the recent research has been focused on environmental regulation and it would be useful to expand this to other policy areas

7.31 Finally, we note that the academic research does not typically comment on empirical issues around regulatory design or the quality of regulation. Again, this is likely to be an important issue when it comes to considering what constitutes best practice in relation to developing regulation.

## Annex A: Sector regulators

	<i>Position in respect of promotion of competition</i>	<i>Position in respect of implementation of Regulatory Impact Assessments (RIAs)</i>
<b>Civil Aviation Authority (CAA)</b>	Empowering consumers is one of the CAA's five key priority activities, with promotion of competition being an important mechanism to achieve this.	The CAA prepares RIAs of provisions as required under the Enterprise Act (2016).
<b>Financial Conduct Authority (FCA)</b>	The Financial Services Act 2012 gave the FCA a new mandate to promote effective competition in the interest of consumers of financial services. Promotion of effective competition is an operational objective which sits alongside a so-called competition duty (to discharge the FCA's general functions in a way which promotes effective competition and is compatible with other operational objectives- i.e., market integrity and consumer protection).	The FCA assesses the impact of its policies by producing cost benefit analysis (CBA) of its proposals. The CBA is published alongside the Consultation Paper on a policy proposal. For more detail on how the FCA does CBA please see <a href="#">here</a> . The FCA periodically prepares Impact assessments of provisions as required under the Enterprise Act (2016).
<b>Ofcom</b>	Section 3(1)(b) of the 2003 Communications Act ("the Act") requires Ofcom "to further the interests of consumers in relevant markets, where appropriate by promoting competition".	Section 7 of the Act imposes a requirement on Ofcom to carry out an Impact Assessment for all important proposals. Ofcom undertook to carry out IAs "in relation to the great majority of our policy decisions". Ofcom's own approach to Impact Assessments guidance was issued in 2005.
<b>Ofgem</b>	The promotion of effective competition while carrying out regulatory functions is included among the	Ofgem periodically prepares RIAs of provisions as required under the Enterprise Act (2016). It also has its own Impact Assessment Guidance

	<b><i>Position in respect of promotion of competition</i></b>	<b><i>Position in respect of implementation of Regulatory Impact Assessments (RIAs)</i></b>
	Powers and Duties of GEMA, the governing body of Ofgem.	(2016), which refers to the need to take competition effects into account. This guidance is currently being updated (and will be consulted on in due course) to incorporate the new Ofgem strategy, especially on sustainability and vulnerability, as well as the Net Zero target.
<b>Office of Rail and Road (ORR)</b>	The promotion of competition through several competition functions is one of a number of duties of the ORR; securing value for money through competition is one of the ORR strategic objectives.	The ORR periodically prepares RIAs of provisions as required under the Enterprise Act (2016). More generally, it adopts the government's impact assessment approach and guidance for assessing its provisions, where appropriate.
<b>Ofwat</b>	<p>The duties for most of Ofwat's work are laid down in sections 2 and 3 Water Industry Act 1991 (WIA91). Under section 2 of the WIA91 Ofwat must carry out most of its work as an economic regulator in the way it considers will best further the consumer objective to protect the interests of consumers, wherever appropriate, by promoting effective competition between persons engaged in, or in commercial activities connected with, the provision of water and sewerage services.</p> <p>The promotion of effective competition also forms a key part of <a href="#">Ofwat's forward programme 2019-20</a>.</p>	<p>Ofwat, as a statutory regulator, is obliged to report against Government's Business Impact Target (BIT) every year. The target relates to providing savings to businesses by regulating in a way that is not only mindful of the burdens it imposes, but that actively looks to reduce these regulatory burdens (for which Ofwat can attribute a £ figure on how we have saved businesses money).</p> <p>Part of the process is to undertake impact assessments on any activity Ofwat does that imposes any work/response/burden on</p>

	<b><i>Position in respect of promotion of competition</i></b>	<b><i>Position in respect of implementation of Regulatory Impact Assessments (RIAs)</i></b>
	The Defra Strategic Priorities and Objectives Statement (SPS) and the Welsh Government SPS also set out strategic priorities and objectives for Ofwat, which Ofwat must act in accordance with alongside its other statutory duties. These include priorities relating to competition and innovation in markets.	business during the course of the reporting period.

We note that there are other sector or economic regulators than those listed in the table above, who have a role in promoting competition in the industries they regulate. For example, in the Devolved Administrations:

- **The Utility Regulator (Northern Ireland)**

The Utility Regulator is responsible for regulating the electricity, gas, water and sewerage industries in Northern Ireland, promoting the short and long-term interests of consumers. One of the Utility Regulator’s statutory objectives is to “promote competition, where appropriate, in the generation, transmission and supply of electricity”. More broadly, the Utility Regulator works to encourage competition in the gas, electricity, water and sewerage services markets.

- **Water Industry Commission for Scotland (WICS)**

WICS’s mission is to manage an effective regulatory framework which encourages the Scottish water industry to provide a high-quality service and value for money to customers. It is part of WICS’s role to facilitate competition in the Scottish water industry. In April 2008 the Scottish water and sewerage market for all non-household customers was opened up to competition.

## Annex B: Literature review methodology

1. This annex provides a summary of the literature review we have undertaken as part of the evidence gathering stages of this report. It describes how we planned and undertook the review, and what its outputs were.
2. We set ourselves two broad questions to research:
  - a) What is the impact of different types of regulation on competition?
  - b) What is the impact of regulation on competition and innovation in different sectors of the economy?
3. To identify the relevant sources for our literature review, we had conversations within the project team, and with colleagues in the CMA who have undertaken similar research, colleagues in the CMA who engage with government on a regular basis, and colleagues from the Better Regulation Executive at BEIS.
4. We identified the following sources for our literature review:
  - a) Academic journal articles / books;
  - b) UK government documents (including policy, guidance and research documents);
  - c) Reports and papers produced by 'inter-governmental' organisations (e.g. EU, OECD, World Bank) that undertake research in the field of regulation or economics more generally;
  - d) Reports produced by organisations that might not show up in the academic paper search – e.g. consultancy studies produced for the UK or other governments, or independent research.
5. The largest source of possible material is item (a) given the possible number of journals and books to search, as well as period of time we could theoretically cover. We therefore focused on developing a methodology to allow us to perform a targeted search and to short-list articles. The rest of this annex explains this methodology and the results we obtained by applying it.
6. In developing a methodology to search journal articles and books, we considered two high-level questions:
  - a) What search tool to use;
  - b) What parameters to specify for the search – i.e. search terms, search period etc.



7. Following detailed consideration and discussion, we reached the conclusion that the most appropriate search tool to use for this study was JSTOR.<sup>57</sup>
8. Our search focused on articles that deal with the relationship between regulation and competition. Early on we determined that a search based on only these two key words was unlikely to be sufficient because - based on our initial (indicative) searches - we found that research into the impact of regulation on specific competitive outcomes was much more common e.g. impact of regulation on economic growth, productivity, number of suppliers in a market, innovation etc.
9. Another parameter we had to consider was the time period to search (in terms of publication dates). An anchoring point for this project was the CMA's 2015 report on competition and productivity. This paper summarised the theoretical and empirical evidence on the relationship between competition and productivity. The paper concluded that there is a strong body of empirical evidence showing that competition can drive greater productivity. It also noted that there is an extensive literature examining the impact on productivity of changes in competition over time, including as a result of deregulation, and that these studies show generally strong positive effects on productivity in sectors where deregulation has occurred, including transport and utilities.
10. In light of this, we decided to limit our academic literature search to articles, papers and books published since 2015. We did, however, agree that we would make note of any pre-2015 relevant articles referenced in the articles we short-listed for review.
11. In order to produce a list of articles for the actual review (our 'short-list' of articles), we started with the results of five searches we undertook i.e. using five different combinations of key words. This process resulted in a 'long-list' of 110 potential articles.
12. In order to move from a long-list to a short-list, we reviewed the long-list and identified which articles were potentially of interest (based on abstracts and summaries). Our short-list included around 35 articles, which were further supplemented by articles we found from other sources and articles suggested by our academic reviewer (see below).
13. In moving from the long-list to the short-list, we used the following criteria:

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<sup>57</sup> The CMA has access to the JSTOR Business & Economics Collection, which contains journal articles and primary sources relating to disciplines relevant to our project (e.g. economics, finance, marketing, management, business administration, industrial relations). The collection includes back copies from 241 journals, including key economic research journals such as The American Economic Review, the European Journal of Risk Regulation or the Journal of Transport Economics and Policy.

- a) We focused on research based on developed / OECD countries, due to similarities between their regulatory regimes and that of the UK;
- b) The initial searches returned a large number of results relating to environmental regulation, financial services, pharmaceuticals. We limited the number of articles we short-listed in these categories, trying to select the most relevant;
- c) We did not short-list many results which involved research into the regulation of occupations / professions (e.g. licensing) outside the UK, as these types of regulations tend to be country-specific and are not very common in the UK. We did note any results which could be useful examples (but did not put emphasis on them).

14. An independent academic, Dr. Peter Ormosi of the University of East Anglia<sup>58</sup>, reviewed the methodology we developed to identify the relevant academic literature. He also reviewed the list of articles we short-listed for inclusion in our literature review. As part of his review, Dr. Ormosi suggested additional articles we could include in our short-list. Following a discussion with Dr. Ormosi, and based on our own consideration of relevance, we added a number of the articles he suggested to our literature review.

15. Dr. Ormosi also reviewed our write-up of the findings based on the literature review, and the conclusions we drew based on it. He was content that the conclusions we have drawn are well founded in the literature.

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