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# Europeanization of EU member-state competition policy: The commission's leadership role

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ABSTRACT

The European Commission (EC) has long intended to play a leadership role in setting a pan-European competition policy; yet, both centralized and decentralized tendencies have been manifest in the European context for competition policy. It is not clear then whether these leadership intentions translate into actual leadership by the EC. We shed light on this issue by considering and estimating whether the EC's leadership is both evident and robust. We present a framework that highlights the costs to Member States of diverging from EC merger policy norms. Employing cross-national panel data (covering 1994–2005) on European merger control, we find that changes in the EC's proclivity to remedy mergers are reflected in Member States in subsequent years. Thus, the European Commission appears to play a leadership role in setting the tenor of merger policy throughout Europe.

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## 1. Introduction

The Treaty of Rome authors gave competition policy – with its embedding in the Community's constitution – a privileged position in the founding of the European Community. Since the European Union (EU) was first conceived as an economic area, competition policy represented a fundamental policy pillar ensuring a well-functioning common market that would be undistorted by the domestic arrangements of Member States (Wilks, 2005). Nevertheless, the 'subsidiarity' principle – authority is granted to EU institutions only after it has been established that Member States cannot satisfactorily exercise such powers – has consistently characterized the balance between Brussels and the Member States (Van Den Bergh, 1996). For instance, Van Waarden and Drahos (2002) note that merger control – our area of empirical interest – involves clear thresholds demarcating jurisdictional boundaries between national competition authorities (NCAs) and the European Commission (EC). Furthermore, the 2004 Reform of competition policy within the EU (where many elements were de-centralized to the NCAs and national courts) highlights these same separations as it is stated that all European competition authorities "are independent from one another. Cooperation between the NCAs and with the Commission takes place on the basis of equality, respect and solidarity" (European Commission, 2003, p. 1).

While the above suggests the decentralization of EU competition policy and the equivalence between the EC and the NCAs, a number of scholars argue that EU competition policy is better characterized as centralized with the Commission having precedence over the various NCAs. Both Neumann (1990) and Van Den Bergh (1996) argue that the Commission is in charge of pan-European competition policy. In this vein, Dutz and Vagliasindi (2000) found East European NCAs to have fully adopted EU competition law and practice; and Amato (1996) – the then Chairman of the Italian competition authority and former Prime Minister – stated that Italy's competition policy was fully derived from EC norms and regulations: a characterization which applies to other EU Member States. Furthermore, while the 2004 Reform of EU competition policy highlighted the supposed equality between the EC and NCAs, it was also stated that the "Commission, as the guardian of the treaty, has the ultimate . . . responsibility for developing policy . . . therefore, the instruments of the Commission on the one hand and of the NCAs

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on the other are not identical" (European Commission, 2003, p. 2). Vives (2009) sums up well the idea of EC precedence when he states that "competition policy has become central in the European Union, with the authority of the European Commission firmly established and with an . . . international leadership role" (p. 19).

Accordingly, the question we ask here is whether Member States actually take their cue from the European Commission when setting the tenor of national competition policy? We engage then in a positive analysis to ascertain whether the EC provides leadership in the realm of merger policy. Specifically, we will consider the use of remedies in merger control, and test whether an upswing in the use of remedies by the EC results in Member State NCAs employing more remedies in subsequent years. As Lyons (2004) notes, our understanding of competition institutions and processes "is not a completed research program" (p. 252). Thus, by providing empirical evidence on whether it is 'EC leadership' or 'subsidiarity' that best characterizes merger control within the European Union, we hope to shed more light on the workings of pan-European competition policy.

Taking such a leadership role implies that European Commission actions not only have the immediate goal of ameliorating anti-competitive merger proposals, but also involve the additional goal of setting a benchmark to achieve desired levels of EU-wide merger control. This inducing of European NCA actions is done indirectly by increasing the potential dissent between the observed EC-level and NCA-level of scrutiny. NCAs face a cost from such dissent, and adjust their policies in order to mitigate these costs. Consider, for instance, that NCAs tend to value more the creation of national champions through domestic mergers despite these mergers potentially harming domestic consumers. From a European-wide perspective, a price-increasing merger of two firms based in one Member State – though operating in other EU Member States – is more likely to be blocked by a supra-national authority than by a national authority (Barros & Cabral, 1994). Thus, the supranational authority would prefer that national authorities have stricter merger control.[3] Furthermore, in order to induce higher levels of NCA scrutiny, the supranational agency can overstate its position against mergers so that it increases observed dissent with national competition authorities. In turn, the NCAs will be stricter with regard to mergers in their jurisdictions to reduce dissent. This mechanism, associated with the interaction between national authorities and the supranational authority – the European Commission in our case – involves the latter acting as a Stackelberg leader.

The paper is organized as follows in order to support our analysis of EC leadership in European merger control. The second section presents a framework that shows how one can derive our principal testable hypothesis regarding EC leadership. The third section provides background on the data employed in our empirical analysis. The fourth section establishes the main empirical specification. The fifth section discusses the empirical results. The sixth section presents some robustness checks. The last section concludes.

## 2. A framework

We can model the leadership argument introduced above as follows. Consider a set of NCAs that face a stream of merger proposals that involve at least some anti-competitive effects: indexed by $\theta$, where a higher $\theta$ means a more anti-competitive merger proposal. In the relevant market, we have both domestic and foreign consumers with surpluses denoted respectively by $CS^d(\theta)$ and $CS^f(\theta)$ in the event of the merger being approved. Furthermore, all consumers suffer due to a higher level of anti-competitiveness; i.e. $(dCS^d(\theta))/d\theta \leq 0$ and $(dCS^f(\theta))/d\theta \leq 0$. But if the merger is remedied, then the level of anti-competitiveness is clearly lower. For simplicity, we normalize this level to zero, $\theta = 0$; i.e. we assume that remedies work perfectly. Similarly, the relevant market (i.e. focal industry) can consist of both domestic and foreign firms – firms whose profits are affected by the merger in relation to the degree of the merger's anti-competitiveness, respectively denoted by $\Pi^d(\theta)$ and $\Pi^f(\theta)$.[4] In particular, the anti-competitiveness of a merger enhances both domestic and foreign firms' profitability, i.e. $(d\Pi^d(\theta))/d\theta \geq 0$ and $(d\Pi^f(\theta))/d\theta \geq 0$.

An NCA $i$ must define a threshold $\hat{\theta}_i$ above which it remedies merger proposals. Furthermore, NCAs care only about domestic consumers and firms, and not about the foreign consumers and firms that are part of the relevant market.[5] NCAs do, however, care about dissent with regard to the EC's position on merger control; i.e. they face a cost to being far away from the defined EC-level of scrutiny. The relevance of this concern can be found in several initiatives aimed at promoting a single competition policy within the European Union even if application is done by different entities. These costs may be related to (i) the EC taking the next "borderline" merger case under its jurisdiction, which of course means that the national authority loses its decision power there, (ii) the EC starting a juridical procedure via the European 'Court of First Instance', (iii) being "punished" by the EC in other European policy areas, or (iv) a more stringent control of all financial flows toward the Member State.[6]

We model this concern with a simple quadratic loss function. The welfare measure for a national competition authority $i$ is then given by:

$$W_i^d = \int_0^{\hat{\theta}_i} f(\theta)[CS^d(\theta) + \Pi^d(\theta)]d\theta + (1 - F(\hat{\theta}_i))[CS^d(0) + \Pi^d(0)] - \frac{1}{2}(\hat{\theta}_i - \hat{\theta}_{EC})^2,$$

where $f(\theta)$ denotes the density of mergers with anti-competitive effects, $F$ is the corresponding distribution function, $\hat{\theta}_i$ is the threshold set by the national competition authority, and $\hat{\theta}_{EC}$ is the threshold set by the European Commission.[7]

[3] Instead of national champion tendencies, one could also consider that national competition authorities give greater importance to regional and labor policies as compared to the EC; thus, these conditions could also give rise to a difference between EC and NCA priors on the optimal tenor of merger policy. As Vives (2009, p. 19) notes, a consistent challenge for EU-wide competition policy has always been "how to avoid opportunistic behavior by national regulators".

[4] Although prohibitions (the outright rejection of a merger due to anti-competitive problems) are an additional tool that competition authorities employ, we focus strictly on the possibility of remedies being imposed in order to avoid cluttering the model with further notation. Focusing on the proclivity of competition authorities to employ remedies to ameliorate the anti-competitive effects involved with merger proposals is, however, in line with recent developments in the cross-national context for merger policy where prohibitions have been less frequently used over the last decade (Seldeslachts, Clougherty, & Barros, 2009; Vives, 2009). Furthermore, accounting for prohibitions would substantially complicate the simple model we propose here, though such a model can lead to similar qualitative predictions.

[5] While many mergers with European-wide competitive implications must be notified to the EC, many other mergers that have European competitive implications due to exports will still be handled by NCAs. Thus, even mergers that are mainly domestic in nature – and thus handled by Member State NCAs – will still have export implications.

[6] One could even consider the costs involved with not being held in esteem by one's peers. For instance, if an NCA exhibits a workload of activity that does not hold up to standard – i.e. the benchmark set by the EC – then they could lose the respect of their peers in other NCAs. See also footnote 24, where we report some robustness checks of possible peer effects.

[7] The quadratic distance function is employed for simplicity. Any function that increases with the distance between the two policy thresholds will generate the same effects.

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