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I. BACKGROUND

There is well-established empirical evidence that competition—spurring efficiency—promotes productivity within firms and between firms. Competition—at least in normal times—seems to be an important factor to generate productivity, innovation, and growth. As Aghion-Griffith concluded, the view that competition and entry should promote efficiency and prosperity has now become a "common wisdom" worldwide.[2]

Currently, economies are in a recession. The situation has initiated discussion whether competition policy and its effective enforcement is at risk. Among other demands, the recession has intensified requests from certain industries in financial distress that competition policy and competition rules be loosened. Requests for subsidies are often part of industries' proposals as well. Politicians, in turn, face a lot of pressure to choose the subsidy route or other options to "loosen" competition enforcement.

As a response, the competition authorities in many countries have declared that they will continue business as usual. Despite that, arguments remain that a loosening of the rules has already happened. This can be seen, for instance, in state aid enforcement and merger policy, where, during crisis enforcement, non-competition factors are claimed to be more important. Moreover, the dangers of protectionism have increased. At the top of the iceberg, the financial sector is a separate chapter itself. All signs indicate that financial sector will face more regulation. Basically, the financial regulators have no options in this respect. How this new regulation will reconcile with competition policy remains to be seen.

As these themes already indicate, it is extremely relevant to discuss the competition policy's long-term future. But, it seems that those who favor competition during the crisis, like competition authorities, are easily drifting to a defensive role in the discussion. That is strange for a number of reasons, and this article argues that

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[2] Summarizing the empirical evidence, *see for instance*: Productivity and Competition, Office of Fair Trading (UK), January 2007 and AGHION-GRIFFITH, COMPETITION AND GROWTH – RECONCILING THEORY AND EVIDENCE, (2005).

competition especially should be seen as an ally for the current macroeconomic stimulus tools.

II. COMPETITION PART OF THE STIMULUS

As the economies are in recession as a result of the crisis, several countries are currently trying to stimulate their economies. To start with fiscal policy, the stimulus programs consist of both tax reductions in order to boost private consumption, and government spending programs, for new public sector investments.

To stimulate private consumption, the most usual fiscal policy instrument is to reduce income taxes or valued-added taxes. The ultimate aim is to increase consumers' disposable incomes and spending power so that individuals can consume more which, in turn, should be beneficial to economies in stress and, for its part, should help to start the recovery. What impact could competition have on the effectiveness of these stimulus schemes?

Competition can play an important role so that the stimulus actions have their desired effects. Above all, competition can place downward pressure on costs and prices. Downward pressure on prices, in turn, increases consumers' spending power which is exactly what governments are currently trying to accomplish with the stimulus schemes. Therefore, it should only be beneficial for the governments' stimulus aims that price levels of goods and services originate from competition and not, for instance, from price-fixing cartels. This way, competition-driven price setting is more likely to stimulate demand than, for instance, illegal collusion. Basically, we're talking about basic rules of the law of demand; the incentive to consume increases as the price level falls. This "partnership-effect" that competition can have with the fiscal policy stimulus schemes can be especially relevant if—and when—the crisis continues to cause downward pressure on wages and disposal income.

Similarly, the same link can be argued in terms of investments. As is well-known, investments are important in the stimulus process through the multiplier effects they have on economic activity in general. Here, again, competition should be beneficial in order to both keep the prices of investment goods competitive and to trigger new investment decisions, especially compared to a situation where, for instance, the raw materials and intermediate goods that investments need are supplied by a cartel or through other collusive arrangements due to a "crisis-related loosening of competition rules."

From the monetary policy side, there is empirical evidence concerning monetary policy in economic disturbances that lack of competition may reduce the flexibility of domestic monetary policy and thereby impede central banks' efforts to stabilize the economy.[3] For the purposes of this article, a very practical and real-life example is illustrated by the banking sector as the central banks are lowering their base interest rates. One of the key purposes of this policy action is to increase demand for new loans (which fuel spending and investments). This is believed to happen through a mechanism where banks reduce their customers' interest rates accordingly, i.e. banks pass on the base rate cuts to their customers more or less in their entirety.

However, if competition among banks is not working properly, the pass-on effect does not take place and there is a risk that the base rate reduction—partly or completely—is only widening banks' loan margins (the reduction only benefits banks' mark-ups). In some countries, there are certain indications that banks have been "mutually unwilling" to fully pass on the interest rate reductions to their customers "in the spirit of financial stability." This would mean that base rate reductions will not have the expected stimulus effect, a situation resulting from the lack of competition. If there is a common agreement among banks not to pass-on rate reductions, there is a competition infringement at hand. The immediate question is: Should the competition authorities loosen their enforcement and not proceed with stopping the infringement? Many would say no, that proceeding is not only necessary for competition enforcement itself but for this stimulus tool to achieve its goals.

Finally, regarding government spending for public investments, competition often takes place through procurement or bidding processes. If and when the procurement rules are applied normally, competition is already, by definition, a necessary part of the process to ensure that taxpayers receive maximum value-for-money for their spending. All in all, this simply means that governments' spending funds for stimulus are used as effectively as possible. This point is also essential given that the majority of countries are stimulating their economies in a budget-deficit environment, and need to finance their stimulus packages (and bank bail-outs) by borrowing from private investors. In Europe, there have already been failed government bond auctions showing that access to funding at a reasonable price (interest) is no longer self-evident for all countries.

One should not brush aside the long-term aims and effects of public investments either. Often, the purpose of public investments is not only the stimulus effect itself but, naturally, to build new infrastructure for future purposes of the economy. Clearly, it is not irrelevant at all how investment spending is used. The more effectively spending is used, the more new infrastructure can be built. Anticompetitive practices, like bidding cartels, do not produce that effect. Rather, it is competition that has the supportive role to play when governments kick-off high-volume investment projects in the middle of an economic crisis.

[3] *See* Bayoumi-Laxton-Pesenti: *Benefits and Spillovers of Greater Competition in Europe: A Macroeconomic Assessment*, Federal Bank of New York, Staff Reports no. 182 (April 2004).

III. IMMEDIATE POST-CRISIS POLICY ISSUES

One day the recession is over. The post-crisis damage control is naturally a great concern of the macroeconomic policy-makers, and it is another topic where they might have a lot of common with competition enforcers.

The political decision-makers may ultimately decide that competition has no role in the economic crisis and competition rules must be loosened, at least temporarily. In this case, one may face arguments that competition will be returned back to the economic toolkit after the crisis is over. However, there are reasons to argue that competition should be able to function normally immediately after the crisis, and any temporary loosening now may prevent that. The issue of subsidies is closely related to this theme.

A. Subsidy Race

One way to loosen competition rules is to financially subsidize private and inefficient market operators, in order to ensure that nationally important companies (often called national champions) can get through the crisis, at whatever cost. However, this policy does not wipe out the question, what lies at the end of the subsidy tunnel? With this policy, in what shape will the economy be in to face the situation when the markets start to function again?

For many, the worrisome issues lie in the scenario of the so-called "subsidy race." This means a situation where countries and governments find themselves in competition with each other regarding which country is more capable of subsidizing its domestic firms. Evidently, the winners of this race are those governments which have the most resources to financially support their firms, including national champions.

The deeper taxpayers' pockets are, the more probable it is that the national champion their government is subsidizing will come out of the crisis alive and well. Yet, whether the subsidized companies are "alive and well" in terms of their long-term effectiveness, is another matter. In any event, the strategy would be that, unlike its non-subsidized rivals which have already exited the markets, after the crisis the national champion will still be there and ready to gain ground in the post-crisis markets, whether domestic or foreign. The national rescue operation of national champions may also include some other tools than just financial ones, e.g. different protectionist measures.

Naturally, for all the small- and open-economies, the risks of a potential subsidy race can be troublesome. The fact that the economy is open naturally means that the markets are open for any foreign entrant, whether national champion or not, and whether entering the markets subsidized or not. A subsidized national champion may be able to use predatory market practices in open foreign markets because it is, in fact, subsidized.

B. Inflationary Pressures and Post-Crisis Export

An economic crisis may cause inflationary pressures in the economy because economic actors—due to the crisis—may have postponed their consumption and investment needs, maybe for years. This may relate to both household consumption and corporate investments. Naturally, there are several factors in the economy that have an effect on the level of inflation. In any event, some quite recent studies suggest that competition is also an important factor in lowering inflationary pressures.[4]

All in all, when the economy begins to recover, there will likely exist a substantial piled-up demand as demand has been lagging behind, perhaps for many years. At the same time, the supply side may not be immediately ready to fulfill the needs of a rapidly recovering economy and the strong increase in demand that comes with the recovery. This may cause inflationary pressures and, in this situation, competition naturally has a role to play. Yet, there is a need to maintain viable competition during the crisis because competition may fail to handle immediate post-crisis inflationary pressures if competition only gradually starts to "wake-up" at the same time as the economy itself is in the recovery process.

In terms of exports, it is quite evident that a tight control of inflationary pressures is highly important, not to say critical, if the economy is planning to succeed in foreign export markets after the crisis. Besides, the export markets may recover sooner than the domestic ones. This, in turn, means that success in the export markets requires domestic markets to be kept competitive, even if the domestic recovery has not yet started (and domestic inflationary pressures are not yet at hand). The strategy of "compete at home, to win abroad" is well known in the literature.[5]

IV. ENTRY ISSUES –FINNISH EXPERIENCES

Output capacity is always declining as a result of the economic crisis. This takes place through market exit (including bankruptcies) and, for those remaining in the markets, adjusting production capacity downwards. In other words, supply will decrease and markets tend to become more concentrated. In terms of competition, one relevant question is: What is the role of entry in a crisis economy?

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[4] *See, for instance*, the study by the European Central Bank which concludes that higher product market competition leads to lower average inflation, and is likely to lead to a permanently lower level of inflation. Przybyla-Roma, *Does Product Market Competition Reduce Inflation? Evidence from EU Countries and Sectors*, European Central Bank Working Papers 453 (March 2005). Also, a study by the European Commission has produced evidence that absence of competition over longer periods allows a higher than average inflation and greater inflation persistence. *See* Pelkmans-Acedo Montoya-Maravalle, *How Product Market Reforms Lubricate Shock Adjustment in the Euro Area*, European Commission, Economic and Financial Affairs, Economic Papers 341, (October 2008).

[5] For instance, Sakakibara-Porter suggest in relation to Japanese economy that intense domestic rivalry is positively associated with international trade performance, *see* Sakakibara–Porter, *Competing At Home to Win Abroad: Evidence from the Japanese Industry*, REV. OF ECON. & STATISTICS, (May 2001).

The picture is perhaps quite mixed. First, companies planning an entry may have severe difficulties in obtaining financing. Cash reserves could be an alternative, but amidst the crisis these may not necessarily be a realistic option. Secondly, in many markets there is a sharp decline in demand, which does encourage entry.

As for pro-entry parameters, the crisis can be beneficial, especially for efficient and cost-effective new entrants. Also, the crisis may cause customers to become more price-sensitive as demand is likely to become more price-elastic, which should favor new, more cost-efficient entrants compared to possible non-efficient incumbents. Furthermore, despite the crisis and the declining demand that probably will result, the market can be very lucrative in the long-run (especially if, as a consequence of the crisis, the non-efficient incumbents are forced out of the markets).

Finland witnessed a very severe economic crisis in the early 1990's. During 1990-1993 the GDP fell by 13 percent, and the unemployment rate rose from 3.5 percent to 20 percent.[6] Interestingly, Finnish competition law was tightened in the middle of the crisis.[7] Despite this perhaps quite radical approach, advocacy was also a very important tool and area of action of the Finnish competition authority during the crisis.[8]

At the same time, as demand collapsed there was a clear development of concentration in several sectors of the economy. However, as the crisis began to release its grip and the recovery started to speed up, several new foreign entrants started to establish branches in Finland. This happened in a number of markets, including banking, construction, and the retail trade. Interestingly, these three sectors are often considered to be high sunk-cost businesses for new entrants. Another interesting point is that the majority of entrants entered from Sweden, which also quite recently had experienced a severe economic downturn.

As for the new entries in banking during the Finnish crisis, new entrants brought fresh liquidity into the markets and, very likely, supported the recovery of the economy. Given that the Finnish banking sector was heavily concentrated during, and as a result of, the economic crisis, these new banking entrants were naturally much welcomed in terms of competition as well.

As regards the construction sector, one new Swedish entrant quite rapidly gained a relatively robust market position in Finland. The nature of the construction market as a typical bidding market certainly contributed to their successful entry.

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[6] For more details of the Finnish and Swedish crisis, of the latest studies *see, for instance,* Jonung-Kiander-Vartia, *The Great Financial Crisis in Finland and Sweden,* European Commission, Economic and Financial Affairs, Economic Papers 350, (2008).

[7] *E.g.*, unlike during the Great Depression of the United States. *See, for instance*, Shapiro, *Competition Policy in Distressed Industries*, ABA Antitrust Symposium (May 13, 2009) and Frankena-Pautler, *Antitrust Policies for Declining Industries*, Federal Trade Commission, Bureau of Economics, p. 72-75, (1985).

[8] As for the importance of advocacy in the current crisis, *see, for instance*, Fingleton, *Competition in Troubled Times*, Office of Fair Trading (UK) (January 2009).

Moreover, although construction is often seen as a high sunk-cost industry for an entrant, there were plenty of skillful workers available after the crisis and, especially concerning the housing market, due to the long recession there was considerable amount of piled-up demand that the new entrant was able to satisfy. The situation was very lucrative for new foreign entrants.

V. CONCLUSIONS

Many countries have introduced and developed modern competition rules as late as from the 1990's onwards. Simultaneously, in many countries, economies have experienced a constant upward slope in growth. Perhaps for this reason, the competition law reforms have gained acceptance easily, without major objections from various stakeholders of the economy. The continuing positive economic cycle may have helped to gradually strengthen the competition regime and its enforcement. Now, during this crisis, the acceptance of the objectives of a modern competition regulation can be in its first real test.

If and when competition represents the microeconomic side of economic thinking, and fiscal policy with stimulus schemes the macroeconomic one, it is worth stressing that this crisis is not the first time these policies seek to find common ground. One of the central ideas of, for instance, the new Keynesian school has been to analyze how market imperfections with "sticky prices," including imperfect market competition, affect economic shocks. This crisis will certainly be a source for new important research in this respect.

There are arguments claiming that an economic crisis requires policy-makers to loosen competition enforcement standards. However, even in an economic crisis, it is important that economies maintain their dynamics and vitality.

This article argues that competition can be an important ally in ensuring that stimulus packages have the maximum stimulating effects needed to kick-off the recovery. Therefore, competition can play a relevant role to ensure that the recovery will ultimately take place, and help economies on the way back to produce normally functioning markets. As such, competition and competition authorities can be important allies with stimulus scheme enforcers.

Ultimately, the question is not about competition policy, but merely of the nation's economic strategy as a whole. For this reason, addressing the question of a crisis period competition policy is almost unavoidable for those responsible for the economic policy in general.