Competition policy, competitiveness and industrial policy

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Background paper for the Oxera Economics Council meeting of 12 November 2024

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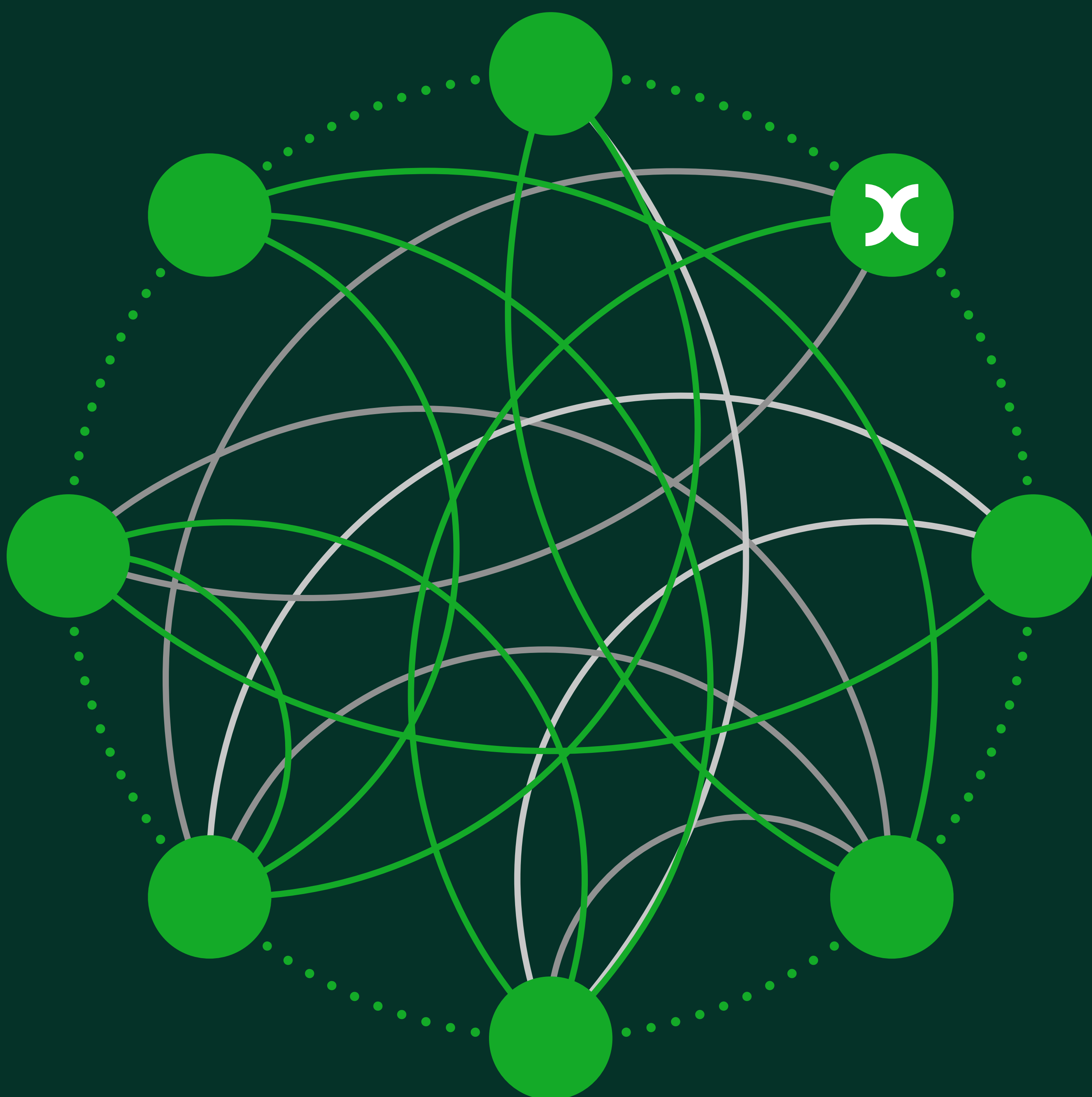

Contents

1	Introduction	1
2	The benefits of competition, and evidence from recent enforcement trends	2
2.1	The benefits of competition	2
2.2	Relevance of recent trends in concentration and profitability	3
2.3	Evolution of competition policy in a digital context	4
2.4	More vigorous competition rules or industrial policy?	5
3	Industrial policy: recent economic discussions	7
3.1	Differing views on industrial policy	7
3.2	Evidence and arguments supportive of industrial policy	8
3.3	Recommendations for the design of industrial policies	11
3.4	Strategic interaction across industrial policies in international settings	12
3.5	General takeaways regarding industrial policy	13
4	Recent proposals and avenues for reform of merger control and state aid	15
5	Discussion of options for reform of merger control	23
5.1	Merger control and scale of European firms	23
5.2	Defensive merger control	28
5.3	Should one introduce non-competition objectives in merger control?	33
6	Discussion of options for reform of state aid control	36
6.1	'Stronger' enforcement of state aid control to preserve the level-playing field?	37
6.2	How does state aid control interact with industrial policy?	38
6.3	The FSR as a 'defensive' application of the principles of state aid control in the context of industrial policy?	38
7	Bibliography	41
A1	The formation of a successful cluster without industrial policy: the case of the Italian ceramic tile industry	45
A2	Ribera Response to questions from MEPs in preparation for the Confirmation Hearing	46

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Figures and Tables

Box 3.1	Infant industry policy: the example of South Korea	10
Box 3.2	Questions for discussion	14
Box 4.1	Market definition in the EU telecoms market—an example	16
Table 4.1	Comparison of Draghi's recommendations for merger control with those specified in the Mission Letter to Ribera	18
Table 4.2	Comparison of Draghi's recommendations for state aid control with those specified in the Mission Letter to Ribera	20
Box 4.2	Legal framework and available options	21
Box 5.1	The Foreign Subsidies Regulation: overview and state of play one year into enforcement	30
Box 5.2	Siemens/Alstom: a summary	32
Box 5.3	Recent proposals and avenues for reform on merger control: questions for discussion	35
Box 6.1	Recent proposals and avenues for reform on state aid: questions for discussion	40

1 Introduction

Competition policy aims to deliver efficient market outcomes by protecting and fostering rivalry among firms to the benefit of consumers. There is a broad consensus among economists that vigorous enforcement of competition policy can therefore contribute to growth and productivity.

At the same time, there are concerns that competition enforcement may have not been sufficiently strict in recent years, as evidenced by rising concentration levels and higher profit margins. This has led to an evolution of competition policy in Europe notably in the digital context (in terms of ex ante regulation, and greater focus on potential "killer acquisitions").

The debate on the optimal level of enforcement of competition policy is taking place in a context where Europe is lagging behind the US in terms of productivity and dynamism. This has motivated recent proposals for a reinvigoration of industrial policy to support the emergence of 'European champions'. These calls are frequently combined with other policy objectives, particularly 'resilience' in light of recent events such as COVID-19-related supply-chain disruptions and the war in Ukraine.

This has led to calls for reform to competition policy to support a strengthening of European industrial policy. The proposals include measures to reform merger control—for example, by introducing an 'innovation defence' to help EU firms to gain scale to compete internationally—as well as proposals to increase the scope of state aid in certain strategic sectors.

The purpose of the 12 November meeting of the Oxera Economics Council is to discuss the proposals for reform of competition policy, in the broader context of Europe's industrial policy and competitiveness. Is there scope for effective reforms which do not undermine the core aims of competition policy, while at the same time supporting the ability of European firms to be more competitive on global markets?

The remainder of this background paper is structured as follows: section 2 sets out recent trends in competition and competition enforcement; section 3 sets out recent economic discussions of industrial policy; section 4 sets out recent proposals and avenues for reform of merger control and state aid; and sections 5 and 6 set out discussion questions related to merger control and state aid, respectively.

2 The benefits of competition, and evidence from recent enforcement trends

It is well established that competition brings significant benefits in terms of efficiency, productivity and growth. A number of studies, including recent ex post studies, have provided evidence of these benefits. Recent trends of rising concentration and mark-ups may also suggest that market power has been increasing due to technological change and possibly underenforcement, although this remains subject to debate (see below).

Nonetheless, despite the evidence that rigorous application of competition rules remains warranted, there have been calls for more active industrial policy and possibly more lax competition policy to accommodate it.

This section provides an overview of the benefits of competition as well as recent challenges and developments in competition policy. This serves as context for the subsequent discussion of recent calls to reflect industrial policy aims in the competition regime.

2.1 The benefits of competition

Competition policy aims to protect consumers by promoting rivalry among firms so as to incentivise them to invest, produce and innovate to supply better products at lower prices. The mainstream view among economists is that competition gives rise to a number of economic benefits, including allocative efficiency (cost-reflective prices), productive efficiency (low costs) and dynamic efficiency (innovation and economic progress). For similar reasons, competition increases the competitiveness of firms and contributes to economic growth. For example, domestic competition can drive firms to become more competitive in international markets.

There is extensive empirical evidence of the benefits of competition, and of the potential costs of underenforcement of competition rules.

For example, recent ex post studies in a number of sectors (health insurance, higher education, telecoms, banks and supermarkets) indicate that higher concentration has been associated with higher

prices.[1] A recent review of merger decisions by the European Commission also finds that the high share of mergers that are unconditionally cleared is associated with implausibly high merger efficiencies, and therefore suggests that EU control has been too lax.[2]

Studies have also raised concerns of negative non-price effects of mergers. These include hampered incentives to innovate, especially when the merging parties pre-merger are part a limited number of innovators within the same innovation area. This issue has been studied mostly in the pharmaceutical sector, including in the influential paper on 'killer acquisitions' by Cunningham et al. (2020).

Note that underenforcement may be a result of two issues: that competition rules are too lenient, or that existing rules are applied inadequately by the relevant competition authorities.

There may be, of course, also a cost associated with overenforcement of competition rules, where a firm's behaviour is erroneously found to be anticompetitive and sanctioned against, or where a merger is erroneously blocked (i.e. false positives or Type I errors). Recent empirical work on merger retrospectives, however, has not identified evidence of overenforcement.

The review of empirical studies in Van Reenen (2011) suggests that increased competition has a positive effect on productivity. Van Reenen argues that the main mechanisms at play are incentives for firms to change management practices. The effects of more competition are twofold: on the one side, poorly managed and less productive firms will lose market share relative to well-managed firms, while on the other, competition raises incentives for incumbents to improve current management practices.[3]

2.2 Relevance of recent trends in concentration and profitability

Notwithstanding the general acceptance that vigorous enforcement of competition policy delivers important economic benefits in terms of efficiency and innovation, there is a general concern that markets have become more concentrated and possibly less competitive over time.

[1] See Lear et al. (2024), pp. 78–81; Allain et al. (2017), which finds an increase in food prices of c. 2% following the French supermarket merger of Carrefour and Promodès in 2000, with increases of up to 4–5% in the merging parties' prices; Ashenfelter and Hosken (2010), which looks at five consummated mergers, finding positive price effects in four of them.
[2] See Affeldt et al. (2021).
[3] Van Reenen (2011).

Recent empirical studies have, indeed, shown that concentration levels and markups in the USA and the EU have risen significantly over the past two decades.[4] For example, Calligaris et al. (2024) finds that concentration in European industries has increased and that firm-level markups grew 7% on average between 2000 and 2019. Díez et al. (2021) finds that average markups have also increased on a global level.[5] Using firm-level data, Bajgar et al. (2019) shows that concentration both in Europe and in North America increased between 2000 and 2014 by 4–8%.

Assessing the evolution of the conditions for competition in the EU over the last 25 years, European Commission (2024a) broadly echoes these concerns, pointing to increases in concentration, markups and profits, at both industry and market level.

Although these trends have given rise to concerns about a lack of competition, the link between the level of competition, concentration and markups is not clear-cut. Shapiro and Yurukoglu (2024) argues that the increase in concentration in the USA may not be a result of declined competition at all, but rather a sign of competition in action. Rising markups may simply be the result of higher efficiency and lower costs, and increased concentration may be the result of reallocation where more efficient firms gain market shares.[6]

The difference in views may stem from the fact that the dynamic competition referred to by Shapiro and Yurukoglu (2024) has taken place largely between US firms. Productivity growth in the EU has been lower than that in the USA over the last 20 years, with the technology industry being the main driver of this divergence.[7] This resonates with the finding of Calligaris et al. (2024) that markups in 'digitally intensive' industries in the EU increased the most, at around 10%, while markups in other industries increased by around 4%.[8] Moreover, the increase in markups is driven by the top 10% of firms, indicating that market power is increasingly concentrated among successful firms.

2.3 Evolution of competition policy in a digital context

A related challenge to competition policy during the last decades has been the increased emergence of platform markets in the context of digitalisation, and a general increase in market concentration in the sector. Platform markets are typically multi-sided and characterised by

[4] See Lear et al. (2024), Section 1.3.2, for an overview.
[5] The authors find an average increase in markups of 6% between 2000 and 2015.
[6] Shapiro and Yurukoglu (2024).
[7] Draghi (2024, hereinafter: 'Draghi Report'), p. 20.
[8] Calligaris et al. (2024).

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network effects as well as economies of scale and scope, giving rise to concerns about a tendency towards market concentration, if not outright market tipping to a single firm. At the same time, these markets are often highly dynamic and associated with innovation.

It is not obvious that the higher margins in digital markets are the result of dynamic competition. Although platform markets, especially in the digital context, are inherently dynamic—with firms frequently operating at a loss for many years in the hope of future recoupment—the identities of the big players (the so-called GAFAM—Google, Apple, Facebook (Meta), Amazon and Microsoft) have been stable for many years.[9] This raises questions such as: is there sufficient competition between established players? Or do these markets need to be contestable for smaller/entrant firms in order to be competitive, and, especially, to remain competitive in the future? Relatedly, has merger policy been too lenient in its treatment of 'killer acquisitions'?

Calls for a more interventionist, more agile competition policy have gained traction in the digital context, in large part in response to such concerns.

The introduction of the EU Digital Markets Act ('DMA') and the UK Digital Markets, Competition and Consumers ('DMCC') Bill address the concerns of entrenched market power and contestability among digital platform markets.[10] Both enable the authorities to intervene more quickly and ex ante in highly dynamic and rapidly changing digital markets.[11]

This raises the additional question of whether recent policy changes targeting digital markets are sufficient to address the aforementioned concerns (to the extent that these concerns are justified), or whether further changes in competition policy are needed.

2.4 More vigorous competition rules or industrial policy?

The recent evidence, on balance, points to a need for more effective and rigorous enforcement of the existing competition rules. Even if lax enforcement may not be behind some of the recent trends in market concentration and profitability, the emergence of firms with growing market power protected by significant barriers to entry makes it even

[9] However, some established digital players have not fared very well (e.g. Netscape, AOL and Yahoo).
[10] DMA recitals 3 and 5; and Schalchi and Mirza-Davies (2023), pp. 10–16.
[11] DMA, recitals 13 and 30.

more important to protect the contestability of markets, prevent exclusionary conduct, and avoid anticompetitive consolidation.[12]

Against this backdrop, however, there have been calls for more active industrial policy and a possible relaxing of competition rules, as discussed in section 4 below.

[12] See Valletti and Zenger (2019).

3 Industrial policy: recent economic discussions

A number of prominent economists have been sceptical about industrial policy in the past, in particular following unsuccessful industrial policies in the 1970s and 80s. Recent research has provided arguments and evidence that industrial policy can be effective at addressing certain market failures that are beyond the scope of competition policy. In light of this research, economists have proposed recommendations for how to design efficiency-enhancing and effective industrial policies.

3.1 Differing views on industrial policy

The established view of the benefits of competition outlined in the above section has implications for industrial policy. Domestic competition makes firms more efficient and thus helps them to compete also in international markets.[13] The best industrial policy may thus be no industrial policy, as Nobel-winning economist Gary Becker famously noted—at least as regards efforts to promote 'national' champions. Becker's view reflects the idea that markets allocate resources more efficiently than governments do. The latter may 'pick winners and losers' based on political considerations and be affected by rent-seeking and information asymmetries.[14] Another way of putting it is that good industrial policy just is competition policy.

In a similar vein, Aghion et al. (2015) argues that industrial policy is most effective when its purpose is to maintain or improve competition. Airbus is the typical example: without the industrial policy-facilitated entry of the European aeroplane manufacturer Airbus, American Boeing might have been a quasi-monopolist. Studies have shown that the effect of another player in the market brought benefits not only for European customers but also globally, with competition in the sector spurring quality improvements and lower prices.[15] However, Neven and Seabright (1995) shows that Airbus actually had a negative impact on global welfare (including both profits and consumer surplus). The presence of Airbus raised Boeing's costs through lower market shares and reduced

[13] In a survey of 400 European exporting firms, the majority of respondents said that domestic competition incentivised firms to improve or maintain product quality (85%), increase efficiency (84%) and increase innovation (78%). Meanwhile, 66% of respondents said that domestic competition did not curb their size in a way that harmed export competitiveness. When asked about the effect of domestic competition on export performance, 42% said that the effect was favourable, compared with 14% who said that it was unfavourable. See Argentesi et al. (2024) and Lear et al. (2024) pp. 221ff.
[14] Compare Juhász et al. (2024), pp. 218–219.
[15] Tirole (2017), p. 370.

economies of scale and scope, and substantially reduced the profits of Boeing.

Piechucka et al. (2024) emphasises the complementarity of industrial policy and competition policy.[16] The authors argue that the two are not substitutes because they deliver different outcomes: competition policy improves economic outcomes by ensuring contestable markets and preventing the entrenchment of market power; and industrial policy corrects for market failures more generally. Piechucka et al. (2023) lists market failures due to the following factors as potential justifications for efficiency-enhancing industrial policy: positive as well as negative externalities, informational asymmetries, coordination failures, and market power/failure of competition.[17] The authors further note that industrial policy is more effective when targeted at competitive sectors and industries.

An overview of the most recent literature on the economics of industrial policy is provided by Juhász et al.[18] Despite taking a more favourable stance on industrial policy, they acknowledge that industrial policy has not always been successful. In particular, they note that in the 1970s and 1980s, in the context of industrial policies described as 'colossal government failures', scepticism about industrial policy became prominent: 'After decades of enthusiasm, developing economies found themselves, in the words of Anne O. Krueger, '"mired down in economic policies that were manifestly unworkable."'[19]

3.2 Evidence and arguments supportive of industrial policy

Some economists consider that the scepticism towards industrial policy, although not unfounded, went too far—that this 'economic pessimism has culminated in whole cloth, impossibility theorem-style rejections of industrial strategy'.[20]

Taking a more positive stance on industrial policy, Juhász et al. (2024) lists three types of industrial policy (infant industry, public R&D, and place-based industrial policy), and provides several examples of studies that analyse industrial policies that had their desired effect. Tirole (2017) distinguishes between non-selective policies (e.g. R&D subsidies

[16] Piechucka et al. (2024), p. 4.
[17] Piechucka et al. (2023), p. 4.
[18] See Juhász et al. (2023); Juhász et al. (2024); and Juhász and Lane (2024).
[19] Juhász and Lane (2024).
[20] Ibid.

in general, or the introduction of a carbon tax) and selective policies, which benefit certain technologies, sectors or firms.[21]

Liu (2019) argues that industrial policy mistakes are minimised when the policy targets upstream sectors, in line with actual policies in the cases of South Korea and, more recently, China, suggesting that 'informational problems of policymakers may not be insurmountable', in certain cases allowing them to 'pick winners' successfully.[22] These findings are consistent with those of Lane (2022), as discussed in Box 3.1 below, which sets out the case of industrial policies in the heavy and chemical industry in South Korea.

Nevertheless, successful clusters can form without industrial policy, as shown by the case of the Italian ceramic tile industry—see Annex A1.

Common reasons for adopting industrial policies include:[23]

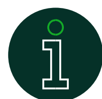
- lack of private R&D, especially upstream, because results cannot be completely appropriated by those funding the R&D, leading to positive spillovers;
- difficulties for SMEs in terms of obtaining funding;[24]
- an absence of coordination among complementary businesses that could form a cluster or 'self-sustaining agglomeration';[25]
- other policy objectives such as national security, resilience and environmental objectives (as discussed below).

It is worth noting that industrial policy is driven not only by considerations that are immediately economic in nature. Rather, it may follow other policy objectives such as security (including military as well as supply-chain security), regional development or environmental

[21] Compare Piechucka et al. (2023), p. 1.
[22] Liu (2019); cf. Juhász et al. (2023). The reason for this result is that 'distortion centrality', which is high for upstream sectors, is a measure of the rate of conversion from government expenditure to consumer surplus—see Proposition 1 in Liu (2019). The intuition is rather technical and the reader is referred to the discussion immediately following the proposition.
[23] Tirole (2017), pp. 366–367.
[24] An important empirical question in this regard is to what extent the spillovers of such an industrial policy benefit the country paying for it more than the policy benefits the rest of the world. See Tirole (2024), p. 994. There may thus be a freeriding effect that undermines countries trying to invest sufficiently in such industrial policies.
[25] See Tirole (2024) (cf. Tirole, 2017, p. 368; and Juhász et al., 2023): 'It is easy to find arguments in favour of industrial policies. They may create cluster effects through infrastructure sharing, enable the informal sharing of information (as when Steve Jobs and his developers learned about graphical user interface while visiting nearby Xerox Park) and promote joint learning by doing. As important, but less emphasized, is the existence of a labour market; most start-ups are bound to fail, and even if they do not, entrepreneurs and their collaborators look for new challenges; a cluster allows for a low-personal-cost job mobility.'

objectives, which may be more or less loosely tied to economic welfare. Nevertheless, even in such cases, policies can often be linked to addressing market failures at least in principle.

In addition, public interventions may be motivated by purely political (which is not to say illegitimate) rationales that may be difficult to tie back to a market failure.



Box 3.1 Infant industry policy: the example of South Korea

An example of an 'infant industry' policy is given by the case of the heavy and chemical industry in South Korea. Lane (2022) details an empirical study of South Korean industrial policy that 'aimed to promote investment and input use through directed credit and investment incentives' in the industry in the 1970s. The author considers two theoretical justifications for the industrial policy in question: (i) dynamic economies of scale arising as a result of learning by doing (either as a positive externality on other firms or within-firm, for example if firms face capital constraints that threaten their survival in 'turbulent nascent periods'); and (ii) linkage effects arising due to spillovers across vertically related sectors. The author finds support for both theories, noting that the industrial policy promoted development in the targeted sectors, and probably in non-targeted sectors as well, causing a shift in comparative advantage, with long-term positive effects that extended long beyond the duration of the policy. Nevertheless, the author acknowledges that his study does not account for the costs or 'allocative consequences' of the industrial policy in question.[26]

Overall, the South Korean policy has been considered a success:[27]

The Heavy and Chemical Industry push under President Park Chung-hee in the 1960s set out to transform South Korea into a heavy-industry powerhouse—a proposition so fantastic that no external funder, including the World Bank, was willing to

[26] See Choi and Levchenko (2022) for further analysis of the welfare gains, and Kim et al. (2022) for further analysis of the costs associated with misallocation.
[27] Juhász and Lane (2024).

finance it. This initiative drove increased output and export development in targeted sectors, shifted comparative advantage toward these same sectors, and made the economy better off—just as policymakers had envisaged.

Tirole (2017) refers to this case as the 'star exhibit for supporters of industrial policy',[28] although studies have also pointed out that not all parts of the industrial policy tools employed in South Korea were successful.[29]

Source: Oxera.

3.3 Recommendations for the design of industrial policies

Given the above arguments in support of industrial policy, it is also worth considering how industrial policy should be designed in order to be effective.

Piechucka et al. (2023) lists three questions for formulating efficiency-enhancing industrial policies:[30]

- What is the market failure the policy is trying to address?
- What is the tool that addresses the market failure with the least possible (unintended) negative effects?[31]
- Does the efficiency gain obtained by addressing the market failure balance the efficiency losses caused by the inevitable unintended negative effects?

In a similar vein, Tirole (2024) provides the following recommendations 'if one is to engage in industrial policy':[32]

(1) Identify the market failure, so as to design the proper policy.
(2) Use independent high-level experts to select the projects and the recipients of public funds.

[28] Tirole (2017), p. 373.
[29] See, for example, Kim et al. (2022).
[30] Piechucka et al. (2023), p. 5.
[31] The authors note: 'it is important to match the right tool to the right market failure. For example, production subsidies would help if the good involved creates positive externalities, but may not achieve much if the source of the issue is information asymmetry.'
[32] Tirole (2024), p. 994. According to the author, the South Korean case involved following many of the recommendations, in particular 'ensuring competition between companies, using peer review, a limited duration for programs, the identification of companies that export successfully, and risk sharing with the private sector' (Tirole, 2017, p. 373).

(3) Pay attention to the supply side (talents, infrastructure) and not only to the demand side.
(4) Adopt a competitively neutral policy.
(5) Do not prejudge the solution, but rather define objectives.
(6) Evaluate ex post, disseminate the results and include a 'sunset clause' in each program, forcing its closure in the event of a negative assessment.
(7) Involve the private sector in risk taking to avoid white elephants.
(8) Strengthen universities and bring them closer to the start-up world.

Aghion et al. (2015) suggests that industrial policy is more effective when targeted to sectors that see more initial competition. In line with Tirole's second and fourth recommendations, the authors suggest that industrial policy should be allocated following proper selection criteria and designed in 'competition-friendly' ways.[33]

When considering the benefits of industrial policy, one also needs to factor in the fiscal costs of providing subsidies to firms, especially by fiscally constrained governments. We return to this issue in the context of our discussion of state aid reform.

3.4 Strategic interaction across industrial policies in international settings

An important aspect to consider, including in the debate around 'European champions' and the emergence of clusters, is the strategic interaction across various states' industrial policies, which can easily give rise to inefficient subsidy races as a result of a prisoner's dilemma. This tends to happen where industrial policies have local benefits, as illustrated by the example of South Korea.

A multilateralist approach to industrial policy may aim at curbing inefficient subsidy races, weakening the case for some types of industrial policy. This may be undermined, however, by some countries' refusal to cooperate. A stark example of the risk of not adopting a multilateral approach is given by 'carbon leakage', where green industrial policies have the effect of causing firms to relocate elsewhere, or shifting demand elsewhere as domestic producers become less competitive relative to foreign rivals. This has the twin effects of undermining the process of decarbonisation at a global level (as CO_2 production is merely relocated elsewhere) and undermining competitiveness of the country introducing the green industrial policy in

[33] Aghion et al. (2015), p. 24.

global markets.[34] Careful design of industrial policies is needed to avoid these effects.

3.5 General takeaways regarding industrial policy

While competition policy may be good competition policy, there are market failures such as those resulting from positive spillovers—for example, between adjacent sectors or as a result of upstream R&D—that do not relate to a lack of competition. Such market failures provide a justification in principle for engaging in industrial policy.

From an economic perspective, in order for industrial policy to be efficiency-enhancing it is particularly important that it:

- addresses a market failure that is clearly established and significant;
- is suitable for addressing the market failure;
- works with, and enhances, existing competition (e.g. using tenders or promoting competing firms); and
- takes into account strategic international interactions.

The latter two points are also relevant for industrial policies motivated by purely political concerns.

[34] See Piechucka et al. (2023), p. 16. Note also that, although decarbonisation can have the advantage of reducing the EU's energy dependence, if it leads to industry moving abroad it can undermine the EU's 'strategic independence' in other sectors.

Box 3.2 Questions for discussion

1. Are the various justifications that have been advanced in support of industrial policy convincing (in theory and in practice)?
2. In light of risk of inefficient subsidy races, how should the EU respond to industrial policy from the USA, China and other countries? Can cooperation work if not everyone is on board?
3. Which recommendations for industrial policy are particularly important from an economic perspective? What is their relationship with competition policy?

Source: Oxera.

4 Recent proposals and avenues for reform of merger control and state aid

Having touched upon a review of the rationale for effective competition policy, as well as evidence on the effectiveness of industrial policy as a complementary tool, this section now turns to the current policy debate, in particular as it relates to calls for competition policy to be adapted to address industrial policy concerns.

At a high level there are two overarching concerns at the centre of the current debate on industrial policy and competition policy, in particular in the context of merger control.

First, there is a concern about promoting the competitiveness of EU firms in strategic international sectors, i.e. 'European Champions', in particular in a digital/high-tech context.[35] For example, the Draghi Report notes that the five largest tech companies from the USA capitalise at around $8.7trn (c. €8.0trn), while only four of the top 50 largest tech companies globally, by market capitalisation, are from the EU (with a combined market capitalisation at $894bn, c. €831bn).[36] Meanwhile, the market capitalisation of the telecoms sector in the EU fell by over 41% between 2015 and 2023: in 2023 it reached a value of €270bn, substantially lower than the €650bn in the USA.[37] Tirole (2017) notes that the only two 'champions' founded in Europe in the second half of the 20th century are Vodafone from the UK and SAP from Germany.[38] In general there have been discussions about a perceived lack of EU dynamism, with some linking this back to EU firms lacking the scale necessary to compete against US and Chinese rivals, including through innovation. Others point to excessive or poorly designed regulation.[39] Box 4.1 presents an example of such concerns relating to the EU telecoms market.

[35] See Draghi Report, p. 298; Letta (2024), p. 50; European Commission (2024b, hereinafter: 'Ribera Mission Letter'), p. 5.
[36] Draghi Report, p. 73.
[37] Ibid.
[38] Tirole (2017), p. 374.
[39] See, for example, Cochrane (2024).

Box 4.1 Market definition in the EU telecoms market—an example

Draghi considers that the EU is lagging behind in relation to 5G broadband networks. The reason he gives for this is that the EU is fragmented into a large number of national markets, with corresponding spectrum fragmentation, such that EU companies lack scale, resulting in higher prices and insufficient returns on investment (below the cost of capital). He notes that the importance of investing in this space is increasing with AI and the need for proper infrastructure to train new models. This kind of infrastructure is developed and maintained by the telecoms.

To address these issues, the Draghi Report proposes harmonising spectrum allocations and harmonising national regulations to create a European market. In relation to merger policy, Draghi proposes to extend the timeline for assessment of merger effects, to be able to include innovation and investment commitments, and not just price effects. He also suggests defining telecom markets at the EU level (as opposed to the member state level), particularly when this facilitates cross-border integration and creation of EU-wide players.[40]

Source: Oxera

Second, there is a concern around 'security, resilience issues, and the related distribution risks to the EU economy', in particular in relation to strategic firms and sectors.[41]

In relation to the second concern, Letta (2024) points to 'recent challenges' (the pandemic, the resurgence of conflict, and the energy crisis) and notes that a balance is to be struck between competitiveness and strategic independence (inter alia). In relation to addressing the resilience of supply chains, the author mentions efforts

[40] See Draghi Report, p. 75.
[41] See Draghi Report, p. 300; Letta (2024), pp. 133 and 135; Ribera Mission Letter, p. 6. As we note below, this may actually lead to narrower geographic markets.

to 'reshore' or 'friend-shore' critical production inputs. Similarly, the Draghi Report mentions 'reliance on a single source of raw material' as a market structure leading to weak economic resilience, possibly resulting in 'frequent shortages and other harmful outcomes'.[42]

A number of proposals are being considered to reform competition policy to help address these concerns. These proposals need to be understood in relation to the legal framework and possible legal options available to the Commission and to member states (see Box 4.2 below).

In terms of merger control, these are as follows.

- The Draghi Report calls for increased emphasis on **innovation** and competition (including an innovation defence in conjunction with behavioural remedies involving investment commitments).[43] It further proposes to add **'security and resilience'** as an additional public interest criterion for DG Competition,[44] the introduction of a **'New Competition Tool'** to intervene in markets with weak economic resilience,[45] the publication of clear **guidance for coordination** (for R&D investment, sustainability, standardisation, etc.),[46] and **effective enforcement in relation to the Foreign Subsidies Regulation ('FSR')**.[47]
- Some of these proposals have been reflected in President von der Leyen's Mission Letter to Commissioner-designate for Competition Teresa Ribera. The mission letter calls for a review of the EU's Horizontal Merger Guidance in order to increase the weight given to **resilience and innovation**.[48] The letter also calls for greater focus on **'killer acquisitions' from foreign companies**.[49]

In Table 4.1 below, we compare each of Draghi's recommendations for future merger control against the guidance set out by von der Leyen in her Mission Letter to Ribera.

[42] Draghi Report, p. 303.
[43] Ibid., p. 299.
[44] Ibid., p. 300.
[45] Ibid., p. 303.
[46] Ibid., p. 300.
[47] Ibid., p. 302. The FSR is a new regulatory tool available to the Commission that applies similar principles to those of state aid control to foreign subsidisation. See Box 5.1 for an overview of the FSR.
[48] Ribera Mission Letter, p. 6.
[49] Ibid.

Table 4.1 Comparison of Draghi's recommendations for merger control with those specified in the Mission Letter to Ribera

Draghi's recommendations	Mission Letter to Ribera
To 'emphasise the weight of innovation and future competition in DG COMP decisions', the Guidance should allow for an **'innovation defence'** ('justified by the need in certain sectors to pool resources to cover large fixed costs and achieve the scale needed to compete at the global level'). In conjunction with an innovation defence, the merging parties should **'commit to levels of investment'** to be 'monitored ex post'.	A **review of the EU's Horizontal Merger Guidance** in order to 'give adequate weight to the European economy's more acute needs in respect of resilience, efficiency and innovation, the time horizons and investment intensity of competition in certain strategic sectors, and the changed defence and security environment'.
	To 'focus on the particular challenges facing SMEs and small midcaps, notably to address risks of **killer acquisitions from foreign companies** seeking to eliminate them as a possible source of future competition'.
To add **'security and resilience' as an additional public interest criterion**, the assessment of which is to be given as an input to DG Competition by an expert authority outside DG Competition.	
To introduce a **'New Competition Tool' ('NCT'), to intervene in markets with weak economic resilience**.	
Publish **clear guidance for coordination** if this is needed for R&D investment, sustainability, standardisation, etc. to the benefit of consumers.	
To ensure **effective enforcement in relation to the FSR** in order to benefit EU consumers and businesses.	To '**vigorously enforce** the Foreign Subsidies Regulation, including by proactively mapping the most problematic practices that could lead to competition distortions.'

Source: Oxera, based on the Draghi Report and the Mission Letter from von der Leyen to Ribera.

Similarly, the Draghi Report has made a number of proposals in relation to state aid control, as follows.

- To return to a normal **strong enforcement of state aid control** to accompany the EU's new industrial strategy.[50]
- To **reform and expand the scope of Important Projects of Common European Interest** (**'IPCEIs'**) beyond breakthrough innovations but subject to specifying the market failures that require EU cooperation. The aim is to make it easier to propose projects and to subject aided projects to a faster

[50] Draghi Report, p. 301.

and simplified review. Draghi also recommends making EU funding available in this area (conditional on EU member states' undertaking reforms to harmonise and facilitate the common market).[51]

- In assessments of the compatibility of aid, **higher aid amounts should be allowed** where the measure **contributes towards EU-wide industrial policy** and helps to strengthen EU coordination.[52] In addition, Draghi recommends that greater emphasis should be placed on the potential impact of aid on both innovation and resilience when assessing the compatibility of aid.[53]
- To make use of state aid and other competition tools to **strengthen the adoption of open access solutions and interoperability** as well as adherence to EU standards. In particular, Draghi recommends that the Commission's assessment of the compatibility of aid should take into account the enhancement of open access and interoperable solutions as well as the development of European-wide standards.[54] For example, the granting of state aid for vehicle charging infrastructure may be conditional on the implementation of interoperability standards.[55]
- In the **energy sector**, the Commission should develop state aid guidelines that **harmonise the type of support** that is provided such that it does not distort the single market.[56] In particular, Draghi recommends that member states should also have the option to provide price relief mechanisms; however, its conditions should be harmonised at the EU level to avoid distortions to competition in light of differences in the financial resources of member states.[57] Draghi also recommends increasing the speed of the administrative process, particularly in relation to network upgrades and investment in grids for electrification purposes.[58]

[51] Ibid., p. 305.
[52] Ibid., p. 301.
[53] Ibid., p. 301.
[54] Ibid., p. 302.
[55] Ibid., p. 302.
[56] Ibid., p. 39.
[57] Ibid., p. 39.
[58] Ibid., p. 301.

In Table 4.2 below, we compare each of Draghi's recommendations for future state aid control against the guidance set out by von der Leyen in her Mission Letter to Ribera.

Table 4.2 Comparison of Draghi's recommendations for state aid control with those specified in the Mission Letter to Ribera

Draghi's recommendations	Mission Letter to Ribera
Strong enforcement of state aid control.	The need to simplify the state aid rules while preserving the level playing field.
Reform and expand the scope of IPCEIs.	The introduction of a European Competitiveness Fund to ensure that member states' proposals for IPCEIs for the most strategic sectors and technologies can be approved quickly.
Higher aid amounts where the measure contributes towards EU-wide industrial policy.	The need to simplify the state aid rules while preserving the level playing field.
State aid to incentivise the adoption of open access solutions and interoperability.	
Guidelines to be developed in the energy sector that harmonise the amount of support to be provided, with the option for member states to provide price relief.	The Mission Letter recommends the introduction of a new state aid framework to accelerate the roll-out of renewable energy.
	Revise state aid rules to enable housing support measures, particularly for energy efficiency and social housing.

Source: Oxera, based on the Draghi Report and the Mission Letter from von der Leyen to Ribera.

Box 4.2 Legal framework and available options

Proposals to reform competition policy need to be understood by reference to the legal tools and options available to the Commission and to member states. These include the following.

- The **Treaty on the Functioning of the European Union ('TFEU')**, which includes the overall legal provisions on conduct (Article 101 and Article 102) and specific provisions on state aid (Articles 107–109). The process for modifications of the TFEU is complex, but none of the proposals currently on the table would require such a modification.
- The **European Union Merger Regulation ('EUMR')**, as set out in Council Regulation (EC) No 139/2004. The EUMR sets out the basic provisions on merger control, including the notification threshold, the substantive test for significant impediments to effective competition, the scope for the Commission's sole jurisdiction (including additional legitimate interests that member states are allowed to protect through appropriate additional measures[59]), and rules for referrals from member state (under Article 22). Amending the EUMR would require a legislative co-decision process involving the Council and the European Parliament. Proposals designed to adjust notification thresholds and referral processes (e.g. to be able to look at potential 'killer acquisitions') would require amendments to the EUMR.
- **Merger Guidelines** (including the Horizontal and Non-Horizontal Merger Guidelines), which set out in some detail how the Commission implements the EUMR, explaining, for example, the role of non-price effects (innovation/investment) and the substantive framework to evaluate merger

[59] These include public security, plurality of the media and prudential rules (under Article 20 of the EUMR).

efficiencies. Several of the proposals for reform suggest amending the Horizontal Merger Guidelines. The process for amendment is simpler than a review of the EUMR, as it involves only the European Commission (after a public consultation process).

- **State aid Guidelines and Regulations**. A very large number of Guidelines and Commission Regulations set out how state aid rules should be applied, including to specific sectors, for specific types of aid such as regional aid, aid for IPCEIs or in terms of block exemptions. For the majority of these rules, the process for amendment would involve only the European Commission (after a public consultation process).
- **The Foreign Subsidies Regulation**. See Box 5.1 for a specific discussion of this new instrument.

Additional tools available to the Commission and/or member states to address some of the issues raised in recent policy recommendations include trade policies (as these can directly affect the competitive constraints exercised by foreign players) and provisions on Foreign Direct Investments ('FDI') (23 out of the 27 EU member states have adopted national legislation for screening FDI, typically on grounds of security, public order and defence).

Source: Oxera.

5 Discussion of options for reform of merger control

5.1 Merger control and scale of European firms

A number of options have been floated to reform merger control to foster the global competitiveness and/or scale of European firms in certain strategic sectors.

We discuss the main options in turn, including: market definition; efficiencies and innovation; remedies design; and overall implications for revised Horizontal Merger Guidelines.

5.1.1 Market definition

Proponents of greater European consolidation typically argue that the geographic market definition adopted by competition authorities is too narrow, and does not take into account the globalisation of markets and the fact that European firms compete on a global stage. Where markets have been defined as national, the argument has been that the move towards a European single market in a number of sectors means that markets should instead be defined at a European level, in particular for mergers examined by DG Competition (rather than by National Competition Authorities).

Market definition has typically tended to be a fairly technical exercise, based on well-established concepts of supply and demand-side substitution. Following earlier calls for global markets in the context of industrial mergers (such as in steel) at the start of the first Vestager mandate, DG Competition has reviewed its practice of geographic market definition and concluded that its approach was sound.[60] Similarly, the recent process of revising the Notice on Market Definition has confirmed the approach followed in recent merger decisions, including in the area of geographic market definition.

There seems to be little scope, therefore, to define markets more widely simply because of a desire to promote the scale of European firms. The more realistic route would seem to be to promote regulatory initiatives to make the single market more effective (e.g. in telecoms and energy), in order to allow for greater consolidation to subsequently take place. If such initiatives are sufficiently tangible and effective, a forward-looking merger control assessment could, in principle, take them into account to

[60] Fletcher and Lyons (2016).

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define wider markets in specific instances. However, there would be a risk that a merger assessment is conducted on the basis of a degree of market integration that does not yet exist and may never materialise, with the consequence that concentration will rise while markets continue to be narrow.

Moreover, current geopolitical concerns regarding security of supply and resilience may actually lead to even narrower or more concentrated geographic markets, to the extent that proximity of supply becomes more important, or foreign suppliers are seen as less reliable. This may result in more intervention despite no explicit change in the stance of policy.

5.1.2 Efficiencies and Innovation

A common criticism of the practice of European merger control is that the assessment of efficiencies is too restrictive. While the European Commission has evaluated and accepted individual efficiency claims in several mergers,[61] no otherwise anticompetitive merger has been cleared on efficiency grounds since the introduction of the EUMR in 2004.

The cumulative three-step test of verifiability, merger-specificity and benefit to consumers has often implied that merger claims have failed at least one step of the test (for example, fixed cost savings are typically not accepted, as they are unlikely to benefit consumers; savings from wholesale synergies may not be accepted as merging parties may be able to capture them by cooperating only at the wholesale level, as in the example of network-sharing agreements in mobile telephony; and some claims fail because merging parties are not able to substantiate them to the required standard).

While the Commission's analysis of efficiency claims has become increasingly detailed and rigorous over time, there is probably scope for greater alignment between the standard of proof for anticompetitive effects and the standard of verifiability for efficiency claims. The two standards should be symmetric in order to properly balance Type 1 and Type 2 errors.

A case in point could be the treatment of innovation efficiencies, in the context where an authority is alleging that a merger would reduce innovation incentives over the medium to long run. In this case, it would

[61] See, for example, *T-Mobile NL/Tele2 NL*, *Orange/Jazztel*, *FCA/PSA*, *GE/Alstom*, *UPS/TNT* and *FedEx/TNT*.

seem appropriate to look at an innovation defence over the same time horizon as the innovation theory of harm, and hence to not insist that efficiencies need to be 'timely' (i.e. occur shortly after the merger).

Even if such a symmetric standard were to be adopted, the mechanism behind the innovation efficiencies would still need to be assessed in detail. Typical innovation efficiencies are associated with the internalisation of R&D spillovers, and/or with a reduction in the incremental costs of R&D. Proponents of great consolidation, however, probably have in mind a broader scope for innovation efficiencies, including benefits from avoided duplication, saving in fixed costs, and possibly also 'Schumpeterian' benefits from lower competition. Any reform of the efficiency framework to allow for greater consideration of an innovation defence will need to take a view on the correct scope and source of innovation efficiencies.

Another challenge with accepting an innovation defence is whether it should be able to compensate for short-run increases in price due to the merger, and how to balance the two effects. In principle, such balancing should be possible even if it implies that consumers may be harmed in the short run (but may benefit from the merger in the medium to long run). Such balancing would inevitably need to be done qualitatively, and may risk leading to greater discretion in merger evaluation.

Preceding Draghi's calls for greater attention to innovation, there had been significant debate on mergers and innovation in a number of European Commission mergers in recent years (e.g. *Dow/DuPont*, *Bayer/Monsanto*, *GSK/Novartis*). This resulted in greater, not less, intervention. Absent a robust innovation defence, the same is likely to happen in the future.

The other area where efficiency assessment could be more flexible is in 'out-of-market' efficiencies. Typically, efficiency claims are accepted only if they benefit the same set of consumers who are affected by adverse effects of a merger. The logic behind this is that merger control should prevent a loss of competition in each of the markets affected by the merger, with no trade-offs across markets or across different set of customers. However, in the current context of the debate on sustainability agreements, some authorities are becoming more flexible on this point. For example, the UK Competition and Markets Authority (CMA) accepts environmental benefits that accrue to the entire UK population, not just consumers affected by the agreement. There may therefore be scope, in principle, for also accepting a broader set of efficiencies in merger control—for example, covering all European consumers. This would be consistent with an overall consumer welfare

standard, but would look at effects on consumers as a whole, potentially across geographic markets.

A more radical proposal would be to adopt a broader welfare standard, putting some weight on producer surplus and hence balancing (potential) global producer welfare gains for EU firms against potential anticompetitive effects for consumers in the EU. This option would, however, run contrary to the EUMR,[62] and would represent a significant departure from the consumer welfare standard.

5.1.3 Remedies

The third candidate for specific reforms floated in the Draghi Report is the issue of remedy design.

The vast majority of mergers that the European Commission finds to be anticompetitive are cleared subject to remedies. Remedy design is therefore a key determinant of the effectiveness of merger control and its impact on the scale of European firms.

Merger remedies are typically structural (at least for horizontal mergers), and are often designed to remove the competitive overlap caused by the transaction (at least for clear-cut remedies in Phase I review).

The Draghi Report appears to be opening the door for behavioural remedies, which would not involve the divestment of assets by the merging parties but would instead be based on commitments to a given future conduct. The Draghi Report mentions investment remedies, which presumably would entail the merging parties committing to a given level of investment (e.g. CAPEX?) for a period of time after the clearance.[63]

Behavioural remedies (including investment remedies) are associated with well-known shortcomings, which explains the reluctance of competition authorities to rely on them, especially in the case of horizontal mergers. These shortcomings include: a) difficulties in monitoring adherence to the remedy; b) difficulties regarding enforcement of the remedy in case of failure to comply (in particular since it is difficult to unwind an approved merger); c) difficulties in setting the appropriate counterfactual absent the merger, and determining that the conduct to be followed by the merging parties

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[62] See Article 2 of the EUMR (which refers to 'the interests of the intermediate and ultimate consumers').
[63] The Report also mentions that 'failure to comply should be associated with adequate disincentives to deviate from the investment plan'.

under the remedy actually represents an improvement relative to that counter-factual; and d) the fact that a behavioural remedy does not address the post-merger incentives of the merging parties to reduce competition relative to the pre-merger counterfactual.[64] Given these well-known concerns with conduct remedies, it is hard to see a strong case for the investment remedies mentioned in the Draghi Report. However, the recent CMA decision on the Vodafone/3 transaction seems to be going in this direction (with the CMA provisionally accepting an investment remedy by the merging parties over the next eight years, coupled with behavioural remedies on price and access).[65]

5.1.4 European Commission Horizontal Merger Guidelines

The Draghi Report recommends a revision of the Horizontal Merger Guidelines to reflect some of the considerations discussed above, notably the need to give more weight to innovation and future competition. The Mission Letter to Ribera has embraced this recommendation, emphasising that 'adequate weight' should be given to the 'acute needs in respect of resilience, efficiency and innovation'.[66] In her responses to questions prior to the MEP Confirmation Hearing, Ribera indicated a shift in the approach to merger control (see Annex A2).

The European Commission Merger Guidelines are fairly old (they date from 2004) and could certainly benefit from an update to reflect recent case experience, case law and progress in economic techniques. In the last 20 years, the US guidelines have been updated twice (in 2010 and in 2023), both times going through significant updates.

A similar process to the one followed by the European Commission for the Market Definition Notice could therefore be usefully started for the Horizontal Merger Guidelines (and is, indeed, likely to start early in the mandate of Ribera).

In particular in the area of innovation competition, the current Horizontal Merger Guidelines are very high-level and do not take a clear position: for example, the Guidelines state that a concentration 'may increase the firm's ability and incentive to bring new innovations to the market', while at the same time, 'effective competition may be

[64] Kwoka (2017).
[65] See Competition and Markets Authority, 'CMA provisionally finds Vodafone / Three could address competition concerns through network investment and customer protections', press release, 5 November.
[66] Ribera Mission Letter, p. 6.

significantly impeded by a merger between two important innovators'.[67] A 'technical' update to the Guidelines on this topic would be likely to result in a stricter approach to innovation competition, in line with recent cases (e.g. *Dow/DuPont*, *Bayer/Monsanto*, *GSK/Novartis*). While this would make it easier to intervene against 'killer acquisitions' (see below), it would actually make it harder to allow for European consolidation on innovation arguments.

In parallel, the Guidelines could also usefully articulate what an innovation defence could look like, but as discussed above, the arguments in favour of an expansive definition of such a defence do not seem to be strong.

5.2 Defensive merger control

As illustrated by the debate around 'European Champions', the concerns relating to competitiveness are not merely concerns about the existence of sufficient competition for the supply to European consumers, but concerns about the lack of European firms among those that are internationally competitive, especially in high-tech industries.

These are inherently supply-side concerns, and they can have implications for merger control, for example in the form of calls to block transactions simply because a foreign company is acquiring a domestic target. An example is given by the stated aim in the Mission Letter to Ribera: 'to address risks of killer acquisitions **from foreign companies** seeking to eliminate [SMEs and midcaps] as a possible source of future competition' [emphasis added].[68]

To the extent that a merger is anticompetitive (in terms of consumer welfare) —be it a killer acquisition or otherwise—such transactions can be blocked without changes to the current regime. The issue arises where calls are for a consumer welfare-enhancing merger to be blocked on account of where the buyer and target are based. As noted above, such calls are motivated by supply-side considerations and hence are not captured by the consumer welfare standard.

One of the new tools for blocking mergers on the basis of supply-side considerations is the FSR. This instrument was introduced with the aim of partially compensating for what was perceived as a strict merger control on European firms in the wake of the *Siemens/Alstom* prohibition (see Box 5.2 below). Although the FSR focuses on unfair subsidies, it

[67] Horizontal Merger Guidelines, para. 38.
[68] Ribera Mission Letter, p. 6.

could provide a possible blueprint for reflecting defensive considerations in the existing merger regime. However, it remains to be seen whether the FSR itself will be effective (as it is only in the early days of its implementation), and whether it would actually benefit European consumers and firms. Box 5.1 below presents an overview of the FSR and of its enforcement to date, just over one year since it entered into force.

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Box 5.1 The Foreign Subsidies Regulation: overview and state of play one year into enforcement

The FSR is a new regulatory tool available to the Commission. Its aim is to 'fill a regulatory gap' left by existing instruments such as EU state aid control, merger control and trade defence.

In essence, it applies similar principles to those of state aid control to foreign subsidisation: if undertakings active in the EU receive subsidies from foreign countries that have a distortive effect in the EU, and if this distortive effect is not outweighed by positive effects (such as public policy objectives), the Commission may impose remedies.

One of the key aspects of the FSR is that it created an ex ante notification obligation for large concentrations (i.e. those with turnover above €500m in the EU for the acquisition target or for the parties to a merger). During the notification, the Commission will check whether the undertakings have received foreign subsidies in the past three years and, if so, whether these are having distortive effects in the EU. The FSR also allows the Commission to call in concentrations that fall below the compulsory notification thresholds (but this does not appear to have been used yet).

In particular, the Commission focuses on subsidies that 'directly facilitate the concentration', i.e. implicitly targeting acquisitions where foreign subsidies allow the acquirer to outbid non-subsidised competitors, where subsidies result in inflated valuations or make the deal possible through deeper pockets. However, beyond this 'theory of harm' centred on the concentration process itself, the Commission can check whether any distortions could also be expected on the 'underlying' markets where the companies are active—it could look at more open-ended theories of harm.

This leads to a number of key open substantive questions, such as the welfare standard to be used to determine the existence of harm: the FSR refers to a 'level playing field' and 'competition on the merits', which is arguably less consumer-centric than traditional merger control. Correspondingly, it raises the question of overenforcement risks, in a context

where the fiscal costs of foreign subsidies are not borne by EU taxpayers, and where EU consumers might benefit (at least in the short term) from subsidised competition from abroad.

In the FSR's first year of enforcement, there have been 85 notifications of concentrations. Only one of these notifications led to an in-depth (i.e. Phase 2) investigation, i.e. the acquisition of European telecoms company PPF by 'e&' (formerly Etisalat), an Emirati, state-backed telecoms company. The case was recently cleared subject to (mostly) behavioural remedies such as a commitment by the Emirati acquirer to operate at arm's length and to not provide financing to the EU operations except in specific cases.

Beyond the concentration notification tool, the FSR creates a compulsory notification requirement for large public procurement bids, and allows the Commission to launch ex officio investigations (i.e. of its own motion) in any other circumstances (i.e. not limited to mergers or public procurement) where it suspects that foreign subsidies have had a distortive impact. So far, the Commission has opened two in-depth investigations into public procurement notifications (both related to Chinese bidders, one in the rail rolling stock sector and the other in the solar panel sector), but these have been terminated due to the bidders having withdrawn from the tender. It is also pursuing two ex officio investigations, one in the security equipment sector and the other in the wind turbine sector, both involving Chinese companies.

Technically, the FSR is not concerned with the nationality of the undertakings, but with the nationality of subsidies received by any undertaking. However, there is of course a de facto correlation between the nationality of a company and the amount of subsidies received from its 'home' government.

Source: Oxera.

Box 5.2 presents a summary of the *Siemens/Alstom* prohibition and the debate that followed.

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Box 5.2 Siemens/Alstom: a summary

The acquisition of Alstom by Siemens was blocked by the European Commission on 6 February 2019. The parties are leading firms in the railway industry in the EEA, with competitive overlaps in signalling systems and very high-speed trains.

The merger became the centre of attention following pressure by Germany and France, which argued for the necessity of the merger in order to ensure that there was a 'European champion' to compete against the Chinese competitor, CRRC.[69] Shortly after the prohibition, Germany and France openly criticised the Commission's decision and called for a relaxation of competition rules, including merger control, for the purpose of creating European champions.[70]

This sparked a debate on the interplay between competition policy and industrial policy. Several academics argued against the idea of relaxing merger control for the purpose of ensuring national or European champions.[71] For example, Peitz and Motta (2019) argued that European merger control was not an obstacle to the creation of such European champions, and that the Siemens/Alstom merger was rightfully blocked as it was a 'clear-cut case of a merger that hurts final consumers in Europe'.

To an extent, the introduction of the FSR (see Box 5.1) can be seen partly as a response to these concerns, i.e. by proposing to tackle foreign subsidies directly rather than relaxing merger control rules to enable EU companies to compete against (allegedly) subsidised foreign competitors.

Source: Oxera.

At a substantive level, a greater focus on killer acquisitions may require the merger control regime to examine innovation concerns more closely, possibly on the basis of high-level qualitative evidence on the prospects for potential competition. This may run counter to greater acceptance of innovation defences in merger between European companies, and

lead to an asymmetry in substantive standards that may be difficult to justify for the Commission. The goals of allowing European firms to gain scale at the same time as intervening more effectively against killer acquisitions may therefore be at least in part mutually incompatible under the current merger control regime.

The debate on killer acquisitions also raises difficult jurisdictional concerns, in particular in the wake of the Court's judgment on *Illumina/Grail* (which rejected the Commission's interpretation of Article 22 of the EUMR). It is quite possible that the Commission's efforts on preventing killer acquisitions will focus on its ability to assert jurisdictions over these transactions, and less so on the substantive standard for evaluation.

It is worth noting that the prospect of being acquired in transactions may have a positive effect on start-ups' incentives to innovate.[72] In this regard, a prohibition may negatively affect innovation incentives in the EU. As Motta and Peitz (2021) notes, however, the prohibition of a 'killer acquisition' does not hinder the owners from selling to other firms that are interested in the purchase but raise fewer competition concerns than incumbent firms.

5.3 Should one introduce non-competition objectives in merger control?

Additional industrial policy questions have arisen as a result of developments that are external to the competition sphere. For example, the COVID-19 pandemic and war in Ukraine have raised questions about supply-chain security, resilience and decarbonisation in the context of energy independence. When considering how these should be addressed in competition policy, it is worth distinguishing between two approaches: (i) incorporating these 'non-competition' objectives into merger control by competition authorities; or (ii) keeping merger control as is, but providing for these non-competition objectives as overriding factors (as an additional factor to block mergers; or as a way to allow mergers that would otherwise be blocked on competition grounds).

Although considerations regarding supply-chain security, resilience and decarbonisation are in tension with standard competition objectives and with the efficiencies of open, globalised markets and trade, at least

[69] Peitz and Motta (2019).
[70] See Germany and France (2019), 'A Franco-German Manifesto for a European industrial policy fit for the 21st Century', 19 February.
[71] See, for example, the open letter from 40 industrial economists in Motta et al. (2019).
[72] Motta and Peitz (2021).

some of these considerations could be reformulated in consumer welfare terms. This may make it easier to reflect them within the existing merger control regime. This is particularly the case in the presence of regulatory policies aimed at achieving these objectives. For example, if firms face strong incentives to decarbonise (due to tough emissions targets and high CO_2 prices), the ability to offer innovative green solutions will become a key parameter of competition and differentiation. Competition policy, by generally promoting innovation, would therefore also be promoting green innovation.[73]

However, difficulties arise if non-competition objectives are to be directly incorporated in merger control. For example, should a merger between high-carbon firms be treated more leniently because it may reduce the output of the merged entity, and hence reduce emissions? Or should a merger between a foreign and a European firm be assessed differently to take into account its impact on security or resilience in Europe?

For strategic sectors, Draghi proposes that 'security and resilience' is assessed by a 'Resiliency Assessment Body', whose assessment is then used by DG Competition as an input in the form of an additional public interest criterion.[74] Taking this input into account may, however, require a change of Article 20 of the EUMR, which lists only public security, plurality of the media and prudential rules as legitimate public interests that member states may take action to protect.

Competitiveness could also be seen as an alternative objective of competition policy, to be pursued alongside a pure competition objective. However, it is not at all clear that these two objectives go in different directions (since competition typically promotes productivity and hence competitiveness – see Section 2), and the argument for pursuing competitiveness as an additional objective is prone to being captured by vested interests.[75]

Box 5.3 presents questions for discussion regarding recent proposals and avenues for reform on merger control.

[73] Schinkel and Treuren (2021).
[74] Draghi Report, p. 300.
[75] See Vickers (2024).

Box 5.3 Recent proposals and avenues for reform on merger control: questions for discussion

4 **Overall concern**: is there a legitimate concern that merger control is preventing EU firms from achieving sufficient scale to compete internationally?

5 **Market definition**: should market definition in merger assessments be more forward-looking and flexible, to allow for efficient consolidation? How should one account for concerns about resilience, which would tend to lead to narrower rather than wider geographic markets?

6 **Innovation**: should innovation concerns play a stronger role in merger review, including the possibility of 'innovation defences'? If so, how should one trade off concerns about loss of innovation with possible innovation efficiencies?

7 **Efficiencies**: should the framework for efficiency reviews be more flexible, with more scope for out-of-market efficiencies and/or a less demanding standard of proof? Would this help European firms become more competitive?

8 **Remedies**: should the remedy toolkit be expanded to include investment remedies and more ex post monitoring?

9 **Killer acquisitions**: is there a legitimate concern about 'killer acquisitions' (in particular by large digital platforms), and if so, what is the best way to address it? Is there a risk of diverging standards for domestic mergers of 'European firms and potential killer acquisitions'?

10 **Non-competition objectives**: should broader objectives be included in merger control alongside traditional competition criteria (such as decarbonisation, resilience or industrial policy)? Or is competition policy sufficiently flexible to incorporate these concerns, to the extent that they are relevant parameters of competition?

11 Are there other areas in which merger control (and, more broadly, competition policy) should be reformed to better contribute to the competitiveness of the European economy?

Source: Oxera.

6 Discussion of options for reform of state aid control

At their core, EU state aid rules aim to prevent wasteful subsidy races between member states and to ensure a level-playing field in the internal market.

Under EU law, 'state aid' designates measures that use state resources and are imputable to the state; are selective; provide an economic advantage to the beneficiaries; and **distort (actually or potentially) competition and trade between EU member states**.[76] Therefore, the 'default' position in the treaties is that state aid is prohibited. However, by exception to the prohibition, aid may be declared 'compatible' on a number of different grounds.

These grounds are set out in Art. 107 of the Treaty on the Functioning of the EU ('TFEU') and include, for example, making good the damage caused by natural disasters or exceptional occurrences, promoting culture and heritage conservation, promoting the economic development of areas where the standard of living is abnormally low (so-called 'regional aid'), or, importantly, 'facilitating the development of certain economic activities or of certain economic areas, **where such aid does not adversely affect trading conditions to an extent contrary to the common interest**'.

This last ground is the justification for most aid measures outside times of crisis. It typically involves demonstrating that the aid meets a number of criteria: necessity of the aid, appropriateness of the chosen instrument, proportionality of the aid measure, existence of an incentive effect and minimisation of undue distortions on competition. Ultimately, the compatibility of aid rests on the notion of a '**balancing test**' being met, i.e. that the positive effects of the aid outweigh the distortions created.

Therefore, in contrast to other areas of competition law, state aid rules naturally encapsulate the notion that objectives beyond those of competition policy may outweigh the distortive impact of state aid on competition. However, at the same time, in the various soft law instruments developed by the Commission such as sector-specific guidelines, the positive effects of aid measures are often also expressed

[76] European Commission (2016).

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in terms of tackling identified market failure, which can be seen as less of an explicit conflict between competition policy and other policy objectives.

Within this context, we can assess the options for reform of state aid control presented in section 4 above.

6.1 'Stronger' enforcement of state aid control to preserve the level-playing field?

The Draghi Report highlights that the loosening of the application of state aid control during the pandemic and the recent energy crisis has fragmented the common market and triggered inefficient subsidy races. Therefore, Draghi recommends the importance of returning to a 'normal enforcement' of state aid control.

The implicit view that underpins this position is that temporary state aid rules adopted in times of crisis were too lenient in terms of the conditions imposed on member states for aid measures to be deemed compatible, while 'normal' state aid control would be stricter.

However, at the same time, a number of policy proposals set out in the Draghi Report point towards a loosening of state aid rules in some respects, e.g. allowing higher aid amounts where the aid measure contributes towards EU-wide industrial policy, placing greater emphasis on the potential impact of aid on both innovation and resilience when assessing the compatibility of aid, or expanding the scopes of IPCEIs (a particular type of aid measures for 'cross-border breakthrough innovation and infrastructure projects that can contribute significantly to the achievement of EU strategies', and that must involve multiple member states).

In addition, the Ribera Mission Letter also plans for the establishment of a European Competitiveness Fund. This in line with views expressed by a number of stakeholders, calling for EU-level funding to replace national aid measures to prevent distortions due to different fiscal capacities and to avoid subsidy races within the Union—EU-level funding does not formally qualify as 'state aid' in EU law.

Therefore, it may be possible to argue that a number of the policy proposals act not as a way to restrict 'public support' to the economy, but rather as a push for such support to be provided, coordinated and assessed at an EU-level as much as possible (rather than being left to member states).

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6.2 How does state aid control interact with industrial policy?

State aid policy has been adapted in recent years to reflect the EU's industrial policy objectives. For example, under the EU Chips act, aid may be granted to 'first-of-a-kind' semiconductor manufacturing facilities. In addition, the Temporary Crisis Framework initially adopted in 2022 as a tool to enable support to the economy following the Russian invasion of Ukraine, was subsequently amended and became the 'Temporary Crisis *and Transition* Framework' ('TCTF'), with the explicating goal of 'foster[ing] support measures in sectors which are key for the transition to a net zero economy, in line with the Green Deal Industrial Plan'.[77] Under both the Chips Act and the TCTF, 'matching aid' may be granted (under a number of conditions) to match support committed by third countries, e.g. to avoid relocation or alternative location choices outside the EU.

Existing state aid rules (whether permanent or temporary) can therefore already be seen as accommodating industrial policy objectives to a certain extent. In addition, new proposals to reform state aid control also include a push in this direction. For example, as highlighted in section 4 the Mission Letter to Ribera recommends the introduction of a new state aid framework to accelerate the roll-out of renewable energy, and the Draghi Report highlighted that state aid control can be used as a competition tool to develop 'efficiency-enhancing industrial policies'.

As set out above, state aid law in itself allows considerations related to competition policy (distortions to the level playing field) to be weighed against the tackling of market failures but also explicitly other policy objectives.

Therefore, rather than a debate as to whether state aid rules should be relaxed to accommodate industrial policy, it is possible to frame the question in terms of how industrial policy may be seen as a way to tackle market failure, or as a separate policy objective to be pursued by state aid intervention.

6.3 The FSR as a 'defensive' application of the principles of state aid control in the context of industrial policy?

To the extent that 'industrial policy' would be defined to encompass policies adopted to avoid 'falling behind' other countries and regions

[77] European Commission (2023), 'State aid: Commission adopts Temporary Crisis and Transition Framework to further support transition towards net-zero economy', press release, 9 March, available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_23_1563. .

outside the EU, the FSR may be seen as a 'defensive' tool for industrial policy.

Indeed, when discussing the need for an expansion of IPCEI rules, the Draghi Report recalls that, in terms of innovation, 'the EU falls behind the USA in many indicators and that the gap is growing'.[78] It also advocates for allowing IPCEI to include not just 'breakthrough' innovations, but wider classes of innovation 'provided that they offer the potential for Europe to jump to the technological frontier in strategic areas where it is lagging behind'.[79]

If industrial policy is to be construed in this 'relative' way, it could be possible to argue that the FSR, by tackling the distortive impact of foreign subsidies, would be better-suited to prevent the EU from 'falling behind', as opposed to using state aid rules to allow for more aid to be granted in the EU (i.e. to engage in a worldwide subsidy race).

This also goes back to the origins of the FSR, which was introduced partly to tackle claims that EU rules were overly restrictive.

[78] Draghi Report, p. 301.
[79] Ibid.

Box 6.1 Recent proposals and avenues for reform on state aid: questions for discussion

12 Is a push for more EU-level funding, cooperation and control a solution to avoid some of the potential pitfalls of industrial policy?

13 In the context of state aid, do industrial policy objectives constitute a market failure (which state aid policy could help address) or a separate, non-competition policy, objective?

14 As state aid rules explicitly allow for separate objectives to be weighed against distortive effects of intervention, do they constitute a more appropriate place than, e.g., merger control for such non-competition objectives to be introduced? If so, under what conditions?

15 As the FSR's stated aim is to ensure the level playing field in the EU by applying principles from EU state aid control to foreign subsidies, could it be argued to reduce the need for active industrial policy?

Source: Oxera.

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A1 The formation of a successful cluster without industrial policy: the case of the Italian ceramic tile industry

An informative case study that vividly illustrates the successful formation of a cluster in the absence of industrial policy is the case of the Italian ceramic tile industry, as vividly described in Enright, M.J. and Tenti, P. (1990), 'How the Diamond Works: The Italian Ceramic Tile Industry', in M.E. Porter, 'The Competitive Advantage of Nations', Harvard Business Review, March–April, pp. 80–81.

The authors describe the radical transformation of the Italian ceramic tiles sector based around Sassuolo from a small local market in the postwar period to a large internationally competitive cluster, with the number of suppliers rising from 14 in 1955 to 102 in 1962, and Italian producers of ceramic tiles based near Sassuolo accounting for 30% of global production and 60% of world exports by 1987.

The authors trace the success of the Italian tile industry back to 'sophisticated and demanding local buyers, strong and unique distribution channels, and intense rivalry among local companies'. These factors created strong incentives to innovate, forcing suppliers to

- overcome dependence on foreign raw materials and production technology,
- develop specialized retail networks and an internationally active industry association and
- improve manufacturing processes on several occasions, increasing exports in equipment and decreasing labour costs (facilitating suppliers' ability to cope *inter alia* with the 1973 energy crisis).

Italian suppliers also benefited from strong local suppliers and 'supporting industries'.

A2 Ribera Response to questions from MEPs in preparation for the Confirmation Hearing

In recent written answers to questions set by MEPs in advance of her confirmation hearings, EVP-designate Ribera has indicated a prudent, but noticeable, shift toward an approach to EU merger control that is more supportive of the need of European companies to gain scale.[80]

Her answer to the specific question on mergers read as follow[81]:

> "Specifically with regard to merger control, the EU has traditionally taken a favourable view towards market consolidation and the benefits it can provide – with the clear exception of when consolidation significantly impedes effective competition, in particular because it leads to excessive market power, which can harm the whole EU economy, including SMEs and of course consumers. While this basic objective of impeding excessive accumulation of market power must remain in place, EU merger control must continue to evolve to capture contemporary needs and dynamics like globalisation, digitalisation, sustainability, innovation and resilience. Changes in efficient scale for investment-intensive activities, or in the geographic scope of operations of rival firms, should be taken into account. Regard should be had to the willingness of customers over time to consider novel suppliers which have developed products in other regions, or to attach value to more trusted and reliable local suppliers. Continuous adaptation is necessary for EU merger control enforcement to remain a key facilitator to the competitiveness of EU companies in full respect of the Treaties, including when they operate in global markets or when global players start to penetrate European markets. While such evolutions take place to a significant extent through the decisional practice, it is essential that the underpinning legal framework remains modern and fit for purpose.

[80] See: ribera_writtenquestionsandanswers_en.pdf
[81] The question on merger control from the MEP was as follows: "What changes might the 'new approach to competition policy' involve, and how can it be better aligned with industrial policy? Are you satisfied with the current state of play of the application of the Merger Regulation? Would you be in favour of Commission's possibilities to also look into mergers below the notification threshold? How will you protect our EU innovators from killer acquisitions or acquisitions of EU based undertakings by foreign-based state-owned enterprises supported and subsidised by their governments in ways that the EU single market rules prohibit for EU entities?".

I am therefore committed to delivering on the task in my mission letter of modernising competition policy specifically for merger control, by engaging in a review of the Horizontal Merger Guidelines in line with my mission letter. My aim is to ensure that merger control gives the right weight to the EU economy's needs and reflects overall policy objectives and market realities, including possible efficiencies. This would be a review with innovation, investment, and resilience among the core drivers.

In parallel, I am determined to swiftly find the best way to ensure that 'killer acquisitions' of target companies with low or no turnover but with high competitive and innovative potential do not escape scrutiny under EU merger rules, just because they do not meet the turnover-based notification thresholds. This is key to protect innovation and future competitiveness in the EU. To this end, I will look into all options without creating any unnecessary additional administrative burden or legal uncertainty for companies.

Separately, I will rigorously enforce the Foreign Subsidies Regulation to protect the Single Market from distortive subsidies by non-European countries, specifically the part of that legislation that applies to concentrations. In doing so, I will strongly push for a global level playing field for European companies, alongside other Members of the College and Member States responsible for other tools such as foreign direct investment screening and trade defence instruments".

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