CENTRAL BANKS AND COMPETITION AUTHORITIES: INSTITUTIONAL COMPARISONS AND NEW CONCERNS

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Pre-crisis institutional consensus

- Independent monetary policy → sound money
- Independent competition policy → free markets

"In 1997, so that interest rate decisions would be set for the long-term needs of the economy, the Government made the Bank of England – Britain's monetary authority – independent. Tomorrow, so that competition will be encouraged for the long-term needs of the economy and consumers, the Secretary of State for Trade and Industry plans to set out a new competition policy for Britain."

– Gordon Brown, 1999 budget

Why independence?

- Commitment in the face of time consistency problem
  - Schelling's thugs
  - Rogoff's conservative central bankers
- Instrument independence ≠ target independence
- View of what instruments can and cannot do well
  - Price stability the best that monetary policy can hope to do
  - Maintaining competition the best that merger policy &c can hope to do
- So have technocrats make the decisions in both spheres

Monetary policy was for hedgehogs

The fox knows many things but the hedgehog knows one big thing

- One instrument – official repo rate
- One target – inflation rate
- One authority – a monopolist – per currency
- Same question every time
- Data mostly public domain
- No appeals

Competition policy is for foxes

- Multi-faceted law
  - Mergers, anti-competitive agreements, abuse of dominance, market inquiries, state aids
- Variety of industries and commercial practices
- Variety of remedies
- Key information confidential
- Others can seek to apply the same law
- Appeals common
- ‘Independence’ as judicialization

Why so different with respect to legal challenge?

- Questions about past or future?
- Speed of effect and of market response
- Transparency and hence accountability differ
- (Ir)reversibility
- Can higher body know better?
- Different effects on vested interests, hence risks of capture

- (What about macro-prudential policy in these respects?)

Competition policy and the banks: pre-crisis

- Special treatment in some jurisdictions
- Sector-specific regulation (e.g. Glass-Steagall and McFadden Acts)

- Merger cases
- Anti-competitive agreement questions
  - Cartels – *Lombard Club*
  - Joint ventures – e.g. credit card MIFs
- Market investigations

Competition policy and the banks: in the crisis

- State aids in EU
  - Rapid and extensive use of “87(3)(b)” condition allowing “aid to remedy a serious disturbance in the economy of a Member State”
- Did not sacrifice competition principles
  - Crisis externalities among banks are abnormal
  - Conditionality, notably follow-up restructuring
- Lifting of merger controls
  - *Lloyds/HBOS* case

Competition-fragility view

- Argues that the latter ‘charter value’ channel justifies toleration of market power in banking
- E.g. measures such as deposit rate ceilings and entry restrictions (akin to cartel by regulation)
- Capital requirements (unless risk-based) are inefficient, and can even have perverse effects by reducing charter value
- Papers include
  - Keeley (AER 1990)
  - Hellmann, Murdock and Stiglitz (AER 2000)
  - Repullo (JFI 2004)

Competition-stability views

- Boyd and De Nicolo (JF 2005) show however that exercise of market power by banks may increase risk-taking by those to whom they lend
- Net effect on bank risk is ambiguous
- Likewise Allen and Gale (JMCB 2004) “find that different models provide different answers. The relationship between competition and stability is complex: sometimes competition increases stability”
- Moreover, moral hazard arising from too-big-to-fail considerations may lead to a positive relationship between concentration and risk-taking

Competition is anyway restrained

- Even if there were a trade-off between competition and stability, competition is anyway constrained by market fundamentals
  - asymmetric information
  - switching costs
  - network effects
- And by <u>crisis-related increases in market concentration</u> (despite divestitures required for EU state aid approval)
- Greater risk of too little competition than too much
- There is no good reason to soften future competition policy as applied to banks (or in general)

Whither independence?

- Judicialization of much competition policy seems unlikely to be reversed
- Is monetary policy no longer for hedgehogs?

  “The bad news is that the crisis has made clear that macroeconomic policy must have many targets; the good news is that it has also reminded us that we have in fact many instruments, from ‘exotic’ monetary policy to fiscal instruments, to regulatory instruments” (Blanchard et al 2010)
- Even if so, that need not mean the end of independence
- Much will depend on evolving views of what policy instruments can and cannot effectively do to maintain sound money and free markets, at the same time as securing stability