Autoriteit Consument & Markt

InSight 2017

The strengths of government and the market

The Netherlands Authority for Consumers and Markets (ACM) is an ardent advocate for making full use of the strengths of the market *and* the government. In this year's edition of InSight, we will present you several examples showing what the strengths of the market are, and how markets are able to safeguard public interests. We also indicate the areas where markets are not up to the task. That is where the government has a clear role. In this edition of InSight, ACM makes three recommendations on how to make full use of the strengths of government and the market. All three of these recommendations fall under the heading of 'high trust, high penalty':

1. Create trust by offering clarity about the rules;
2. Offer more latitude for individual responsibility;
3. Take advantage of that trust, but monitor the outcome.

As long as the government sets the boundaries, making effective use of the market can benefit consumers and public interests.

Opportunities and options for businesses and consumers

In a lot of markets, consumers are able to decide for themselves what products and services they wish to purchase, and what they are willing to pay for them. Businesses vying for the customer's attention will introduce innovative products and services at as little cost as possible. That is the strength of the market.

There are also situations where society believes that everyone should have the opportunity to take out a certain product or service at a reasonable price. This applies to, for example, health care, public transport, energy, postal services, and telecom. If these services were left to the market to provide, they would not be provided automatically or for everyone. That is why the government safeguards the public interests in these sectors through laws and regulations. That is the strength of the government.

The right mix between market and government: a matter of customization

Widely different opinions about the roles that government and the market should play are put forward in the public debate on this topic. Sometimes, the market is rejected because the outcome does not automatically meet society's needs. On the other hand, sometimes any government intervention is seen as undesirable because it would do more harm than good. In the real world, however, that contrast is slightly more nuanced, and various hybrid forms are possible. The question is what combination of government and market will ensure that the many interests of society are well protected: products and services of high quality at affordable prices, sustainability, solidarity, and many other public interests. And, some of these interests are also at odds with each other.

What is the right mix between market and government? That varies in each case, and changes over time because of social preferences and technological advances[1]. Finding the right balance is often a learning process. The discussions about government and the market are not about how, say, the market for peanut butter functions. In that example, freedom of choice, fair prices, opportunities for businesses, consumers, and innovation are all the result of the free-market process. It is obvious to leave the market process alone in that situation. However, no market is completely free of government intervention. Think for example of requirements regarding, and oversight of, workplace conditions, product safety, and the environment. Yet, sometimes it is not enough to put in place such preconditions. Sometimes it is desirable, by using taxes, subsidies and/or regulation, to change market incentives, to correct market outcomes, or for the government to take on an active role.

As a market authority, ACM is charged with the enforcement of compliance with the rules that protect consumers against misleading and unfair commercial practices. ACM is also charged with the enforcement of compliance with the rules that are needed to make sure the competitive process takes place in a fair manner, and with the rules that have been imposed on a number of specific sectors in order to guide the market process. Whether it is about rail, telecom, energy, health care or the data-driven economy: politicians ask a lot from regulators. For their part, market participants and regulators need clear rules from lawmakers.

The benefits and costs of competition

Consumers are central to ACM's thinking. The key benefit of having competitive markets is the fact that consumers are able to choose the product or service that satisfies their needs best. The underlying idea behind introducing competition, including in public or semi-public sectors, is that people make choices based on needs and prices. That principle holds true for the peanut butter market but also for products that the government believes should be available for everyone such as health care and public transport. Many studies have demonstrated the positive effects of competition.[2] Productivity levels rise, more jobs are created, and there is more innovation. In the energy and telecom markets, too, competition has positive effects. For example, an average household today pays 30% less on its energy bill than it did in 2006. And, since 2004, over half of all energy consumers have switched providers or have switched contracts with the same provider. In the telecom market, one in five consumers over the past three years switched carriers. Yet, such benefits do not tell the entire story, as competition also demands something in return from society.

Because of competition, some businesses are more successful than other firms. The futures of workers in a shrinking industry will be far less secure than those of workers in growing industries. That is why it is critical to have a robust social welfare system. But paying attention to career development programs and retraining programs will also reduce people's concerns over uncertain futures.

Eliminating competition is not the solution
Competition may lead to inequality. Think of inequality between businesses and employees that score better than businesses that are in trouble. Or think of inequality between well-informed consumers and consumers that have been badly informed. In order to maintain public support, it is critical that everyone is able to reap the benefits that competition produces. If competition were eliminated, the pie may be shared equally, but it would be a smaller pie than before. And what is disheartening to see is that vulnerable consumers and employees in particular will then suffer the most from higher prices and higher unemployment in the country.

[1] *Maatschappij niet klaar voor digitale samenleving,* Rathenau Institute, 9 February 2017, https://www.rathenau.nl/nl/nieuws/maatschappij-niet-klaar-voor-digitale-samenleving
[2] *Factsheet on how competition policy affects macro-economic outcomes,* OECD, October 2014

Double the costs are not always a waste of money
Another consequence of competition is a waste of financial resources since it means that the sector as a whole sometimes pays twice. For example, it is not particularly useful to build multiple grids or natural-gas networks. Such infrastructures costs billions of euros, and all services can be offered over a single infrastructure anyway. At first glance, this does seem to be the case with fixed telecom networks as well. However, it turns out that the Netherlands, with two full-fledged telecom networks, has more effective competition in comparison with countries with just a single network. Prices are lower, investments are rolled out much sooner, and quality is higher.[3] The argument that competition leads to higher expenditures because of double the costs must be weighed against the benefits of competition. Therefore, the market plays a different role in energy than it does in telecom.

Cooperation, public interests, and the government's role

Market participants can play a role in the process of fleshing out public interests. They can do so of their own volition or with support from the government. The government increasingly lets businesses launch initiatives. These may require cooperation among businesses. It is not allowed to make arrangements that restrict competition. Such arrangements may fall within the boundaries of what is allowed under the Dutch Competition Act only if they produce sufficient benefits for consumers in other areas such as quality or sustainability.

Cooperation is allowed as long as consumers and competition are not harmed
Cooperation and competition do not necessarily always clash. Businesses only add value in a market if they offer products or services that consumers actually want to buy. To that end, businesses conduct market research into the needs of customers. They subsequently work with suppliers and all kinds of parties who wish to help those businesses sell their products or services.

Working together with customers or suppliers is different from collaborating with direct competitors. In the latter case, there is a higher risk of consumers being harmed by, for example, market-sharing arrangements or price-fixing agreements. A critical eye is thus required.

Competitors are allowed to make arrangements such as environmentally-friendly arrangements. Such arrangements are only permitted if studies reveal that the positive effects of such an arrangement on the environment are greater than the price increase it causes. If this is the case, the arrangement in question would not necessarily conflict with the rules that prohibit restriction of competition between businesses.[4] Over the past few years, for example, ACM has looked into various arrangements including ones on energy-neutral housing renovations, on livestock farming and antibiotic resistance, and on boar castration without anesthesia, and has ruled that these are permitted (in whole or in part) from a competition-law perspective. In those decisions, ACM followed the basic principles laid down in its Vision document on Competition and Sustainability[5] and in the central government's policy rule[6].

In the past, ACM has been critical of collaborations where the positive effects on the environment for

[3] Europe's Digital Progress Report 2016: Connectivity, European Commission
[4] As tested in the coal case: https://www.acm.nl/en/publications/publication/12046/ACM-deal-over-closing-down-coal-power-plants-harms-consumers/
[5] https://www.acm.nl/en/publications/publication/13077/Vision-document-on-Competition-and-Sustainability/
[6] 2016 Policy rule on competition and sustainability, http://wetten.overheid.nl/BWBR0038583/2016-10-06 (in Dutch). For the 2014 version in English: https://www.acm.nl/en/publications/publication/13077/Vision-document-on-Competition-and-Sustainability/ (under attachments).

consumers did not offset the drawback of reduced competition. In most cases, the companies involved would then choose to go at it alone, independent from the others (such as with the so-called ‘Chicken of Tomorrow,’ which involved chicken meat produced under enhanced animal welfare-friendly conditions), or the government would introduce relevant legislation because it considered it to be desirable from a broader social perspective (such as with the closure of coal-fired power plants).

Competition and solidarity can also go hand in hand
As a result of the market process, consumer needs become central, as long as consumers are willing and able to pay the associated costs. If those costs are not the same for everybody, it could lead to an undesirable market outcome. In the health insurance market for example, solidarity plays a major role when determining the level of competition. If health insurers were to be able to compete without any oversight, they would have a strong incentive to have unhealthy consumers pay more for their insurances than healthy consumers. That is not solidarity. That is why we have an individual health insurance mandate in the Netherlands.

In other sectors, too, where there is no market incentive to serve expensive or vulnerable consumers at the same price, unregulated competition will eventually eat away at solidarity. That is why a universal service obligation has been imposed in public transport, telecom and postal services in order to protect vulnerable consumers. Everyone should be able to ride a bus or train at a reasonable price, or be able to get a phone number, or be able to send and receive letters, even if you live in a remote area. Additional legislation to ensure competition does not run off the rails is often put in place in sectors where lawmakers have explicitly set solidarity with vulnerable groups of consumers as an objective. However, drawing the line between solidarity and where the market can do its thing is a political choice, one that needs to be made very carefully.

The government may introduce temporary measures in order to stimulate innovation
In some situations, the government may take on a role themselves in the market process, for example, if the market does not address a public interest in the short term. For instance, power storage may eliminate the need for upgrading the grid at a local level. That can have a positive effect. But if distribution system operators are consequently allowed to store power, it may prevent the creation of a commercial market for storage services. In the longer term, that may have enormous negative consequences. That is why ACM believes that sometimes the government could give the market a boost (albeit a temporary one) in order to get the market going. That will keep in place the incentive for the corporate sector to spur innovation[7]. For example, ACM has found that, at this moment, many initiatives in the market for storage services are already being developed, and that system operators are able to purchase these services in order to optimize their system management. From that perspective, it is thus not necessary to give the market a temporary boost.

When deciding between the government stepping in or leaving it to the market, the problem is that the long-term effects are often difficult to foresee. We may be talking about innovative products and services that we currently do not know yet, and that are made by market participants that possibly do not even currently exist: concrete evidence is thus lacking (still). Without any evidence, people quickly make the assumption that no drawback exists either. Yet, the contrary is often the case.

Various innovations in the past have shown that it is crucial to combine the best of both worlds, and to avoid

[7] ACM’s position on the division of roles in the energy transition:
https://www.acm.nl/en/publications/publication/16898/Give-the-market-the-opportunity-to-function-properly-in-the-energy-transition/

putting all the eggs in either the government's basket or the market's basket. Mazzucato[8] demonstrates that, for example, the development of the iconic iPhone was actually made possible by early investments made by the US government. The same holds true for various other innovations in the pharmaceutical industry, the biotechnology and nanotechnology industries, and the agriculture and food industry.

Finding the balance between government and market that is effective: three recommendations

The call for finding a balance between government and the market that is effective is not new. The question is what 'effective' means in this context. With what guidelines can the market's strengths be taken advantage of more effectively? We put forward three recommendations for making better use of the strengths of both the government and the market. All three of these recommendations fall under the heading of 'high trust, high penalty'.

Create trust by offering clarity about the rules
In order to make use of the market's strengths, you need trust. Trust is the foundation on which the economy is built. It makes market participants collaborate with one another, and makes them prepared to take risks. And it also prevents market participants from being needlessly exposed to rules and regulation.

When operating in complex environments, businesses will function best if they are given clarity about the rules in advance. That clarity begins with regulators providing clear information about the standards that need to be complied with, and that businesses can be held accountable for. ACM recently did just that in the ports sector. Another example is the Compliance Charter that ACM drew up in 2014 together with telecom provider KPN. By using its internal checks and balances properly, KPN is thus able to take on its responsibility.

Offer more latitude for individual responsibility
In addition to having clear rules, the nature of those rules is also important. Open standards give market participants more latitude and more responsibility than do detailed regulations. They also offer market participants and regulators better options to deal with changing circumstances in a flexible manner.

One such example is the basic principles for ACM's oversight of primary care. In that document released in 2015, ACM offered latitude to primary-care providers for cooperation in order to improve health care. In these principles, it was agreed upon that ACM would not intervene as long as collaborations were in the interest of patients, they take place in the open, and all parties involved are able to reach a mutually satisfactory agreement. Should complaints arise, the parties to the agreement will first be given the opportunity to adjust their potentially harmful behavior. An interim evaluation has revealed that competition oversight is currently no longer seen as a limiting factor in care-based collaborations.

Another example is the bill on the general applicability of sustainability initiatives[9]. This bill offers more latitude to new developments that take place in society. And it enables collaborations on sustainability to get off the ground sooner and more often.

[8] Mariana Mazzucato (2013), The Entrepreneurial State: debunking public vs. private sector myths, Anthem Press, New York
[9] Letter to the Dutch House of Representatives 'Hoofdlijnen wetsvoorstel algemene gelding duurzaamheidsinitiatieven' (literally in English: 'Outlines of bill on general applicability of sustainability initiatives') https://www.rijksoverheid.nl/documenten/kamerstukken/2016/10/24/kamerbrief-met-hoofdlijnen-wetsvoorstel-algemene-gelding-duurzaamheidsinitiatieven (in Dutch)

Take advantage of that trust, but monitor the outcome
Open standards and clear rules offer market participants freedom. But what would happen if that freedom were not used properly, and abuses took place? Interventions would then be warranted. This is an essential element of ‘high trust, high penalty’. After all, responsibility over negative results of a risky decision should lie with the one that made that decision. If negative results can be passed on to others, sometimes even on taxpayers, it becomes very inviting to take on too much risk. Both the private sector and the public sector should make sure that decision-makers do not take on substantial risks of which they are prepared to accept the positive outcome but not the negative outcome.

In some situations, the ‘penalty’-part of ‘high trust, high penalty’ is not always fully thought out in the Netherlands. When something goes wrong in semi-public organizations, people often call for increased oversight. It remains to be seen whether that is an effective solution. Increased oversight can lead to more red tape, a loss of trust, and a reduced sense of responsibility among the parties involved. Proportional penalties always depend on the context. Sometimes, it is necessary that parties are able to go bankrupt more easily, that the price of a potential bankruptcy is shared more equally among stakeholders, that executives are held accountable for their failures, that performances become more transparent so that naming and shaming can do its job, or that regulators are able to impose appropriate fines.

‘High trust, high penalty’ does not necessarily mean that a lot of high penalties should actually be imposed all the time. The mere threat of high penalties can stimulate both the market and the government to track down and solve problems at an early stage.

Conclusion: making full use of the market is helpful to public interests and consumers

Businesses should be able to compete in a healthy manner. That is how they are able to create innovative products and services, and how consumers will actually have something to choose from. The task of the government is to set the boundaries. For most sectors of the economy, setting those boundaries usually does not go beyond enforcing the rules, including the Dutch Competition Act.

In sectors where public interests are at issue, it is often quite complicated to reap the benefits of the market without harming any public interests. In the public debate, an argument is sometimes made for pushing back the role of the market in such sectors. But such an argument ignores the possibility that the government could just as easily fail in those markets. And sometimes the image is created that services that the government provides are for free. That is obviously a misconception.

In order to make full use of the strengths of the market and the government, the principle of ‘high trust, high penalty’ must be applied consistently. As a result thereof, trust is offered to the market, full use of the freedom is made, and the social costs of abuses are limited.

The strengths of competition remain underutilized if the market is completely eliminated. In virtually all semi-public sectors, the market is able to play a useful role, although that role may vary in each individual situation. As long as the government sets the boundaries, making full use of the market is helpful to public interests and consumers.