Comments on the Proposed Transatlantic Trade and Investment Partnership ("TTIP") by The Roundtable on Trade and Competition

The following comments relate to a regulatory proposal for application in the TTIP, and respond to the request for comments in the Federal Register, dated April 4, 2013. Our comments focus specifically on section 2(f) (i) (l) as well as the generalized request for comment on new principles or disciplines addressing emerging challenges in international trade.

These comments are framed in light of the following basic proposition. Both the EU and the US have embraced competition on the business merits as the organizing economic principle, which is key to a productive and innovative economy. Competition on the merits relies on regulation and legislation being as pro-competitive as possible, consistent with EU and US regulatory goals. Pro-competitive regulation and legislation tend to maximize economic welfare (measured by consumers' plus producers' surplus) and the rate of economic growth.[1] When anti-competitive regulation and legislation are allowed to fester, deadweight losses (pure net reductions in net economic surplus) are imposed on the economy. Such losses are generally associated with lower rates of economic growth and innovation. Accordingly, it is vital to better align regulatory promulgation mechanisms on both sides of the Atlantic around competition principles, in order to promote economic welfare.

We believe that if competition assessments are used to evaluate from a market standpoint the welfare losses generated by regulations (both present and future), this will help ensure that regulation is as pro-competitive as possible. We advocate that the appropriate measure or metric by which these assessments should be made is their impact on consumers' and producers' surplus. It should be noted that regulatory barriers that serve as trade barriers as well have consumers' and producers' surplus effects in the markets where they appear, as well as producers' surplus impacts in other markets. Furthermore, in order for assessments of this type to actually be workable, early public release of proposed regulations is key, and so transparency is a vital part of the generation of pro-competitive regulation. The goal is to produce a regulatory climate designed to grow economies based on non-zero sum, mutually beneficial economic transactions among firms.[2] We also recognize that a number of member states of the EU (such

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[1] Existing empirical research is consistent with the proposition that more pro-competitive regulatory environments and robust competition law are associated with higher economic growth, *ceteris paribus*. *See, e.g.,* Alessandro Diego Spoliti, "Competition and Economic Growth: An Empirical Analysis for a Panel of 20 OECD Countries," MPRA Paper No. 20127 (Dec. 2009), *available at* http://ideas.repec.org/p/pra/mprapa/20127.html (product market liberalization and labor market deregulation associated with an increase in total factor productivity, and reduction of market rigidities is associated with enhanced innovation); Steven J. Nickell, "Competition and Corporate Performance," 104 Journal of Political Economy 724 (1996), *available at* http://ideas.repec.org/a/ucp/jpolec/v104y1996i4p724-46.html (stronger competition is associated with a significantly higher rate of total factor productivity growth); Niels Petersen, "Antitrust Law and the Promotion of Democracy and Economic Growth," Max Planck Institute for Research on Collective Goods (Jan. 2011), *available at* http://www.coll.mpg.de/pdf_dat/2011_03online.pdf (antitrust law has a strongly positive effect on the level of GDP per capita and economic growth).

[2] We note that a number of EU member states (including, for example, Bulgaria, Romania, and Croatia) already have mandatory competition assessments as part of their regulatory reform processes. Such mechanisms (in these and other jurisdictions) might help inform the development of future competition-based regulatory and legislative review processes.

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I. Anti-Competitive Market Distortions ("ACMDs")

Anti-Competitive Market Distortions are the "behind the border" barriers that adversely affect both trade and domestic markets. Various attempts have been made to deal with them, but none have proved very successful because: (1) trade methods tend to focus on whether the measures are discriminatory, as opposed to anti-competitive; and (2) domestic competition agencies typically lack the political power and tools to ensure pro-competitive regulation. We believe that the TTIP represents a great opportunity to make progress on the systematic reduction of ACMDs. Since both the EU and US profess to be entities whose economies are based on competition on the merits as a normative economic organizing principle, both entities ought to be in favor of attempts to promote pro-competitive regulation, and eliminate ACMDs where possible. We thus advocate an agreement to eliminate ACMDs between both jurisdictions.

Anti-Competitive Market Distortions are typically government regulations, or legislation which impedes competition, or distorts a competitive market. Examples fall into categories which are as follows (non-exhaustive list)[3]:

1. Restrictions that raise barriers to entry or expansion in a market

Increased barriers to entry reduce competitive pressures on existing firms in the market, potentially resulting in higher prices, lower quality of goods, and reduced innovation. Barriers to exit should also be considered, as they turn investments into sunk costs, thus increasing the risk associated with entry.

Restrictions that increase barriers to entry can take several forms, including (but not limited to) those below:

a. Restrictions that give monopoly rights to a firm

(a) Only one firm or a limited set of firms are permitted to provide certain goods. The effect may be to reduce competitive pressure and facilitate collusion among these firms.

(b) Common in agricultural marketing boards, industries seem as natural monopolies, etc. In addition, historically, government-owned companies have often enjoyed monopolies in their respective market(s).

(c) Exclusive rights may be given to encourage infrastructure investments or research. The idea is that the guaranteed revenues

[3] This list is drawn from the work of the International Competition Network's project on Competition Assessment, and is available at www.internationalcompetitionnetwork.org

that come from the granted market power encourages the firm to make investments in infrastructure that it would otherwise not have made.

(d) Exclusive rights may also be intended to achieve social goals, such as narrower control and monitoring of the consumption of certain substances (e.g. alcohol).

(e) May also be used as a means of subsidizing some sort of universal service – the monopoly creates the profits to ensure expanded service (e.g. postal service, where profitable routes are used to subsidize mail delivery to remote locations).

b. Restrictions on which firms are permitted to compete in the market

(a) Even where the regulation does not grant an exclusive right, it may unnecessarily limit which firms can compete in a market.

(b) Firms may be required to conform to certain business models (e.g. must be structured as a partnership; clinic cannot be co-owned by non-practitioners, etc.)

(c) Foreign ownership restrictions.

(d) Minimum mandatory set of services must be offered.

(e) "Set-asides", allocating a portion of supply to a particular type or class of suppliers.

c. Restrictions that limit access to essential infrastructure, resources, or facilities

(a) Often related to exclusive rights, discussed above.

(b) May take the form of access to facilities such as airports (particularly slots) or towers for antenna, infrastructure such as electricity cables, pipelines, resources such as natural resources (e.g. fishing rights) or regulated resources (e.g. agricultural quotas), etc. May also include rights-of-way, e.g. access to underground below city streets to install cables.

(c) Incumbent firms (especially traditional government-sanctioned monopolies) may enjoy preferential access to infrastructure, resources, or facilities that are needed to effectively compete in a market.

(d) May be mitigated by mandating access at a regulated price. However, such regulated prices may also lead to margin squeezing and other anti-competitive behaviors.

d. Restrictions which stop the free flow of goods and capital across borders

(a) May take the form of prohibitions or taxes on the import of goods from other jurisdictions.

(b) Such restrictions may also take the form of unnecessary regional standards, e.g. requiring that products be packaged or presented in a certain way (e.g. requiring margarine to be coloured white).

(c) Business location requirements, or requirements to have local establishments or facilities.
(d) Reduces the number of firms in a given geographic area, giving them more market power.

e. Licensing or educational requirements

(a) Professions may require minimum educational standards or practical experience. These restrictions are often stricter than what is needed to protect consumers, and serve instead to exclude some practitioners from the market. For example, professionals from other jurisdictions with equivalent expertise to domestic practitioners may be nevertheless forced to retrain.

f. Regulatory standards that impose a significant cost for compliance, e.g. rigorous product testing requirements, or forced adoption of certain technologies.

g. Financing constraints – firms often need to rely on external financing to start up a business. Thus, any significant restrictions on the free flow of investment capital can become a barrier to entry.

2. <u>Restrictions that control how firms are allowed to compete in a market</u>

a. Market regulations that favor certain firms over others.

(a) Government-owned companies and/or traditional monopolies may be given preferential treatment, e.g. rights of first refusal on contracts or sales, more generous terms of sale, preferential access to restricted facilities or infrastructure, etc.

(b) Standards for product quality can be set in such a way as to favour some firms over others, e.g. requiring a particular technology, or

strict standards that require investments beyond the reach of small competitors.

(c) Where new restrictions are being implemented in a market, regulation may allow existing firms or practitioners to have a permanent or temporary break from the new restrictions. So called "grandfather clauses" can unfairly favor incumbents over new entrants. Generally these are more problematic where the relief for incumbents is long-term, although it will depend on circumstances of each market.

b. Price controls

(a) Regulations may set specific prices, or otherwise influence how prices can be set in the market. Often put in place for natural monopolies, such as utilities, telecom, transport, etc. Often used in conjunction with government-granted monopolies, to help control high prices that would otherwise result from market power.

(b) When maximum prices are set, firms' incentives to innovate by providing new and/or high quality products can be substantially reduced. Also, suppliers may be able to coordinate their prices around the maximum price.

(c) Minimum prices may be set to discourage consumption of certain goods, e.g. alcohol, gasoline. They may also be used as a means of protecting small suppliers from "unfair" competition by larger firms that can achieve better economies of scale.

(d) When minimum prices are set, low-cost suppliers are prevented from winning market share by undercutting their rivals.

c. Control of non-price terms of sale

(a) Non-price terms of sale, such as contract lengths, warranties, servicing, and inducements, can also be an important part of a product offering. They may also be an important part of promoting products.

(b) Regulations that restricts such terms can eliminate a viable avenue of competition and reduce choices available to consumers.

d. Restrictions on quantity

(a) Regulations may also control the amount of quantity of a good that can be produced by each firm (e.g. quotas). Measures restricting supply below competitive levels will either increase prices to

consumers or lead to the undersupply of products. If instead supply is set above competitive levels, this can result in oversupply of products and inefficiency.

e. Restrictions on advertising

(a) Advertising restrictions are common in regulated professions, often seem as essential to maintaining the dignity of the profession and consumer confidence.

(b) Restrictions on advertising for undesirable products or to vulnerable groups may also be implemented.

(c) Restrictions on false or misleading advertising not usually a problem – if anything, such restrictions provide consumers with the ability to make better choices, and improve competition.

(d) May be restrictions on comparative advertising (where firms explicitly compare their price, quality, etc. against their competitors' offerings) or non-comparative advertising (general statements about the firm's products, without comparisons to others'). Restrictions may also be imposed on the medium and channels used for advertising, e.g. can only advertise to wholesalers, not directly to retailers.

(e) May restrict advertising of many items of significant value to consumers, including prices, hours of operation, technical specifications, etc.

(f) May have a disproportionate impact on new entrants, as they prevent the firm's ability to tell consumers about their presence in the market and price and quality of their products.

3. <u>Restrictions that shield firms from competitive pressure</u>

a. Regulations that exempt the activity of a particular industry or group of suppliers from the operation of general competition law

(a) Particular sectors may be exempt from the general competition law, especially government-owned companies. Such companies are free to engage in a number of anti-competitive acts – cartels, abuse of dominance, etc.

(b) They may or may not be subject to sector-specific legislation. Where such sector-specific legislation contains industry-specific limits on anti-competitive behavior, concerns may be reduced.

b. Regulations that permit firms or practitioners to exchange information or communicate each others' intentions, which may reduce their incentives to compete. Such regulations may inadvertently facilitate cartels between firms.

(a) Regulations that create self-regulated professions can be problematic. On the one hand, professionals can ensure that sufficient standards are put in place to protect the public and adapt to new technologies and social policies.

On the other hand, self-regulated professions often adopt rules that reduce incentives or opportunities for members to compete, e.g. price restrictions and advertising restrictions. Unduly strict qualification requirements may restrict entry, especially from professionals trained in other jurisdictions. Self-regulated professions may also jealously guard their scopes of practice from practitioners in related fields.

Voluntary standards and suggested guides can be less problematic than required restrictions, but can still be used by members to collude.

Powers may be delegated to a single entity that operates as both the regulatory body and as an industry association advocating for its members, creating a conflict of interest. It is preferable for regulatory functions to be given to an independent body where possible.

(b) Regulations that require firms to publish information on their outputs, prices, sales, or costs. Such publications can significantly aid in formation and maintenance of cartels – facilitates monitoring for defections.

c. Restrictions that limit the amount of profits that a firm may collect, or the market share it may accumulate. Such restrictions (e.g. rate-of-return regulation) prevent firms from benefiting from achieving efficiencies, taking risks, and innovating, reducing their incentives to do so.

d. Restrictions that control the choices available to consumers.

(a) Limitations on which firms consumers may buy from discourage entry into the market by other firms. Remaining firms have less incentive to vigorously compete, as consumers have effectively become a captive market.

(b) Limiting information available to consumers means that they may mistakenly choose firms that do not provide optimal price or quality. This enables sub-optimal firms to stay in the market. Often related to advertising restrictions, previously discussed above.

II. <u>Regulatory Promulgation and Cost-Benefit/Impact Analysis</u>

1. Systems of Review

The TTIP is an opportunity to craft a set of regulatory promulgation principles that bind both parties to meaningful competition assessment of new regulations. Both US cost-benefit analysis and European impact assessment should take into account the effects of proposed new regulation on competition and markets. This is not to say that there should not be any regulation where competition is harmed, but rather that there should be a process whereby such competition costs are made explicit, so regulators and legislators can render better informed decisions. We believe that this process should contain the following elements, which, if missing, could be subject to binding dispute settlement.

The Executive Orders that set up the US federal regulatory review process, coordinated by the Office of Information and Regulatory Affairs ("OIRA") within the Office of Management and Budget, specifically references the need to assess the impact of new regulation on competition. Those orders must be read in light of the Congressional Review Act ("CRA"), which defines a "major rule" as one that will result in at least one of 1) an annual effect on the economy of $100 million or more; 2) a major increase in costs or prices for consumers, individual industries, Federal, State or local government agencies or geographic regions; or 3) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of US-based enterprises to compete with foreign-based enterprises in domestic and export markets.[4] Executive Order 12866 provides that a major rule is a rule that may "have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities." In both cases, the role of the rule's impact on competition is a very important factor to consider.

In the CRA, each one of the relevant categories can be interpreted as a competition assessment test of sorts. Although these have largely been interpreted in terms of compliance costs, their impacts on competition are potentially far more significant. Yet, despite this emphasis on competition, competition assessment in the US system is a comparative rarity.

There are other examples of legislation requiring impact assessments that can be seen to be competition assessments in fact. Section 654 of the Treasury and General Government Appropriations Act, 1999 (P.L. 105-277, 5 U.S.C. § 601 note) requires federal agencies (other than GAO) to assess their pending regulations that "may affect family well-being" to determine whether the proposed benefits of the action justify the financial impact on the family. Family well-being includes many other social issues to be sure (such as whether legislation impacts the marital bond, the strength of the family etc), but it is clear that financial impact on the family of particular regulation must mean some measure of consumers' surplus loss. As noted in Regulatory Analysis Requirements; A Review and Recommendations for Reform (Christopher Copeland, April 23, 2012), "Section 1022(b)(2)(A) of the Dodd-Frank Wall Street Reform Act (12 U.S.C. § 5512) establishes certain "standards of rulemaking" for the newly established Consumer Financial Protection Bureau (CFPB). Specifically, it states that the Bureau "shall consider—(i) the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting

[4] 5 U.S.C. s 804 (2)

from such rule; and (ii) the impact of proposed rules on covered persons, as described in section 1026, and the impact on consumers in rural areas."" This section illustrates once again a competition test associated with new regulations under Dodd-Frank, which would evaluate the impact of those regulations on consumers. Section 15(a) of the Commodity Exchange Act (7 U.S.C. § 19(a)) requires the Commodity Futures Trading Commission (CFTC) to consider costs and benefits before issuing certain regulations, and states that those costs and benefits "shall be evaluated in light of - (A) considerations of protection of market participants and the public; (B) considerations of the efficiency, competitiveness, and financial integrity of futures markets; (C) considerations of price discovery; (D) considerations of sound risk management practices; and (E) other public interest considerations." This focus on competitiveness and efficiency (in particular the latter) is once more an assessment based on consumers' and producers' surplus.

2. The Importance of Transparency

Transparency is often regarded as an optional extra – a nice thing to have in the regulatory promulgation process to ensure that the public's views are being heard. However, transparency is not an extra, but rather a vital part of the regulatory promulgation process. Without it, the proper regulatory assessments cannot be done. In the US, the Administrative Procedures Act of 1946 requires agencies to publish Notices of Proposed Rulemaking and give interested persons an opportunity to comment for at least a thirty day period. Internally, there are a number of statutes that require agencies to alert other members of the government to their proposals early in the process. These include the Negotiated Rulemaking Act of 1990, and the CRA, which requires major rules to be delayed for 60 days pending a review by GAO and the Congress. Executive Order 12889 on the NAFTA requires agencies to provide a 75 day comment period for technical regulations or SPS measures. Transparency is necessary in the case of competition assessments, in particular because competition agencies will need to collect some survey evidence from market participants in order to determine the competitive effects of the proposed regulation.

It is therefore important that in the context of the TTIP, there be transparency in comment periods and adequate periods during which the public can review proposed regulations so that their comments can meaningfully contribute to the regulatory promulgation process.

3. Competition Assessment of New and Existing Regulations

We have noted that there is ample authority in a number of executive orders and legislation in specific areas that suggests that competition assessment of new regulation has always been a part of the process. Unfortunately this has rarely been done as a practical matter, or only on an ad hoc basis. We advocate competition assessment as part of the regulatory process, and note that in Europe, various member states have competition assessment as a mandatory part of the regulatory promulgation process. Essentially, competition assessment evaluates the harm to the competitive market as measured in producers' and consumers' surplus losses, which result from particular proposed regulations or legislation. These losses are particularly destructive to a nation's economy, because they are deadweight losses which result in wealth being destroyed (not merely transferred). Successful competition assessment requires a process that allows early input based on real drafts of regulation and legislation. While the fact

of the assessment should be mandatory, other regulators and legislators should be free to follow its recommendations or not. Where they choose not to follow the recommendations of a competition assessment, they should explain their reasons for so doing in writing. We recommend that the sectoral regulator or relevant legislative committee must either accept the competition assessment and attempt to re-regulate in ways that are less anti-competitive, or must give a rational justification for continuing on the regulatory pathway that is damaging to competition. We anticipate that a simple statement that the view of the regulator is that the benefits outweigh the costs with some reasonable justification would be sufficient to satisfy this requirement. We believe that such a statement, by itself, will over time have domestic impacts that will ultimately lead to better and less anti-competitive regulation.

4. Legislation

Competition agencies should be involved in the legislative process as well as the regulatory process. In the case of legislative committees, the competition agency should be asked to testify before the committee to explain the anti-competitive harms of legislative proposals. Failure to invite the competition agency to give public testimony would be a violation of these core principles.

5. Sectoral Regulation

In the case of sectoral regulators, the regulator should have met with the competition agency and engaged in a sufficient dialogue to ensure that a reasonable regulator would be informed of the competition assessment, and be in a position to weigh it against the alleged benefits.

We believe that the advantage of this approach is that it will force the kind of discussions that must ultimately lead to more, rather than less, pro-competitive regulation and thus will start turning deadweight losses into surpluses. We are hopeful that this process will lead to a virtuous circle as regulators and competition agencies work more seamlessly together.

6. Recommendations

We recommend that focus be paid to the manner in which regulations are promulgated and the impact of regulation and legislation on competition. We believe that sharing of reports on competition assessments of legislation and regulation between US and EU agencies are warranted. In the area of dispute resolution, we think that some of level of dispute resolution is needed as long as it is limited to whether the competition assessment has been performed, and to ensure that it has been taken account of by the relevant regulator. Where the regulator does not take account of it, this would be permissible as long as the regulator provides a rational justification in writing.

III. Conclusion

While authorities on both sides of the Atlantic have paid lip service to the concept of competition assessment, we believe that there is a unique window of opportunity to better embed

these concepts into the regulatory promulgation process on both sides of the Atlantic. By doing this, deadweight losses in our economies that result from anti-competitive market distortions created by regulation and legislation can be eliminated and new wealth can be injected into both economies at a time of great need. However, such processes will not simply be effective without some level of dispute resolution around the actual promulgation mechanisms suggested here. Holding ourselves to account in the manner in which competition assessment is included in regulatory and legislative analysis will go a long way to ensuring that pro-competitive legislation and regulation consistent with regulatory goals is more likely in the future.

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On Behalf of the Roundtable on Trade and Competition.

The Roundtable on Trade and Competition is a 501c3 foundation dedicated to the promotion of trade liberalization, competitive markets and property rights protection around the world. The Roundtable believes that this three legged stool of economic development is most likely to lift the poor out of poverty around the globe.