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TROUBLE IN PARADISE: WILL TECHNOCRATS REVIEW GLOBAL MERGERS FOREVER?

SIMON J. EVENETT*

Mergers and acquisitions (M&A), be they domestic or cross-border, represent one important means through which economies restructure. Whatever their associated benefits to the firms directly involved, it has long been recognised that such M&A can lead to economic concentrations and, quite separately, in the case of foreign takeovers, to political backlash. Governments, recognising the various stakes involved, have established agencies to evaluate M&As, often before the transactions are completed. The trend, at least in the industrialised countries, has been to make such agencies relatively independent of central government. Whatever advantages independence has been thought to bring, arguably government steps concerning cross-border M&As on both sides of the Atlantic have, over the last twelve months, raised questions about the longer term independence of competition agencies, or about what such independence is likely to be worth. This paper describes the status quo in merger enforcement, discusses a number of recent developments, and examines their implications for competition agencies. In my view, their situation is probably weaker than they think and this reflects a number of prior choices on their part, the consequences of which are only now becoming clear.

The remainder of this short paper on the political economy of merger reviews and associated enforcement is organised as follows. The next section describes the paradise of independent and isolated

competition agencies that review mergers and acquisitions. The third section describes how that splendid isolation has, by and large, not been affected by numerous international developments. The fourth section describes the trouble in paradise witnessed in recent times as governments have taken various measures on selected cross-border mergers and acquisitions and draws out a number of potential implications for future merger enforcement. Concluding comments follow.

Paradise

Before characterising the regimes used to review mergers and acquisitions, it is worth recalling the magnitude of the underlying corporate transactions. According to most observers, there have been five waves of mergers and acquisitions over the last 100 years or so, the last two of which (at the end of the 1980s and during 1995–2000) arguably had a substantial cross-border component. The merger wave at the end of the 1990s was broader in scope than its predecessor at the end of the 1980s, which was essentially a US and UK affair. By 2000, the peak of the last wave, firms in Continental Europe, parts of East Asia (notably Korea and Singapore) and Latin America joined British and American firms in what was probably the first truly global wave of M&A. Although precise estimates of the amount of M&A are hard to come by, at its peak M&A deals worth between \$4 and \$5 trillion were announced, over a trillion dollars of which had some cross-border element.¹

Ease of financing, in particular the ability to issue large quantities of stock, was probably the single most important determinant of the timing of the last wave of M&A. It is significant that the stock market correction in the early part of this decade heralded an end to so-called cheap money (or, rather, cheap financing). Cross-border M&A, for example, fell and fluctuated between \$300 and \$400 billion during



The merger wave at the end of the 1990s was the first truly global M&A wave

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¹ To have a cross-border element an M&A transaction must involve firms whose headquarters are located in two or more different jurisdictions or involve commerce in two or more different jurisdictions.

2002–2004. Much of that M&A was in the service sector, with the financial sector accounting for the lion's share of M&A in that category. Total cross-border M&A in manufacturing currently runs at half of that in the service sector. The comparable totals for the primary sector account for less than five per cent of total cross-border M&A in services.

As well as being a means of corporate restructuring, mergers and acquisitions are significant because they form part of the market for corporate control through which, ideally, managers and senior executives of publicly-traded companies are provided with sharp incentives to maximise shareholder value. Although it may seem rather obvious, it is worth recalling that the discipline actually felt by senior executives depends on a number of factors, some of which are in the control of the state. The relevant factors include the identity of the shareholders and their propensity to sell, any legal restrictions on the conduct of hostile mergers and acquisitions, and the other characteristics of national corporate governance systems. Countries differ markedly in the extent to which their firms are bought by foreigners. In Europe, for example, in terms of the absolute value of cross-border M&A, British firms are bought most often, followed by German firms, then French firms, and Italian firms finishing a distant fourth. While some of these international differences may reflect market factors, they almost certainly reveal differences in national policies and attitudes towards foreign mergers and acquisitions.

Concerns about the market-power increasing consequences of mergers and acquisitions led national policymakers to establish, and occasionally to reform (typically by strengthening), merger review procedures. The technical, essentially legal and economic, nature of merger reviews has led, along with a general tendency of politicians to withdraw from intervening in firm decision making, policymakers to create independent competition or antitrust agencies to undertake reviews of M&A according to guidelines specified in national legislation. In industrialised countries, the creation of independent competition agencies is most pronounced, although notable exceptions exist. Independence from political influence can have many facets, but some experts argue that the right to open and close a merger review on terms decided by the competition agency alone provide the minimum necessary degree of independence.

Competition laws that relate to mergers and acquisitions typically specify, amongst others, the size of M&A transactions that must be notified to the competition agency and the timing of such a notification. The latter is thought to be particularly important as competition agencies are said to have the most leverage when a transaction is notified before an M&A transaction is completed by the parties. National laws often provide for a variety of steps that a competition agency can take after it has reviewed a merger, including approving a merger without changes, an outright prohibition of the merger (or the right to sue for an outright prohibition), seeking structural changes to a merger (including divestitures), and seeking behavioural remedies from the parties (such as a commitment to lease a piece of technology to other parties at a specified price for a specified period of time). These powers give truly independent competition agencies significant leverage over private sector interests that come before it. However, it should be noted that many competition statutes specify mechanisms to review, or in some cases override, an agency's use of these powers.

Nations differ markedly in the extent to which government ministries, other state bodies, and the courts can review the merger-related activities of a competition agency or can opine on the same matters as those addressed by the competition agency. One option is that a minister can override an agency's decisions on pre-specified grounds, such as national security, public interest, national economic interest, etc. (Here much turns on the definition of these terms and their interpretation.) Another option is to allow a government body to review the merger or acquisition on grounds unrelated to competition. For example, a sectoral regulator may review a proposed merger to see if any public service requirements are likely to be compromised by the transaction. A third option is outright exemption from the merger law, where certain specified economic activities (e.g. sectors) or entities (e.g. state-controlled firms) need not seek approval from the competition agencies for any M&As that they engage in.

Use of these three options has different consequences for competition agencies with merger review powers. On the one hand, the existence of agencies conducting non-competition-related reviews has given competition agencies license to focus solely on the efficiency-related (or resource allocation-related) aspects of M&A. This accounts

Political review on other than competitive grounds has consequences for competition agencies

in part for the strong nexus between law and micro-economics in merger enforcement, and in competition law enforcement more generally. In doing so, competition agencies implicitly signal to the central government that if the latter wants mergers evaluated on some other grounds they had better legislate to that effect or create another body to undertake a separate evaluation of M&A. Competition agencies may also benefit in that some of the corporate or political pressure to decide in favour of a certain interest may be deflected to other state bodies or officials with the relevant decision-making powers. Together, this may give the impression of a competition agency under less pressure than comparable state bodies that is steadfastly holding to its efficiency-related criteria, so reinforcing the image of independence.

The downsides of these review mechanisms can, however, be fairly severe. A non-competition agency may conduct its review and demand changes from the parties involved that are, in fact, competition-impeding. In such circumstances, a competition agency may engage in what is known as competition advocacy, seeking to discourage the non-competition agency from taking measures that distort the competitive process. The downside here, then, is that the second review of a merger creates additional work for the competition agency. Worse, if the second reviewer rejects the competition agency's advice then the latter's credibility may well be adversely affected. With respect to ministerial overrides of the competition agency's decisions, the signal sent by such overrides to aggressive corporate and political interests about the standing of the competition agency cannot be positive.

Fortunately to date, with a few notable exceptions, the two disadvantages mentioned above have not been much in evidence. Overall, then, competition agencies have found themselves in an enviable position. Their independence and focus on efficiency-related concerns enables them to avoid a number of potentially difficult circumstances and to deflect pressures to other state bodies. Moreover, the popularity of M&A as a tool of corporate restructuring ensures a steady stream of reputation-enhancing opportunities for all concerned and a certain profile for the competition agency and its officials within the private sector. Power, limited constraints on action, and a narrowly construed mandate is the paradise that independent competition agencies have created for themselves. Will it last?

Potential spoilers: Bloody foreigners

The integration of national markets into the world economy and the spread of merger review laws around the globe has had important implications for the political economy of competition policy, although not of the sort that economists might have anticipated. The purpose of this section is to describe the dogs that did not bark, those that did, and how leading competition agencies have handily dealt with the potential challenges to their independence that have had international origins.

The fact that a merger or acquisition can be reviewed in many jurisdictions gives rise to potentially conflicting decisions by national competition agencies. At the extreme, this can involve one agency prohibiting a merger while another accepts the proposed transaction. Disagreements of this type are, in fact, quite rare but when they do happen they can be very pointed (as the proposed General Electric-Honeywell transaction demonstrated.) A milder form of disagreement can have significant consequences, too: different competition agencies may seek remedies and divestitures which, when considered in the aggregate, can undermine completely or partly the viability of the proposed transaction.

Viability, however, is not the correct microeconomic metric with which to assess the effects of multi-jurisdictional merger review. Resource allocation is the metric preferred by economists. In this respect, each competition agency that reviews a proposed transaction can make two types of mistake: (1) on the basis of the effects in its own jurisdiction it can prohibit a merger that is, in fact, world welfare improving and (2) it can allow a merger that is actually world welfare reducing. These mistakes amount to being too strict or too lenient, respectively. As there are many competition agencies, and given that, in principle, only one agency need prohibit a merger for it not to go ahead, then the combined effect of multi-jurisdictional merger review is likely to be a regime that is too strict rather than too lax. This means that some M&A deals that could have improved on net the world's allocation of resources may well have been frustrated.

The economist's standard prescription in such cases is to advocate some form of joint decision-making mechanism whereby one agency decides the merits of a merger in multiple jurisdictions, adding up the costs and benefits across many economies to see if a

Independence of national competition agencies has been challenged by extra-jurisdictional merger review

proposed transaction should go ahead. With the exception of the European Union, where arguably the creation of a supranational competition agency with teeth was an unintended consequence of treaty-making 40 years ago, no other region has seriously pursued this option of pooling sovereignty. It must also be admitted that there is little evidence as to the magnitude of the losses created by multi-jurisdictional merger review, just as there is little available evidence for the contrary proposition: namely, that in a multi-country world the simultaneous application of national merger reviews leads to the globally optimal allocation of resources. I suspect that the real explanation for the lack of international collective action here lies not in information and evidence, but elsewhere.

Corporations with interests that span many countries may find the current system of national merger reviews expensive, intrusive, uncertainty-creating, and ultimately frustrating of their plans. In principle, these firms may well welcome a “one stop” shop for merger reviews in a region or sub-region. However there may be other, arguably more attractive, alternatives from these firms’ point of view. First, businesses may advocate the narrowing of differences in the implementation of merger reviews, perhaps reducing the costs of merger reviews and the time taken to clear transactions. Of course, as many of these firms are headquartered in industrialised economies, it would be desirable from their perspective if national merger review practices generally converged to those in richer economies, which these firms are used to dealing with. A second stance is to overtly or covertly discourage the spread of merger review laws in the first place. A gentle alternative here is to discourage the application of these laws by nascent competition enforcement regimes, often by arguing that other challenges (such as prosecuting cartels and undertaking competition advocacy) should take priority. Here much is made of the “complexity” of appropriately enforced merger reviews, with the implication that developing countries don’t have the staff expertise to implement them.

For the established competition agencies, the spread of merger review laws is a mixed blessing, too. One might have thought that the spread would expand the number of allies for each competition agency and afford senior officials at leading competition agencies with opportunities to develop reputations on the world stage. Against these benefits are likely to be a number of concerns on the part of competi-

tion agencies. The first is that international business is at best lukewarm about the spread of merger review laws. Established competition agencies may well suspect that there is little to be gained by making the case for merger review laws worldwide in a way that antagonises multinational businesses based in their jurisdiction, especially if the latter decide to take their revenge by lobbying for reductions in the powers and resources of the national competition agency. Rather than give up entirely on trying to influence nascent merger review regimes, competition agencies have an incentive to offer advice that international business finds palatable. The strong presumption underling many technical assistance programmes run by leading competition agencies that competition advocacy, a non-enforcement activity, should be a priority for new competition agencies, followed in time by cartel enforcement, is consistent with the above explanation.

Another strategy open to leading competition agencies is to encourage, for those jurisdictions with merger review laws on the statute books, the adoption of “best practices,” which just so happen to almost entirely correspond to the existing procedures of the leading competition agencies. Moreover, to placate the business community, the antitrust or competition bar could be encouraged to participate in the design and dissemination of these merger-related best practices. Such an initiative could, of course, be entirely voluntary, thus not encroaching on the independence of national competition agencies or obligating those agencies to seek changes in national laws, which would bring another unwelcome group (politicians) into the equation.

The creation of the International Competition Network (ICN) in 2001, whose members are only competition agencies and whose numbers now total approximately 90, can be seen as a vehicle towards promoting convergence towards ideally simpler, less arbitrary merger review regimes by encouraging the rest of the world’s competition agencies to converge to the practices of their counterparts in leading industrialised countries.

This interpretation is consistent with the ICN’s heavy focus, in its first three years, on merger reviews and to a lesser extent on competition advocacy. Now that much of the work on mergers has been completed, it is noteworthy that private sector representatives are mumbling about the ICN losing momentum and are expressing concerns about the expan-

National competition agencies prefer competition advocacy and adoption of best practices to more merger review laws

sion of the ICN's activities into cartels. The resistance to creating an ICN working group on abuses of a dominant position, or monopolisation, which has eventually delayed such an initiative for at least two years, is probably another indication of the reluctance of some competition agencies to get too far ahead of vocal private sector interests.

The spread of competition law and market integration more generally have posed two other threats to the nicely constructed paradise mentioned earlier. Ironically, the first comes from other national competition agencies which, perhaps unsurprisingly, have sought cooperation from their more experienced peers. Outside of established technical assistance programmes and contacts at international conferences, the willingness to engage in cooperation, especially on enforcement matters, is limited. There may well be two benign explanations for this outcome: legal constraints on the form of permitted cooperation and the staff resources necessary to respond to cooperation requests. In addition, however, one cannot discount other possibilities. First, a competition agency may fear a backlash from domestic politicians if it cooperates with a foreign enforcement agency that, it transpires, is bringing enforcement action against multinational corporations, some of which are based in the former's jurisdiction. Here self-preservation would take priority over combating anti-competitive practices abroad. Second, leading competition agencies may not want to create even implicit obligations to cooperate with foreign agencies. For this reason the more discretionary forms of assistance to new competition agencies would be emphasised, such as training and long-term advisors, rather than actual cooperation in enforcement cases. Such agencies would probably follow a strategy of ABC to nascent competition regimes: Anything But Cooperation. These choices would be consistent with the assumption that the preservation of independent rights of action is the key objective of established national competition agencies.

Nowhere is the opposition from leading competition agencies to measures that might infringe on their powers and prerogatives greater than when it comes to international trade agreements. Trade policy is an arena where in most jurisdictions the corporate and bureaucratic interests are too large for comfort for many competition agencies. The logic of trade negotiations with its emphasis on compromise and mercantilism does not sit well with the absolute pursuit of efficiency. Moreover, competition provisions of

trade agreements are typically not central to the negotiating exercise, ensuring that the resulting legislation might result in the competition agency's interests being overwhelmed by other factors. Leading competition agencies have often called into question the value of competition provisions in free trade agreements, arguing that they are ineffective and wishful thinking. Some of these criticisms may be true (I too have my doubts about some such provisions) but one cannot help wondering if it is the preservation of independence at home that really drives the opposition to more formal modes of cooperation.

Having said all this, there are a small number of cooperation agreements between competition agencies. For the competition agencies in larger economies, these tend to be with those trading partners where there is a lot of cross-border M&A in both directions, offering both parties' respective business communities more expeditious and less fraught merger reviews. Where significant M&A volumes are absent, such agreements are much less in evidence. Moreover, cooperation agreements on matters that prejudice commercial interests, such as cartel investigations, are even rarer.

This section has described the various ways in which the consequences of international market integration and the spread of national competition laws have been managed by leading competition agencies. From the perspective of maximising their independent room for manoeuvre, these agencies have done very well indeed. Whether, in a globalising world, customers are best served by these arrangements is another matter.

Trouble in paradise

While established competition agencies have been, by and large, successful at fending off unwelcome foreign initiatives, they have been much less successful on home ground, especially in Europe and in the United States. In the last few years, and in particular in the last twelve months, a number of seemingly unrelated events have taken place that call into question just how far paradise's realm extends and whether that realm will shrink in the future. In the United States, the proximate cause has been concerns about the national security implications of cross-border M&A. In Europe, concerns about the capacity of European firms to compete in world

Preserving independent rights of action is the key objective of established national competition agencies

markets, and whether there will be “enough” such firms, have cast long shadows over the regulation of mergers.

Underlying developments on both sides of the Atlantic is the notion that nationality does indeed matter, at least in the eyes of politicians and others influential persons and groups in society. In the United States, concerns about the nationality of owners of ports and oil facilities have ensured that two foreign takeovers of companies with US assets were scuppered. The furore, in early 2006, over Dubai Ports World’s potential acquisition of certain US ports from the British company Peninsular and Oriental Steam Navigation Company ended up pitting the US Federal government against many members of the US Congress and arguably large swathes of public opinion. Considerations of efficiency were given short shrift by policymakers and, as far as I can discern, the US antitrust agencies made no public interventions in this debate. One can appreciate the reluctance on the part of US antitrust officials to disagree with many Congressmen and women. However, their silence may come at a price as some in Congress are advocating expanding the definition of national security (itself relatively loose) to include economic security. Should this proposal be enacted, then US antitrust authorities could find themselves increasingly marginalised as opponents to proposed cross-border M&As of US assets seek to influence the inter-agency process responsible for security matters, however defined.

National security, national champions, and nationality may override the focus on efficiency

This example highlights the advantages and limitations of the sole focus on efficiency as the metric used to evaluate mergers and acquisitions. On the one hand, a focus on efficiency lets competition agencies “duck” or avoid very contentious evaluations on national security grounds. Yet, these agencies do so by ceding ground to other government bodies. Moreover, once elected officials get involved with evaluating a case, they may be tempted to draw more general lessons, possibly redrawing the boundaries where efficiency-based rationales take priority over other metrics and vice versa. In short, an exclusive focus on efficiency provides only so much “cover” for competition agencies and that protection comes at a price.

In some respects, matters are worse in Europe. Unlike in the United States, where in principle concerns about national security could be relatively clearly defined and are distinct from economic

objectives, in Europe the very metric of efficiency has been called into question through a number of different means. The argument that mergers should be allowed because they enhance the ability of the firms involved to compete on world markets, a claim that is often made by supporters of so-called national champions or as the French Prime Minister calls it “economic patriotism”, suggests that the effect of a merger on resource allocation in the affected markets (which the efficiency criterion assesses) is not accepted in highest counsels of government, at least in Paris, Berlin (although arguably the newly appointed government may differ in this respect from its predecessor), Madrid, and elsewhere.

Moreover, claims that non-European companies should not be allowed to take over large European corporate groups, such as the proposed takeover by Mittal Steel of the French-Luxembourg-Spanish group Arcelor, suggest that nationality rather than efficiency matters. Furthermore, the reluctance of some European governments to countenance national banking and energy companies being bought up by foreign, but still European, companies suggests that the notion of nationality in the minds of some European policymakers is pretty tightly drawn.

Whatever its attractions, the exclusive focus on efficiency, and therefore the denial of the importance of other metrics, has – from the perspective of political economy – put competition agencies on the defensive. By failing to address what others see as legitimate objectives to be pursued as economies restructure, competition agencies invite political and corporate interests to circumvent or override them. For example, competition agencies were given a blunt reminder of their place on the political food chain when, in 2002, the German Ministry of Economics rejected the Federal Cartel Office’s recommended prohibition of E.on’s takeover of Ruhrgas. (The German government based its objection to the recommendation on the argument that the combined entity would be a substantial export powerhouse.)

There is another risk of the growing divergence between what governments want from their micro-economic policies and what competition agencies deign to provide and that is that the former will create state bodies that will do their current bidding. Over time, these state bodies will inevitably seek to extend their remit, possibly at the expense of the

competition agency. The result may well be institutional rivalry between a purist competition agency and an opportunistic state body. Paradise may slowly resemble an impeccably kept vegetable plot in the middle of a run-down urban ghetto.

Worse still, to the extent that foreign investors are discriminated against in the M&A arena, competition law will almost surely return to the agenda of state-to-state commercial negotiations. In this respect it is worth noting that the disputed Arcelor-Mittal Steel transaction has already been a topic of conversation at a summit between the Prime Minister of India and the President of France (in early 2006.) This is probably the first time that the occupants of these two posts have discussed competition-law related matters. Frustrated foreign investors are likely to argue that disciplines on the conduct of merger reviews be placed on the negotiating table in future trade agreements. Should this come to pass, competition agencies will have to evaluate the potential harm such provisions could do to both its independence and to the standing of other agencies that review mergers. In these circumstances, splendid isolation appears to be a far less tenable long-term option.

Defenders of the status quo in competition agencies are not without a few good arguments of their own. They could point out, correctly, that the robust microeconomic underpinnings of efficiency compare well to the relatively sloppy definitions of competitiveness, national champions, and economic patriotism, and that the former provide a better guide to policymaking. Moreover, they could argue that the correct response to apparent changes in government preferences is to advocate efficiency-based principles more forcefully, and not to abandon them. These arguments have some appeal, but each implicitly takes the view that ideas can trump interests in the political arena, a questionable proposition at best.

Perhaps a more imaginative response on the part of competition agencies could be to identify the reasons why policymakers are dissatisfied with current corporate performance, be it export-related or some other metric, and to examine what measures to promote competition could play in furthering the goals. This approach might indicate some responsiveness on the part of competition agencies to new government priorities. Even so, it still leaves open the question as to the metric to be used when evaluating mergers and acquisitions.

Paradise lost

Competition agencies successfully rode the wave of economic reform that took hold around the world from 1985 onwards. Many such agencies were created, and existing agencies were reinforced and often made independent, especially in industrialised economies. The associated freedom and a number of strategic choices (such as the adoption of efficiency standards) enabled competition agencies to initially avoid a number of entanglements, in particular foreign constraints. Underpinning this success, however, were many governments' commitments to liberalise markets.

Now that government priorities appear to have evolved on both sides of the Atlantic to include national security, national champions, and competitiveness considerations, the question arises as to whether the commitment-free and wide-ranging paradise created by competition agencies will continue. Trouble in paradise is brewing and it is unclear that competition agencies have recognised the scale of the threats to them, or have begun to formulate adequate responses. In the current climate it is difficult to see how competition agencies can maintain their splendid isolation, especially if governments continue to pursue non-efficiency objectives in policies towards corporate restructuring, of which mergers and acquisitions are an important component. Assuming these state objectives persist, then either the technocrats will not reign over M&A forever or they will have to learn how to accommodate to and make the most of a new political reality.

Return to state-to-state negotiations on merger issues will dilute the power of competition agencies