Tenth CEPR/EAERE Webinar on Climate Policy
Competition and Sustainability:
On proposals to relax competition policy to promote Green Deal Objectives

25 October 2022 - 05:00-06:30 CET – Online

For the Tenth CEPR/EAERE Webinar on Climate Policy, Till Requate (University of Kiel) gave a presentation on Do we need green competition policy?, Maarten Pieter Schinkel (University of Amsterdam) on Methods and rules protecting competition to promote sustainability and Roman Inderst (University of Frankfurt and CEPR) on Incorporating Sustainability Benefits in Competition Analysis. Their presentations were followed by a discussion on the effectiveness of competition policy involving sustainability issues, moderated by Marc Ivaldi (Toulouse School of Economics, EHESS and CEPR) and a Q&A session with the audience.

Panellists:

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Moderator:

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Key Points of the Webinar

The European Commission (EC) recently published Draft Horizontal Guidelines (DHG) aiming to give a legal playing field for the assessment of horizontal cooperation agreements. The latter are prohibited by the article 101.1 of the Treaty on the Functioning of the European Union (TFEU), except if they consider the promotion of competition and contribution to consumers welfare, with the condition that there are no restrictions in the agreement which are indispensable.

Chapter 9 of the guidelines is devoted to agreements pursuing sustainability objectives, which notably include addressing climate change, eliminating pollution, limiting the use of natural resources, respecting human rights, fostering resilient infrastructure and innovation, reducing food waste, facilitating a shift to healthy and nutritious food, and ensuring animal welfare. The rationale of the agreement is to respond to some residual market failures that are not addressed by regulatory or public policies. It aims to avoid excessive assessments and provide legal security and stability by defining *safe harbour* and conditions that need to be satisfied so that agreements, a priori prohibited, can be accepted without an evaluation. One example given by the EC is to allow firms to share data on whether and which suppliers adhere to certain standards, which should greatly reduce compliance costs. In some cases, if going beyond the *safe harbour*, an assessment is needed, and four elements need to be satisfied for an agreement to be approved: it must raise efficiency gains which need to be documented and substantiated by firms and entities; it must be indispensable to overcome "first mover disadvantages"; the gain needs to be passed on the consumers—either there is a willingness to pay for this sustainable objective or there will be a collective benefit—and finally, the agreement shall not eliminate competition.

The questions raised by the draft are the following: can competition promote sustainability? What is the economic foundation of the guidelines? Will the EU law be more efficient or effective with the guidelines?

- ### Relationships between imperfect markets and sustainability

  - #### Market structures and environmental policies

The Pigouvian paradigm teaches us that, if a market is competitive, a tax on externalities (or a corresponding quantity instrument) leads to the first best outcome, given that the tax is set at the right level to reflect the marginal damage. Market imperfections through imperfect competition, by contrast, should be addressed by competition policy as far as possible.

The European Commissioner for Competition, Mrs Margaret Vestager, stressed in a speech on September 20th, 2022, that: "*The starting point here is that a green competition policy still has to be - well, a competition policy... and environmental taxes and rules makes it expensive for companies to operate in ways that harm the planet.*" This statement expresses the spirit of the *Tinbergen rule,* which states that each market imperfection should have a suitable instrument. In this context, this would mean that competition policy instruments should deal with competition policy and environmental policy tools to internalise externalities. The first person to discuss market structures and environmental policies was Buchanan. He criticised the *Pigouvian paradigm* in when there is imperfect competition because a monopolist produces too little and thus pollutes less than firms in competition. Solow further extended this analysis to the exploitation of renewal resources by stating that monopolists exploit resources slower than competitive markets. A second-best analysis has been carried by Barnet, who shows that for a monopolist, the emission taxes fall short of marginal damage. This result extends to many other kinds of imperfectly competitive market structures; typical the second-best tax is smaller than marginal damages. This means that we can adapt our environmental policy gradually to the market structure in a second-best way. The question is whether the converse holds: can more lenient competition policy compensate for too lenient environmental policy? As an example, in the case of abuse of a dominant position, one can show theoretically that when emissions taxes are too low, a regulator should allow for a great price cap to regulate a monopolist. By contrast, the welfare effects of horizontal agreements prior to price competition for clients are ambiguous.

- Remaining uncertainties on competition and sustainability policy

The article 101 (3) allows for horizontal agreements if the benefits to consumers are as least as large as the anti-competitive effects. The draft of the new guidelines tries to extend the field of applications to horizontal agreements on sustainability issues and tries to reduce negative externalities. The guidelines give guidance on how to measure such benefits, but still stress that the benefits must accrue to the consumers that are currently living. Strictly speaking, the guidelines rule out horizontal agreements that benefit future generations only, as they cannot directly benefit.

Mrs Vestager furthermore stated in her speech that "*The third kind of benefit comes when an agreement helps the society as a whole – like an agreement to cut the pollution or carbon emissions from a product. Of course, those benefits are welcome. The trouble is that to get a better environment for everyone, a limited number of consumers has to pay more. And that could mean those agreements contradict a fundamental principle of the competition rules – the principle that restricting competition for a product can only be justified if the consumers of that product are not worse off the balance.*" This raises the question of the need to extend benefits through **greenhouse gases (GHG) emission** reductions. However, ubiquitous pollutants such GHGs can be much better addressed by simple instruments, such as taxes and tradable permits. Furthermore, unilateral agreements by firms may increase total abatement costs without lowering total emissions, in particular if regulated by the EU-ETS.

Regarding **merger control**, all criteria applied to weighing benefits against anti-competitive effects should also be applied to horizontal mergers. However, in contrast to national merger control such as in Germany, the European Merger Control Directive does not allow for this. A change should be considered here, and not only for mergers in the name of improving the environment.

Mrs Vestager also addressed in this speech the problem of **killer acquisitions** by stating that: *"I sympathise with the worry that big businesses could buy up green innovators and kill their new ideas, while those companies are still too small for the mergers to have to be notified.*" However, the problem of killer acquisitions is a general one not only applying to green innovations.

The same applied to **state aid**, and Vestager declared in that regard "*We consulted on a set of draft guidelines on state aid for climate, energy, and the environment... Those new rules will vastly expand the scope for using state aid to help reach the goals of the Green Dea*l." However, the new rules should expand the scope in general, notably to key technologies and break through innovations, and not only to sustainable projects.

Finally, there can also be issues with **vertical agreements** that are anti-competitive (e.g., exclusive dealing), but may be justified, for example by excluding dealers that supply unsustainable pre-products. Similar guidelines need to be developed for such cases.

Methods and rules to protect competition and promote sustainability

Cases in the Netherlands

Back in 2013, the Netherlands already dealt with the balancing of a possible exemption under its national version of article 101.1. This arose in the setting of an agreement between many parties in the country to move towards more sustainable ways to produce electricity. The electricity companies' part of the negotiations jointly agreed to close their coal-fired electricity plants or to do so within five years, thereby reducing capacity to produce electricity by 10% in the Netherlands. The Dutch Competition Authority considered that this agreement was a potential violation of the competition law and of the antitrust cartel prohibition. The authority stated that even if there were benefits, they were insufficient to allow an exemption. This agreement would have indeed increased electricity prices in the Netherlands by a value of EUR 75 million a year, whereas the environmental value of the reduction of fine particles emissions and CO_2, claimed because of the agreement, would only have been only EUR 30 million a year. This rather low number is explained by the fact that the coal-fired plants would float their emissions rights or buy them on the European ETS.

A second case in the Netherlands concerns an agreement formed in 2015 by poultry farmers in response to the poor feeding conditions of chickens pointed out by animal right activists' groups. The Dutch Competition Authority, however, concluded that the agreement was too light: the price of chicken meat would have gone up by EUR 1.46 per kilogram of chicken breast, whereas the Willingness to Pay (WTP) of the consumers for chickens was only EUR 0.80 cents. Consumers were thus not fully compensated, and the agreement considered as not acceptable under article 101.3.

The Authority started developing guidelines, which are still floated, to indicate on which grounds it would be able to agree for a change. It developed an interesting and revolutionary approach regarding environmental damages agreements and believes that the benefits are not merely to the users, but that others' benefit should also be considered. In other words, consumers might be harmed by the agreement, but if there are others who are benefiting in a compensating way, it shall be added to the balance and there can be a decision to allow a horizontal agreement. An example of a positive case the authority recently accepted is an agreement between Shell and Total to jointly set up a programme to pump CO_2 in empty North Sea gas fields. The investments would only take place if the two companies worked together, and they would only collude if they coordinated on 20% of the price. Getting the project off the ground was necessary, according to the Authority, as the benefits that society would gain would be more than the cost of restriction of the competition.

Risks of Green Antitrust

The essence of what we are observing in these cases is a potential conflict between sustainability and competition. The idea is that restricting competition will stimulate sustainability initiatives. It is not about restricting output in a *Buchanan* second-best kind of logic, stating that reducing externalities is simply done by reducing output. Agreements are supposed to be about the sustainability and expressly not about prices and quantities. Furthermore, it does not concern R&D, because exemption clauses exist on that topic., nor new ways of greening, but rather about implementing existing ways to filter and have greener production (E.G., close coal-fired plans).

One important question is whether we should really expect companies to take more Corporate Social Responsibility (CSR) in cooperation than in competition. Most of the literature shows that CSR is likely to have a competition dimension or to be something driven by the shareholders, owners, or activist CEOs. Furthermore, literature in the 2000s, which looked at voluntary collaboration in this domain before environmental purposes, shows that these voluntary collaborations have been essentially failures. Using a semi-collusion model - looking at coordination on the green dimension, not on the competition dimension ,quantities or prices - Spiegel and Schinkel show that companies will actually invest the least in sustainability if they can coordinate about the sustainability dimension and invest the most if they can coordinate about prices or quantities. Nothing happens if the WTP is zero or negative but, for any positive willingness, sustainability investments are the lowest if you allow companies to coordinate their sustainability level. This result is explained by the fact that CSR is a dimension of competition policy. It is costly to produce more responsibly, but it attracts customers. Coordination limits this competitive drive. On the contrary, production agreements will increase CSR efforts, but will steeply decrease consumer welfare.

Furthermore, two risks need to be highlighted on why green antitrust can be counterproductive. First, as in the coal case in the Netherlands in 2015, we may observe cartel greenwashing with maximum price increase for minimal green impact. To respond to this, the competition authority would need to constantly monitor a green collaboration, with prohibitively large information requirements. Secondly, green antitrust can provide further excuse for continued government failure, which shifts responsibility towards collaborative self-regulation, whereas public policy is easily superior - regulation, taxes, subsidies.

In its guidelines, the EC clearly states that the consumers should receive a *"fair share of the benefits when the benefits deriving from the agreement outweigh the harm caused by the same agreement, so the overall effect on consumers in the relevant market is at least neutral.*" It also states that it shall be about actual preferences of consumers and not about preferences companies believe the consumers might have. Finally, only one article in the guidelines mentions "first mover disadvantages", in stating that there might be cases where the sustainability benefits cannot be achieved if left to the free interplay of market forces. The actual disadvantages are not very well defined but seem to be thought of as a situation where an individual firm would benefit too little to take the hurdle and invest in the green product alone, while others will benefit somehow. It results in a competitive stand-off that collaboration would help to overcome. However, literature highlights that it must be more than that, and that sustainability investments are the lowest under CSR. There is a need for spill overs: if efforts by one firm largely benefit other firms and leads to an equilibrium, collaboration would lead to investment. However, one may wonder why it would be the case that the initiating company would not itself benefit enough, and that other companies will benefit more or that the original company will be stuck with losses.
Furthermore, we may also wonder if one can expect a stable coalition to form for these public goods, as companies will have a shirking or free riding incentives in their cartel.

- **Incorporating Sustainability Benefits in Competition Analysis**

  - **Evolutions and opportunities of the Draft Horizontal Guidelines (DHG)**

The possible incorporation of sustainability benefits raises many questions. The discussion is far from being purely academic, as shown by both the publication of guidelines on the topic by various authorities and changes in the law, such as in Austria, where ecological benefits are now explicitly recognised in the competition law. The EU DHG are developing a new, separate section on sustainability, which is defined very broadly, also including explicit reference to human rights and animal welfare. However, examples are mainly framed in the context of externalities avoidance with explicit reference to market failures - not already addressed by regulation - as a key component of sustainability agreements' efficiency. Another part of the guidelines importantly looks at agreements that do not raise competition concerns, or where there is a soft *safe harbour* (e.g., those related to the creation of a database about sustainable suppliers or distributors).

Concerning agreements that do not fall in these categories, it raises the questions of their assessment. Two important aspects to consider are efficiency and indispensability. With regard to efficiency, any benefits that are accounted for, even within a sustainability agreement, must be explicit and always "*objective, concrete and verifiable.*" The DHG acknowledges explicitly that next to use value benefits, non-use value benefits may be of relevance. With this new focus, new measurement instruments will become appropriate, such as surveys or conjoint analysis. In other words, it is a broader and more explicit concept of efficiencies without a softening of the standards of the Commission. Regarding indispensability, the DHG acknowledges explicitly the "first mover disadvantages" without an agreement, and that a sufficient scale might be needed if the parties don't sufficiently concentrate efforts on the respective standard or label, and, in a more behavioural perspective, that consumers may fail to sufficiently understand or appreciate benefits. The EC seems to recognise new approaches where firms would need to cooperate to reach some efficiencies. More generally, it appears to be more open to the particularity of sustainability.

The DHG also acknowledges "collective benefits," which seem to remain within the consumer welfare standards, with the full compensation as guiding principles. However, benefits that consumers accrue in the same market if other consumers change their behaviour (externality) are acknowledged.

  - **Assessment and measurement**

Taking the hypothetical example of the jointly agreed introduction of new, cleaner fuel phasing out an older one, for which consumers do not have an immediate benefit from, the externalities consumers have on each other is something worth taking into consideration, as a large fraction of citizen are consumers. We will also suppose that the previous attempts to introduce this new sale fuel have failed because of insufficient take-up. To assess this case in terms of efficiency, the first approach from a standard "individualistic" consumer welfare analysis, would be to elicit consumers' WTP for this new product. This could be assessed with tools such as surveys or conjoint analyses. Non-use values may considerably change with the context of elicitation, including consumers' awareness of benefit, information available or social norms. In particular, currently observed purchase behaviour may provide insufficient information. Context specific realisation of WTP is not an artefact but can represent an opportunity to acknowledge consumers' welfare and allow them to express preferences in a wider way. However, one must be careful not to over-expand and to consider a consumer's view, not a citizen view, as well as consumers' specific preferences and not general values. Furthermore, the phrasing of the context is important to introducing energy consumption more explicitly (e.g., by presenting the consumption plan). Hypothetical choice experiments may make obsolete the super-imposition of "true preference," for instance, supposedly not recognized energy saving benefits. On the other hand, the collective consumer welfare analysis keeps the other consumers choice constant but conducts elicitation through scenario changes to assess the welfare of the consumers, not only if they change in behaviour, but also for a change in other consumers' choices. This approach is not new to environmental resources economists but constitutes a radical change for consumer wealth analysis.

In terms of methods and measurement, indirect methods can be used regarding impact on consumers. This includes hedonic pricing methods (in surrogate markets), which measure consumers' averting or defensive expenditures or health impact studies (monetizing increased morbidity risks, etc.). However, such approaches must be applied with great care : WTP for change of consumption of others is not paid up by the consumer; we may also wonder which preferences over consumption of others are legitimate. Furthermore, competition authorities lack instruments for compensation/re- distribution of burden; and finally, prevailing standards are the outcome of a political process, already reflecting collective preferences, including for distribution and fairness, and considering the whole set of available instruments.