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COMMENT: Brussels has not gone far enough in its merger reforms

By Xavier Vives
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The European Court of First Instance (CFI) yesterday upheld the 2001 decision by Mario Monti, the then European Union competition commissioner, to prohibit a merger of General Electric and Honeywell in spite of "manifest errors of assessment" by the Commission. The GE/Honeywell case and three subsequent court defeats on merger decisions led Brussels to embark on a reform of its merger review process.

Now Neelie Kroes, Mr Monti's successor, wants more powers to oversee all large mergers even if they affect companies within a single country. Should she have her way? In spite of the reforms introduced in May 2004, European merger control risks standing in the way of corporate restructuring made necessary by globalisation.

Globalisation enlarges and integrates markets. The result is that the size of a company becomes critical in some sectors and the allocation of capital that was efficient before the wave of globalisation is so no longer. Mergers are a prime instrument of restructuring for companies to compete and survive. However, consolidation may endanger competition, which drives economic efficiency and consumer welfare.

The role of merger control is precisely to avoid potential harm to consumers. To be effective it must be speedy, rigorous, fair and predictable. The Commission's procedure has improved dramatically over the years but still fares unevenly. In 2002 the CFI overturned prohibition decisions in the cases of Airtours/First Choice, Schneider/Legrand and Tetra Laval/Sidel.

The subsequent reforms include a revised substantive test, more checks and balances, publication of merger guidelines and the creation of the Office of the Chief Economist. These developments align the EU with US policy and practice, reduce uncertainty for the merging parties and raise the standard of economic analysis. Nonetheless, European procedure may still put obstacles in the way of takeovers. In the Schneider/Legrand case a completed takeover was blocked by the Commission and had to be undone, only for the decision to be overturned by the CFI. In the EU, unlike in the US, the takeover proceeds while being examined by the competition authority.

Brussels took more than two months to decide on jurisdiction in the unsolicited takeover of Endesa, the Spanish utility, by Gas Natural - the decision, although technical, had to be taken by all 25 members of the Commission. The result of such flaws may be to raise the cost of mergers, in particular of hostile takeovers, where time is of the essence. It would be ironic if European merger control ended up protecting incumbents from hostile bids and preventing necessary restructuring. This would put EU-based companies at a disadvantage to their US counterparts.

Ms Kroes' request for the Commission to have more flexibility in obtaining jurisdiction over large mergers is intended to ensure consistency of treatment. Whether the thresholds for allocating merger jurisdiction among competition authorities should be modified is a complex issue on which little academic research has been done. The true challenge for both national and EU competition authorities is to allow the restructuring required by globalisation, while extending competition as well as the market for corporate control.

Countries that allow unrestrained exercise of market power at home are shooting themselves in the foot; the best school for international competitiveness is a high degree of domestic rivalry. The example of Santander and BBVA, the internationally successful Spanish banks - formed out of a domestic consolidation process - follows from the early financial liberalisation and increase in competition in Spain.

More powers and flexibility for Brussels may imply more scope for delays and lobbying. The 2004 merger reform has not gone far enough. For the competition authority to have more discretion, more checks and balances must be implemented and the scope for influence by pressure groups reduced. One idea is to establish an administrative panel that would make a public recommendation on merger decisions to the 25 commissioners. This would separate the internal team of investigators and prosecutors from the judges or decision-makers. The commissioners could still overturn the panel's recommendation but they should give a reason.

Failing a move in this direction, Ms Kroes' request for more discretion may backfire and put on the agenda the creation of an independent European competition agency, perhaps in the mode of the US Federal Trade Ã‚ÂCommission.

The writer is professor of economics and finance at Iese Business School and at Insead (on leave)

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