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Competition and Trade: Which Policies for Europe?

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European competition policy is currently questioned with regards to its effectiveness and purpose. In particular, it is accused of hindering the emergence of large companies. Apart from the fact that size does not always confer a decisive advantage, the analysis performed in this *Note* shows that the European competition policy is rather successful in achieving its current goals, promoting investment, productivity and purchasing power. Regarding concerns about international competition, it is the articulation of trade policy that needs to be addressed. This *Note* argues that Europe should not sacrifice its competition policy but instead should be more demanding in defending its interests and enforcing the rules, in accordance with its international commitments.

Since the 2000s, concentration and profit margins have increased more in the United States than in Europe. At the same time, US purchasing power and investment have also experienced the largest decreases. This indicates that it is not the European competition policy that is too rigorous, but the United States' that is not enough. This does not mean, however, that the European competition policy should not evolve. For instance, in view of the problems of excessive delays in proceedings for the abuse of a dominant position, we recommend that the use of provisional measures be facilitated. Similarly, in order to combat pre-emptive acquisitions, we are in favor of allowing *ex-post* control of concentrations.

With regard to trade policy, the priority objective must remain a reform of the World Trade Organization (WTO), with priority given to industrial subsidies and transparency obligations on non-tariff measures, on the implementation of regulations and on subsidies. However, in view of the difficulties and time required to develop WTO rules, it is imperative to consolidate the defense of European interests at the same time. We recommend that vigilance and enforcement of the principle of reciprocity in market access be strengthened, in particular through more strategic and proactive use of the consultation and dispute settlement system in the event of breaches. Promoting public procurement reciprocity is also needed. To embody and implement this requirement of reciprocity, we support the creation of a position of European Chief Trade Enforcer. On subsidies, we recommend strengthening transparency requirements and facilitating the adoption of countervailing measures when a partner's subsidies are detrimental, but also making more reactive use of trade defense instruments in the event of industrial subsidies or unfair trade practices detrimental to European interests.

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Is there a competition problem in Europe?

The European competition policy is based on two pillars: a clear doctrine of European consumer protection and a clear independence of its application by the Commission, which guarantees its impartiality and builds the confidence of the Member States in its decisions. This policy is sometimes accused of hindering the achievement of the Union's strategic objectives. To assess this point, we analyze the effects of competition policy in Europe by comparing it with the United States. The scope of our analysis includes all policies that have an impact on market structures and competitive behavior of companies: merger control, State aid, and the opening of public and private markets.

Competition, concentration and value-added

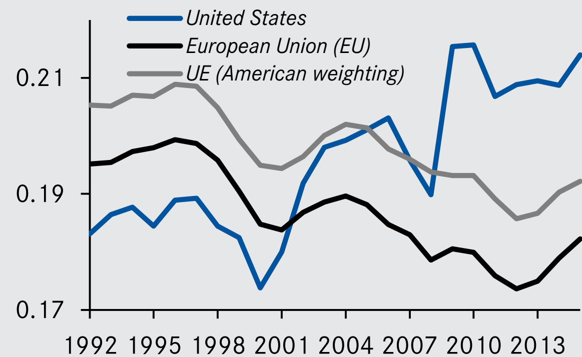
Until the 2000s, American markets were more competitive than European markets, with lower prices and often lower margins. These trends were then reversed, with a sharp increase in profit margins in the United States, but not in Europe (see Figure 1). This evolution of margins can be compared with the evolution of concentration over the last fifteen years: increasing sharply in the United States, it is relatively stable in Europe. Measuring concentration in Europe (i.e. 28 Member States in which the degree of concentration may vary by sector) is a more complicated exercise than in the United States, but all available studies conclude that the increase is significantly higher in the United States than in the European Union.[1] Moreover, for the United States, this result remains valid when the digital giants (GAFAM) are excluded. On the other hand, margins are stable or declining when the analysis is limited to sectors subject to international competition.

Finding 1. In the United States, there is a significant increase in concentration in many sectors and a distortion of value-added sharing in favor of profits. This is not the case in Europe.

Competition, price and purchasing power

Competition policy in favor of consumers should translate into lower prices. To test this idea, we compare the evolution of prices in relation to the unit cost of labor between Europe and the United States. This exercise carried out in the ten main countries of the European Union and the United States shows that over the 2000-2015 period, prices increased by 15% more in the United States than in Europe, but wages only increased by 7%. The price/wage margin fell by around 8% in

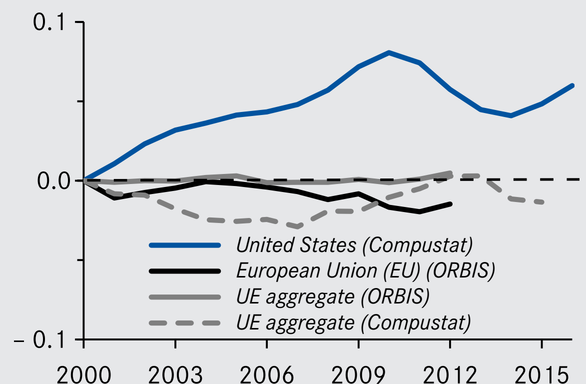
1. Profit margins in the United States and the European Union, 1992-2015



Reading: Profit rate for the non-agricultural business sector, excluding the real estate sector. The black series is first aggregated in the European Union (EU) countries, within industries, by weighting production in EU countries, and then in EU industries by weighting by gross industrial production. The grey series uses American industrial weights to eliminate compositional effects.

Source: OCDE, STAN.

2. Evolution of concentration levels in the United States and the European Union 2000-2015



Reading: Absolute changes in the concentration ratio of the eight largest firms (CR8) in all sectors, weighted by real gross output, from 2000 onwards. The US CR8s are based on Compustat's consolidated financial data. European Union (EU) figures are also based on Compustat data and non-consolidated financial data from ORBIS. The country series treat each country as an independent market. The aggregate series consider the EU as a single market. See Philippon T. (2019): "Les marchés européens sont-ils devenus plus concurrentiels que les marchés américains ?", *Focus du CAE*, no 31-2019, May.

Sources: ORBIS and Compustat.

The authors would like to thank Jean Beuve, Scientific Advisor of the CAE who followed up on this work, and Étienne Fize, Economist at the CAE who assisted them.

[1] According to the OECD, the CR8 has risen from 0.35 to 0.45 in the United States and from 0.26 to 0.29 in Europe, see Bajgar M., G. Berlingieri, S. Calligaris, C. Criscuolo and J. Timmis (2019): "Industry Concentration in Europe and North America", *OECD Productivity Working Papers,* no 18. For more details, see Philippon T. (2019): "Les marchés européens sont-ils devenus plus concurrentiels que les marchés américains ?", *Focus du CAE*, no 31-2019, May.

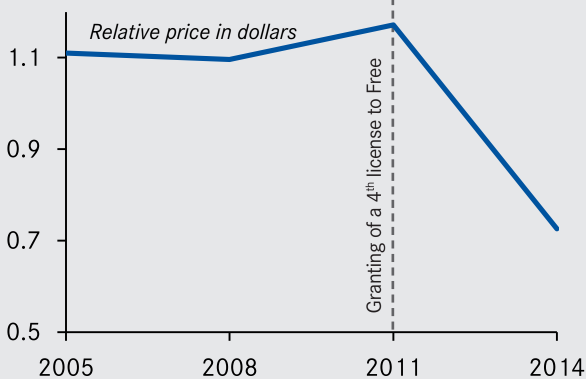
Europe compared to the United States. For a worker with a median salary, this represents an 8% increase in purchasing power.[2]

In addition, price decreases in Europe are often the result of economic policy measures with pro-competitive effects. For example, following the granting of a fourth license to Free in France in 2011, prices fell by 40% in less than a year. Prices for telecommunications services, which were higher in France than in the United States until 2011, have become and remain lower (see Figure 3). These results are consistent with the report of the European telecoms regulator which shows that in the three countries (Germany, Austria, and Ireland) where the number of operators has increased from four to three, prices have increased.[3]

Competition, investment, and productivity

A (too) strict competition policy could weigh on corporate profits to the point of limiting investment or innovation. This theoretical argument is valid but its empirical relevance seems limited. The comparative developments in the United States and Europe in concentration, profits, share prices and investment for the five most rapidly concentrated industries in the United States are very telling from this point of view. Concentration, operating margins, and share prices have increased in the United States at the same time as investments, including intangible investments and R&D, have declined. Conversely, concentration has decreased in Europe and investments have remained (relatively) stable, despite lower profits and lower share prices.[4] If the concentration in the United States is a sign of a lack of competition, this is exactly what the theory would predict.

3. Telecommunications price index in France and the United States, 2005-2014



Source: World Bank, International Comparison Program.

Finding 2. Investment and productivity in Europe have not been negatively affected by lower industrial concentration compared to the United States.

More generally, recent work analyzing the impact of competition policy (concentration, barriers to entry, etc.) on the differential of productivity between the United States and the European Union shows that in industries where competition is more intense in Europe, we observe a similar, or even slightly higher, productivity level than in the United States.[5]

In the end, nothing suggests that Europe implements an "excessively" rigorous competition policy, in the sense that it would hinder development, even if at the same time the United States seems to have become too lax. Profit increases in the United States have been used to increase dividends and share buybacks but not investment or R&D. In addition, recent research shows that the decline in competitive intensity has been favored by increased spending on lobbying regulators and policies.[6] Competition policy in Europe, on the other hand, is showing signs of success with lower prices and at least equivalent productivity. The relative weakness of innovation in Europe has many causes, but competition policy is probably not one of them. To explain the export performance of European companies, it is rather the articulation with trade policy that must be questioned.

The articulation between competition policy and trade policy

Competition policy and trade policy are closely complementary: the former provides a framework for the internal market while the latter defines the conditions of external trade. Their joint action must allow for (unbiased) "merit-based

[2] Gutiérrez G. and T. Philippon (2018): "How EU Markets Became More Competitive Than US Markets: A Study of Institutional Drift", *NBER Working Paper*, no 24700, June.

[3] Body of European Regulators for Electronic Communications (BEREC) (2018): "Price Effects of Mobile Mergers in Austria, Ireland and Germany", *BEREC Report on Post-Merger Market Developments*, no BoR (18) 119, 15 June.

[4] See Philippon (2019) *op. cit.*

[5] See Gutiérrez and Philippon (2018) *op. cit.*

[6] Gutiérrez G. and T. Philippon (2019): "The Failure of Free Entry", *NBER Working Paper*, forthcoming.

competition" at the international scale. The coherence of this approach is reinforced by the coordination and progressive convergence of principles and practices on issues related to merger control, cartels, and abuses of dominant positions.[7] It also relies on the multilateral trade framework of the World Trade Organisation (WTO), based on the principles of non-discrimination, reciprocity, and transparency. Competition and trade policy actions are supposed to detect and sanction the behaviors of companies and states that do not respect the common rules of the game. However, the current context, marked by a decline in multilateralism and increasing state interference in international competition, raises questions about the adequacy of the approach inherited from the WTO framework to defend European interests.

Competition policy: controlling distortions linked to the exploitation of market power

Competition policy is justified by the fact that fully competitive markets ensure the best allocation of resources and benefits in terms of price, quality, and innovation for consumers. In particular, the proper competitive functioning of markets makes inefficient or technologically outdated firms disappear, attracting capital and jobs to more efficient sectors and technologies; this dynamic effect, often forgotten by those who see competition as just a means of lowering prices, is key for innovation and its diffusion in economy. However, the presence of externalities (e.g. environmental or R&D-related) or strategic corporate behavior (cartels, abuse of dominant position) sometimes prevents these virtuous mechanisms from operating. For various reasons, prices are no longer good signals for decisions. In such cases, competition policy is responsible for correcting imperfections in corporate behavior that impede the proper functioning of markets.[8]

This competition policy is one of the pillars of European integration and the single market. Its legal principles are contained in texts of different levels of the hierarchy: treaties, regulations, and guidelines. Its implementation is an exclusive competence of the Commission[9] (through its Directorate-General for Competition), which operates mainly in three areas: the detection and repression of cartels, abuses of dominant positions and merger control.

While action against cartels and abuses of dominant position takes place *ex-post*, once the potentially illegal conduct has been observed, merger control takes place *ex-ante* (see Box 1). This is what brings this aspect of competition policy closer to sectoral regulation, which also defines *a priori* the rules under which companies in regulated sectors (telecommunications, energy, etc.) can operate. While competition policy in Europe has been stricter in its implementation than in the United States (see *above*), the Commission's rejection of mergers is extremely scarce, while unconditional acceptance constitutes the vast majority of cases. Over the period from January 2010 to December 2018, among the 2,980 merger transactions notified to the Commission, 2,704 were accepted unconditionally (90.7%), including 1,949 (65.4%) in Phase 1, and 156 transactions were conditionally approved. Among these accepted mergers, some have given rise to very large European champions, such as the mergers between Luxottica and Essilor in eyewear and between Lafarge and Holcim in cement, to quote only two examples. Moreover, merger control has not deterred merger operations since, only 56 of those 2 980 operations were withdrawn in Phase 1 and 9 in Phase 2. These withdrawals cannot be attributed to the severity of the Commission's criteria. Finally, only 7 transactions were refused by the Commission (2 of which involved American companies). While the preservation of competition sometimes imposes asset transfers to companies, merger control does not appear to be an obstacle to the emergence of large European companies.

Moreover, whatever the complexity and extent of the competition concern raised by the Commission in a merger, there are usually solutions through the establishment of "remedies" discussed between the parties and the Commission (see Box 1). However, while many national authorities accept "behavioral" commitments (whereby companies commit to implement, or not implement, particular behaviors), this is not the case for the Commission, which over time and under the strict control of the European Court of Justice, has increasingly limited the commitments it accepts to "structural" remedies: companies must agree to sell particular assets (establishment, production line, subsidiary company...). However, if the implementation of such commitments is less difficult for the Commission to monitor, they have the disadvantage of not being reversible, while behavioral commitments can always be adapted if new events change the competitive functioning of the market. In France, the competition authority has reduced the behavioral commitments made by the Canal+ Group when it merged with TPS and then when it acquired Direct 8 and Direct Star channels, to take into account the arrival of audiovisual content platforms such as Netflix and Amazon.[10] It would be appropriate to allow for easier and more frequent application of these behavioral measures, in particular by amending (at least) the Commission's communication on remedies admissible under Council Regulation (EC) 139/2004 and Regulation (EC) 802/2004.

[7] Issues related to the implementation of these policies (e.g. regulatory challenges posed by digital platforms and the evolution of competitive damage assessment methods) are regularly discussed in the framework of the International Competition Network and the OECD.

[8] The correction of other market failures is generally entrusted to other policies, such as environmental policy or policies by which the State itself produces certain public goods (education, health, etc.).

[9] This is why giving another body, such as the Council, a power of evocation would considerably upset the European institutional balance. Decisions on competition matters are taken by the College of Commissioners.

[10] See the two decisions of the Competition Authority 17-DCC-92 and 17-DCC-93 of 22 June 2017.

1. Merger control

The logic of merger control is based on the fact that the merger of companies, in particular, horizontal mergers between operators in the same relevant market, can generate two effects. On the one hand, the merger may reduce competitive pressure: the market power obtained by the new entity allowing it to increase its prices, reduce the supply of differentiated products, no longer be subject to the "competitive stimulus" to undertake R&D actions, etc. On the other hand, it can have beneficial economic effects: the merged entity can achieve economies of scale (elimination of duplicates, reaching critical size) and has greater resources for R&D. The role of the competition authorities is to examine merger proposals and draw up a competitive assessment, including an analysis of all these aspects, to prevent mergers that would significantly impede effective competition in the European Economic Area or a substantial part of it.

Above certain thresholds expressed in terms of turnover,[a] proposed mergers must be notified to the Commission, which carries out a two-stage assessment procedure. Phase 1 is a rapid competitive analysis (25 business days) at the end of which the merger may be authorized with or without commitments from the parties. In more complex cases, the Commission opens an in-depth investigation (phase 2) at the end of which it authorizes or refuses the merger. As in phase 1, when the Commission authorizes the merger, it may make it conditional on undertakings being given by the companies. These commitments may be of a behavioral nature (a commitment to do or not to do) or, more often, structural (transfers of assets to competitors in order to preserve sufficient competition on the market after the merger).

[a] Thresholds defined in Regulation (EC) no 139/2004 on the control of concentrations between undertakings (the EC Merger Regulation).

Recommendation 1. Facilitate the application of behavioral measures in commitments undertaken by companies to adapt to post-merger market developments.

Regarding State aid, the Commission's competence derives from the need to harmonize the conditions of competition between the Member States: it is, therefore, a European specificity. As in previous areas, one of the objectives of State aid control is to ensure that it does not distort the market. In addition, there is a related but fundamental objective: the achievement of the single "internal market", in which the conditions of competition are equivalent throughout the Union. This excludes the possibility for a Member State to subsidize its companies in a way that distorts competition in the internal market.

The implementation of competition policy has evolved considerably since the mid-2000s, from an initially more legal approach to recently a more economic implementation. In the antitrust field, the cumbersome and administrative *ex-ante* notification of agreements has given way to *ex-post* control (Regulation 1/2003). Similarly, merger control has confirmed the abandonment of the test of "creation or strengthening of a dominant position" in favor of the economic test of "a substantial reduction of competition" resulting from the operation (Regulation 139/2004). With regard to abuse of dominant position, the Commission has adopted, after many debates at European level, its Communication on abuse of dominant position which takes the same path in favor of a more economic approach.[11] Finally, State aid control is also moving towards a more economic approach. On the one hand, since the aid is derogatory from the normal functioning of market economies, it must be justified by an identified market failure for which public intervention is necessary; while on the other hand, the subsidy must just compensate what is necessary to overcome the failure in question, without giving the company receiving it, beyond this compensation, any advantage that is likely to distort competition.

European trade policy: defending the European Union's offensive and defensive interests

The Union's trade policy is also an exclusive competence of the European Commission, which negotiates free trade agreements with the various regions of the world on behalf of the Member States under the aegis of the WTO, which defines a multilateral framework for international trade. It is the body that possesses the trade defense instruments to remedy unfair practices like anti-dumping duties and countervailing measures to subsidies.[12] However, their final implementation is subject to examination by the Committee on Trade Defense Instruments, composed of representatives of the Member States, which may oppose the Commission's recommendations by a qualified majority. Anti-dumping proceedings are based on complaints from European companies about "abnormally low" prices charged by foreign competitors on the European market. The difficulty lies in assessing the "normal" price that would prevail in the absence of dumping, as a low price may reveal lower costs and not necessarily foreclosure behaviors by competitors. The Commission's investigation must, therefore, provide evidence that these prices are indeed linked to dumping and that European companies are harmed. If such evidence is

[11] Guidelines on the priorities adopted by the Commission in the application of Article 82 (now 102) of the Treaty on the Functioning of the European Union to abusive exclusionary practices of dominant undertakings.

[12] Even though safeguard measures are also trade defense instruments, they are not supposed to respond to unfair practices, but rather to situations of sudden surge in imports making it difficult for European industry to adapt.

provided, the Commission may apply anti-dumping duties to the products in question to compensate for the difference due to this practice. At the end of 2018, 94 anti-dumping measures were in force (27 of which were extended to third countries to avoid circumvention), two-thirds of which concerned China.[13]

In terms of countervailing measures, additional customs duties may be applied to imported products that benefit from prohibited or detrimental subsidies in their country of origin. However, while the procedure is similar to anti-dumping, the demonstration of the existence of subsidies is sometimes difficult and the establishment of "injury" or "serious prejudice" (under the terms of Article 5 of the WTO Subsidies Agreement) even more challenging. The WTO requires its members to notify subsidies granted to companies, giving priority to a complete provision of information every two years. Otherwise, the Commission must investigate the cases submitted in order to demonstrate the existence of subsidies. At the end of 2018, 12 countervailing measures were in force (one extended), half of which concerned China.[14]

But unlike competition investigations, where it has the capacity to investigate companies under its jurisdiction, the Commission cannot do the same for subsidization practices to companies operating from sovereign states. To access relevant information, the Commission must ask the States and companies concerned to cooperate, and in the event of refusal, make estimates from available (and sometimes limited) sources. Moreover, the European trade policy is mainly organized around the negotiation of trade agreements and relatively little around their monitoring, so that non-compliance with commitments by states that have signed agreements with the European Union is insufficiently detected and corrected by appropriate measures.

In addition, the European Commission operates under the supervision of the European Court of Justice and in compliance with WTO rules. This has an important consequence: both have a restrictive definition of what constitutes a subsidy (or State aid within the meaning of European competition policy). Aid granted from direct State resources shall be considered to a subsidy. Aid that takes more indirect forms, such as access to a resource (natural resource or production factor) at a preferential price or the use of a loan at a subsidized rate by a public bank, is difficult to qualify and quantify.

European trade defense instruments were modernized in June 2018 to give the Commission the capacity to act more efficiently. Among other amendments, the Commission can take up the matter *ex-officio* and is no longer limited to practices denounced by the companies. If it discovers practices other than those initially denounced (dumping or subsidies), it can impose duties. However, it is still too early to know whether these changes will be sufficient and effective.

To accomplish the goal of better protection, a screening mechanism for foreign investment was introduced in March 2019. It provides the Union with a cooperation mechanism for controlling the purchase of domestic companies by foreign ones when security or public order are potentially threatened. This mechanism coordinates institutional structures and organizes information and evaluation sharing, with the Commission being able to issue an advisory opinion. In this sense, it is an important institutional innovation. It is the result of growing doubts about the European Union's ability to defend its interests through a completely open investment regime, since State interests and sovereignty issues are becoming increasingly important in acquisition projects. However, its limitations are obvious. In particular, it does not create any obligation other than information and it is only intended to protect security and public order, even though it explicitly provides for the context and circumstances of the investment to be taken into account, including the possible control of the investor by a State.[15]

Finding 3. Anti-dumping and anti-subsidy controls are long and complex to implement. In response, Europe is developing defense instruments, including investment screening.

What are the issues and which strategy should Europe adopt?

Despite their consistency, the above principles face different limitations in their implementation. While its main competitors do not always have practices equivalent to its own, the question is the following: to what extent is the European Union effectively defending its interests and, where appropriate, what additional measures would be useful? In practice, there are two main problems, relating to dominant positions and subsidies.

Risk of abuse of a dominant position in a foreign market

The asymmetry in the implementation of competition policy, highlighted above with regard to the United States, also exists with regards to China, albeit for different reasons. Competition

[13] European Commission (2019): *37th Annual Report from the Commission to the Council and the European Parliament on the EU's Anti-Dumping, Anti-Subsidy and Safeguard Activities and the Use of Trade Defence Instruments by Third Countries Targeting the EU in 2018*.

[14] European Commission (2019) *op. cit.*

[15] See the draft Regulation of the European Parliament and of the Council establishing a framework for filtering foreign direct investment in the Union of February 2019, paragraph 13.

2. Competition policy in the People's Republic of China

The so-called "anti-monopoly" law, which came into force on January 1st, 2008, marked the birth of genuine competition policy in China, in the sense given by modern capitalist economies. The purpose of this law is to "prevent and restrict monopolistic behaviors, ensure fair competition in the market, improve economic efficiency, protect the interests of consumers and society as a whole and promote the healthy development of the socialist market economy" (Article 1). Its implementation was mainly based on the National Development and Reform Commission (NDRC) for the supervision of pricing practices, the State Administration of Industry and Commerce (SAIC) for non-tariff practices and the Ministry of Commerce (MOFCOM) for merger control.

While this law is largely inspired by European practices, it also includes specific provisions, adding to the objective of protecting consumers in the internal market the objective of defending China's economic and industrial interests on an international scale. Article 4 thus emphasizes that the State shall develop and apply competition rules compatible with the socialist market economy and Article 5 shall encourage mergers and acquisitions as a means of achieving economies of scale. The law also provides for broad exceptions to the rules governing practices, with the examination of a merger or acquisition having to take into account, for example, the "influence on national economic development" (Article 27-v), a concept that is at best vague, while the protection of the "legitimate interest in foreign trade" may exempt from the rules governing anticompetitive agreements (Article 15-vi).

This possibility of "subordination" of competition policy to industrial policy is also observed in practice. In particular, it is made possible by a certain lack of transparency in the application of competition policy. Thus, foreign companies report being disproportionately targeted compared to local companies (inequalities in market access in obtaining state subsidies and in the enforcement of regulations).[a] The difficulties in implementing competition law are also linked to China's specific characteristics, in particular, the significant weight of local authorities, which sometimes oppose the Party's wishes at the national level and therefore the central agencies in charge of competition policy, particularly on issues of non-tariff practices by state-owned companies. In response to these difficulties, all the prerogatives relating to the application of competition policy have been brought together in a single agency, the State Administration for Market Regulation (SAMR), but it is too early to judge its effects.

[a] See, for example, Deloitte and AmCham China (2019): *China Business Climate Survey*.

policy in China is in the process of being developed, and while there have been significant structural reforms in recent years, it remains subject to industrial policy decisions (see Box 2). In sectors where the Chinese authorities favor export capacity, competition on the domestic market is not always an objective, as the authorities often seek to promote (and often constitute) one or more national champions, even if this means creating a dominant position on their market.

This asymmetry in the application of competition policy creates the risk that European companies may face competitors who can rely on a dominant position in their national market. With regard to the risk of distortion of competition that this entails, it should be stressed that the competence of European competition policy extends to all cases with effects on the European market, whether they involve mergers and acquisitions or abuses of a dominant position. A proposed merger between foreign companies that could distort competition on the European market may, therefore, be the subject of a request for a remedy or blocking by the Commission, as in the case of the 2001 prohibition of the merger between Honeywell and General Electric. The case has never before arisen for Chinese companies, but the same control would then apply, and European competition policy would have the means to enforce its decisions, for example, by not recognizing the newly formed entity under European law, thus preventing it from carrying out any economic activity in Europe.

Where the company already enjoys a dominant position on its market, the European rules for the prevention of abuse of a dominant position apply. Various recent procedures have shown that this policy is binding on companies, both European and non-European. However, three main questions remain to be asked, namely excessive delays of procedures, the case of killer acquisitions and competition on third markets.

Sometimes excessive delays

Delays in dealing with abuses of a dominant position can be problematic, notably in particularly technical cases. In general, the so-called "effects-based" approach in competition policy is very demanding in terms of economic analysis. It involves sometimes huge amounts of data and requires considerable work from both parties and authorities to model, discuss the used assumptions, select appropriate techniques, econometric models and results. This exchange, which is necessarily long, may be incompatible with business times in some sectors where certain behaviors of dominant companies may lead to the disappearance of competitors. Instruments exist to take rapid action, which freezes the market in a state compatible with the survival of competitors

until the case is processed. This instrument, called "provisional measures", exists in the texts at European level, but the European Court of Justice (ECJ) has gradually reduced its scope by requiring the Commission to have qualified the practices beforehand in order to pronounce such measures, i.e. to wait until the problem is solved. Making these protective measures easier and allowing the ECJ to let the Commission accept protective measures is desirable, but this must be done through relaxation of Regulation 1/2003 (Article 8) on the implementation of the competition rules laid down in Articles 81 and 82 (now 101 and 102) of the Treaty.

Recommendation 2. To allow for a faster application of remedies for abuse of dominant position by facilitating the use of provisional measures.

The case of "killer" acquisitions

Due to network effects, which are growing on a global scale, and the ability to develop in a large number of more or less related markets by capturing consumer value, large digital platforms raise unprecedented competition issues. The risks of abuse of a dominant position are numerous, as illustrated by the abuses of a dominant position dealt with by the Google Shopping Commission in 2017 and Android in 2018 (respectively 2.4 and 4.3 billion euros in penalties).

While the analysis of issues specific to large digital platforms is beyond the scope of this *Note*, this case illustrates the problems posed by sectors where disruptive innovation plays a central role in competition, creating a favorable context for "killer acquisitions", i.e. the acquisition of innovative start-ups with no significant revenue by giants seeking to nip potential competitors in the bud.[16] Such purchases are not subject to merger control when the acquired companies are at an early stage of development and have a detrimental influence on innovation.

Between 1991 and 2018, the GAFAMs (Google, Apple, Facebook, Amazon, and Microsoft) made 634 acquisitions for a total amount of more than 142 billion dollars. Without being able to prejudge the "killer" nature of all these acquisitions, however, such amounts indicate that it is necessary to deeply think about this issue. Several solutions are being considered to address the problem of killer acquisitions. The first would be to lower the thresholds for notification in terms of turnover. The German competition authority, which has been experimenting with this solution for a year, is not satisfied with it. As competition law is transversal and non-sectoral, this lowering leads to the inclusion of many transactions that are not relevant from a competitive point of view. Such a solution must, therefore, be ruled out.

Another solution is to introduce a threshold in terms of the value of the transaction, which makes economic sense: if a transaction reaches a high amount for the purchase of a company with low (even any) revenues, it is because this company represents an important stake for the buyer. This does not necessarily reflect a pre-emptive will, but one could imagine that the acquiring company would have to demonstrate it, by reversing the burden of proof. However, the value of the transaction can be easily manipulated, unlike turnover, and behavior that conceals the actual price of the transaction could occur.

The third option is to allow *ex-post* control by the competition authority of certain mergers. Such *ex-post* control generally exists in the United States and the United Kingdom where *ex-ante* notification of mergers is optional and where the authority can intervene well after the implementation of the merger and impose its dismantling. Such a solution could create legal uncertainty but has a double advantage. On the one hand, it treats pre-emptive acquisitions as abuses of a dominant position, which they are (and it is normal that such abuses are treated *ex-post*). On the other hand, it allows authorities to focus only on cases that appear to raise a competition problem. This solution, also recommended by the French Competition Authority, seems best to us.

Recommendation 3. To control pre-emptive acquisitions, allow *ex-post* control of certain mergers by the competition authority.

However, beyond the application of competition policy, the development of digital platforms is also largely dependent on the size of the market, given the importance of network effects. In this respect, regulatory barriers are an obstacle to the creation of a market of sufficient size and the development of key players. Greater European integration would be needed to reduce the fragmentation of the single market, particularly in the service sector.

Competition in third markets: should we fear the "mastodons"?

By its very nature, European competition policy only deals with the effects on the European market. It, therefore, leaves open the question of whether the dominant position enjoyed by some of their foreign competitors constitutes an unfair

[16] Killer acquisitions are not only the preserve of large digital companies, they are also very present in biotechonologies, see Cunningham C., F. Ederer and S. Ma (2018): "Killer Acquisitions", *SSRN Working Paper*, no 3241707.

advantage in third markets. The competitive position on the home market affects that on foreign markets mainly in two cases: the company implements cross-subsidies (a part of the revenues on its market is used to subsidize a low selling price elsewhere) and the company operates in a sector where size is a decisive competitive advantage.

To our knowledge, the existence of cross-subsidies has not been proven on a large scale. In such a case, two solutions are possible. The first is to request the opening of an anti-dumping proceeding from the importing country, as this practice corresponds precisely to the definition of dumping in trade law. The second is to bring a dispute to the WTO for the implementation of harmful subsidies. This would be consistent with the WTO Agreement on Subsidies in cases where the dominant position granted on the domestic market can be interpreted as a form of price support (Article 1.1, sub-paragraph a.2). Given the difficulty in establishing the reality and consequences of the lack of enforcement of competition policy, however, it is doubtful that such an approach would be operational in the current state of international agreements.

The question of size is more complex. While the lax application of competition policy by our partners may allow some of their companies to grow to a larger size than they would otherwise, often significantly larger than their European competitors, is this a decisive competitive advantage? Several arguments may suggest this: the growing importance of digital platforms, for which network effects make size a central asset; the growing importance of intangible capital, which often gives rise to significant sunk costs, and the ever-increasing amounts required to invest in new production tools (e.g. semiconductor foundries) or to develop new products (e.g. automotive, pharmaceutical, aeronautics). However, these elements are specific to certain sectors or activities. In general, let us put the importance of size into perspective: the declining trend in the price of capital goods reduces fixed production costs, while the fall in transaction costs allows companies to specialize, and expand internationally. The frequent failure of merger operations also illustrates the fact that a larger company is not always more efficient.[17] In the very specific context of Chinese state-owned enterprises, the groupings orchestrated by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) have been followed by a significant deterioration in their economic performance.[18]

We cannot, therefore, assume the impact of size on productivity and we must rely on empirical studies. Recent academic work indicates that levels of the returns to scale are close to 1, with a slight upward trend over the last twenty years.[19] In addition, a positive link between export performance and the fact that companies have faced more intense competition in their domestic markets has been highlighted by several studies.[20] Consequently, size does not generally confer a decisive advantage, and its importance does not seem to be greater than in the past. However, in some sectors where sunk costs are very high and/or network and scale effects are particularly important, the poor application of competition policy in the home country is, in fact, an undue advantage. Unlike a subsidy, however, this distortion results in higher prices,[21] suggesting two possible responses. A first would be to consider it as a subsidy through price support, but the implementation difficulties highlighted with regard to cross-subsidies would probably be even greater in this case.

It is, therefore, better to focus on the second solution, which is to insist on reciprocal market access. If this policy raises prices in the domestic market of the country that practices it, then it offers opportunities for foreign companies, provided that access to that market is not hindered. Reciprocity is one of the founding principles of the multilateral trading system and can be implemented in this case. WTO rules, when formalized, are effective in combating undue market access barriers. To ensure the effectiveness of reciprocity of agreements, transparency obligations on non-tariff measures and on the implementation of regulations must be strengthened to minimize informal or poorly identified obstacles. These requests must be an important focus of the WTO reform negotiations. The effectiveness of international commitments also assumes that the means for enforcement are provided, in particular by filing complaints when breaches are identified. This has not always been the case so far, as evidenced by the limited number and ambition of WTO appeals

[17] Most studies report merger failure rates (in their ability to achieve expected objectives) of between 70% and 90%. See Christensen C.M., R. Alton, C. Rising and A. Waldeck (2011): "The New M&A Playbook", *Harvard Business Review,* vol. 89, no 3, March.

[18] While SASAC was responsible for improving the performance of large state-owned enterprises, which led it to bring about mergers dividing their number by about half, the average rate of return on the corresponding assets drop from 6% in 2005 to 2.6% in 2017. See Lardy N.R. (2018): *The State Strikes Back*, Peterson Institute for International Economics.

[19] A 10% increase in a company's size increases its output from 10.3 to 10.8%, which means that its productivity increases from 0.3 to 0.8%, see De Loecker J., J. Eeckhout and G. Unger (2019): "The Rise of Market Power and the Macroeconomic Implication", *NBER Working Paper*, no 23687. In addition, Covarrubias M., G. Gutiérrez and T. Philippon (2019): "From Good to Bad Concentration?", *NBER Macroeconomics Annual and University of Chicago Press*, forthcoming, find returns of scale close to 1 and without significant evolution.

[20] Clark D.P., J. Creswell and D.L. Kaserman (1990): "Exports and Antitrust: Complements or Substitutes?", *Review of Industrial Organization*, vol. 5, no 2, pp. 41-51, and Hollis A. (2003): "Industrial Concentration, Output, and Trade: An Empirical Exploration", *Review of Industrial Organization*, vol. 22, no 2, pp. 103-19.

[21] When this is not the case, for example for some digital platforms, it means that their development –even in a dominant position– is not a sign of a deficiency in competition policy.

concerning Chinese subsidies.[22] The European Union has never initiated WTO dispute proceedings directly challenging subsidy schemes in China. It only complained against forced technology transfers in 2018, after US initiatives. Also, it has not argued that Chinese policies bereft it from the benefits expected from the agreements ("non-violation complaints"). In addition to the threats to the WTO dispute settlement system, it is time to make more strategic and offensive use of it.

As the impact of these actions is both uncertain and often slow to materialize, it is necessary to strengthen the Union's ability to put pressure on its partners in order to ensure that reciprocity is respected. Public procurement is an important area where the action is possible. Indeed, their openness is only ensured within the framework of the WTO through a plurilateral agreement, to which only a part of the organization's members are signatories. China, in particular, has still not signed it, although this prospect had been established since its accession in 2001. The broad commitments to open up European public procurement to foreign competition, therefore, do not find reciprocity among many of our partners. Proposals have been discussed since 2012 to restore a certain symmetry and make it possible to penalize companies of partners that have not made a commitment to open up their own public procurement. They have not been successful so far, even though a new proposal for an International Procurement Instrument was formulated in 2016. It is now urgent to conclude it.

Recommendation 4. Reinforce vigilance and requirements in the application of the principle of reciprocity in market access. Make more systematic use of the consultation and dispute settlement system when breaches are identified. Restore reciprocity in the opening of public procurement.

The appointment of a "Chief Trade Enforcer" would also be useful. Appointed by the European Commission and provided with the means of investigation, this Chief Enforcer would be empowered to take various measures to remedy the shortcomings identified (publication of the conclusions –naming and shaming–, formal requests, transmission to the Commission for referral to the WTO Dispute Settlement Body, *ex-officio* initiation of anti-dumping and anti-subsidy investigations as permitted by the recent reform of trade defense instruments, safeguard measures). When appropriate, its conclusions should also be taken into account in decisions on public procurement and foreign direct investment. Such an embodiment is necessary because trade policy rules are not sufficiently precise and comprehensive to ensure effective implementation of partners' commitments, bringing the expected benefits. The challenge is not to obtain strict compliance with all commitments, which is out of reach, but to implement targeted and coherent actions to correct the most important problems.

Recommendation 5. Create a "Chief Trade Enforcer" position, tasked with embodying and implementing reciprocity requirements.

Industrial subsidies

The use of industrial subsidies and instruments to remedy their adverse effects (countervailing measures, i.e. anti-subsidy duties) are governed by the corresponding WTO agreement. In practice, this framework is currently unsatisfactory. Its rules are too restrictive in their definition and too demanding in the evidence they require. In particular, a subsidy can only be characterized when a financial contribution by the government or a public entity can be identified (excluding income or price support), and the WTO Dispute Settlement Appellate Body has interpreted that an entity must "possess, exercise or be vested with government authority" to be considered public.[23] However, this case only covers part of the practices. In the Chinese case, the protean nature of subsidies, often in the form of privileged access to capital and various inputs, through a multitude of channels and structures, goes well beyond this framework.[24] This problem is aggravated by the lack of transparency of many WTO members. Indeed, notification requirements are often not well respected, when they are not simply ignored.[25] Witness of the tensions induced by the implementation of these obligations, the counter-notifications made five times since 2011 by the United States, concerning nearly 500 Chinese subsidy measures that, according to the United Sates, should have been notified and but had not been notified.[26]

[22] Zhou W., H. Gao and X. Bai (2019): "China SOE Reform: Using the WTO Rules to Build a Market Economy", *International and Comparative Law Quarterly*, vol. 68, no 2.

[23] OMC (2011): "Definitive Anti-Dumping and Countervailing Duties on Certain Products from China", *Appellate Body Report*, no WT/DS379/AB/R, para. 317.

[24] Wu M. (2016): "The 'China, Inc.' Challenge to Global Trade Governance", *Harvard International Law Journal*, vol. 57, pp. 1001-1063.

[25] See the annual reports of the Working Group on Notifications (latest: WTO, G/SCM/152, 29 October 2018).

[26] Office of the US Trade Representative (2018): *Trade Policy Agenda and 2017 Annual Report of the President of the United States on the Trade Agreements Program*, pp. 105-106, March.

Only two types of company- or industry-specific subsidies are prohibited by the WTO Agreement on Subsidies and Countervailing Measures (SCM): the ones that are contingent upon export performance or upon the use of domestic over imported goods. The others are only enforceable if it is possible to establish the existence of “injury” or “serious prejudice”, which is often very difficult. Given the necessarily limited investigative powers of the Commission, this makes it difficult to restore the balance between companies operating from countries that do not respect the same rules. However, the duration of the examination procedures prior to the implementation of compensatory measures is often too long in relation to the life of the business.

The best response to this would be a reform of the WTO Agreement on Subsidies. The Commission’s proposals to this end are welcome, as they aim in particular to “improve transparency and notification of subsidies”, better clarify commitments concerning state-owned enterprises and make constraints on the most distortive types of subsidies more effective.[27] In particular, the creation of a rebuttable presumption that non-notified subsidies would be detrimental to partners and therefore susceptible to compensatory actions would be a powerful lever to change the nature of incentives in this area.

Recommendation 6. Make subsidies a priority subject in WTO reform negotiations, in order to strengthen transparency obligations and facilitate the adoption of countervailing measures when partner’s subsidies are harmful.

Such reform must remain the priority objective: the establishment of multilateral rules to limit distortions linked to subsidies is the solution most in line with European values and interests. But given the extreme difficulty in substantially changing WTO rules, it is necessary to prepare a “plan B” in case of failure, making it possible to defend European interests and, as a result, to improve the Union’s ability to negotiate constructive reform. The reform of trade defense instruments and the reform of the methodology for determining anti-dumping duties, which recently entered into force, are the first step in this direction. These instruments must now be used reactively as soon as justified, in accordance with our international commitments. In particular, the most appropriate response to partners’ industrial subsidies is the implementation of countervailing measures. Although we have highlighted the limitations of the current WTO agreements, full use must be made of the existing rules and the flexibility allowed by the recent reform of trade defense instruments where industrial subsidies or unfair competitive practices harm European industries.[28]

The foreign direct investment must also be taken into account because it is another subject on which State strategies can distort competitive logic. In this case, we have recalled above that the European Union has just adopted a system for screening foreign direct investment when it represents a potential threat to security or public order. On a purely economic level, any restrictions in this respect must be handled with caution, as they can easily be diverted to protect sectoral interests from the competition without valid justification, and can have an impact on incentives to invest. However, concerns about public funding (to avoid distortions related to subsidies) and the preservation of competition (to counter killer acquisitions) could also be addressed more systematically.

Recommendation 7. Reactively use trade defense instruments when industrial subsidies or unfair trade practices harm European industries. Address more systematically concerns related to public financing and the preservation of competition in the screening of foreign direct investment

State aid can be used for an active European response

Without entering into the complex debate on European industrial policy, the question arises as to whether the Union’s response should take a more active form. In this respect, competition policy is often seen as a constraint due to the discipline it imposes on the State aid. In this respect, the main criticism of industrial policy is that public authorities are poorly qualified to select the companies benefiting from their actions (picking winners). This is because information on the performance of companies is often scarce and potential candidates have an interest in concealing information on their costs in order to distort public decision-making to their benefit. In the European context, moreover, State aid carries the risk of non-cooperative strategies by the Member States. This explains the strict framework applied in Europe, which may give rise to fears that public investments will not be implemented even though they would be socially beneficial.

[27] European Commission (2019): *Concept Paper on WTO Modernisation*, September.

[28] In the case of China, Section 15(b) of its WTO Accession Protocol allows for “special difficulties” to be invoked in the application of the Agreement on Subsidies and Countervailing Measures to make the assessment of the subsidies concerned more flexible. See Zhou *et al* (2019) *op. cit.*

However, the modernization of the State aid rules has provided a framework to address these disadvantages, as it promotes the implementation of projects that are difficult to finance because of the technological or financial risks they present, even though they allow significant challenges to be met. This legal framework, known as Important Projects of Common European Interest (IPCEI), makes it possible to grant significant amounts of aid to large industrial projects. The eligibility criteria attached to them ensure that they avoid the shortcomings mentioned above by requiring them to target an entire sector and not individual companies that would be chosen *ex-ante*, and by ensuring that the benefits are not limited to a single Member State. These criteria prevent the aid in question from reducing the strength of intra-European competition, which could prove counterproductive. Provided they are respected, therefore, there is nothing to prevent Member States and/or the European institutions from implementing ambitious initiatives to guide economic activity through a combination of investments in technology and infrastructure, in particular, such as those motivated by the need to address the challenges of climate change adaptation. The alignment of national interests can certainly be a limitation in some cases. Poland was thus rather reluctant at first to the ongoing development of a Franco-German IPCEI on electric batteries, as it hosts a Korean battery plant on its territory. In this field as in others, adapting to the challenges of competition challenges Europe to achieve cohesion.

In the current context of a decline in multilateralism, Europe must arm itself to defend its economic interests. It is less on the side of its competition policy, given the benefits for European consumers, than in the articulation with trade policy that it must look for ways to better enforce the rules and defend its interests.

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