What's new in merger control: theory and policy

Panel discussion - "Whither merger control?
Recent debates on digital and foreign acquisitions"

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Good afternoon everyone.

I would like to thank the Toulouse School of Economics for the kind invitation to join this session and for the opportunity to contribute to the discussion on merger control and the path to economic recovery.

The current context

I will start with a note on the current context, of which we cannot be oblivious. We are going through quite unprecedented times. The pandemic has been a major economic shock. Record quarterly and annual year-on-year declines in GDP[1] were registered during the past year.

And as we face the economic crisis, we have seen early and persistent calls for relaxing competition enforcement, namely in merger control[2].

Some have been arguing in favor of exceptional measures, such as state aid and subsidies, or cooperation agreements, or, specifically in merger control, asking competition authorities to allow for greater concentration, sometimes even for national or European champions.

At the same time, there is a possible near-future scenario where competition authorities will have to deal with an increase in the number of mergers appealing to a failing firm defense.

How to respond to such trends

In facing these trends, it is the competition authority's duty to sustain that more competition, not less, is needed for a full and prompt economic recovery.

And this is where I will anchor my points of view.

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[1] Declines in Q2 YoY: -13.9% in Portugal, -11.8% in the Euro area. Source: Eurostat, *GDP quarterly data, YoY rates: https://ec.europa.eu/eurostat/documents/portlet_file_entry/2995521/2-08092020-AP-EN.pdf/43764613-3547-2e40-7a24-d20c30a20f64*.

[2] E.g. Padilla and Petit (2020), "Competition policy and the Covid-19 opportunity", *Concurrences Nº2-2020*.

Resilient vs. zombie firms

First, that economic resilience is built by resilient firms.

I quite agree with some authors who call for a case-by-case analysis of firms and sectors. That the state aid response should be used only for sectors and firms which would be viable if it were not for the temporary shock they are going through.

Of course, when this option for state aid based only on efficient firms has a significant impact on labor, other public policies should support the requalification of workers. And as others have mentioned, a crisis is a tremendous opportunity to revise laws and set them free from inhibiting barriers to entry or expansion. This includes labor laws and regulations which contain numerous barriers to labor mobility.

So, letting so-called zombie firms fail may have many important benefits for the economy. Some authors call it a "cleansing effect" that ends the crowding out of growth opportunities for more efficient firms[3].

Despite the short-term cost for public decision-makers and for workers themselves, this has the potential to set the economy free from a long-term drag on its competitiveness.

This links us back to the call for national champion support. This call, to be fair, precedes the pandemic and is cyclical across decades. The most recent was probably seen during 2018 with the Siemens/Alstom decision[4]. At that time, a group of competition economists found proposals for relaxing merger control "extremely worrying"[5].

It seems legitimate to sustain, based both on theory and on some historical evidence, that insulating firms from competition does not make them stronger. Such an industrial policy does not necessarily breed champions – true champions do not seem to need such help. Also, it may be too high a responsibility to be borne by public decision-makers when picking winners.

We must not lose sight of the fact that true champions arise from stable macroeconomic environments, with competitive and stable fiscal policies, where they have access to high quality and competitive infrastructure and utilities, to an educated workforce, and operate under neutral economic regulation and an effective judicial system. So public recovery efforts should focus also on those variables.

It therefore seems like an ill-choice to ask competition policy, in some instances, to relax merger control.

Competition authorities must remain focused on their institutional purpose – promoting competition and consumer welfare. The process must be based on the accumulated experience

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[3] Padilla and Petit (2020), "Competition policy and the Covid-19 opportunity", *Concurrences Nº2-2020*.

[4] European Commission, Press release: http://europa.eu/rapid/press-release_IP-19-881_en.htm

[5] Motta, Peitz, https://sites.google.com/site/massimomottawebpage/Open%20letter%20on%20European%20champions%20with%20signatures.pdf?attredirects=0&d=1

of competition authorities, on evidence and on the economic literature. Enforcers have built, over the years, robust best practices based on these principles. So a merger should not be allowed if there are anti-competitive concerns with no countervailing efficiencies accruing to consumers. Allowing other considerations to be factored in competition authorities' decisions may compromise the technical quality of competition analysis, and the objectives of competition policy.

The failing firm defense argument

This brings me to another topic in merger control. The accumulated experience of competition authorities also extends to failing firm defense.

It is still unclear to what extent there is going to be an increase in the number of mergers appealing to such arguments. But we can reasonably expect this to be the case, once public financial support wears out or once public and private moratoria on loans are phased out.

Non-performing loans will rise and inefficient, zombie firms will be exposed. Bear in mind that during crises, banks may have incentives to keep non-viable firms afloat so as to avoid recording severe losses on their balance sheets. This adds to the number of zombie firms[6], which perpetuates inefficiencies in the market[7] and may crowd out lending to viable firms.

Now, even though current economic conditions are unprecedented, addressing failing firm defense is something well established in competition policy. To accept such arguments, competition agencies[8] must follow a rigorous application of the failing firm defense test.

The conditions of the test are well known. The firm must be under verifiable financial distress such that the firm and its assets would inevitably leave the market. And there must be no feasible alternatives that raise less competition concerns.

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[6] The OECD uses a definition where so-called zombie firms are firms aged ≥10 years and with an interest coverage ratio <1 (i.e. operating income less than interest expenses) over three consecutive years.

[7] Cf. seminal paper: Caballero et al. (2008). Zombie lending and depressed restructuring in Japan. American Economic Review.
For an overall assessment of the phenomenon in the OECD and Europe: McGowan et al. (2018). The Walking Dead? Zombie Firms and Productivity Performance in OECD Countries; and Andrews & Petoulakis (2019). Breaking the Shackles: Zombie Firms, Weak Banks and Depressed Restructuring in Europe. Summary available here.
For an assessment of the phenomenon in Portugal: Gouveia & Osterhold (2018). Fear the walking dead: zombie firms, spillovers and exit barriers. Working Papers 2018 – Banco de Portugal. A summary in Portuguese is available here. Three main results are found: i) in some sectors, there is a significant number of zombie firms in Portugal; ii) the prevalence of these firms limits the growth of productive viable firms; iii) the reduction of barriers to exit and restructuring reduced the prevalence of zombie firms and promoted growth.

[8] Examples from Autoridade da Concorrência's merger review: Ccent. 10/2013 – Modelo Continente/Ativos Hiper Sá and Ccent. 45/2018 – Grupo HPA Saúde / HSGL [1][2]

This accumulated experience is reflected in horizontal merger guidelines, which detail how to proceed when such arguments are raised[9].

The potential of competition policy

I would like to move from the pressure on competition rules to the potential of competition policy.

I have already alluded to the fact that for economic recovery to be at its full potential, competition must be **embedded** in its underlying support policies. More specifically, in merger control, we should not overlook the fact that it is competition that drives firms to innovate.

Innovation brings welfare and offers opportunities for firms who want to become leaders in their own field. Despite the pandemic, areas such as digital markets and sustainability are growing and these trends can help kick-start the recovery.

On this end, merger control has a significant contribution to make, given the increasingly important role of innovation theories of harm. For this reason, in pursuing its objectives, competition authorities play a key role in maintaining an economic environment that breeds innovation and brings welfare gains to consumers.

It is also one of the reasons why competition authorities must be especially vigilant of incumbent's killer strategies towards potential competition.

For the digital economy, where competition takes place in terms of competition **for** the market, the threat of disruptive entrants is crucial to discipline incumbents.

For the green economy, authorities' focus should be on incumbents which lag behind and seek to shut down or delay green innovation into the market.

But certainly more on this will be said throughout the panel discussion.

So my final message would be:

However challenging it may be to maintain a strong enforcement and an effective merger control, competition authorities **must be resilient** towards outside short-termism.

This is how they contribute to an economic recovery build on resilient foundations.

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[9] As an example, AdC's Horizontal Merger Guidelines, Section 2.8, in Portuguese: http://www.concorrencia.pt/vPT/Noticias_Eventos/ConsultasPublicas/Documents/Linhas%20de%20Orienta%C3%A7%C3%A3o%20para%20a%20An%C3%A1lise%20Econ%C3%B3mica%20de%20Opera%C3%A7%C3%B5es%20de%20Concentra%C3%A7%C3%A3o%20Horizontais.pdf