A criticism to the EU competition policy as an important contribution to overcome slow economic growth in EU countries.

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There is widespread consensus among economists and politicians alike that effective competition is crucial to an open market economy. Competition leads to lower prices, higher quality, more innovative goods and services, wider customer choice[1] and ultimately faster economic growth.[2] In the European Union, it is primarily the Commission who is responsible for ensuring the proper functioning of the internal market. Although heralded as a great success, EU competition policy is not without its weaknesses.[3] This paper examines some of the flaws of EU competition policy and argues that it must adapt to the economic realities of the globalized world, if it is to make a major contribution to overcoming the overly endemic slow economic growth in the EU.

The first part assesses drawbacks of the EU’s anti-trust and cartel policy. The second part examines the area of state aids. The third part in turn appraises the policy regarding merger control. The final part summarizes the main points and draws some overall conclusions, notably in view of the impacts on growth dynamics.

1.

Anti-trust and cartel policy

In order to fully benefit from the advantages of the single market, the EU regulatory authorities try to prevent the formation of monopolies or cartels which could have potentially competition distorting effects.[4] Although this policy is right in general, the market is not always able to achieve an optimal allocation of resources. In case of so called market failure it can be preferable for the EU to implement an
effective industrial policy. It has long been argued by industry representatives that the Commission’s overly narrow focus on fostering competition can be counterproductive and have adverse effects on both growth and overall welfare in society.[5]

The Commission has indeed adopted quite a restrictive policy towards cartels and national monopolies.[6] Article 81 of the EC Treaty allows some “block exemptions” but, de facto, these only concern small and medium sized enterprises that represent a small share of a given market.

For the last three decades, DG Competition has been quite tough towards the “crisis cartels” proposed in various industrial sectors in order to face the increasing international competition. In 1982 for instance, the Commission prevented the formation of a cartel including the six major European zinc producers. This restrictive behaviour accelerated the loss of competitive advantage by those companies and ultimately contributed to redundancies and slower economic growth in the sector.

At least four economic arguments stand in favour of a less restrictive approach towards certain cartels and monopolies.[7] Firstly, it can be argued that allowing the formation of big “European champions” can generate important scale economies and thereby increase Europe’s competitiveness on the world stage.

Secondly, the potentially positive spill-over effects stemming from the creation of cartels should be taken into account. The Japanese producer and consumer groupings (Keiretsu) in the field of electronics for example tend to generate a “learning-by-doing” effect that provides benefits even for firms in other sectors.

The third argument concerns Europe’s reputation for being a high quality producer. Since asymmetries concerning access to information can be significant in certain sectors, the existence of visible “European champions” constitutes a strong advantage in terms of perceived quality.

Finally, it can be argued that the adjustment costs of liberalizing former monopolistic markets can be particularly high in Europe considering the rigidities of the labour market. Given the high social cost associated with mass unemployment, market liberalisation could hence have an overall negative effect on growth in the EU.
2.

State aids policy

From a purely economic perspective, giving state aids in an integrated market is rarely justified and furthermore it could be considered as a waste of money for the MS granting them. [9]

The Commission has frequently been criticized, both, for being too strict in some cases and too lenient in others. On the one hand it can be argued that the DG Competition applies excessively strict procedures to prohibit a Member State from intervening economically in order to help particular firms and regions in crises. On the other hand, DG Competition has also been criticized for being overly lenient with the counterproductive aids sometimes attributed to inefficient companies.

Concerning the first point, one can argue that by not allowing State aids to firms which are in financial difficulties, those firms will be forced to either close down or to significantly cut down the number of employees. Consequently, the unemployment rate will increase and aggregate demand fall. This in turn will lead to a decrease in quantity produced and ultimately a fall in real income growth.

As has been shown by Keynes,[10] stimulating the demand through a program of public investments, can lead to a higher production of goods and services and a positive growth effect in the long run. Accordingly, in order to get over a situation of economic downturn and to avoid high unemployment and deflation, a more flexible approach concerning state aids should be allowed. This would promote demand at a macro level for equilibrating again the market and consequently increase the general consumption level.

Furthermore, by allowing state aids to firms in financial difficulties it is possible to reassure private investors which can greatly facilitate the recapitalization of the company. In fact, entrepreneurs will be
willing to invest only if they think that the production will increase in the long run, in other words if there are positive expectations. However, by constraining state aids to concerned companies, they will be forced to make redundancies. This will portray a negative image to investors and further dampen the prospects for fresh investment and economic recovery.

Moreover, if we consider world trade, the Commission’s restrictive approach towards state aids puts European firms at a disadvantage vis-à-vis other international firms. US and Japanese firms for instance benefit from relatively easy access to public and private investments. By limiting the support that Member States can give to European companies, their competitive position in the global marketplace is threatened and this penalizes the general economic growth in the European Union.

As regards the implementation of the state aid policy, one problem stems from granting financial support to inefficient companies. State aids are often used to avoid painful but necessary restructuring which is obviously counterproductive and distorts competition. This was for instance the case with Alitalia, where very generous state aids were granted for paying some social expenditures and wages instead of streamlining the company.

Grating state aids for non-competitive companies might lead to other problems, such as less money for research and development, education, training of employees, etc. This can jeopardize the long-term investments of the European Union in new technologies and thus its competitiveness at the global level.

In order to meet the objectives set up by the Lisbon strategy, the European Union should support the big European actors and, most of all, investment in research and development, innovation, etc.

The Commission acknowledges the need to orient the state aids towards areas with added value,[11] in accordance with the Lisbon Strategy and decided to re-orient the funding towards these sectors and to correlate them with the regional aids and cohesion funds. The idea behind this is to encourage clusters and centers of excellence.[12] However, the aid, as proposed by the Commission, targets mostly SMEs, which could jeopardize the development of the big economic actors.

On the other hand, there are sectors in Europe, such as shipbuilding, coal and fisheries[13], where state
aids are difficult to justify by economic means and hence lead to lower economic growth.

Sometimes, the Member States grant state aids before notifying the Commission.[14] If state aids are not permitted, they should be paid back. However, in the meantime, they produce the effects of interest free loans. That gives an unfair competitive advantage to the concerned company.

Moreover, during the accession negotiations, the Commission granted some concessions regarding the state aids for some sectors, such as the steel industry.[15] Although refunding those state aids would certainly entail some social costs in the form of redundancies, it is competition distorting that the steel sectors from old member states did not receive similar payments.

3.

Merger control policy

The main aim of merger control is to avoid “the creation or strengthening of a dominant position as a result of which effective competition would be significantly impeded in the common market.”[16] Although there is nothing wrong with this per se, the EU has repeatedly been criticized for its overly conservative approach in defining the relevant market and assessing dominance. The principal argument is that the EU stifles the ability of European firms to compete globally by opposing efficiency enhancing mergers. This has obvious negative consequences for Europe’s competitiveness and consequently growth prospects.

The EC’s 1991 rejection of the intended take-over of DeHavilland by Aerospatiale and Alenia provides a good early example of the Commission’s distorted view of market dominance. The planned takeover was rejected because the Commission argued that the combination would hold an unacceptable 50% world market share in short-distance jets and an even larger share within the EC. However, “the exclusion of viable substitutes (i.e. turboprops) and a narrow understanding of the geographic scope of the market (i.e.
Europe) not only exaggerated the venture’s potential impact on competition but ultimately did so at the expense of foregone efficiency gains."[17]

It has also been argued that Europe’s merger policy is inherently biased against small countries by defining the relevant market as the narrowest one where merging companies can exceed a threshold degree of market power. On the grounds of market dominance, mergers between companies from small member states are more likely to be blocked. Those companies are thus being prevented from growing to a size perceived as sufficient to compete on a global or even regional scale.[18]

A good example of this counterproductive ‘double-standards’ approach is given in The Economist[19]. In 2001, the Commission threatened to bar a merger between two Swedish banks, SEB and Swedbank, unless they disposed of a sizeable part of their branch network. Despite the merger being a tiny competitor in the wider European banking market, the Commission argued the combination would acquire a dominant position in the Swedish market. By contrast, the proposed merger of Deutsche Bank and Dresdner Bank, two big German banks, was not expected to run into major difficulties with EU competition authorities because it would not have resulted in local monopolies.

4.

Conclusion

As argued in the introduction, effective competition is necessary in order to reap the full benefits of the Single Market, achieve global competitiveness and set Europe on the path for sustainable economic growth. There is no doubt that the Commission has done a formidable job at fostering competition and slashing market-distorting measures in the EU. However, by adopting a sometimes overly strict competition policy, the EU runs the risk of forgetting that the pursuit of competition is a means to an end (to achieve maximum sustainable growth), not an end in itself.

By focusing too narrowly on maintaining competition in the European Union or in individual Member
States, the Commission may actually reduce the growth prospects of European firms in the wider market. Today’s global economy requires firms to cooperate closely with national governments, to build a network of partners and to cooperate in areas ranging from R&D to collaborative selling arrangements. Depriving European firms from following these much praised business principles is counterproductive. Instead of hindering European firms from fully expanding their competitive advantages, the EU should support such initiative, provided that it does not stifle competition to an unacceptable degree.

Combining an effective industrial policy with an efficient competition policy is certainly not an easy task. The line between an acceptable state aid and financial support distorting the market is often blurred, and judging whether a proposed merger could lead to an unacceptable dominant position can be a daunting task. Nonetheless, the Commission will have to manage these conflicting demands if it is to help Europe to be put back on track for the economic prosperity that it needs so badly.

Word Count: 1994

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[8] Generally speaking, the regime of State Aids has been created by the Article 87 of the EC Treaty which “prohibits any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain firms or the production of certain goods.”


[11] According to Neelie Kroes, Member of the European Commission in charge of Competition Policy, the money should go to areas "where it contributes to social or regional cohesion and where it boosts innovation, risk capital, research and development" (Competition Policy – Past, Present and Future, Meeting with Committee on Economic and Monetary Affairs, European Parliament, Brussels, 21st June 2005, available here ..

[12] Communication from the Commission, Consultation Document on State Aid for Innovation, available at


[15] For instance, Romania received a stated aid worth 50.000 billion ROL (1.4 bil euros) for the period 1993-2004, for restructuring the steel sector (on the condition to reduce the production capacities with 2.05 million t for this period), available here , 7.11.2005

