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**EUROPE IN GLOBAL,  
INNOVATION-BASED  
COMPETITION:  
MEETING NEW CHALLENGES OR  
SEARCHING FOR NEW  
PROTECTION?**

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## Sommaire

<b>Introduction:</b> .....	<b>2</b>
<b>Session 1:</b>	
<b>Competition in European market and economic performance</b> .....	<b>3</b>
<i>Market integration and competition in European services</i> .....	3
<i>Achieving a level playing field in the EU: some suggestions</i> .....	5
<b>Session 2:</b>	
<b>Innovation policies and industrial policies</b> .....	<b>12</b>
<i>Industrial policy as innovation policy</i> .....	12
<i>EU policies to promote the growth of firms</i> .....	14
<b>Session 3:</b>	
<b>Cross-border mergers and acquisitions</b> .....	<b>19</b>
<i>Introduction</i> .....	19
<i>Financial globalization and the labor market: myths and realities</i> .....	20
<i>Is European M&amp;A regulation protectionist?</i> .....	23
<b>Round table:</b>	
<b>Global competition: a catalyst for growth in Europe?</b> .....	<b>26</b>
<i>Competition: a catalyst for growth in Europe?</i> .....	26
<i>Innovation: a competitiveness factor but also a global resource</i> .....	27
<i>Are there strategic sectors to be protected?</i> .....	27

## Introduction:

### Frédérique Sachwald

Despite the projections, globalization has persisted since the bursting of the Internet bubble and the 9/11 attacks. The rules of the game have changed, assigning a major role to innovation-based competition. New participants have also asserted themselves: the emerging countries are playing an ever greater role in trade. Hence the need for firms to redefine their development strategy. This new scenario entails many changes, such as relocation of production, public-policy emphasis on innovation, and adjustments in national innovation and production systems.

One conclusion is inescapable: the EU15 are heavily specialized in mid-high-tech products, such as automaking and machinery. But—unlike the United States—the EU15's presence remains very modest in high-tech-intensive products and the new information and communication technologies (NICTs).

China, meanwhile, is often portrayed as a menace. Many see China as one of tomorrow's leading technological powers. Yet it is still heavily specialized in low-tech products such as textiles and in the assembly of imported products such as cellphones and television sets. While its high-tech exports appear to be booming, they are largely generated by multinationals operating in the country.

Among the high-income countries, two groups stand out: the first (Japan, Germany, South Korea, China) is highly specialized in manufactured goods, the second (United States, United Kingdom, Spain, Japan, Hong Kong, Switzerland) in services. The countries display different profiles and we observe several specialization profiles, even within Europe. This raises two issues: the strengthening of a single market—particularly in services—and the role of innovation in coping with the new situation. Today's conference will address Europe's position in the new globalization phase. It will look more closely at competition not only at the national level but also at the European level as well as the interactions between these different competition levels.

Our speakers will present the results of their research on these topics in four sessions. The first will focus on EU regulations and the single market, particularly for services. The second will discuss innovation policies and industrial policies. The third is devoted to cross-border mergers and acquisitions. We conclude with a round table that will examine relevant public policies.

## Session 1: Competition in European market and economic performance

### Market integration and competition in European services

**Luis Rubalcaba Bermejo**

*“The substantial role that services can play  
in European integration justifies  
a common regulation.”*

Services are everywhere in European economies. Yesterday, they were sheltered from competition; today, their gradual liberalization has become a key issue in public debate, triggering widespread reactions.

#### **Definition of services**

The three main sectors of the economy, after manufacturing, are public services, services business and real-estate services. Banking and financial services represent a smaller share. Industrial firms use them to improve their competitive advantage (human-resources administration, financial intermediation, etc.). Services therefore contribute to firms' competitive positions in all economic sectors.

Despite this great diversity, services exhibit some common characteristics, the main one being the interaction between supplier and user.

#### **Role of services in growth, and services-market integration**

In the United States, services generate 80% of value added. Some European countries such as Luxembourg, the United Kingdom and the Netherlands will soon match that figure. While many countries are still heavily specialized in manufacturing, one trend is clear: the importance of services in the advanced economies is growing steadily.

The service sector—chiefly business services and public services—is a major source of jobs. Yet services are the target of widespread attacks. Some observers fear that services are curbing economic growth in European countries. Because of the expansion of services, it is argued, the advanced economies tend to grow far more slowly than the developing

countries, whose economies are still based on industry and agriculture. Others criticize the weak innovative capacity of services relative to industry.

An examination of the facts shows that most of these arguments are very often grounded in myth. While some services are indeed characterized by low productivity, they do contribute to innovation and growth in industrial societies—especially in the knowledge sphere. Business services are therefore largely responsible for productivity growth.

### **Policies to foster service growth**

In addition to tourism and transportation, some countries such as the United States and the United Kingdom are leaders in service exports. Meanwhile, India and some countries of Central/Eastern Europe such as Hungary and Romania have made substantial progress in the area.

The lack of a single market for services explains the weak growth in service-sector productivity and innovation capacity in Europe by comparison with the United States. The fragmentation of EU service markets is due both to natural obstacles (such as language) and artificial obstacles. The diversity of service regulations among EU Member States is a tremendous hindrance to service-market integration: for example Spain has more than 600 regulations, most of which differ substantially from those of other Member States.

The many failures of the service market and the critical role that services can play in European integration therefore justify a common regulation. Also, to cope with the relocation threat, Europe needs to be far more competitive and integrated in the service sector. Policy responses to these challenges are vital.

In this connection, the 2004 revision of the Lisbon strategy asserted the importance of services in reaching the goal of a stronger European economy. But the EU still needs to define complementary actions in the area of services, particularly to promote innovation and quality. These policies are essential to improving the effectiveness of regulatory policies.

The European economies are service economies. The EU still has many challenges to meet, notably in terms of innovation, productivity and market integration. In the global context, the EU service market is far too heterogeneous. Europe needs to establish a true internal market for services.

## Achieving a level playing field in the EU: some suggestions

### Onno Brouwer's speech

#### A. INTRODUCTION

1. I would like to start my contribution with a reference to Joseph Schumpeter, who stated over eighty years ago that entrepreneurs and not Governments lead innovation and technological change. As many other statements made by Joseph Schumpeter, this statement is still true today. The innovation drive of entrepreneurs makes economies work and improve their functioning.

2. In markets characterised by Schumpeterian competition, entrepreneurs with innovative ideas can contest the market position of established companies. This in turn spurs competitors to also launch innovation initiatives and creates general welfare. This is the process which Schumpeter coined "the process of creative destruction".

3. There is an important link between innovation and the opening of markets in Europe. The creation of a "level playing field" is crucial to achieve the opening up of European markets and allow for Schumpeterian competition.

4. A "level playing field" relates to a state of equality or equal opportunity. In the context of EU policy-making, this means that European companies must be able to compete on an equal level and with equal opportunities throughout the EU. The rules of the game must be clear and equal, and the rules must not be changed in the middle of the game.

5. In practical terms, a "level playing field" implies that laws and regulations of the EU and EU Member States must be applied in an identical manner to all companies, be they national companies or companies from other Member States. It also means that public authorities that enforce European or national rules do not favour national companies over companies from other Member States. These authorities must apply the same criteria when taking their decisions, using the same procedures and within the same time limits, for all European companies.

6. A level playing field in Europe allows entrepreneurs to launch their innovative ideas across European markets. The creation of a level playing field is therefore at the heart of the debate that we are having today on competition in European markets.

7. The existence of a "level playing field" is therefore not surprisingly one of the cornerstones of the EU's internal market and the EU has identified the completion of the internal market as "a crucial building block" to improve Europe's overall business development. The realisation of the internal market is key to complete the Lisbon Agenda to improve the EU's competitiveness and innovation strength.

## The EU's actions in creating a level playing field

8. The EU's actions in creating cross-border competition and a level playing field do so far include the following.

- ***First, the liberalisation of sectors of the EU's economy***

9. The EU continues to set further steps in the liberalisation of strategic sectors of its Member State economies such as the energy, telecommunications and banking sectors. The efforts so far have dismantled former national monopolies and should offer companies from other Member States the opportunity to compete with them.

- ***Second, the enforcement of the EU's internal market and competition rules***

10. It is important in this respect that Member States have to notify national legislation that can pose obstacles to trade between Member States to the Commission. This includes legislation imposing products standards and other product requirements. The Commission can ultimately take Member States before the Court of Justice in Luxembourg when their legislation does impede cross-border trade in the EU. It should be noted in this context that EU procedures to challenge obstacles to trade must be more efficient.

11. The competition rules, if applied correctly and consistently, can also significantly contribute to the creation of a level playing field. The Commission can initiate antitrust proceedings against companies that use anticompetitive practices to shield off their markets from foreign competition.

- ***Third, the adoption of common standards***

12. Common European standards for products and services can ensure that companies only have to abide by one set of rules to become active in all 25 Member State markets]

- ***Finally, tax harmonisation***

13. Harmonisation of the Member State tax systems can help to avoid that these systems favour national companies over companies from other Member States and it is necessary to reduce the negative effects which co-existing national tax systems can have on market integration.

14. Nowadays, however, there are significant challenges.

## Challenges to uphold the benefits of a level playing field

15. Although much has already been achieved, the European Union currently faces major challenges to uphold the benefits of a level playing field in Europe. On the occasion of its mid term policy review the Barroso Commission qualified the internal market and the

preservation of a stable level playing field in Europe as its "most immediate policy challenge." These challenges include the following.

***First: Member State opposition to foreign takeovers***

16. In a number of high-profile merger cases, cross-border European mergers have faced increased resistance from national governments and we have also witnessed attitudes from national industries one should worry about.

17. It is long established that the European Commission has the exclusive competence to assess the competition effects of big pan-European mergers. Yet, national governments have recently challenged this competence.

18. Within days of the announcement that German group E.ON planned to acquire Spanish utility Endesa, the Spanish government issued a decree giving its national regulator power to veto. It is generally believed that the Spanish government favours a takeover of Endesa by Spanish counterpart Gas Natural.

19. In another case, the Commission cleared the bank merger between Unicredito from Italy and HVB from Germany. The Polish government opposed the merger between Unicredito and HVB's Polish subsidiaries. It indicated that the Commission wrongly assessed the impact of the merger on the Polish market and employment in Poland. Ultimately, the Parties struck a deal with the Polish government selling of some branches and the brand name of BPH.

20. In the end, opposition from national governments can be lethal for competition. The merger between Albertis and Autostrade would have created the biggest toll road operator in the world. The deal however faced fierce opposition from the Italian transport regulator and various Italian ministries. In the face of this opposition, Albertis and Autostrade ultimately decided to put their transaction on ice. The European Commission had given the green light for the transaction and had even tried to take legal action against the Italian authorities that blocked the deal.

21. It is clear that protectionist interventions are not only harmful for the parties involved in a specific transaction. Political opposition to European takeovers can raise suspicions on future entries into the markets in question.

***Second: political rhetoric weakens the case for a level playing field***

22. A striking development along the same line is that some national politicians present nowadays opposition to market integration in a positive light without even mentioning their obligations under the EU Treaties.

23. Dominique de Villepin, France's Prime Minister, stated in July 2005 that "When the world is changing, it is a question of our strengths...and defending France and other things French."

24. Lech Kaczynski, the populist Polish president, put it even more bluntly by stating that “What interests the Poles in the future of Poland is the future of Poland and not that of the EU”.

25. There is no need to say that such political rhetoric undermines the public support for the EU’s internal market and the “No” vote against the European Constitution does not come as a surprise in such context.

26. It is of course not only politicians adopting political rhetoric. Antoine Riboud, founder of Danone, used to say that “Danone is like the cathedral of Chartres, and one does not buy the Chartres cathedral”.

27. In such environment, the EU is increasingly facing difficulties in pushing through major pieces of EU legislation that are aimed to create a level playing field in the EU.

28. The Commission’s proposal for a Services Directive is a case in point. That Directive would have opened up a big part of the European economies to competition and innovation. The Commission’s proposal was however watered down substantially in the face of opposition from Member States and of Members of the European Parliament. The image of the Polish plumber and nurse entering other European markets against low wages that national politicians created, has fed the opposition against the Services Directive. Similarly, a European Directive to facilitate crossborder takeovers and mergers has also been watered down.

***Third, there seems an increasing reluctance of Member State to comply with EU legislation***

29. A further challenge is posed by Member States that omit to abide by EU legislation that is key to creating a level playing field. The EU is increasingly confronted with this problem.

30. This requires a continuous vigilance of market actors and the Commission. Examples of legislation being ignored are manifold. In April 2006, the Commission took all Member States except the Netherlands before the Court of Justice in Luxembourg for not meeting their energy market obligations. These Member States failed to implement EU legislation that aims to open up their gas and electricity markets.

31. Another worrying trend is that Member States sometimes knowingly adopt legislation that is in clear violation of EU law. Legislation granting governments golden shares in companies, for example, deters foreign investment and impedes the free movement of capital within the EU. For this reason, the European Court of Justice has consistently prohibited such shares. This does not preclude Member States from refusing to abandon these shares or in fact to introduce new ones.

## **B. SOME SUGGESTIONS**

32. The picture is of course not only gloomy. The opposition of national governments to transactions in sectors in which European cross-border transactions were unthinkable twenty years ago, shows that the EU’s internal market is working. The question is what

needs to be done to continue the process of enhancing competition within the Community. I have a number of suggestions, among which the following.

***Suggestion 1: industry needs to take an ever more active role***

33. Industry has a special responsibility in monitoring that a level playing field in Europe is realised and maintained. It is industry that identifies the obstacles to trade in its day to day practice.

34. Initiatives such as the European Enterprise Institute are important in this regard. This Institute assembles politicians and business and is intended to offer a platform on open and frank dialogue on the state of the European economy.

***Suggestion 2: a vigilant use of existing complaint procedures***

35. The European Commission has wide-ranging powers to enforce the EU's internal market and competition rules. It is absolutely necessary that industry stays vigilant in filing complaints with the Commission and alert members of the European Parliament if protectionism from governments or dominant companies arises.

36. The current framework for lodging complaints with the European Commission needs however to be reviewed. An obvious issue is timing. Industry experience shows that Commission proceedings take too long. The commercial context can have changed dramatically by the time the Commission has finalised its action. Prompt and faster Commission action is indispensable. Member States must politically cooperate to achieve this.

37. Transparency in the Commission proceedings can greatly enhance the prospects of a prompt and adequate response to threats to the integrity of the EU's internal market. The current proceedings for dealing with complaints that Member States have violated EU law, is not transparent. The company that complains that a violation has occurred has no formal role in the process. To a large extent, the process concerns negotiations between the Commission and the Member States that take place behind closed doors. Increased transparency and a greater role of industry complainants in the process can ensure that issues are tackled with in an efficient manner. It can enhance the accountability of the Commission and the Member States in upholding the integrity of the internal market.

***Suggestion 3: better Regulation***

38. If it is established that common regulations at EU level are necessary, it is important to ensure that Community legislation is proportionate and does not leave too much room for different interpretations of Member States. The latter can lead to major barriers to trade.

39. A key initiative is the EU's Better Regulation initiative<sup>1</sup>. The Better Regulation initiative includes a simplification programme for existing legislation and a systematic impact

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<sup>1</sup> Strategic Review of Better Regulation in the European Union, COM(2006) 689 final, 14

assessment every time new legislation is adopted. It also involves improved consultation of industry and other stakeholders and the reduction of administrative burdens. This is done by the EU institutions at a European level, and increasingly also by Member States in the context of their national action plans to enhance the competitiveness of their economies.

40. It is of vital importance that:

- o Regulation achieves clearly stated public policy goals without imposing unreasonable burdens on industry or on consumers

- o Regulation is predictable, clear, unambiguous and enforceable

- o Regulation establishes an environment in which governments can meet their public policy objectives by maintaining fair competition in the market

- o Better regulation can work only if all parties involved in the regulatory process are committed to achieving it. This requires proper consultation and transparency.

A good example of problems that bad legislation can cause is the EU Directive concerning the presentation and sale of tobacco products which was adopted in 2001. It left unclear how business secrets could be protected. It had to do with mandatory reporting of ingredients. Many Member States are prepared to avoid mandatory public reporting of genuine business secrets, but if one of the 27 Member States does not provide that guarantee, the guarantees given by the other 26 are worthless. The industry has since set up extensive consultations to improve the Directive.

41. Recent developments indicate that the Better Regulation Initiative risks being stalled. It is very important to pursue this initiative with great vigilance and that industry insists on this initiative being kept alive.

***Suggestion 4: Community regulations should not stifle innovation***

42. Talking about regulation, It is important to recall that the EU is not operating in a vacuum. The level playing field as of today is very often a global one. Important initiatives of the EU can impact significantly on the competitiveness of the EU in overseas markets.

43. The EU Regulation on Registration and Authorisation of Chemicals (REACH) is a good example. It may have a positive effect on the protection of consumers against important health risks but it is important to guarantee that important overseas markets (such as the US, India, China and Australia) adopt similar protection standards.

44. This example shows the tremendous importance of permanent dialogue between the EU and its trading partners on protection standards in fields such as consumer protection, environment and public health. The German Presidency of the EU has made the economic partnership between the EU and the US (the Transatlantic Initiative) one of its priorities.

45. The German Presidency has also rightfully also identified intellectual property protection as one of the cooperation areas between the EU and the US. This is important, as the EU and the US share an obvious common interest in protecting IP rights in overseas markets.

46. In light of this focus, progress on the European patent is very important to boost innovation in the EU. Unfortunately, progress has stalled because of disagreement among the Member States on the language requirements of patent filings and the ultimate jurisdiction of the Court of Justice. Internal Market Commissioner McGreevy has called upon industry to push their governments to support the patent. This is an important example of the shared responsibility of business and politicians in boosting innovation in Europe.

***Suggestion 5: increase accountability of national politicians and members of EU and national parliaments (dealing with EU affairs)***

47. Finally, an important point to be addressed is the relationship between national parliaments and the relationship between national parliaments and the EU parliament.

48. The suggestion in the proposed European Constitution to give national parliaments a more formal role is to be welcomed. Closer ties between members of national parliament and Members of European Parliament will increase the accountability of national politicians and the accountability of MPs dealing with European affairs.

### **C. CONCLUDING REMARKS**

49. The realisation of a level playing field and the internal market is and remains a priority to enhance innovation and competition in Europe.

50. The challenge posed by the enlarged European Union and the globalised economy call for ever closer consultation of industry and closer cooperation between industry and government.

51. Regulation, be it at EU or at national level, needs to meet the quality standards of Better Regulation. If this cannot be achieved, innovation and competition are harmed.

## Session 2: Innovation policies and industrial policies

### Industrial policy as innovation policy

**James Foreman Peck**

*“One of the goals of industrial policy is to encourage an innovation policy that is efficient and not only effective.”*

Can industrial policy solve Europe’s dilemma? Should industrial policy support the national champions faced with economic change, or support competition to promote future winners? These questions are widely debated. One of the goals of industrial policy is to encourage innovation effectively.

#### **Industrial policies can be counter-productive**

Not all industrial policies are *effective* (a measure is effective when it produces the expected results) and they are seldom *efficient* (a measure is efficient when it yields good results). As a result, they very often have a poor public image. Recent studies challenge both their effectiveness and their efficiency. The “Barcelona” study (Gual and Jodar, 2006) shows that a one-point increase in State aid lifts factor productivity by only 0.76-1.05%. The main cause of industrial-policy inefficiency, the authors argue, is the attitude of administrative officials, who are more concerned with process than with the results obtained. To achieve policies that are efficient and not just effective, these players should adopt the approach of economists, who seek to assess whether public policies yield the expected results.

The issue today, therefore, is to determine how to implement efficient policies, which apply State and public-sector resources so as to obtain a greater social return than if the same resources had been used differently.

## **Why does Europe need an industrial policy?**

Europe unquestionably needs an industrial policy for several reasons. First, manufacturing industries have experienced many relocations to low-wage countries. By comparison with the United States, Europe is therefore less successful in facing the Asian challenge. Second, R&D as well seems to be leaving Europe for the United States and the rest of the world.

European industrial policy does not focus sufficiently on stimulating innovation. No strategic sector has been clearly defined. The Lisbon strategy centered on leveling the playing field by making aid available to all sectors. Much of the additional aid consisted of tax exemptions. At the EU level, the largest share of aid went to the environment and energy, followed by regional development. The R&D share remains fairly modest.

Innovation policy should aim at the commercial exploitation of new ideas as products and processes. It would therefore be well worth creating institutions and supporting R&D in the event of market failure, i.e., particularly in knowledge-based sectors. Yet the ideal scope for conducting an effective innovation policy is not yet clearly defined. A Community Innovation Survey (CIS) study concluded that a firm aided by the State or a decentralized government agency had only a 22% probability of engaging in R&D. As for EU aid, the study found its productivity to be zero. Cooperation with universities seems more useful.

Technical progress is needed to improve living standards and the environment. This notion is therefore an argument in favor of efficient innovation rather than effective innovation. Despite the widespread use of subsidies to support innovation, they may not be genuinely efficient, even though they sometimes produce results. Hence the need to put innovation policy on a firmer footing.

## EU policies to promote the growth of firms

**Emmanuelle Maincent**

*“A rigid industrial structure and the lack of new firms in emerging sectors are the reasons for Europe’s difficulty in facing international competition”*

The debate over industrial policy is often polarized between advocates of greater aid to small businesses and defenders of an interventionist industrial policy to promote industrial champions. The first see EU regulations and administrative costs as the main obstacles to small-business creation. The second see a strong and more resolute industrial policy as the only way to cope with international competition.

The EU Commission tends to promote small firms—notably via the Better Regulation agenda—whereas Member States launch many industrial-policy initiatives and actions to support their national champions.

### **Arguments in favor of supporting industrial champions**

Advocates of support to big firms rely on several arguments. The most common invokes size effects and economies of scale and scope. It is driven by the desire to promote the emergence of European champions. It has influenced the establishment of the single market. A complementary argument is that the knowledge economy and the dissemination of knowledge must now prevail. Public aid is essential where the market has failed. That is the rationale behind France’s large-scale industrial projects launched after the Beffa Report, which stressed the role of large firms in disseminating knowledge and promoting the industrial structure. Defenders of support to big firms believe that the EU should underwrite large-scale projects, which involve heavy coordination costs. The third argument is that large firms exert an agglomeration effect and serve as catalysts for the industrial structure and innovation. Examples are competitiveness clusters which are currently developed in many Member States.

The advocates of support to the high-tech sector claim that the market is not efficient enough to foster the emergence of new sectors. They propose, for example, to reproduce the Airbus model in other sectors such as nanotechnologies and biotechnologies.

## **Weighing these arguments against the reality of Europe's industrial structure**

It is worth comparing the reality of Europe's industrial structure with the arguments of the defenders of a "European champions" policy and active support for high-tech sectors.

### Comparative advantages in medium-technology sectors

Europe's comparative advantages are concentrated in low- and medium-technology sectors, which account for 42% of the EU25's total manufactured exports. While Europe has some comparative advantage in high-knowledge sectors, their export share remains at a modest 28%.

### International champions in traditional sectors

Europe's industrial structure consists essentially of SMEs, or even micro-enterprises. By contrast, large firms make the greatest contribution to European employment and value added, albeit with variations between countries.

Yet the rankings by *Fortune* and *Business Week* show that, unlike the United States, Europe lacks international champions in the new sectors. In European countries, the technological base is generally composed of large firms—often a century or more old. In the United States, the most R&D-intensive firms are smaller than the European average, they are young, and they operate in new sectors.

Moreover, while there are few differences in business creations and mortality between the United States and the European Union, a study by Bartelsman, Scarpetta and Schivardi<sup>2</sup> shows that the main gap lies in business creation and growth. Once they enter the market, U.S. firms grow faster in terms of workforce and size than their EU counterparts.

### A false debate?

This raises an unavoidable question: should we not abandon the manichean debate "for"/"against" large firms? The main reason for Europe's difficulty in coping with international competition would appear to be the rigidity of its industrial structure and the lack of business creations and business growth in new sectors.

## **Role of European policies**

### European Union competencies

At first sight, EU competences seem to be rather limited, but in reality they are quite large. The EU Treaty empowers the Commission in the areas of competition policy, establishment of the internal market, trade policy and spending (through the EU budget).

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<sup>2</sup> "Comparative Analysis of Firm Demographics and Survival: Micro-Level Evidence for the OECD Countries," OECD Economics Department Working Papers 348, OECD Economics Department.

However, it has no specific competency in industrial policy, which is the responsibility of Member States (which was not the case in the former ECSC Treaty). The Treaty's Article 157 declares competitiveness to be the final objective of industrial policies. To this end, the Commission must therefore establish horizontal instruments that do not create distortion between sectors or between firms.

#### What can be done at the EU level

The EU can play a role in promoting competition as well as the emergence and growth of firms. Large firms are not bad for the economy provided they can evolve in a competitive market.

The prerequisite for making European companies more competitive is to achieve the internal market. While great progress has already been made toward market integration in manufacturing, much still needs to be done in energy and services, including financial markets. At the same time, Member States must play a role. This calls for a proper transposition of EU directives in the Member States.

It is also important for EU competition policy to be consistent with trade policies, notably as regards the use of trade-defense instruments which can shelter markets and decrease competitive intensity.

Lastly, R&D policy, which accounts for only 4% of the EU budget, is very inadequate. While an increasing volume of EU structural funds goes toward meeting the Lisbon objectives, the Member States are largely responsible for resource allocation. The main recipient is infrastructure, far ahead of R&D. Moreover, national initiatives are highly fragmented. Many competitiveness clusters have been set up at the behest of Member States. It is very important to rationalize clusters at the European level.

The economic challenges facing the EU are well known, and the responses depend on political decisions. The Member States therefore need to find a common vision.

## Does the return of industrial policy threaten competition policy?

**Simon Evenett**

*“Competition policy and industrial policy are complementary”*

In recent years, industrial policy has taken front stage again. This revival is a sign of a changing political environment. Competition regulations had created a liberalization-friendly environment in the past fifteen years; now, the wind is blowing in the opposite direction. Skepticism about excessive market liberalization is growing. Does the return of industrial policy threaten competitive mechanisms? How severe is the threat?

### **Industrial policy vs. competition policy?**

Industrial policy threatens competition policy. But the threat is not insurmountable and should not be overestimated.

To understand the issue properly, we must clearly define the concept of “industrial policy.” While there is some consensus on industrial-policy objectives and dynamic measures of performance, each country has its own tool for implementing these policies. A United Nations Experts Group has recently conducted a census of these tools: it found about thirty government measures classified as intervention tools (such as raising customs duties). However, some tools hinder competition.

Moreover, competition rights do not mean unbridled competition. A strongly interventionist country may have many competition laws. Competition policy is thus not incompatible with industrial policy. On the contrary, their objectives may converge substantially. The desire to maximize performance in the long run does not conflict with the quest for better resource allocation.

Only three scenarios can threaten the competitive environment:

- when industrial policy is implemented to create national champions and protect them from competitors;
- when governments arrange agreements between firms in the same sector, thus fostering cartelization;
- when subsidies are paid to certain favored firms.

These threats are therefore limited. They must, however, be taken into account by authorities in charge of competition policy.

### **Competition agencies' responses to the rise of industrial policies**

The authorities in charge of competition policy have a very poor image in public opinion. The public sees the agencies as attacking large firms instead of helping them cope with international competition.

They must therefore explain the relevance of their actions.

- They should begin by offering reassurance, stressing the lack of a direct connection between the degree of competition and firm size. Their sole aim is to ensure that the market works properly, not to target big business.
- Thanks to the set of tools at their disposal, competition authorities can also show that industrial-policy measures should target stated goals, and that the best policy measure will be the one that creates the least distortion. The government should therefore consider not one, but several measures to meet its objective. It should use totally transparent assessment criteria and introduce periodic assessments to measure the impact of public policies.
- Competition authorities should explain how their work contributes to industrial-policy goals and, more generally, to economic performance.
- Competition agencies could incorporate some of the goals of governments' industrial policies in the selection criteria for the cases that they will handle. Indeed, the choice of cases is not determined exclusively by the criterion of competition infringement. Other determinants can also be taken into account. However, this is a very delicate issue. In their assessments, the agency and the government may not weight the criteria identically.

Competition policy and industrial policy are not incompatible. But the resurgence of industrial policy is a sign that the political climate is moving toward a less liberal environment. Those who believe in market efficiency have a role to play in crafting an effective industrial policy.

## Session 3: Cross-border mergers and acquisitions

### Introduction

#### **Frédéric Jenny**

This session addresses highly controversial issues in the news: cross-border M&As, competition policy and economic patriotism. The speakers will explore in greater detail some of the questions raised in the previous session. What are the hypotheses formulated by advocates of economic patriotism and industrial policy? Do these visions correspond to reality? Augustin Landier will analyze some preconceived ideas in this area.

In the previous session, Simon Evenett suggested several ways in which competition authorities could bridge the gap between competition-policy and industrial-policy approaches. His final proposal was that competition authorities, rather than leave industrial policy to be implemented by others, should incorporate some of its goals into their own practices and enlarge the criteria with which they analyze anti-competitive behavior.

Nihat Aktas will give a paper that focuses on the reality of European M&A regulation. Can we detect criteria, implicit in the decisions, that are not totally consistent with effectiveness criteria?

## Financial globalization and the labor market: myths and realities

**Augustin Landier**

*“There would be much to gain  
by not asking corporate executives themselves  
for their opinion on which governance systems might work.”*

### **The three bad wolves**

Three specters of modern times are said to haunt financial markets today: (1) private equity funds, which buy companies to gut them and then sell them off to the highest bidder, (2) hostile acquisitions, in which buyers take over firms against the will of incumbent executives and staff, and (3) U.S. pension funds, which allegedly force French firms to adopt short-term policies.

Each of these “three big bad wolves” should be examined in context so as to avoid fantasizing about its true relevance and impact.

#### Private equity funds

The terms “private equity fund” and “leveraged buyout” (LBOs) are used to describe the mechanism in which a holding company goes into debt to acquire another firm. Through this transaction, the purchaser transfers the debt burden to its target. The transfer puts the target under heavy pressure, forcing it to invent a new strategy and to restructure.

We can recall examples of such takeovers that have had a very negative impact on employment. But the question is to determine the average effects of this type of transaction so as to design a suitable policy in response.

The empirical evidence is fairly consensual: target firms invest less because of the heavy financial pressure. By contrast, the impact on employment remains unproven. Current observations show that any job losses are confined to the firm’s top management.

#### U.S. pension funds

When an American company invests in Europe, it necessarily has a growth strategy in the European market. In such cases, therefore, we observe that employment levels remain

stable and that productivity and wages rise. Wage reduction is always a secondary motive for the acquisition. Restricting such acquisitions would thus be very dangerous for employment.

### Hostile acquisitions

The data indicate a sharp decline in the number of hostile acquisitions. On average, they create more value than “friendly” deals, especially mergers between equals. Why? Because, in a takeover bid, bidders set out to convince the target’s shareholders rather than its executives. This approach acts as a filter and curtails the more extravagant bids.

In fact, placing greater restraints on such acquisitions can have utterly harmful consequences. A study by Bertrand and Mullainathan (Harvard-Chicago) specifically examines such restraints in U.S. states. The authors show that protecting inefficient firms from hostile takeover bids lowers the pressure on their management and leads to pay raises for managers rather than employees. The firms thus survive as they are, without creating jobs. If hostile acquisitions are potentially negative, it is for the executives, not for the workers.

### **False culprits**

France is a country where “industrial logic” is seen as the antithesis of “financial logic.” The French talk of the “financialization” of the economy as contradicting economic common sense. But the facts show that such arguments are totally baseless.

Some believe that the “dictatorship of the 15% ROA” in the financial markets is nonsensical and goes against sound business principles. But empirical studies reach an entirely different conclusion. More than one-third of U.S. listed corporations have negative profits. If the “15% dictatorship” were genuinely in force, we might expect the market to severely punish them. Yet the situation is just the opposite: stock prices indicate that such firms are actually quite popular with shareholders. The firms are often indebted because of their investments, and so enjoy robust growth rates. Their capitalization may greatly exceed the value of their existing assets. Financial markets can thus finance projects yielding long-term returns—for example, in biotechnologies.

Furthermore, pension funds are often designated as scapegoats by corporate executives, who see them as a source of pressure forcing them into very-short-term projects and decisions. But markets, in fact, are merely “heralds” of future constraints, i.e., those arising from competition in the goods market.

### **Costs of an “economic patriotism” policy**

By and large, financial markets are not the enemy of employment. The language used by business executives, which implies that markets prevent them from taking good decisions, is not used in bad faith. But it reflects a genuine conflict of interest between shareholders and managers. There would be much to gain by not asking corporate executives themselves for their opinion on which governance systems might work.

Empirical studies also show that economic-patriotism policies have a real cost. For now, there are no mechanisms that can substitute for financial markets. Is it France's destiny, therefore, to invent such a mechanism? That is not a historical certainty. Although only one-third of the French population currently believes in free-market efficiency, that was not the case in the 1920s. In those days, French stock markets were far more active, relative to market size, than their U.S. counterparts today. At the time, France was strongly anti-statist, and viewed the market as a form of emancipation from political power held by a highly conservative bourgeoisie. Today, the French display nostalgia for the statist policy of large-scale projects undertaken in the thirty years of postwar prosperity ("les Trente Glorieuses"). But that policy was largely driven by technological catch-up, not innovation. The present situation is totally different and, in the circumstances, economic *dirigisme* has not proven its worth.

In the 1980s, many French national champions went abroad, taking growth dividends with them. To stem this capital flight, France must adopt a true growth-oriented approach and not protect its firms.

There is another persistent problem in France. Sharing value added is not synonymous with sharing risks. When shareholders are highly diversified, firms have an incentive to take more risks and refocus. Employees suffer greatly from these situations, which increase their likelihood of unemployment. The problem here thus stems from the combination of a fluid capital market with a still highly rigid labor market.

### **How to reconcile the French with capitalism?**

The notion that employees should take part in managing their firms is dangerous indeed, because it is based on governance models that have not proved their viability. To reconcile the French with capitalism, one should consider instead such reforms as the introduction of insurance plans in the labor market, the reform of our savings and pension systems, and the possibility of regaining control of productive assets. Economists should demonstrate that redistribution is not incompatible with the market.

## Is European M&A regulation protectionist?

### Nihat Aktas

*“EU competition policy is used to protect rival European firms, to the detriment of consumers.”*

The empirical study presented by Nihat Aktas deals with European regulation of mergers and acquisitions (M&As) and regulators' true motives. To the question of why there are regulators in the M&A market, the answers most often given are consumer protection and the fight against abuse of dominant position. Yet empirical studies have found little evidence to confirm these hypotheses.

A recent article by Bittlingmayer and Hazlett suggests three possible motives behind M&A regulation:

- Bureaucratic self-interest, assuming there is a link between media coverage of the regulation of an M&A transaction and the career of the regulator in charge of the case
- Political extraction
- Private benefits.

The third hypothesis is the object of the study presented here. The results show that, in the 1990s, EU regulation was used to protect a privileged group of rival firms of European nationality.

### Research question

The study examines whether official intervention in an M&A deal is more likely when the bidder is a non-European firm and when domestic competitor firms are being harmed.

If the results of the econometric tests (cf. PowerPoint presentation) show a negative and significant interaction, the hypothesis is validated. A negative impact at the time of an M&A announcement is incompatible with the market-power hypothesis. The reason is that, in order to corroborate the latter, the announcement of the deal would have had to produce a positive impact on the merging entities and the rival firms. An increase in the industry's market power will have a positive impact on rival firms because of the transfer of wealth from

consumers to firms in the industry. We therefore expect to find a positive impact on all firms—both the merging firms and their competitors. By contrast, when the likelihood of intervention rises, we expect a negative impact on both groups.

The study focuses here on the timing of the M&A announcement and on measuring the value created by the announcement. In finance, the standard methodology for estimating the value is based on an estimation of abnormal returns (i.e., the impact on share prices). The aim here is to determine whether the returns are negative for rival firms. Such an observation would be incompatible with the market-power hypothesis.

## **Sample used**

The study uses an EU sample for several reasons. For some time, most notably since the Boeing case, EU competition regulation is suspected of protectionism. In addition, a recent study has produced a surprising result: the European Commission tends to launch a greater number of in-depth investigations against non-EU bidders than against EU firms. This finding is all the more alarming as a large proportion of EU-approved combinations involve non-European bidders.

The sample data come from reports by the Commission (available on the DG Competition [DGC] website) and the Securities Data Corporation (SDC) database. They were recorded from the initial implementation of the European regulation (January 1990) to December 2000. During the period, the Commission received 1,573 notifications. The purpose of our study entailed some restrictions: both parties in the M&A (bidder and target) had to be listed on stock markets and be in competition with each other. The sample was thus narrowed to 290 observations. Second, to answer the questions raised by the study, we had to identify all the competitors of the two firms involved in the M&A. We registered a total of 814 rival firms.

The analysis of stylized facts shows that 81% of transactions were approved outright by the EU, 8.6% were approved but with concessions, and 10.3% required in-depth investigation. During the period, 64% of M&As were initiated by European firms, 36% by non-European firms.

## **Analysis of results**

### Impact on stock-market returns for firms involved in M&As (slide 9)

M&As create value for the firms involved: the coefficients are 0.10%, 9.05% and 0.88% for the bidder, target and two combined respectively. By contrast, the transactions are value-destructive for rival firms, with a significantly negative coefficient. These results are consistent with the market-power hypothesis.

On average, therefore, M&As appear to increase competition in the industry.

When the deal is announced, how does the market perceive the transactions that will be subject to in-depth investigation four months later? (slide 10)

Value creation is far greater for firms later subject to in-depth investigation than for firms authorized outright or after concessions. Consistently with the market-power hypothesis, these results suggest that regulators investigate the M&As that create the greatest market value. Indeed, the most value-creating firms are the ones likely to generate an increase in market power or an abuse of dominant position.

Is EU competition policy protectionist?

We tested the protectionism hypothesis using a probit model, in which the dependent variable is set to 1 if the deal was challenged by the Commission (i.e., the Commission imposed concessions and/or the deal went to phase 2) and 0 if not. The explanatory variables are the bidder's nationality, the variable measuring wealth creation among rival European firms, and an interaction variable (product of the first two variables) to test the protectionism hypothesis.

The results show that the interaction variable's coefficient is negative. Consequently, when the bidder is non-European and the impact is negative for rival European firms, we find the highest probability of Commission intervention. Competition regulation is therefore used to protect rival European firms, to the detriment of consumers.

## Round table:

### Global competition: a catalyst for growth in Europe?

In France, competition is not regarded as the best way to boost growth. A large percentage of public opinion prefers the national-champions approach. The presidential candidates talk of protection more than of opening. This raises a question today: are we sure that competition and growth go together?

### Competition: a catalyst for growth in Europe?

According to Nadia Calvino, competition regulations are too often blamed for everything. They are accused with equal fervor of being either “ultra-liberal” (i.e., free-marketers) or over-protectionist. These diametrically opposite attitudes are largely due to the multiplicity of interests at stake.

Businesses have very clearly understood the potential benefits from the establishment of a single market. Many firms believe that sector reorganization should involve not only restructuring in Member States but also the acquisition of foreign companies. This largely explains the increase in cross-border mergers. Some received ideas should therefore be discarded. In fact, large French corporations—such as Total Fina Elf, Air France KLM, and GDF Suez—have benefited substantially from EU market integration. Moreover, competition is in no way the enemy of employment. Cross-border acquisitions can preserve jobs more easily than concentrations in a single Member State, which create redundancy in local economies.

EU competition policy does not impede industrial restructuring. It seeks to promote the creative-destruction principle as far as possible: the role of the DG Competition is to ensure the proper functioning of the market and protect consumer interests.

Inevitably, this increase in competition since the mid-1990s poses the question of country specialization. Patrick Artus notes that global competition does not benefit all EU countries equally. They fall into two very distinct groups. Germany and Sweden have abandoned certain sectors to strengthen their industrial specialization. France, Italy and the United Kingdom have not truly shifted their specializations. The difference between the two groups cannot be explained by population structure, educational skills, R&D expenditures, innovation efforts or public infrastructure. The true causes of this distinction boil down to two problems. The first is microeconomic market mechanisms: the labor market does not ensure a proper allocation of labor to firms that need it. This defective allocation is notably due to the inefficiency of public agencies operating in the labor market. Secondly, the lack of a European Small Business Act hinders the smallest firms from growing their market share. According to the Commission, such a law could bias public-procurement procedures.

Competition could be a catalyst for growth in Europe. It does not impede industrial restructuring and does not threaten employment. Yet, for competition to benefit all countries without penalizing some, it would be important—particularly in France—to review microeconomic market mechanisms and ensure that the potential of the smallest businesses is not hampered. Another question remains unsettled, according to Lars-Hendrick Röller: which problems can be tackled with competition policy, and which can be addressed by innovation policy?

## Innovation: a competitiveness factor but also a global resource

The link between competition and innovation is now undeniable. Endogenous-growth theories have shown that innovation plays a dominant role at all development levels, notes Luc Soete.

Innovation policies must be tailored to individual countries' development levels. Europe therefore needs to examine innovation policy from a fresh angle. At present, research policy is far too restricted in terms of the very definition of research—as was already the case back in the 1960s. Today, the situation is entirely different and the realm of innovation is changing. The concept of national technological competition has been superseded by the sheer volume of international knowledge flows.

It is therefore important to stress innovation policy rather than R&D support policy alone. The definition of R&D emphasizes novelty in all its forms and removes the notion of routine. Innovation incorporates outsourcing, cooperation, and other mechanisms, since it stresses the reuse of knowledge bricks in other environments, for other purposes, in other settings. The innovation user becomes potentially global. Exchanges take place from rich countries to poorer ones and vice versa. The aim of innovation policy is no longer to achieve technological change for technology's sake, but rather to meet the needs of a society as a whole, at all levels of the social scale. Formerly, most target users of radically new technologies consisted of customers at the top of the pyramid (e.g., firms). Today, the situation is totally different. Innovators soon realized that opportunities for growth and market opening are very limited among "high-end" customers. Many firms responded by setting up laboratories to identify overall social needs, particularly for users at the base of the pyramid. The aim should be to recombine the categories of knowledge already on the shelf.

At present, the notion of innovation is creating an entirely new framework for international competition. Much more attention is being paid to different income bases in societies. However, the Seventh European Framework Programme remains far too strongly anchored in the "European cocoon," where knowledge is not yet defined in overall terms. We should aim for a knowledge-dissemination policy that fosters external contributions, in particular with researchers in developing countries.

## Are there strategic sectors to be protected?

Laurent Cohen-Tanugi argues in favor of introducing a strategic dimension into the discussion. The early twenty-first century is witnessing an acceleration of competition, the

crisis of EU integration, a dilution of EU integration in globalization, the rise of emerging economies, increased conflictuality, and an ever-closer interpenetration of political and economic issues. But the striking feature today is the disconnect between globalization and geopolitics.

There is a sharp contrast between the western world, where State interventionism has become suspect, and the emerging world, where the State reigns over the economic sphere. Should we intervene in takeover bids launched against economically strategic sectors, or act against certain predator States that do not share our democratic principles? Yes, according to Laurent Cohen-Tanugi. Today's debate is no longer confined to protectionism vs. liberalism, but is also geopolitical. Absent EU control and an EU equivalent of America's Exxon-Florio national security legislation, the government of each Member State remains the best judge.

For Patrick Artus, the most critical role that market supervisory authorities have to play concerns governance. It would make sense to adopt a consistent doctrine whereby we would refuse acquisitions by firms that fail to respect basic governance rules.