Structural Policies, Regulation and Competition: The Economics of National Champions

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[1]The views expressed here are my own, and they are not necessarily shared by the Norwegian Competition Authority.

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The main question

- Globalisation – a relevant topic
  - Imports and exports important for small nations such as Portugal and Norway
  - Internal market in EU implies that national markets become international markets
- Apparently a larger scope for national champions
  - When no longer a closed economy, we should help our domestic firms in the rivalry with foreign firms
  - A lax competition policy would make it possible with large, domestic firms
- **Main question**: Should we have a ***lax competition policy*** to promote ***national champions***?

The national champions debate

- Some recent examples of heated debates
  - Mittal (India) acquired Arcelor (France and Luxembourg) in the steel industry
  - ABN AMRO (Netherland) acquired Banco Antonveneta (Italy)
  - Both Gas Natural (Spain) and E.ON (Germany) has tried to acquire Endesa (Spain)
- Discussion between Commission and member countries about the 2/3 rule on merger control
  - The rule deciding whether a merger is investigated by national competition authorities or DG COMP

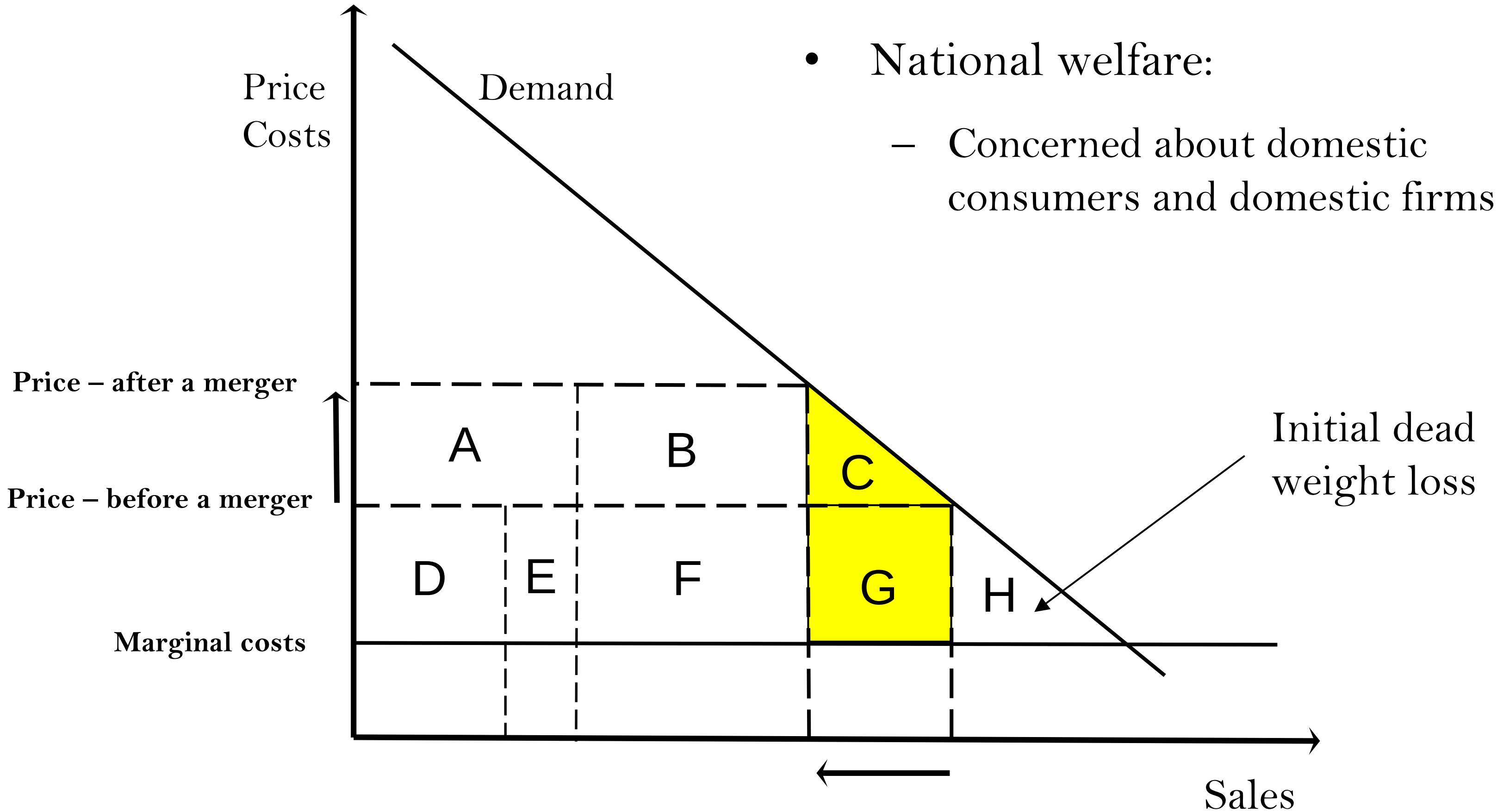
The structure of the talk

1. A simple theory of (no) national champions
   - Dampening of competition
   - Profit shift out of the country
2. Some counter-arguments: What if
   - Cost savings when domestic merger?
   - International, integrated market?
   - International merger as an alternative?
   - Acquisition by foreigners as an alternative?
3. Some concluding remarks
   - Farmed salmon; success with no national champions
   - Cement; costs associated with a lax competition policy

1. A theory of (no) national champions

- Let us consider an example
  - Domestic market with three symmetric firms
  - Imperfect competition initially
  - A merger between two firms
  - No cost savings, and thus a price increase following a merger
- We compare two different initial situations
  1. Closed economy: All three firms are domestically owned
  2. Open economy: The non-merging firm is foreign owned
- How will a merger affect national welfare?

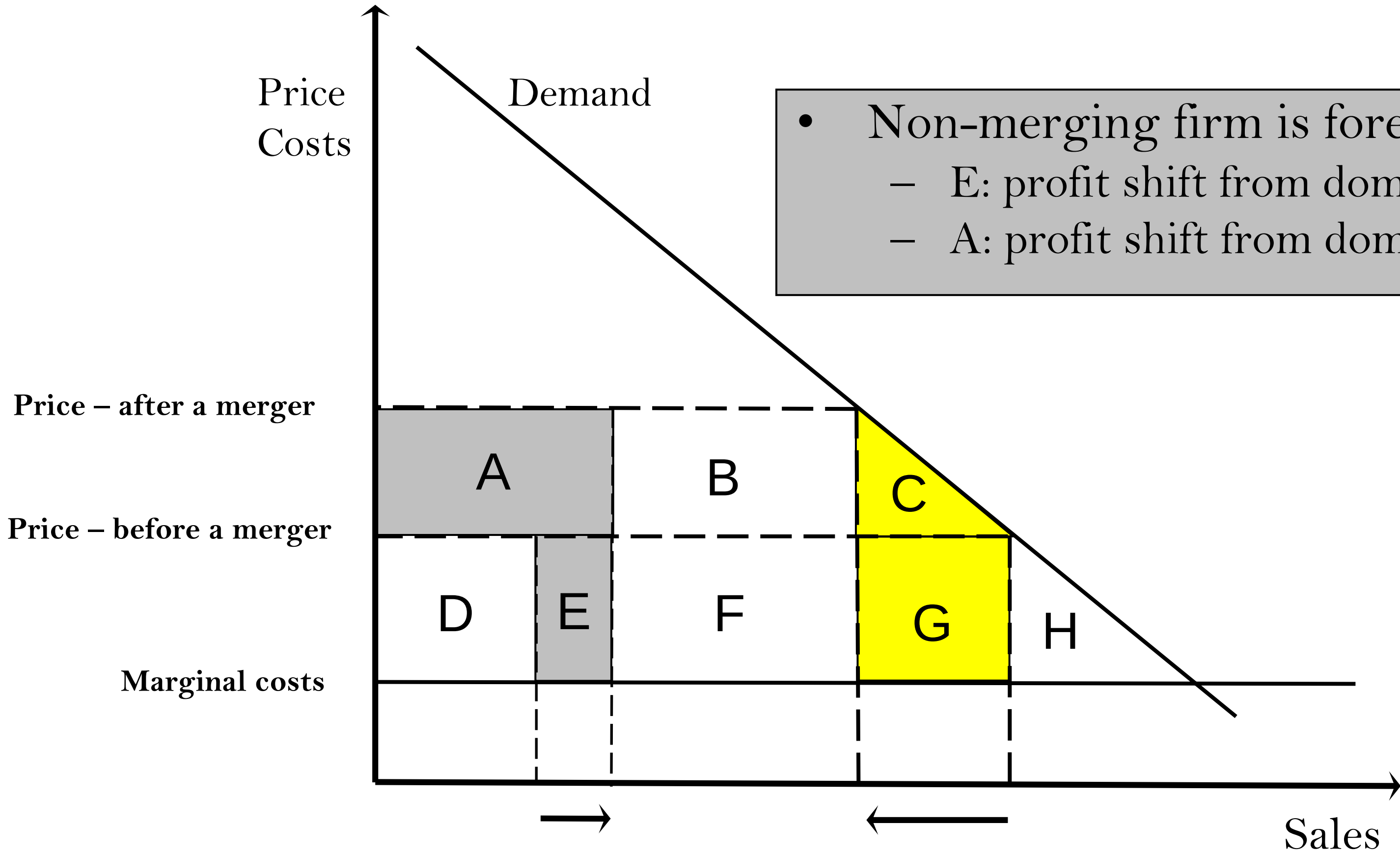
The loss from a merger – closed economy



- National welfare:
  - Concerned about domestic consumers and domestic firms

- C + G = Increase in dead weight loss

The loss from a merger – open economy



- Non-merging firm is foreign owned
  - E: profit shift from domestic firms
  - A: profit shift from domestic consumers

- C + G = Increase in dead weight loss
- A + E = Profit shift out of the country

Some concluding remarks – so far

- A merger between domestic firms can be detrimental to national welfare
  - Price-dampening merger; dead weight loss
  - Non-merging, foreign firms benefit from higher prices and increased own sales
- Should be more sceptical towards merger in an open economy than in a closed economy
  - Profit shift out of the country argument
  - In sharp contrast to the idea of promoting a national champion
- What have been left out in our very simple analysis?

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2.1 Cost savings?

- Sufficiently large cost savings will lead to a net gain
- But we have to think about which cost savings
- If savings in fixed costs, still a price increase
  - Example: not duplicate head quarters
  - Still a profit loss out of the country
- If savings on variable costs, we might observe a price reduction
  - Must have a substantial lower variable cost to eliminate the planned price increase following a merger
  - Profit loss out of the country relevant unless large savings in variable costs

Cost savings – empirical findings

- No clear evidence of any systematic cost reduction following a merger
- Empirical studies from Norway in line with such a conclusion
- Helpful to look at general studies of economies of scale and scope in particular industries
  - Ex: Economies of scale exhausted in Norwegian banking industry?
- Important implications for merger policy
  - Claims concerning cost savings should be met with scepticism unless detailed evidence
  - To trace the price effect of a merger, one should focus on the possible changes in variable costs

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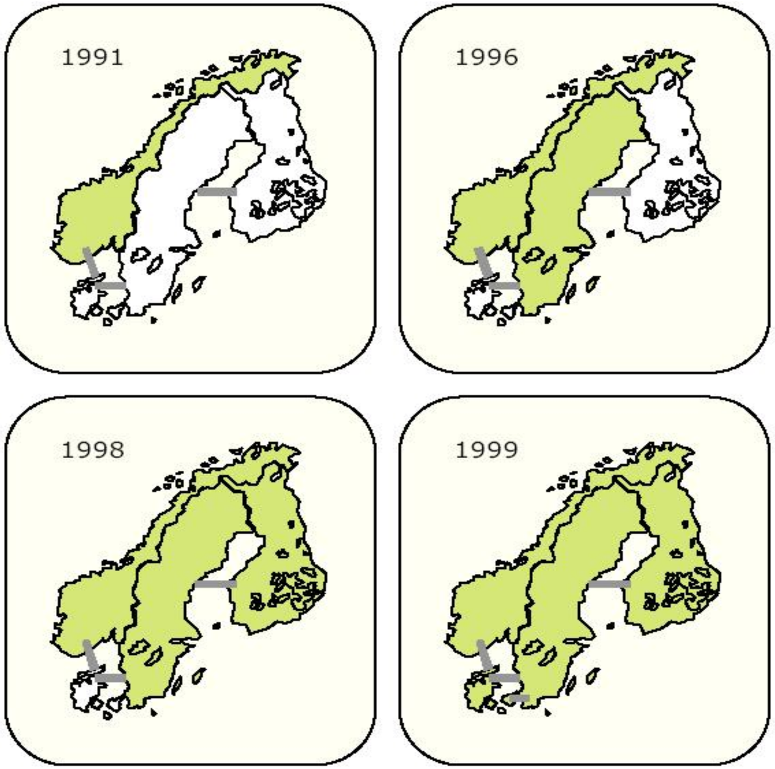
2.2 International, integrated market?

- Domestic market part of a larger, inter-national market
  - Ex.: the Nordic market for electricity with one common spot market
- Should a domestic merger then be permitted?
  - If the country is a net importer, the answer is clearly no
  - If the country is a net exporter, it *might* increase domestic welfare with a price-increasing merger

The Nordic Power Exchange

- Nord Pool Established in 1992
- The first *international* power exchange
  - From a Norwegian to a Nordic power exchange
- 119 TWh traded in spot in 2003
  - 33% of the total Nordic consumption



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Beggar-thy-neighbour policy?

- In the Nordic electricity market Norway is on average a net exporter (but about to disappear)
  - *Can* be beneficial with a merger if price-cost margin very low at the outset
- But there are valid arguments for not pursuing such a national champion strategy
  - If consumer welfare standard, a price-increasing welfare never optimal
  - All countries jointly worse off if each country follows such a beggar-thy-neighbour policy
- Scope for a supranational competition policy
  - See the discussion concerning the 2/3 rule for mergers between Commission and member countries

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2.3 International merger an alternative?

- A domestic merger could prevent a merger between a domestic and a foreign firm
- But if such a merger is permitted, the non-merging firm is a domestic firm
- The non-merging firm benefits most from a price-increasing merger
  - Profit shift into the domestic country
- Would a domestic merger lead to larger cost savings than an international merger?

Cost savings – international merger

- Could be that an international merger leads to larger cost savings than a domestic merger
  - The domestic firm gets access to technology and knowledge of multinational firm
  - An international merger can lead to competition between trade unions in different countries
- Ex.: Electrolux threatening to move production from Italy plant (Zanussi) to other plants in Europe
- Even an international merger might lead to higher prices, but a more limited price increase
  - A domestic merger more detrimental to welfare
  - But how to take into account the fact that an international merger curbs the trade union?

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2.4 Acquisition by foreigners?

- Could transfer resources out of the country?
  - Head quarter moved to a foreign country
  - Foreigners grabbing domestic firms at a low price
- An empirical question whether foreign owners transfer resources out of the country
  - Norwegian study indicate that foreign owned firms behave more or less as domestic firms
  - No clear evidence from international studies that majority owners typically exploits minority owners
- A shift of head quarter as a potential problem
  - Lack of control – what is the effect of that?
  - But skilled labour might stay in our country, and can be reallocated to alternative activities?

Low price when acquiring domestic firms?

- Hard to find any empirical evidence supporting such a claim
  - Acquiring firm pays a premium, often 30- 40% above intial stock value for acquired firm
  - If so, foreigners are paying a premium and the selling domestic shareholders are the winners
- Norwegian study finds the same pattern
  - Price premium paid by acquiring firm
  - Higher price premium when foreigners are involved in a bid for acquiring a domestic firm

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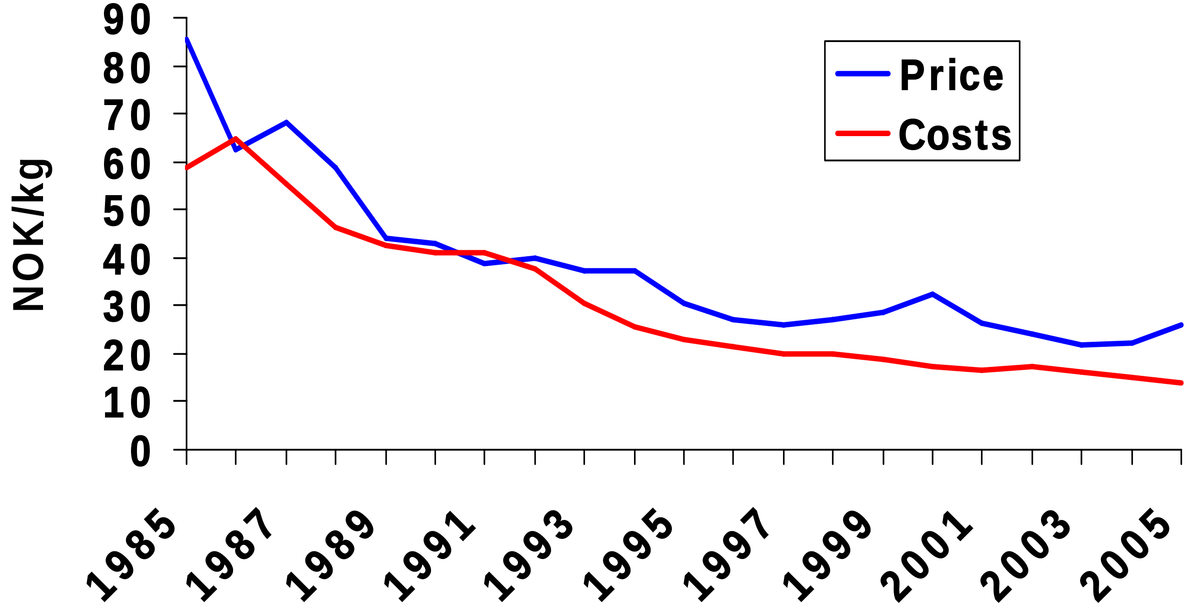
3. Some concluding remarks

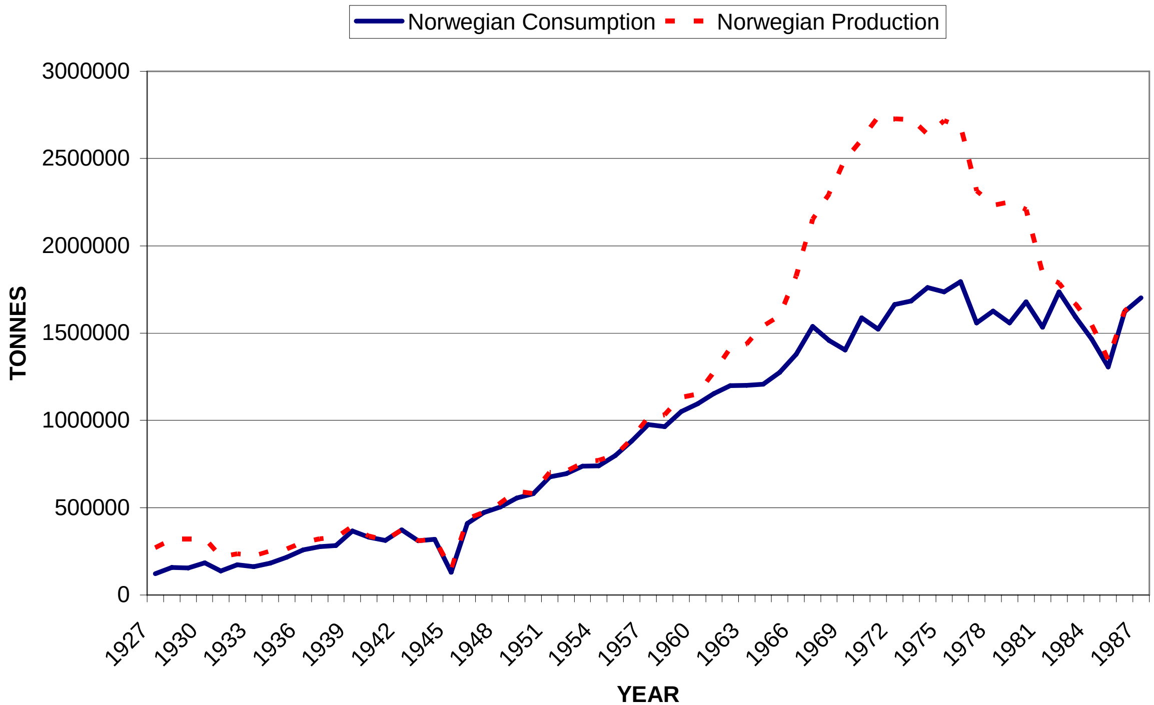
- A well functioning competition policy will curb national champions and increase welfare
  - Competition at home spurs innovation and cost efficiency, and may lead to success in an international market
  - In that respect no conflict between industrial policy and competition policy
- Two examples from Norway illustrate the idea
  - No national champions in farmed salmon, and despite this success in the global market
  - Lax competition policy in the cement market, which led to wasteful investments

Price of salmon and Norwegian cost of production 1985-2005 (2004=1)



- A restriction on ownership prevented a national champion
- Sales tripled from 1990 and until 2001, and costs dropped quite dramatically

Price cartel – Norwegian cement: Joint sales office at home 1923-67



- Market shares at home distributed according to its share of capacity
- Incentive to overinvest in capacity, which they did after World War II
- Export price did not cover costs associated with expansion in capacity