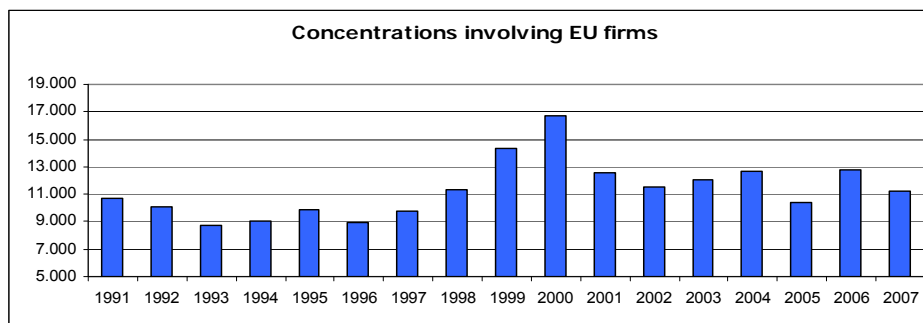


Concentrations – Mergers

- The pro-competitive effect deriving from the elimination of barriers put in place by the Internal Market Programme drives the «not efficient» out of the market.
- Allen, Gasioreck & Smith (1998) estimate an average decrease of the price / cost margin of 4% p.a. as a consequence of the IMP.
- Nickell (1996) shows that in the period immediately preceding and after the IM there is a decrease in the number of firms throughout Europe, generally larger and more efficient.
- Part of this process is the «merger mania». The Commission, anticipating the increase in the number of mergers, introduces the Merger Regulation in 1989.

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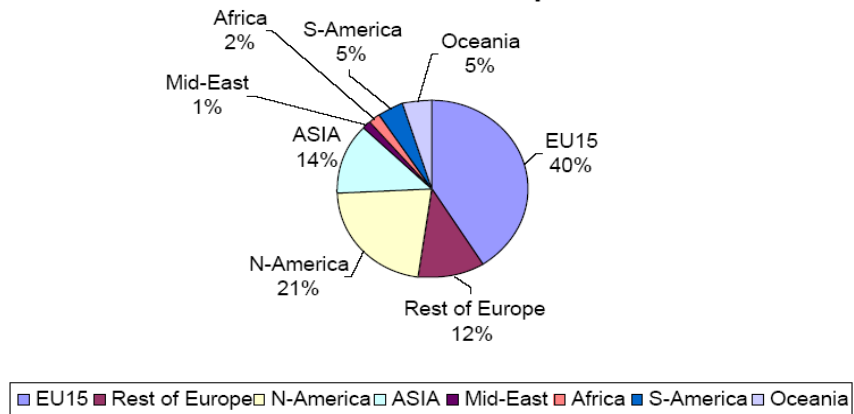
Evolution of Mergers



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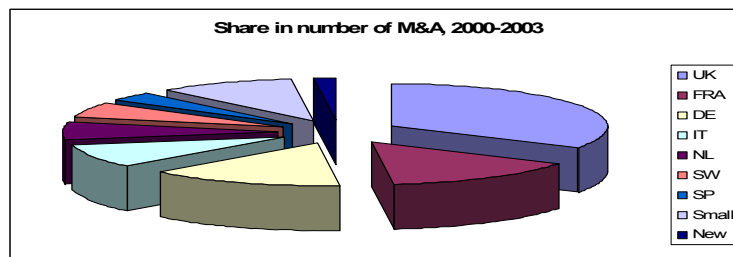
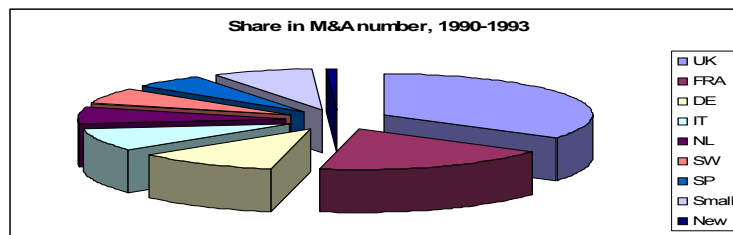
Geographical target of Mergers

**Graph 1: World breakdown of target by main regions
number of transactions - period 1990-2003**



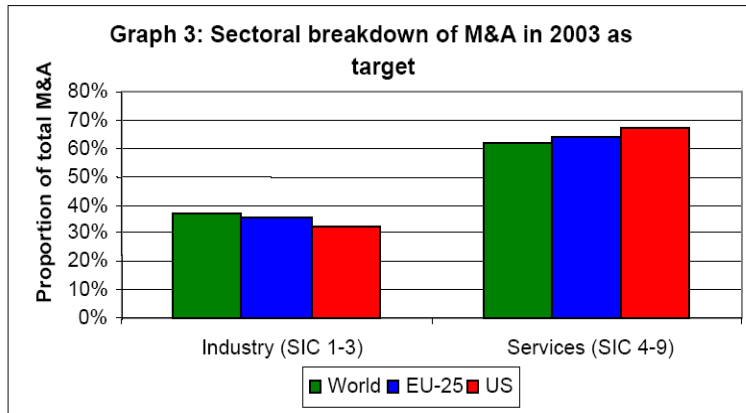
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Mergers – Differences within Europe



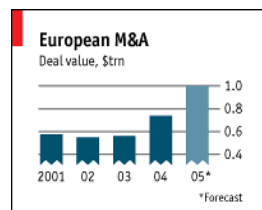
111

Sectoral targets of Mergers



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Another merger wave?



La grande nation
European cross-border merger & acquisition activity
Jan 1st-Aug 15th 2005

Country of acquirer	Deal value \$bn	Number of deals
France	59.5	146
United States	55.6	398
Italy	27.9	76
Britain	19.8	272
Spain	18.0	53
Sweden	15.7	136
Switzerland	11.7	70
Germany	7.4	164
Denmark	6.6	91
Saudi Arabia	6.6	2
Total	286.6	2,251

Source: Dealogic

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Another merger wave?

Des opérations tous azimuts

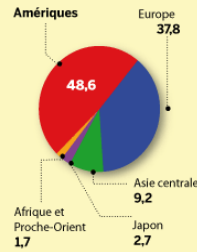
► LES DIX PREMIÈRES FUSIONS-ACQUISITIONS EN 2006
en milliards de dollars

CIBLE	ACQUÉREUR	MONTANT
BellSouth Corp (Etats-Unis)	AT&T Inc. (Etats-Unis)	89.432
Endesa (Espagne)	E.ON (Allemagne)	71.386
Gaz de France (France)	Suez (France)	40.971
Arcelor (Lux.)*	Mittal (Pays-Bas)	39.463
Sanpaolo IMI (Italie)	Banca Intesa (Italie)	37.624
America Telecom (Mexique)	America Movil (Mexique)	35.293
Equity Office Properties Trust (Etats-Unis)	Blackstone (Etats-Unis)	32.512
HCA (Etats-Unis)*	KKR (Etats-Unis)	32.147
Norsk Hydro (Norvège)	Statoil (Norvège)	31.998
BAA (Royaume-Uni)*	Ferrovial (Espagne)	30.190

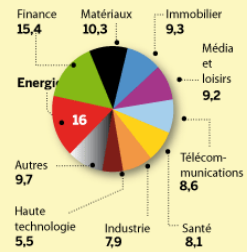
Source : Thomson Financial

*achevé

► PAYS D'ORIGINE DES CIBLES
en %

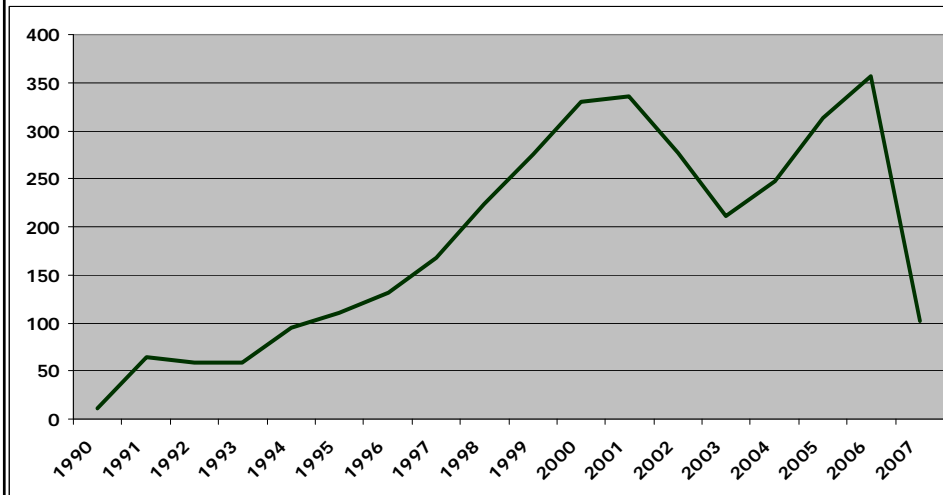


► SECTEURS D'ACQUISITION
en %



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Notifications to DG COMP



Mergers – Legislation - 1

- Merger rules are not part of the Treaty: Regulation 4064/89, modified by Reg. 139/2004, is secondary legislation.
- Art. 2(3): "A concentration which would not significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared compatible with the common market."
- Commission jurisdiction is concerned with large mergers:
Geographical limits – more than one MS needs to be affected –
and dimensional limits – the size of turnover needs to be above a threshold.
- Single shop stop.
- Authorisation procedure with clear deadlines:
 - Within seven days from offer, notification to DG Comp, who in turn has 30 days for authorisation – autonomous decision of the Competition Commissioner.
 - If there are doubts, Phase II, four months investigation.
 - At the end:
 - a Authorisation
 - b Prohibition
 - c Authorisation with remedies
 - d Notification withdrawal and suspension of the merger.

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Mergers - Legislation - 2

- The most difficult cases are often under c: parties negotiate with DG Comp remedies of the kind:
 - Structural – modification of ownership, parties undertake to dispose of assets, be it totally or partially, to limit the market power stemming from the merger.
The Commission wants the asset acquiring entity to be a competitive firm, capable of challenging the merged firm, while the latter has an opposite interest.
Further, there is a fundamental asymmetry of information between those who operate in the market and those entering because of acquisition of assets.
 - Behavioural – parties undertake to follow specified business practices when enjoying the market power emerging from the merger.
Behavioural remedies would need a monitoring capability that DG Comp can hardly provide.

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Structural remedies

- Structural remedies are the most frequent
- The most drastic of all, break up, was seldom implemented in the US and never in EU
- The best known case was the break up of AT&T in the 1980's.



Courtesy of Ansgar Held

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Mergers – Legislation - 3

- Time deadlines imposed on the Commission decisions are a highly appreciate element: the US judicial procedure is much slower.
- All merger control procedures are in fact *ex-ante*, and based upon the suspicion that a potential dominant position arising from the concentration would be illegally exploited by the merged firm.

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Unilateral and coordinated effects

- The illegal exploitation would normally take place along two modalities:
 - Unilateral effects: the merged firm will abuse its dominant position.
 - Coordinated effects: the market configuration resulting from the merger – i.e. the decrease in the number of firms operating in the market – will be less competitive, and the tendency towards collusion will increase

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Unilateral effects

- The level of concentration is measured by the Herfindahl-Hirschman index, $HHI = \sum_i m_i^2$. When the market is perfectly competitive, $HHI = 0$, in case of perfect monopoly $HHI = 10,000$.

$$L = \sum_i \frac{m_i^2}{\varepsilon} = \frac{HHI}{\varepsilon}$$

- According to DoJ Guidelines:
 - If after concentration $HHI < 1000$, authorisation
 - If after concentration $1000 < HHI < 1800$, authorisation if $\Delta HHI < 100$.
 - If after concentration $HHI > 1800$, open investigation procedure.

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Coordinated effects

- In EU legislation there is no reference to “collective dominance”. The CFI and the ECJ have confirmed that the Commission can indeed apply the concept of collective dominance both under art 82 and Merger Regulation.
- 1989 Merger Regulation: a concentration can be prohibited if and only if it creates/strengthens a dominant position, as a result of which competition would be significantly impeded. This made difficult to prohibit mergers that would substantially lessen competition even without the identification of a dominant position.
- The Commission filled the gap claiming that mergers in this condition would lead to collective dominance through coordinated behaviour.

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Collective dominance cases

- In **Gencor / Lonhro**^[1], the Commission blocked the merger claiming coordinated effects as the resulting entity would have 30-35% of the world platinum (and associated precious metals) market, Anglo-American with another 30-35% and the Russians with depleted mines producing 10% decreasing to near zero in a couple of years. The CFI upheld the Commission decision stating that there is no need for the oligopolists to be connected formally by specific links in order to prove that collective dominance exists.
- In another landmark ruling^[2] the ECJ quashed the **Kali / Saltz / Treuhand** decision, but confirmed that joint dominance - or coordinated effects - was in fact covered by the Merger Regulation, and that the Commission had in it the legal base to rule.

^[1] Gencor / Lonhro Commission Decision of 24 April 1996, Case No IV/M.619

^[2] France v. Commission, Joined cases C-68/94 and C-30/95, ECJ decision dated 31.3.1998.

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Airtours / First Choice case

Airtours bid to take over First Choice, both UK based holiday tour operators. After the merger there would have been three major tour operators left in the market:

1. The merged entity (with $19.4 + 15.0 = 34.4\%$ market share),
2. Thomas Cook (20.4%)
3. Thomson (30.7%).

All other players would have less than 3%.

After a phase II investigation, the Commission decided on Sept 22, 1999 to prohibit the merger, assessing that it would create a situation of collective dominance in the market for short-haul foreign package holidays in the UK. The Commission's view was that the three remaining operators would be able to coordinate behaviour by restricting capacity put on sale, and thereby raising prices for British consumers.

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The CFI decision

The CFI (June 6, 2002) did not disagree with the market definition applied by the Commission, nor with the analytical framework used to evaluate whether the transaction would lead to a collective dominant position with co-ordinated behaviour. But the CFI found that the Commission had not proven that:

1. the three remaining operators would have an incentive to cease competing with each other;
2. there were adequate deterrents to secure unity within the alleged dominant oligopoly;
3. the smaller tour operators controlling altogether 3% of the market, potential competitors and consumers would not be in a position to destabilise the alleged dominant oligopoly.

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Efficiency defence

- The merger is supposed to generate gains for the parties: cost savings, elimination of duplications, streamlining of distribution structures, efficient scale.
- Higher efficiency allows lower costs, and this is by itself an increase of welfare / surplus.
- US DoJ *Guidelines* state clearly the nature of the problem: there is a trade off to be determined between the improvement generated by the efficiency gains and the worsening generated by the increase in market power.
- The new Regulation has modified the relatively strict stance of the Commission: "In In making this appraisal, the Commission shall take into account: [...] the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition." (Art.2(1)b).

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The General Electric / Honeywell case

- The largest merger ever attempted
- The General Electric Company is a diversified industrial corporation active in fields including aircraft engines, appliances, information services, power systems, lighting, industrial systems, medical systems, plastics, broadcasting (through the NBC media channel), financial services and transportation systems. GE had at the time the world's largest market capitalization.
- Honeywell is an advanced technology and manufacturing company serving customers worldwide with aerospace products and services, automotive products, electronic materials, speciality chemicals, performance polymers, transportation and power systems as well as home, building and industrial controls.

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The markets

Markets - Product categories		Competitors	Customers
1. Jet engines	1.a Jet engines for large commercial aircrafts	GE - Rolls Royce RR - Pratt & Whitney P&W (UTC) - CFMI (JV of GE / SNECMA) - IAE (JV of RR / P&W)	Airbus, Boeing
	1.b Engines for regional aircrafts	GE- Honeywell - RR - P&W - CFMI (JV of GE / SNECMA)	Embraer, BA Bombardier, Fairchild Dornier,
	1.c Engines for corporate jet aircrafts	GE - Honeywell - Rolls Royce - Pratt & Whitney	Cessna, Gulfstream, Raytheon, Dassault, Bombardier
	1.d Maintenance, repair and overhaul MRO	GE - Honeywell - RR - P&W - Airline maintenance departments - Independent service companies	All the above
2. Aircraft systems	2.a Avionics (all equipment used for the control of the aircraft)	Honeywell (50%) - Rockwell Collins (30%) - Thales(10%)	All the above, plus GE
	2.b Non-avionics (all equipment used in operating the aircraft)	Honeywell - Hamilton (UTC) - BF Goodrich - SNECMA	All the above.
3. Engine controls	Accessories used as inputs in the production of engines.	HoneywellHamilton (UTC)	All the above plus GE

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Dimensions

The merger had several dimension to be scrutinised:

- **horizontal nature** for large regional jet engines, 1.b,
- **conglomerate nature** as in several of the above markets/product categories only one of the merging parties was present, and
- **vertical nature** as Honeywell and GE had a supplier customer relationship in different of the above markets/product categories such as 2a and 3, and also because GE through GECAS is a relevant buyer of airplanes. The conglomerate and vertical aspects are the interesting ones.

The market/s concerned are all markets where entry is difficult: high sunk costs, technological requirements.

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The Commission's position

The Commission maintained that:

1. GE was already dominant in jet engines, and that
2. through the merger it would become increasingly dominant leveraging its market power through:
 - GE Capital
 - GECAS
 - Bundlingcreating dominance where GE was not present, but Honeywell yes.

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Decision and CFI ruling

- On 3 July 2001, the European Commission declared the proposed merger incompatible with the Common Market.
- On 14 Dec 2005, the CFI upheld the Commission prohibition: the Court ruled that the Commission was right to prohibit the deal because a GE-Honeywell combination would have created a dominant position in markets for jet engines for large regional aircraft, for corporate jet aircraft and for small marine gas turbines, but said it made "some errors".
- The court rejected the Commission's use of "conglomerate effects" economic theory. The CFI said "the Commission did not sufficiently establish that the merged entity would have bundled sales of GE's engines with Honeywell's avionics and non-avionics products." The CFI said the Commission must have "convincing evidence," citing as an example a hypothetical internal document which would show the "settled intention of the board."
- On the Commission's side, the Court found GE could have brought to bear the financial strength of GECAS in establishing a dominant position for its large commercial jet engines, prior to the proposed purchase of Honeywell. "The Commission could legitimately consider GE to have used the commercial strength of subsidiaries within its group, in particular the aircraft leasing company GECAS, to win contracts which it might well not have won without their involvement," the Court said in a statement.

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Understanding the divergence[‡]

How did the North American and European antitrust authorities reach diametrically opposed conclusions about the likelihood of anticompetitive effects in a high-profile transaction involving world-wide markets? We see two underlying explanations for this outcome.

1. First and foremost, the divergence exposed in *GE/Honeywell* is rooted in fundamental substantive and economic differences in doctrine between the United States and EU merger regimes. In particular, *GE/Honeywell* makes clear that EU regulators will invoke "portfolio effects theory" to block conglomerate deals that they fear will cause leading firms to become even more effective competitors. In contrast, in the US, lower prices resulting from mergers are welcome, even when they are predicted to cause leading firms to gain market share.
2. Second, the procedures in place in Europe contributed to the ability of the Competition Commissioner to block the proposed merger of GE and Honeywell based on dubious economic grounds and very weak evidence. In particular, the absence of timely and independent judicial review of the Commissioner's decision [...] gives enormous discretion to the Competition Commissioner and to the Commission's Merger Task Force.

[‡] Donna E. Patterson and Carl Shapiro "Trans-Atlantic Divergence in GE/Honeywell: Causes and Lessons" Antitrust Magazine, Fall 2001.

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Economic divergence

Size: Is Big Bad? The EU's Final Decision [...] seems to rely on GE's success and financial strength relative to its competitors as evidence that the merger was likely to lead to anticompetitive effects. [...] The EU's reasoning: GE's size and financial strength are a source of GE's dominance in engines and are likely to be used by GE in Honeywell's lines of business as well if the merger were to be consummated.

Dominance in Bidding Markets. GE was considered dominant having won more engine orders recently than its competitors, often by bidding aggressively. [...] The EU finds dominance in a bidding market based on the ability of the firm in question to win bids through aggressive discounting. [...] In the US, dominance would be found in bidding markets when rivals were unable to offer credible, attractive alternatives: the firm in question was not forced to compete aggressively to win.

Competition Is Foreclosure? We use the term "foreclosure" to refer to situations where one firm uses its monopoly power to limit the ability of others to compete effectively against it. [...] In the EU, a firm that wins by serving customers' needs may be characterized as having "foreclosed" its rivals. [...] The EU's reasoning [is] very clear: the merger will allow GE/Honeywell to make attractive package offers, and "[a]s a result, the merger is likely to lead to market foreclosure on those existing aircraft platforms."

The Efficiencies Offense. [...] Very different views of what constitute "efficiencies" in mergers. The U.S. approach and reasoning regarding efficiencies is: (1) Mergers that lead to lower prices are pro-competitive. (2) We are most confident predicting the effects of a merger based on the economic incentives that will face the merged entity. (3) Therefore, if combining the assets of the merging firms gives the merged entity an economic incentive to reduce prices that would not otherwise arise, the combination involves merger-specific efficiencies that count in favor of a proposed merger. [...] The EU's reasoning: (1) "Genuine" efficiencies, such as cost savings, are welcomed and count in favor of the merging parties. (2) Lower prices that result from "strategic behavior" do not count as "efficiencies" and may be regarded as anticompetitive.

Colorful reactions

- John R. Wilke, *U.S. Antitrust Chief Criticizes EU Decision to Reject Merger of GE and Honeywell*, WSJ, July 5, 2001, at A3 (quoting Assistant Attorney General Charles James: "Clear and longstanding U.S. antitrust policy holds that the antitrust laws protect competition, not competitors . . . [The EU decision] reflects a significant point of divergence.")
- Hal R. Varian, *Economic Scene; In Europe, GE and Honeywell ran afoul of 19th century thinking*, N.Y.T., June 28, 2001 ("When evaluating a merger, United States antitrust officials tend to focus on the benefits to consumers, while European regulators give substantial weight to the impact on competitors, especially if they are 'national champions.'")
- Editorial, *Europe to GE: Go Home*, W.S.J., June 15, 2001, at A14 ("In the Honeywell case, novel antitrust theories have been dreamed up simply because it would be unthinkable to let a large U.S. company go about its business unmolested.")
- Editorial, *Obstructionist Europe*, Washington Post, June 22, 2001, at A24 ("[F]or the first time ever, the Europeans seem poised to block a merger that has been approved by U.S. regulators; and . . . they are doing so on the basis of speculative reasoning about bundling that is controversial, to put it kindly.")
- Democratic Senators John "Jay" D. Rockefeller, IV and Ernest F. Hollings warned of possible retaliatory action by Washington. See William Drozdiak, *European Union Kills GE Deal*, W.P., Jul. 4, 2001, at A1 ("U.S. Senators . . . warned that thwarting the merger would . . . compel retaliatory action by Washington.")
- U.S. Treasury Secretary Paul H. O'Neill called the decision "off the wall" and said that something needed to be done to bring the EU back in line. See Brian M. Carney, *Loggerheads: Mario Monti, Central Planner*, W.S.J. Europe, Jul. 6, 2001, at 6. 134

State Aids

- EU State Aids legislation prohibits MS from supporting unevenly their undertakings.
- The US do not have a comparable legislation.
- The enforcement of State Aids legislation is relatively different from merger control and antitrust:
 - MS, and not firms, are the target.
 - ECJ and not CFI is competent.
 - MS behaviour is very often rooted in social reasons not easy to ignore.
 - The analysis of the dossier requires very often managerial competence.

Reasons for supra-national State Aid control

1. The first and most prominent one is that cross-border externalities may drive a wedge between national and international interests. Cross-border externalities occur when national governments do not take into account the (negative) side-effects of their intervention on other European states.
2. Second, national authorities face commitment problems. Kornai (1980) generally referred to this problem as the "*soft budget constraint*". The idea is that governments may not be able to commit to clear rules and a fixed budget *ex ante*.
3. Third, the proper functioning of the internal European market. National state aid measures are counterproductive, because they not only directly harm other countries (the basic externality argument) but also undermine the functioning of the European internal market. Supranational state aid control acts as a commitment device to a principle – the internal market principle – which is in everybody's interest *ex ante*, but difficult to abide by *ex post*.

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State Aid - Legislation

Article 87

1. Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market.
2. The following shall be compatible with the common market:
 - (a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
 - (b) aid to make good the damage caused by natural disasters or exceptional occurrences;
 - (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, insofar as such aid is required in order to compensate for the economic disadvantages caused by that division.
3. The following may be considered to be compatible with the common market:
 - (a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
 - (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
 - (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;
 - (d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest;
 - (e) such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.

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State Aids – Conditions

- Conditions for State Aids are:
 - Trade among MS, as ever.
 - Transfer of public resources, including forsaken revenues as for example in the case of fiscal State aids. Resources can belong to any level of Government.
 - Economic gain for the beneficiary, such as the granting of a State good/service pricing it differently from usual.
 - Selectivity: a “general aid” is not State Aid.

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State Aids – Compatibility 1

- Art 87(3) defines a few categories of compatible State Aid. The economic rationale for compatibility is market failure, sometimes complemented by the concept of merit good.
- Market failure takes place when the market, on its own, does not produce the optimal quantity.
- A merit good is a good or service that is considered as having special relevance for the State, assessing it with a value judgement deriving from its power to interpret the citizens will.
- The Council – Bruxelles, March 2003 – demanded a substantial reduction of State Aids, down from the present 0,60% of EU GNP, and a re-orientation towards horizontal objectives.
- The Commission is now revising the whole structure of legislation, and in particular the Block exemption regulations.

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State Aids – Compatibility 2

- R&D, innovation, risk capital, environmental investment are often examples of market failures.
- SME's often suffer from relative disadvantages for market imperfections.
- Social cohesion: aids targeted at reducing regional disparities or to the integration of categories of workers and social groups.

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State Aids - Policy

- The Council – Brussels, March 2003 – demanded a substantial reduction of State Aids, down from the present 0,60% of EU GNP, and a re-orientation towards horizontal objectives.
- The Commission is now revising the whole structure of legislation, and in particular the Block exemption regulations.
 - Aids for SMEs
 - Aids for R&D
 - Aids for Environment
 - Aids for Rescue and restructuring
 - Aids for Employment
 - Aids for Training
- The Commission is targeting a more economic approach

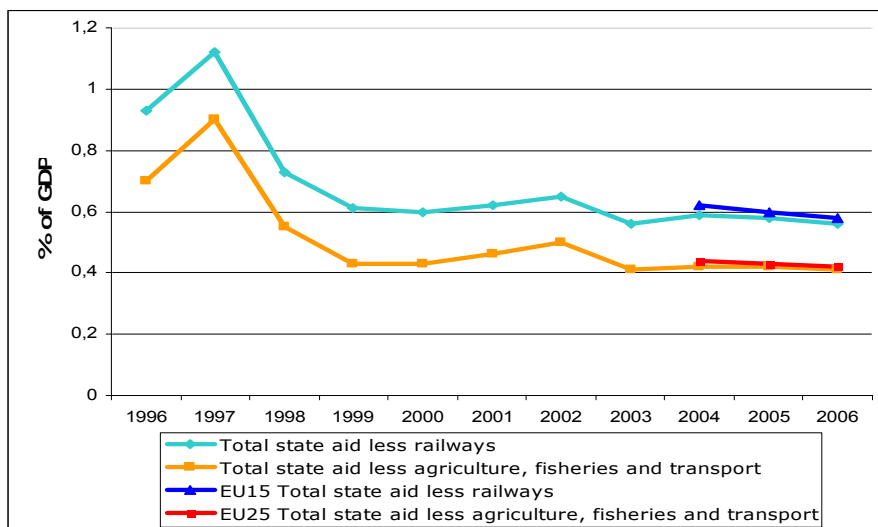
141

Total State Aid less railways in 2006

Country	Million euro	as % of GDP	Country	Million euro	as % of GDP
Belgium	1.225	0,39%	Czech Rep	755	0,66%
Denmark	1.289	0,59%	Estonia	54	0,41%
Germany	20.219	0,87%	Cyprus	111	0,76%
Ireland	988	0,57%	Latvia	291	1,80%
Greece	556	0,26%	Lithuania	128	0,54%
Spain	4.879	0,50%	Hungary	1.407	1,57%
France	10.389	0,58%	Malta	115	2,29%
Italy	5.511	0,37%	Poland	2.310	0,85%
Luxembourg	110	0,32%	Slovenia	254	0,83%
Netherlands	1.865	0,35%	Slovakia	223	0,51%
Austria	2.310	0,90%			
Portugal	1.450	0,93%	EU 10	5.648	0,91%
Finland	2.552	1,53%			
Sweden	3.515	1,15%	EU 25	66.723	0,58%
United Kingdom	4.215	0,22%			
EU15	61.073	0,56%			142

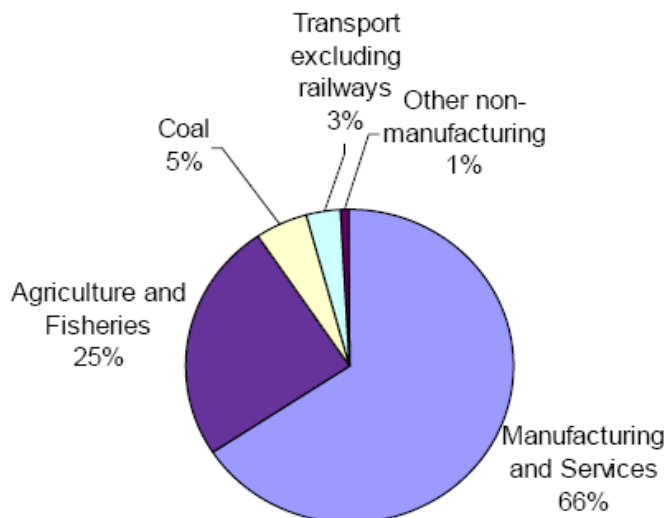
Evolution of State Aid

1996-2006 – Percentage of GDP



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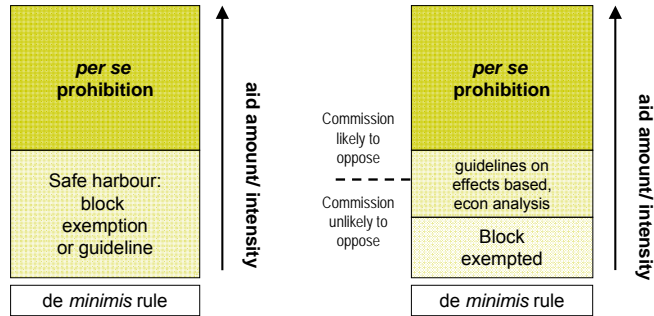
EU 25 Total Aid by sector in 2006



Test for an economic-effects based approach

1. Is there a market failure or another objective of common interest (e.g. social or regional cohesion)?
2. Is the aid measure targeted, i.e. does the proposed aid address the market failure or other objective? In particular:
 - Is the aid measure an appropriate instrument, i.e. are there other, better placed instruments?
 - Is there an incentive effect, i.e. does the aid change the behaviour of firms?
 - Is the aid kept to a minimum, i.e. could the same change in behaviour be obtained with less aid?
3. Are the distortions of competition and effect on trade sufficiently limited, so that the overall balance is positive?

Traditional and possible architecture of State Aid Tests



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State Aids in 2002-2004

	EU25	EU 15	New MS	BG	RO	CZ	EE	CY	LV	LT	HU	MT	PL	SI	SK
Total State aid less agriculture, fisheries and transport in million €	48991	42717	6274	65	981	1826	9	231	15	43	808	139	2902	135	167
State aid as percentage of GDP (%)	0.49	0.45	1.35	0.36	1.86	2.23	0.10	1.96	0.14	0.26	1.08	3.27	1.44	0.54	0.57
Population (million)	450.6	376.5	74.1	7.8	21.7	10.2	1.4	0.7	2.3	3.4	10.1	0.4	38.2	2.0	5.4
State aid per capita (PPS)	109	109	161	23	118	336	11	368	13	26	136	514	158	92	59

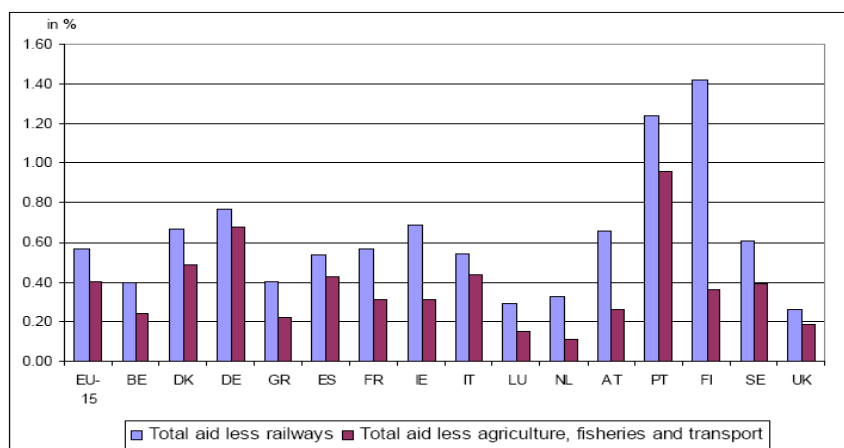
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Sectoral distribution of State Aid 2002 - 2004

	Percentage of Total				Total
	Manu facturing	Services	Coal	Other non manuf	Million €
EU-25	70%	14%	15%	1%	49.064
EU-15	74%	12%	13%	1%	42.790
New MS	46%	25%	28%	1%	6.274
BG	70%	0%	5%	25%	65
RO	65%	1%	11%	23%	981

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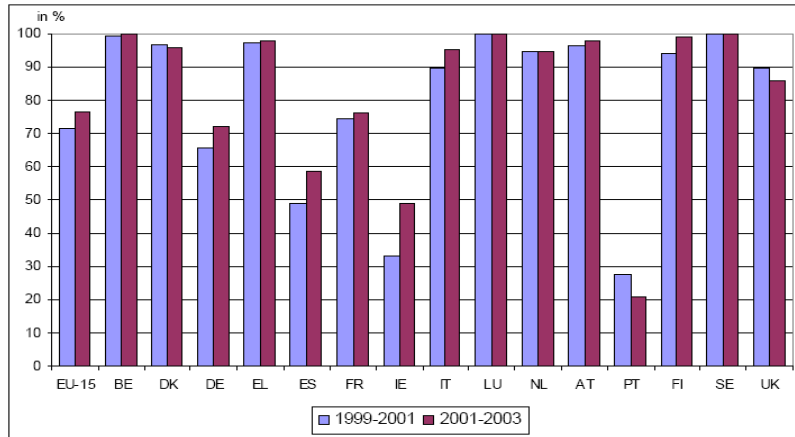
State Aids in 2003 as a percentage of GDP



Source: DG Competition

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Share of SA directed to horizontal objectives 1999-2003



State Aid for horizontal objectives and particular sectors 2002 -2004

	Annual averages					
	EU-25	New MS	BG		RO	
	%	%	mio €	%	mio €	%
Horizontal Objectives	68	23	29.4	45	130.3	13
Environment	19	2	0.6	1	9.6	1
SME	11	3	0.3	1	20.1	2
Employment aid	3	5	9.6	15	13.3	1
Regional aid (1)	18	8	18.9	29	87.4	9
Sectoral aid (2)	32	77	35.8	55	851.0	87
Manufacturing	7	25	16.5	25	538.6	55
<i>of which shipbuilding</i>			-	-	11.3	1
<i>of which steel</i>			6.5	10	132.9	14
<i>of which motor vehicles</i>			-	-	46.3	5
Coal	15	28	3.2	5	103.0	11
Other Non-manufacturing	1	1	16.1	25	205.4	21
Other services	1	0	-	-	3.9	0
Total aid less agriculture, fisheries and transport in million €	100	100	65.1	100	981.2	100

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Industrial policy: an example (1)

- Jean Louis Beffa, the CEO of Saint Gobain, drafted in 2004 a report on a new industrial policy in France for President Chirac.
- The report stresses the role of industry in economic growth and urges the Government to re-orientate public R&D support in favour of large companies in technology intensive sectors such as pharmaceuticals, environment, transport and energy.
- It defines two axes for the State intervention.
 - First, public support is necessary to initiate and guarantee risky, long term and large scale R&D projects in an instable economic environment.
 - Secondly, public intervention is necessary to coordinate the action of industries, sub-contractors, customers and scientists around an identified strategic project. Notably, the Report identifies a major role for public authorities in transferring the results of public research.
- The report recommends the creation of an "Agence de l'Innovation Industrielle" which would have a central role in the organisation, the monitoring and the assessment of the subsidised programmes.

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Industrial policy: an example (2)

- The preliminary assessment under Community rules for State aid for R&D raises a number of issues. Some of these relate to recurring issues in the scope of aid to R&D, such as aid intensity, eligible costs, incentive effect, etc. and are likely to be clarified at the notification stage.
- Some other issues, such as potential discrimination and lack of transparency in the allocation of the funds, stem from the nature of the proposal, notably with regard to the composition and to the role of the Agency that the report proposes to be created.
- Mr Beffa has indicated in an interview that the current programmes have failed "to strengthen the strong". It is not a priori clear, however, why it is necessary to target aid to large companies. Large firms typically suffer much less from market failures (such as limited access to capital due to information asymmetries on risky and long-term investment projects) than SME's.
- The "Agence de l'innovation industrielle" will identify strategic projects, and this raises the question of concerted action. The agency will involve various groups of representatives (industry participants, unions, government, parliament). It is not clear however how this set-up will work out in terms of incentives, efficacy, the "incentive effect" of state aid, ...
- The report builds heavily on the tenet that - in France at least - the larger enterprises play an important role in R&D. French SME's play a role in R&D which is apparently less important. This should raise questions as why this happens, which are left largely untouched in the report. The answer may well lie in SME's having insufficient access to capital, business services and the like. A more balanced approach would have to highlight the need to remove impediments for SME's as well.
- Even acknowledging that there may be a rationale for supporting large companies as they may be the nucleus of an "industrial cluster", it is also clear that handing out substantial subsidies for large companies creates thorny issues in terms of distortions of competition.

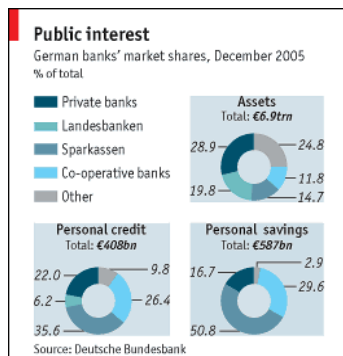
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The Landesbanken case.

- The German 'three pillar model':
 1. Private banks
 2. Genossenschaftsbanken – cooperative banks
 3. Sparkassen - saving banks (40% market share)-> historically grown/ base of German 'Wirtschaftswunder'/ supportive for SMEs
- German banking sector in general considered as:
 - Low concentration (HHI 442, declining)
 - Low profitability
 - But relatively stress-resistant
- Bank- v. market based financing: role of credit financing in Germany dominant (14.5% credit) compared to US (9%) or other European countries (10-13%)

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German and European Banks



Country	Banks	Branches	Staff	Banks per 100,000 people
Luxembourg	162	253	22,549	35.8
Germany	2400	45,467	702,750	2.9
France	880	26,370	429,347	1.5
Italy	778	30,944	336,979	1.3
Netherlands	145	3,980	131,129	0.9
Spain	265	40,445	241,664	0.6
UK	346	11,300	453,000	0.6

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Landesbanken - 1

- Landesbanken have three objectives:
 - Financial services to public authorities
 - Refinancing of saving banks
 - Private banking as universal bank
- Landesbanken are partially or wholly State owned
- Other shareholders are mainly saving banks or other Landesbanken
- Landesbanken were covered by broad State guarantees against bankruptcy (Anstaltslast & Gewährträgerhaftung)

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Landesbanken - 2

- Anstaltslast "maintenance obligation". The public owners are responsible for securing the economic basis of the institution and its function for the entire duration of its existence. It was first recognised in 1897 as a general principle of law by a high German court.
- Gewährträgerhaftung "guarantee obligation". The guarantor will meet all liabilities of the bank which cannot be satisfied from its assets. It was explicitly introduced in several Länder laws in 1931/32 when the previous direct liability of the municipalities was replaced.
- The guarantees allow the public banks (12 Landesbanken, around 550 savings banks of widely varying size as well as 11 special purpose credit institutions engaging in public policy motivated financing, together roughly 1/3 of the German banking market), significantly cheaper funding than competitors on the European financial markets.
- Both guarantees are neither limited in time nor in amount. Also, the credit institutions do not have to pay any remuneration for them.

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EU intervention

- Private bank association filed complaint in 1999
- Monti and Koch-Weser agreed in 2001 to:
 - allow State guarantees only for entities purely following public interests (promotion of SMEs, R&D, environment, etc) and in line with EC State aid rules -> restructuring until end 2007
 - Revoke State guarantees from July 2005
 - > unclear effect on their rating (now AAA-> BBB?->0.4-1% additional refinancing cost)
 - > may result in loss situation for some banks
- The Commission filed State aid cases against seven German Landesbanken.

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