# How should regulators balance competition, economic growth and other political priorities?

BRIEFING PAPER

December 2024

SMF Social Market Foundation

Stuart Hudson, Former CMA Strategy Director

Some business leaders fear competition policy and regulation are jeopardising the government's economic growth mission. Former CMA Strategy Director and Downing Street Special Adviser Stuart Hudson explores whether there is a trade-off and, if so, how the tensions can be resolved.

## KEY POINTS

- The Labour government aims to achieve the highest sustained growth in the G7, recognizing the need for increased private sector investment to help deliver this. However, some business leaders express concerns that excessive regulation and competition enforcement could hinder investment.
- Economic regulation aims to address market failures such as market power, externalities and information asymmetries. Since the 1980s, successive governments have delegated much of this economic regulation to expert independent bodies.
- But economists disagree over how much intervention is needed. For example, those following Kenneth Arrow argue that more competition will drive innovation , while those following Joseph Schumpeter emphasize the incentive provided by potential monopoly profits, and there are live debates on how to strike the right balance. In recent years, governments have failed to give clear and consistent policy guidance to regulators on these issues, instead oscillating between pressuring regulators to intervene more and to deregulate. Today, Labour needs business to help drive its growth agenda, while also delivering on its manifesto pledges and seeking to maintain public trust on the economy.
- Regulators have been forced to resolve controversial policy questions without clear guidance or accountability, thereby risking public criticism and accusations of conflicts with government policy. High-profile cases like the Vodafone/3 merger and the FCA's consumer duty highlight these tensions.
- Suggestions include clearer and more actionable strategic steers from ministers, and stronger parliamentary oversight of regulators.
- Regulators should defend their independence within set policy frameworks, maintain transparency in decision-making, avoid overcorrections, and ensure independence in individual case decisions to balance growth and competition objectives effectively.

In its general election manifesto Labour said that its number one priority in government would be to secure the highest sustained growth in the G7. There is widespread agreement that achieving this objective requires a significant increase in investment by the private sector – but some business leaders have told ministers that excessive regulation and enforcement of competition law could make it much less appealing for them to invest in the UK.

These issues came to a head at the new government's global investment summit in London in October. The Financial Times[1] headline read, "Prime minister targets competition authority and other regulators he believes are stifling global appeal". It went on to quote Keir Starmer as saying, "We will rip up the bureaucracy that blocks investment…and we will make sure that every regulator in this country, especially our economic and competition regulators, takes growth as seriously as this room does."

A few weeks later, in her Mansion House speech, Chancellor Rachel Reeves turned to a similar theme, this time in respect of financial regulation. She argued that in the years since the global financial crisis, "The UK has been regulating for risk, but not regulating for growth."

The government has now issued new recommendations[2] to the FCA. It has also indicated a new strategic steer is on the way for the CMA; and the chief executive of the CMA has responded[3] by setting out how it is delivering on the government's growth agenda. Change is clearly on the way but how should regulators ensure they get the balance right between these various priorities?

To answer this question, we need to look at three things: the economic debates that have shaped the actions of regulators; the political judgments that are faced by ministers; and the institutional apparatus to enable the economics and the politics to be considered and the trade-offs to be resolved.

## THE ECONOMIC DEBATES

In the classic free market view, there is little if any need for regulation. Voluntary exchange between buyers and sellers in a market will serve the interests of both, without the need for any outside control. The price mechanism will provide information and incentives (i.e. if a good is in short supply relative to demand, its price will rise, indicating to producers there are profits to be made if they produce more of the good). This should also encourage innovation in products and techniques (as producers can win business from competitors if they find better ways of satisfying customers). For Milton Friedman, consumers needed no added protection because if they are not happy they can switch away to a different supplier; and if there is not currently a better supplier in the market, the incumbent's combination of high prices or low quality and high profits means new entrants will see the opportunity to come in and capture business from them.

To be sure, this process of market competition will lead to an unequal distribution of income and wealth, as some people and businesses prove more successful than others. That is why there have been such longstanding debates between the political parties over how much redistribution is desirable in order to compensate for inequitable market outcomes.

But the rationale for economic regulation is different from this ethical debate. Instead, it is that there will be certain circumstances in which the market fails on its own terms because the flow of information and incentives does not work properly.

Three key market failures are:

- Market power i.e. if a company is so strong in a particular sector that it can raise its prices or reduce the quality of its products without new competitors being able to enter successfully or customers being able to switch away.
- Externalities e.g. if a factory produces a good which it can sell successfully but in doing so it causes pollution, the costs of which are borne by people other than the buyer and the seller.
- Information asymmetries e.g. if a customer does not know enough about a product or service to be able to make good choices about what is in their interests, leaving them vulnerable to exploitation by unscrupulous sellers.

Importantly, concern about market failures has not been confined to governments of the left. It was Mrs Thatcher who set up the first economic regulators because of the market power enjoyed by the newly privatised British Telecom and British Gas; and her government also gave a greater role to the competition authorities. The Labour government elected in 1997 and the Conservative-led government from 2010 broadly agreed with this settlement. That is, there is a set of economic questions over which the political parties disagree and which are the subject of political debate (e.g. how much to tax, spend, borrow and redistribute) but there is also a set of economic questions which are fundamentally technical in nature and which can be delegated to independent experts to resolve (e.g. whether certain mergers create excessive market power or assessing the appropriate cost of capital for investors in monopoly networks).

However, there is a problem with this delegation of apparently technical questions to independent regulators. Even if there has been a broad consensus among politicians that regulation is needed, there is no consensus among economists on how tough regulation should be. That makes it difficult to delegate the problem completely to unelected technocrats, because even the technocrats cannot agree on what the right solution is.

If we look at the issue of market power, economists agree in general that competition is good for growth, but not necessarily on what the ‘right’ level of competition is. For Kenneth Arrow, it was the presence or fear of competition that provides the incentive to invest and to innovate; otherwise a producer would simply sit back and enjoy its monopoly profits. This implied that regulators should be promoting competition vigorously. But for Joseph Schumpeter, it was the prospect of being able to enjoy monopoly profits in the future that provided the incentive to innovate; if the market was perfectly competitive, there would be no reason to invest. Today, most economists would accept that you need a bit of both – the fear of competitors behind you and the possibility of juicy profits ahead of you – but they rarely concur on how much you need of each; or on which is likely to have the more powerful effect in a given situation.

Consequently, there is a live debate amongst competition authorities, academics and private practitioners internationally over whether the authorities have been getting this balance right recently. Evidence has been put forward in the US[4], the EU[5] and the UK[6] that competition appears to be weakening across the economy on a range of indicators and that a tougher approach to competition enforcement might be required. Meanwhile, other academics have cautioned[7] that some of these indicators might not actually point to a widespread decline in competition at all and that there is no case[8] for a toughening of enforcement.

Not only do economists disagree on how tough competition enforcement should be, they also disagree on the consequences if they get their decisions wrong. It used to be thought that Type 1 errors (false positives) were worse than Type 2 errors (false negatives). For example, if an anticompetitive merger was wrongly cleared, it was thought that the subsequent rise in prices would attract new entrants into the market, but if a procompetitive merger was wrongly blocked, the benefits of the deal would be lost forever. More recently, competition authorities in the US and UK have questioned this, fearing that clearing bad mergers could lead to a degree of market power which endures for longer and is harder to shift.

Furthermore, these hitherto dry academic debates are now playing out in very heated ways. For example, Tommaso Valletti, Professor of Economics at Imperial College London, thinks that when it comes to corporates, "big is bad, because concentration is political power, it is corruption, it is a risk to democracy."[9] He says the small number of mergers being blocked currently is "ridiculous." For Tim Wu, previously an adviser to President Biden and now Professor of Law at Columbia Law School, there is a "curse of bigness"[10] which may require some of the biggest companies to be broken up in order to make industries more dynamic. He writes, "The simplest way to break the power of Facebook is breaking up Facebook." But Carl Shapiro, Professor of Economics at the University of California, Berkeley, argues, "I do not see widespread deconcentration of the economy as a wise response [to concerns over corporate power]. The economic costs would be enormous."[11] He also writes, "Those who over-promise what antitrust can realistically deliver are doing a disservice to the very people they profess they are trying to help."

That all leaves competition authorities – and those sector regulators that have a mandate to promote competition – with a complex job to do. They are not simply technicians who are following a clear instruction manual. Nor are they judges who are applying a well-established body of case law. Whether they want to or not, they are having to take a policy stance on issues that are highly contested in their field, and this is playing out in their decisions on some highly controversial cases. In the case of the CMA, this includes recent investigations such as the merger of the telecoms businesses Vodafone and 3, where the companies argued that the deal is vital in order to give them the scale necessary to invest in upgrading the mobile network, while critics countered that by taking out a competitor the merger would incentivise the combined business to raise prices for consumers. And as the controversy over the Vodafone/3 merger heated up, it became the subject of debates in parliament[12] and select committee hearings[13].

## POLITICAL JUDGMENTS

Some of this came as a surprise to ministers and officials who had become accustomed in recent decades to keeping out of the above issues. The broad principles for delegation to independent agencies – which I have written about previously[14] – were that technical questions could safely be handed over to expert bodies while elected politicians focus on decisions with significant distributional impacts or where there are trade-offs with other policy priorities.

In merger control, therefore, ministers' role was limited to a very narrow set of 'public interest' grounds for intervention, on issues such as national security and media plurality where the CMA lacked expertise. Competition, on the other hand, was the CMA's domain of expertise and ministers were expected to leave well alone. Yet it is becoming clear that competition issues can themselves be the subject of debate on which ministers might be expected to have a view.

First, there is a growing body of evidence that changes in competition do have distributional impacts, bringing them much more clearly into the bailiwick of elected politicians. The CMA has found[15] that weak competition hits the poorest households hardest because they tend to spend a larger proportion of their income in markets that are highly concentrated. Meanwhile, the benefits of weak competition accrue to shareholders in the form of higher monopoly profits, and since the wealthiest in society are far more likely to own shares than the poorest, weak competition therefore exacerbates economic inequality. This has led some academics to conclude[16] that there could be a greater role for competition law enforcement in reducing economic inequality. Ministers may well have a preference, therefore, for stronger or weaker competition law enforcement depending on their social policy objectives.

Second, competition policy and consumer protection can interact with an elected government's economic policy objectives. As mentioned earlier, the new Labour government wants to attract greater private sector investment into the UK in order to drive economic growth. Its policy levers for delivering this are currently limited because the difficult fiscal position that it inherited means it cannot offer financial incentives for investment to anything like the same extent that the Biden administration has done in the US through the Inflation Reduction Act. At the same time it is imposing a range of direct and indirect other costs on businesses by increasing national insurance, the minimum wage and employment rights. Especially in the aftermath of the Budget, a government that promised to be the most pro-business in history needs to find other ways to deliver on this pledge. It therefore has a strong incentive to look at competition policy and deregulation, as these are levers that can be pulled with little or no immediate financial cost to the exchequer.

Third, decisions by regulators not only have an immediate effect on the companies directly involved. They also have broader signalling and deterrent effects on a wider range of companies and investors, and these effects can sometimes be harmful to government policy. For example, the FCA has been criticised for introducing proposals to 'name and shame' companies that it is investigating. Whatever the specific merits of the proposal, it led some investors to compare the FCA's approach

with that of other financial services regulators internationally, and to draw a negative conclusion about what the new policy says about how welcoming the UK is as a destination for investment. This is why the current government and its predecessor queried whether the FCA's proposed change is really in line with its new secondary objective to facilitate the international competitiveness of the UK financial services sector.

Fourth, this is particularly tricky territory for a governing party of the centre-left that invariably worries about public perceptions of its economic competence. The Labour leadership knows that over the past fifty years it has never won an election when it was not trusted on the economy. It also knows that most voters are not trained economists and so rely on proxies by which to judge a government's economic competence. The most obvious proxies for voters to use are what they see happening to their own disposable income; and what they hear being said publicly by people who might have a good claim to know about the economy, such as those who run well-known businesses. This reinforces the incentive for the government to try to keep business leaders on side – or to get them back on side following the Budget – and so where business leaders are strongly critical, this becomes a point of danger for regulators.

This is all obviously uncomfortable for the government – as ministers worry about conflict between the regulator and government policy – but it is also problematic for the regulators themselves. Absent clear guidance from parliament or ministers, the leaders of regulators are forced into setting policy themselves on areas that are often controversial in their field, and they must do so with no democratic mandate, limited parliamentary accountability and uncertain political cover. This makes it more likely that they will find themselves unintentionally in politically sensitive territory, as the CMA has found post-Brexit when it had to start reviewing international mergers whose UK impacts would previously have been reviewed by the European Commission, such as Microsoft's acquisition of Activision.

## INSTITUTIONAL SET-UP AND RECOMMENDATIONS

How then should these economic and political questions be resolved, and by whom?

This is challenging in the UK because of the institutional independence that has been given to the economic regulators. Many of them are structured as 'non-ministerial government departments', with ministers excluded by statute from having a decision-making role on certain cases. This was put in place by parliament in the post-privatisation era in order to give confidence to investors that regulatory decisions on price controls or merger reviews would be taken free of lobbying or political interference. However, it leaves ambiguity over the respective roles of ministers and the regulators in setting broader questions of policy, such as how far the regulator should seek to ensure its approach is consistent with the policy of the government of the day; and whether it wants to stick to or depart from the approach being taken by authorities in other major jurisdiction such as the EU and the US.

## RECOMMENDATIONS FOR THE GOVERNMENT AND PARLIAMENT

The government may decide that it is happy for the regulators' boards to settle these broader policy questions themselves. But if that is going to be the case, the regulators should be subject to greater parliamentary accountability, given that their decisions are made by people who are unelected. At present, the chief executives of the regulators are not even subject to a pre-appointment hearing; and in most cases parliamentary committees do not have regularly scheduled hearings with the chief executives and chairs to scrutinise their work. For example, after the CMA chairman and chief executive gave evidence to the Business Select Committee on the work of the CMA in June 2019, the next equivalent session took place nearly four years later, in May 2023. That is not frequent enough. The relevant select committee should have an annual oral evidence session with the chief executive and chair of each of the regulators they are responsible for scrutinising.

Alternatively, the government could decide that it will give greater policy direction to each regulator. It can do so through the issuing a 'strategic steer' which is typically issued once in the lifetime of each parliament, but here too there is room for improvement. If you look back to the creation of the first independent economic regulators there was an acceptance that ministers should be able to set broad guidance to avoid conflict between an unelected regulator and government policy. But as I explained in evidence[17] to the Lords Industry and Regulators Committee, such steers have proved unsatisfactory to date, often being long on abstract nouns and conflicting priorities but short on actionable guidance on how the priorities should be ranked, making it harder for regulators to take the steer on board and more likely that ministers get pressed to intervene in individual cases, which is the worst of all worlds.

The forthcoming new strategic steers to the CMA and sector regulators offer an opportunity to change this, with clearer and more specific guidance. I have sometimes heard it said that ministers cannot give such clear direction to regulators because it would conflict with their statutory duties or, in the case of the CMA, that the strategic steer cannot apply to mergers. I cannot find anything in the Enterprise Act that would make this so. The Act gives substantial discretion to the CMA and it is perfectly appropriate that ministers should set out guidance to which the CMA should have regard in this area. For example, if the government wants the CMA to take greater account of efficiencies in mergers, or to be more open to accepting behavioural remedies in those mergers where the CMA finds competition concerns, it can say so.

Finally, ministers need to be more consistent in the political direction that they give regulators. Too often in the past, they have oscillated between pressure to deregulate in order to help businesses and pressure to toughen up to help consumers, often in response to a high-profile failure or scandal. The FCA has often been placed in this position, and has faced it again recently[18].

## RECOMMENDATIONS FOR REGULATORS

There is also more that the regulators themselves can do. First, they must make a conscious choice about how far to assert their independence in making policy. As Bill Kovacic has written, the independence of any regulatory agency is tempered by the ability of politicians to appoints its leaders, control its funding and set the level of oversight that it faces. If a regulator pursues a policy which appears to run counter to that of the government of the day – for example in favour of greater intervention when the government wants to deregulate (or vice versa) – it will find its democratic legitimacy challenged and its freedom of action constrained. The utility regulators[19] have long experience of this.

Second, when regulators make policy choices, they should be transparent and consultative in how they do so. A good example is the recent announcement[20] by the CMA chief executive Sarah Cardell that the CMA will undertake a public review in the new year of its approach to remedies in those mergers that it finds would reduce competition.

Third, when regulators shift policy direction, they need limiting principles to avoid the risk of overcorrecting. Such an overcorrection has contributed to the crisis in the water sector where Thames Water is on the brink of financial failure. Faced with political anger over the water companies' financial engineering and the large dividends that were enjoyed by their private equity investors in early price review periods, Ofwat prioritised cost savings and keeping customers' bills down, but this led to underinvestment, the consequences of which are now being seen in the poor quality of the infrastructure.

Finally, once the overall policy has been set, regulators should be robust in defending their independence in decision-making on individual cases. A democratically elected government has the right to give broad policy guidance to an unelected regulator - and this should be good for predictability and for consistency. But having set out its guidance transparently, the government must then ensure the regulator is able to take its decisions on individual cases independently, free from lobbying and political interference.

## CONCLUSION

In the vast majority of cases, competition is good for growth. Potential investors into the UK do not tend to call for closed markets and the cosseting of incumbents. But this still leaves policy choices to be made on how tough competition enforcement should be; on how regulators should strike the balance between greater protections for consumers and deregulation to incentivise business investment; and on how far UK regulations should depart from those in other countries that are trying to attract investment.

Too often in the past, governments have failed to address these questions properly, offering no or inadequate guidance to regulators but then blaming the regulators for making decisions that they do not like. This is not good enough. A case can be made either for centralising this policy-setting to ministers in the elected government, or

for delegating it to technocrats in the expert regulators, but either way an explicit choice needs to be made in order to make the regime more predictable for investors. The process for setting the policy needs to transparent and, once the policy has been set, regulators must be allowed to get on with their job.

## ABOUT THE AUTHOR

**Stuart Hudson** was formerly Senior Director of Strategy at the CMA and a Special Adviser to Prime Minister Gordon Brown. He is a Partner at the advisory firm Brunswick where he regularly consults for corporate clients on regulatory issues. He writes here in a personal capacity.

# ENDNOTES


[1] https://www.ft.com/content/3d8593a0-ce3b-4ce1-a039-f95c74362e0e

[2] https://assets.publishing.service.gov.uk/media/673712ee12f25d73081271e8/CX_Letter_-_Recommendations_for_the_Financial_Conduct_Authority__FCA__-_Nikhil_Rathi_14112024.pdf

[3] https://www.gov.uk/government/speeches/driving-growth-how-the-cma-is-rising-to-the-challenge

[4] https://econfip.org/wp-content/uploads/2019/05/Confronting-Rising-Market-Power.pdf

[5] https://competition-policy.ec.europa.eu/system/files/2024-06/KD0924494enn_Protecting_competition_in_a_changing_world_staff_report_2024.pdf

[6] https://assets.publishing.service.gov.uk/media/67195323549f63039436b3b1/The_State_of_UK_Competition_Report_2024.pdf

[7] https://www.nber.org/papers/w32762

[8] https://www.nber.org/papers/w32627

[9] https://thecounterbalance.substack.com/p/the-european-system-of-monopoly

[10] https://globalreports.columbia.edu/books/the-curse-of-bigness/

[11] https://faculty.haas.berkeley.edu/shapiro/fixingantitrust.pdf

[12] https://hansard.parliament.uk/commons/2023-12-14/debates/49799BEC-25D0-4F7A-B6FF-C50AA5C28746/ThreeAndVodafonePotentialMerger

[13] https://committees.parliament.uk/committee/365/business-and-trade-committee/news/197875/could-threevodafone-uk-merger-lead-to-higher-mobile/

[14] https://stuarthudson.com/power-without-accountability/

[15] https://www.gov.uk/government/publications/state-of-uk-competition-report-2022/the-state-of-uk-competition-report-april-2022#concentration-industry-structure-and-distributional-impacts50

[16] https://one.oecd.org/document/DAF/COMP/GF(2024)5/en/pdf

[17] https://committees.parliament.uk/writtenevidence/126384/pdf/

[18] https://stuarthudson.com/should-the-fca-name-and-shame-companies-that-are-under-investigation/

[19] https://stuarthudson.com/why-politicians-worry-about-regulators/

[20] https://www.gov.uk/government/news/cma-is-rising-to-the-challenge-on-growth-says-ceo