Structural Policies, Regulation and Competition: The Economics of National Champions[1]

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Abstract:

Globalisation and the transition from national to international markets raise many questions, and one important question is whether one should support national champions. In this talk it is argued that such a policy – for example through a lax competition policy – will quite often be misguided. It can be detrimental to national welfare, because it results in a profit shift out of the country. A lack of competitive pressure in the domestic market caused by a national champion policy may slow down technological change and result in higher prices. It is argued that in an open economy it is less scope for a lax competition policy which permits national champions than in a closed economy. The experience in the Norwegian farmed salmon industry the last 25 years illustrates the success when not pursuing a national champion policy, while the experience in the Norwegian cement market since the 20s illustrates the loss associated with a lax competition policy.

[1] This talk was held at the 25th anniversary for the CISEP - Research Centre on the Portuguese Economy – on February 16th 2007 in Lisbon. The views expressed here are my own, and they are not necessarily shared by the Norwegian Competition Authority.

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1. An introduction

During the last decades we have observed what many would characterise as globalisation, or more precise an increase in globalisation. One important element in this development is the transition from national towards international markets. In Europe the establishment of the internal market in 1992 gradually changed many markets from national to European markets. Domestic firms are therefore less protected in their home market than we observed for example in the first decades after World War II. This raises numerous policy questions. In this talk I have chosen to focus on one particular question that has been debated in many European countries in recent years: Should each nation actively promote own national champions?[3]

The argument in favour of such a policy is straightforward and rather simple. By promoting our domestic firms, they will be better prepared to compete against foreign firms. From a national perspective we should therefore promote our own domestic firms, and thereby increase our national welfare. This calls for a rather lax national competition policy. One implication could be that we should support mergers between domestic firms, and another implication could be that we should not ban cooperation between domestic firms. When domestic firms unite their forces, it should thus be in the interest of the whole nation. This seems particularly important for small nations, such as for example Norway and Portugal, so their firms can come on more equal terms with large firms from the large nations such as the US and France. In this talk I will argue that such an advice is misguided. It is not in the interest of a small nation to promote champions by having a lax competition policy.[4]

Before I present the possible arguments for promoting national champions, let me briefly discuss how trade liberalisation as such might influence the decision to support a national champion. Lower trade barriers should apparently be a substitute for competition policy, since lower trade barriers would lead to tougher competition in domestic markets. If this is true, a

[3] Some recent examples of possible takeovers of domestic firms by foreign rivals that led to a debate include (i) Mittals (India) takeover of Arcelor (France and Luxembourg), (ii) ABN AMROs (Netherland) takeover of Banco Antonveneta (Italy), (iii) Albertis (Spain) failed attempt to merge with Autostrade (Italy) and (iv) Endesa (Spain) as the target for takeover bids by E.ON (Germany) and Gas Natural (Spain). For more details, see wikipedia on the topic *economic nationalism*.

[4] Note that in our discussion that promoting national champions will turn out as the opposite as promoting competition in the domestic market. In Sørgard (2006), the effects of promoting competition in seven Norwegian industries are discussed.

lax competition policy and thereby the permission to establish national champions might be an optimal policy. However, it turns out that it is not that straight forward and that competition policy has a role to play also in an open economy.[5] Lower trade barriers will have an effect on national welfare in the case with a domestic merger to establish a national champion and it will also have an effect on national welfare in the case with *no* domestic merger. It is therefore highly uncertain how trade liberalisation as such will influence the optimal domestic merger policy unless it leads to perfect competition. In fact, there are studies that find that lower trade barriers could either make mergers more profitable or promote collusion.[6] In the following, let us therefore leave the question of trade liberalisation as such and take for granted that we have an open economy. Given a certain level of trade barriers, what would be the effect of promoting national champions by applying a lax competition policy?

The plan of the talk is as follows. In the following section I use a very simple framework to explain why a domestic merger can be more detrimental to national welfare if foreign firms are present than if they are not. In Section 3 I discuss whether cost savings for the merging firms might be an argument for permitting a domestic merger. In Section 4 I discuss whether national champions should be allowed when the domestic market is part of an international market. Furthermore, in Section 5 I discuss whether national champions should be allowed in order to block a merger between a domestic and a foreign firm, and in Section 6 whether they should be allowed to block an acquisition of domestic firms by foreign owners. In Section 7 we offer some concluding remarks, and illustrates the lessons from this talk by referring to the Norwegian farmed salmon industry and the Norwegian cement industry..

2. A simple theory of (no) national champions

To explain the possible effect of a so called national champion, let us think about a particular market where three symmetric firms – identical cost structure and demand potential – operate. For the moment, we consider a national market where two of the firms are domestic firms and

[5] This is discussed in detail in Neven and Seabright (1997), Richardson (1999) and Horn and Levinsohn (2001).
[6] Gaudet and Kannouni (2004) shows that lower trade barriers leads to tougher competition, which means that a dampening-of-competition merger is profitable with lower trade barriers. Lommerud and Sørgard (2001) shows that lower trade barriers might lead to tougher punishment following a deviating from collusion, and that lower trade barriers therefore makes collusion more sustainable.

one firm is a foreign owned firm. Furthermore, let us assume that those three firms compete, although in an imperfect way.[7] Then all three firms earn profits.

In line with the idea of a national champion, let us assume that those two domestic firms coordinate their behaviour. We will denote it a merger, but a cartel agreement between those two firms might lead to the same outcome. Let us for the moment assume that there are no cost synergies following a merger.

Is there from a national point of view any reason to allow such a merger? The answer is no. In fact, seen from a national perspective it is more problematic to allow such a merger than what would have been the case if all three firms were domestic firms. [8] We can use Figure 1 to illustrate this.

Prior to the merger we observe imperfect competition, with a dead weight loss equal to the area marked H in Figure 1. This is the standard text book effect of imperfect competition, where the price the marginal consumer is willing to pay exceeds the costs associated with the production of one extra unit (the marginal cost). An extra unit production will thus generate an increase in the utility for the marginal consumer that exceeds the cost it incurs. Production should then be expanded until the marginal willingness to pay is equal to the marginal cost. By expanding production to such a level the society would increase welfare equal to area H in Figure 1.

A merger with no cost synergies would not help to alleviate the misallocation in this particular market. On the opposite, it would make things even worse. When two firms merge they do not compete head to head any more. When they do not compete, we observe less intense rivalry between all firms in the industry.[9] Less intense rivalry would mean that prices go up. Higher prices will imply that the consumers buy less. This would lead to an even larger dead weight

[7] This could be true if they compete a la Cournot with homogenous (or differentiated) products, or a la Bertrand with differentiated products. In the former we could interpret it as if they compete on capacities, while in the latter they compete on prices.

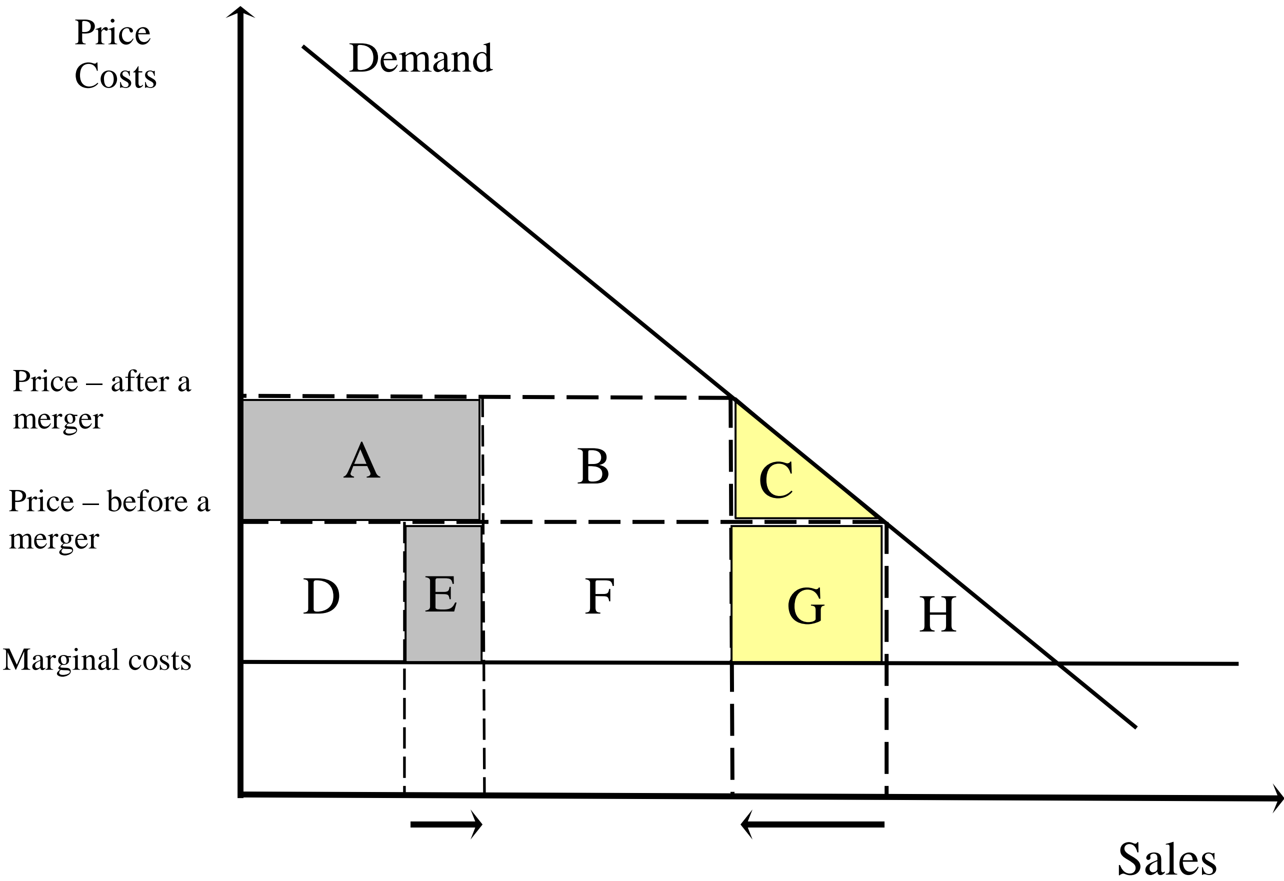
[8] The idea presented here is addressed in a formal model in Barros and Cabral (1994. This is one of the first articles analysing merger policy in an open economy, and note that it was written by the two Portuguese economists Pedro Pita Barros and Luis Cabral.

[9] This is true except in the specific situation where firms sell identical products and they compete on prices. In such a case the firm that increases its price will lose all its sale, and a merger will have no effect on prices unless there is a merger to monopoly.

loss than prior to the merger. In Figure 1 this is illustrated with the increase in the dead weight loss from area H to area C + G + H.

So far we have not taken into account that there are domestic and foreign firms in this particular market. C + G would be the loss associated with a merger in a domestic market where we have only domestic firms. However, we assume that the non-merging firm is a foreign firm. Since we for the moment assume that all firms are equal before and after the merger, the effect on prices would be the same irrespective of whether all the firms are domestic or only the two merging firms are domestic. Despite this, it will make a difference for national welfare if we allow the non-merging firm to be a foreign firm.

Figure 1: The effect of a merger between the two domestic firms



The merger would lead to a redistribution of sales between the firms. The merging firms have incentives to reduce their joint sales after the merger. By doing so the prices would raise. The non-merging firm, though, can be a free rider on the merger. It can replace some of the sales withdrawn by the merging firms. If it only replaces a part of their sales reduction, the total

quantity in the market has gone down and the market clearing price has increased. Then the non-merging firm can have a double dividend: It can (i) sell more, and (ii) at higher prices.

The non-merging firm is by definition a foreign firm. The merger between two domestic firms has thus been beneficial for the foreign firm. First, it has increased its sale. This leads to a profit shift from the domestic to foreign firms, and this is equal to the area marked E in Figure 1. Second, it achieves a higher price for all of its sales. This leads to an additional profit increase in the foreign firms which corresponds to a loss of consumer surplus, and this equals area A in Figure 1.

We then see that the fact that the non-merging firm is a foreign firm does not make the merger between two domestic firms more advantageous seen from a national perspective. On the contrary, the existence of a foreign firm in a domestic market is an argument for banning a domestic merger. If all three firms had been domestic, the loss from the merger would be equal to area C + G. When the non-merging firm is a foreign firm, the loss associated with a merger between the two domestic firms equals C+G+A+E.

This extremely simple model does not at all support any idea of promoting national champions. On the contrary, the one and only prediction from such a simple model is that one should do the opposite: Be sceptical to any proposal to support domestic firms in a domestic market with foreign firms.

Our simple model is in sharp contrast to the idea of national champions. Let us try to discuss some other possible arguments for promoting a national champion.

3. Cost savings as an argument for a national champion?

First, a domestic merger may lead to large cost savings. All else equal, this is an argument for permitting a domestic merger. It can then be better prepared to compete even more fiercely against a foreign firm. However, we have to think carefully about the possible effects of such a cost saving. One alternative would be that the merged firms save on fixed costs. For example, by merging the firms could establish one instead of two head quarters and thereby lower costs. If the merged firm is rational, though, such a cost saving will not affect its pricing

policy. Given its fixed costs, the firm set prices that maximize its net profits, i.e., profits exclusive fixed costs. This implies that the loss associated with a profit shift out of the country is the same as with no cost savings, and from a national welfare point of view the profit loss and the dead weight loss must be compared with the fixed costs savings. In addition, one might have to compare the effects of a domestic merger with the right alternative that might be a merger between a domestic and a foreign firm (see below).

Alternatively, the merged firms save variable costs. One example would be a firm with a high variable cost merging with a firm with a low variable cost. If the merged firm is able to produce to the low variable cost, this would be an argument for setting a lower price for the merged firm. However, the merger as such would give an incentive to compete less fierce and to set higher prices. The reduction in variable costs must therefore be sufficient large for the merged firm to set a lower price following the merger. It has been shown that there has to be rather large savings in variable costs before a merger leads to lower prices.[10] This suggests that the profit shift out of the country argument is relevant unless savings in variable costs are substantial. If these cost savings are substantial, though, the profit shift argument is reversed. Then the existence of a foreign firm is an additional argument for permitting a domestic merger, since lower prices leads to a more limited profit shift out of the country.

It is then an empirical question whether price is expected to fall as a result of cost savings following a merger. In the empirical literature on the effects of mergers there are some studies that do find that mergers lead to lower costs, while others do not find any such effect. The general picture, though, seems to be that there is no clear evidence of any systematic cost reduction following a merger.[11] Empirical studies from Norway are in line with such a broad conclusion.[12] This implies that any claim that a domestic merger will lead to cost savings should be met with scepticism if not the merging firm has detailed evidence pointing in such a direction. Furthermore, it is even harder to argue that a merger will lead to lower variable costs in general, and then there is even less scope for a price reduction following a merger.

[10] This is shown in Farrell and Shapiro (1990) for the case of Cournot competition. See Werden (1996) for the case of Bertrand competition with differentiated products.
[11] In Scherer and Ross (1990) it is concluded that it is typically lower costs in industries with fierce competition, indicating that a merger that dampens competition might lead to higher costs. In specific studies of the effect of mergers the picture is mixed. For example, Kramp (1994) finds from French data that the productivity is lower after a merger while Liechtenberg and Siegel (1987) and McGuckin and Nguyen (1993) finds the opposite results on US data.
[12]See Klette (1993), Vik (1996) and Kringstad (1997).

One of the sectors in Norway where the national champion argument has been put forward in the discussion of mergers is banking. A survey done in Norway indicates that economies of scale might not be exhausted for small and medium size banks in Norway, while the minimum efficient scale is reached for large banks in Norway.[13] However, the mergers we have observed in Norway have typically been between the largest domestic banks. Then one cannot argue that such mergers should be permitted because they leads to large cost savings. On the contrary, the argument in the previous section seems to be valid. In the Norwegian banking industry we have foreign owned banks, and they are the one that will benefit most from mergers between large, domestic banks. A national champion policy will thus be detrimental to domestic welfare according to our analysis unless there is detailed evidence of large costs savings associated with a domestic merger.

4. National champions to compete in an international market?

Second, one may argue that the domestic firms are active on a larger market than the national market and thus that it would be in the interest of our nation that they merge.

Let us for the moment assume separate markets. One example could be the case where the firms in question operate in foreign markets as well as the domestic market, and where those markets are not integrated. A merger between two firms with cost savings might be in the interest of foreign consumers. It can be shown that this can be true if firms at the outset compete more fiercely in the foreign market than what is the case in the domestic market. Then a merger between domestic firms might lead to lower prices in the foreign market, where even modest cost reductions may lead to lower prices. On the other hand, it leads to higher prices in the domestic market where it is a merger to monopoly. In this special case it could be that a competition policy that favours national welfare would ban a merger between domestic firms that could benefit foreign consumers.[14] Then merger policy would be stricter than what might be optimal seen from a global perspective.

In the previous example national markets are not integrated. From a European perspective this might not be the most relevant case, since the idea behind the internal market in European

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[13] See Gabrielsen (1997) for a survey of the potential for cost savings following mergers in the banking and the finance sector.

[14] See Haufler and Nielsen (2005), who apply a simple model to show that this might be the outcome.

Union established in 1992 was to integrate national markets in Europe. However, one may question whether we have an internal market in EU. The European Commission has made an effort to establish an integrated car market, and a recent study indicates that they have succeeded in reducing price differences between national markets.[15] In many other markets, though, we observe that brand names are national, which clearly indicates that we should consider national rather than a European market in most cases. There are exceptions, though, where we observe even global markets. Concerning Norway, we have numerous industries that compete on an international and in some cases even global scale with rather standardised products such as oil, gas, farmed salmon and some particular metals.

With the warning that many markets are national, let us now consider the remaining markets where we have an integrated market which encompasses several national markets. The Nordic electricity market is such an example, where Norway, Sweden, Denmark and Finland have joined a common, integrated spot market.[16] Should for example Norway support a domestic merger in such a market? It is hard to argue that a domestic merger in Norway would lead to any reduction in marginal costs, since (almost) all production in Norway is hydro power with a very low marginal cost. The initial presumption would then be that such a merger would lead to higher prices, if any price effect at all.[17] If so, should we allow a domestic merger? The first – and apparently obvious – answer is that it depends. If our country is a net importer, we are in principle in the same situation as discussed in association with Figure 1. A domestic merger would lead to higher prices. The foreign firms importing to our domestic market will benefit from higher prices in our integrated market and thus from higher prices from domestic consumers. Then there will be a profit shift out of the country.

If our country is a net exporter, it might be beneficial for national welfare with a domestic merger. Higher prices following a merger would lead to higher prices to domestic as well as foreign consumers. From a national perspective we will consider only domestic consumers' utility and domestic firms' profits. If we apply a total welfare standard, it is straight forward to see that a price equal to marginal costs is not optimal. A marginal price increase will lead to a larger increase in profits for sales to foreign consumers than the increase in dead weight loss

[15] See Goldberg and Verboven (2005),
[16] The discussion in this and the following sections draws on Sørgard (1997).
[17] In a hydro power system the total amount of water is fixed in the short run, which implies that it is important to understand how water is reallocated for production of electricity between different periods (for example, winter versus summer). See Skaar and Sørgard (2006) for a discussion of how this idiosyncratic feature of a hydro power system should be taken into account in the analysis of a merger.

associated with domestic consumers. It can be shown that there will be a so called critical price, which is a particular price where the profits from foreign consumers and the dead weight loss from domestic consumption are balanced out on the margin. If prices are close to marginal costs, a domestic merger could then be beneficial for national welfare. The larger exports relative to domestic sales, the higher the critical price-cost margin and the larger the scope for a domestic merger to improve national welfare.

Before we conclude that it can be beneficial for national welfare, we have to take into account two counter-arguments. One is rather technical in nature, and the other is more fundamental.

The technical one concerns the welfare standard we apply. So far we have assumed that we apply a total welfare standard, where one EURO to the domestic firm has the same weight as one EURO to a domestic consumer. Due to such a consideration, the profit increase for the firm due to higher prices from both foreign and domestic consumers outweighs the loss for domestic consumers. However, in most countries the competition authorities apply a consumer welfare standard. In such a situation a merger will be banned if the consumers are hurt. For a national competition authority it is typically the case that the domestic market is the relevant jurisdiction. It is easily seen that a consumer welfare standard would not allow the competition authorities to consider whether the profit increase from foreign consumers more than outweighs the loss for the domestic consumers. Unfortunately, I must say, in Norway we apply a total welfare standard in merger cases. This means that we in principle could accept a merger that hurts domestic consumers, because it hurts foreign consumers even more and thereby benefits a domestic firm selling to foreign consumers.

The more fundamental counter-argument concerns the game we play as a nation. Think about the situation described above, but where we have two countries with an integrated market. Country one has a large production in one particular market, and is a net exporter for the product in question. According to the argument referred above, it might be the case that country one then accepts a merger because it gains domestic firms more than it hurts domestic consumers. But then country two would be the loser. The merger would by definition hurt their consumers, and since this country by definition has a rather limited production in the market in question the loss for the consumers outweighs the possible profit increase for their firms.

Although country one may benefit in this particular market by playing such a game, what happens in other markets? In another market the situation might be reversed, with country two as the net exporter. Then country one would not be in favour of any merger. Country two, on the other hand, might in this particular market be in favour of a domestic merger. If country two permits a domestic merger, country one will be the one that is hurt by such a policy. The example is truly relevant for the Nordic electricity market, which is an integrated market with one common market place and one common price (as long as there are no bottlenecks in the transmission network).

In a wider perspective, both countries are hurt by such a policy where national welfare is decisive for a decision to permit a merger or not. The game they play could therefore lead to the worst outcome they could have seen from a joint perspective. This game between the nations leads to a 'beggar-thy-neighbour' policy.

The potential for a 'beggar-thy-neighbour' policy shows that there is a scope for a supra-national competition policy. A supra-national competition policy is exactly what we got in Europe. If a merger concerns several national markets, conditional on certain criteria the merger can be transferred from national competition authorities to the European Commission. Then the Commission takes into account a European perspective, which might stop some nations from promoting national champions. Recently we have witnessed a debate within the EU concerning the 2/3 rule. If 2/3 of the turnover of the merged parties is within one member states this particular member state should investigate the merger. The Commission has proposed to change this rule so that more mergers are investigated by the Commission. Some member states have been very much against such a change, and no doubt the national champion argument is an important element in this debate.

Despite the critique towards the national champion argument, one should note that domestic mergers and acquisitions can be beneficial for a country and the world as well if it takes place in a rather competitive, global market. The development in the industry for farmed salmon might be an example of this.[18] Norway was a pioneer in the development of this industry, and its long coast gave it a comparative advantage. The industry was heavily regulated at the outset. For example, there were detailed restrictions on ownership, to prevent any firms from

[18] See Bjørndal, Knapp and Lem (2003) for a description of the market structure and development in the salmon industry.

acquiring all the local plants. The technology gradually changed, and both in production and marketing it became a larger potential for exploiting economies of scale. We have observed mergers and acquisitions to better exploit economies of scale. Despite the observed mergers and acquisitions, the price reduction was quite substantial. From 1981 to 2006 the real price of farmed salmon fell from NOK 80 per kg to NOK 25 per kg. The Norwegian government has a restriction saying that no single owner could have more than 25 % of total production in Norway. The primary reason for such a restriction was that it should secure at least some local ownership of the farmed salmon industry. The 25 % rule in Norway is an example of a public policy that prevented large national champions from being established. Obviously, it did not stop the Norwegian salmon industry from expanding a. It tripled its sales from 1990 to 2001, and it has now approximately one third of the world market.

5. National champions to block an international merger?

Third, one could argue that a domestic merger would prevent a merger between a domestic and a foreign firm. The idea is that blocking such a merger is beneficial for domestic welfare. One reason would be that such a blocking of an international merger would prevent any profit shift out of the country.

Let us return to our initial argument concerning a merger and a profit shift out of the country. We have shown that in a typical merger – a price-increasing merger – the outside firm is the one that benefits most from the merger. It can free ride on the sales reduction made by the merging firm, and have a combination of larger sales and higher prices. By doing so it will be a profit shift from the merging firms to the non-merging firm. Since the non-merging firm is a domestic firm, it will be a profit shift which is beneficial for the domestic firm. In that respect an international merger is more favourable for national welfare than a domestic merger.

Blocking an international merger could make it possible with a domestic merger. This could be beneficial for national welfare if it leads to costs savings.[19] However, it is difficult to argue that a domestic merger on average triggers more cost savings than an international merger. On the contrary, theoretical predictions and empirical evidence indicates that an international

[19] For an elaboration of this argument, see Horn and Persson (2001).

merger may lead to larger cost savings than a corresponding domestic merger. There are at least two possible reasons for that.

First, it can be due to the nature of foreign, multinational firms. It has been argued that a multinational firm that enters a domestic market may produce to lower costs than a domestic firm.[20] The reason is that a multinational firm has access to unique technology and knowledge. If the multinational firm merge with a domestic firm, this technology and knowledge can be transferred to the former domestic firm. Some empirical studies do find that multinational firms produce at a lower cost. An empirical study for Norway does not find any significant difference in productivity between domestic and multinational firm operating in the domestic market.[21]

Second, it can be due to the vertical relationship in the industry and in particular the relationship with the trade unions. Trade unions are typically national. This means that if two domestic firms merge, the trade unions in those two firms join forces if not they have done so already through a nation-wide trade union. The trade union might respond to such a situation by setting a higher wage, thereby capturing a share of the potential profit increase in the market. Such an increase in wages can be transformed to higher output prices, and can thereby be detrimental to domestic consumers.

However, let us compare this situation with a merger between firms serving a domestic market but where the firms are located in different countries. If two firms located in different countries merge, the merged firm will have to deal with two independent trade unions. In such a case the merged firm will be in a favourable bargaining position. It can threaten to shift some of the production to the plant in the neighbouring country, thereby forcing the trade unions to offer lower wages. The merged firm can thus trigger competition between the trade unions, and this leads to lower wages.[22] Lower wages might in turn lead to lower product prices. However, as we noted earlier, the reduction in marginal costs must be substantial for prices to go down following a merger.

[20] See Simpson (1994) for a survey of the theoretical literature, and for an empirical study for Norway.
[21] In Simpson (1994) the productivity of Norwegian owned firms are compared with the productivity of foreign owned firms in the domestic market. It is found that foreign firms are larger and has lower costs. But controlling for the systematic difference in size between Norwegian and foreign firms, there are no longer any significant difference in productivity between Norwegian and foreign owned firms.
[22] See Lommerud, Straume and Sørgard (2006), where this is shown in a formal model where firms either merge or there is an acquisition game.

There are numerous examples of firms pursuing such a strategy. The Swedish multinational firm Electrolux has plants in many countries in Europe. In 1997 the firm's sales stagnated. It announced in November 1997 that it planned to restructure production in Europe and close down some plants in its subsidiary in Zanussi in Italy. In December 1997 Electrolux and the trade union signed an agreement where it was decided that there would be no plant closures in Italy. The trade union had agreed on a package of measures that included lower wages, for example that newly-recruited workers would receive a lower wage than the minimum level set by the company-level bargaining for the next two years.[23] It is documented that in such industries as automobile, electrical consumer products and food manufacturing products the plants within multinational firms are engaged in internal competition for both current production and future investments as was the case in Electrolux.[24]

Since an international merger leads to lower marginal costs than a domestic merger, it is obvious that the international merger will lead to lower prices than a corresponding domestic merger. However, even an international merger might lead to higher prices. Since firms in this setting can merge just to curb the trade union, and thus to shift rents from the union to the owner of the firm, we might expect that there will be too many international mergers seeen from society's point of view. But the interesting thing to note is that despite this argument a domestic merger is found to be always more detrimental to domestic welfare.[25] The main reason for this is, as explained in association with Figure 1, that higher prices shifts profit to the non-merging, foreign owned firm.

6. National champions to block acquisitions by foreigners?

Fourth, one could argue that one should allow domestic actors to acquire domestic firm in order to prevent foreign actors' acquisition of domestic firms. This is an argument along the same lines as in the previous section. However, one unique argument not raised in the previous section could be that one by doing so could prevent foreigners from moving

[23] In a press release the trade union stated that 'the agreement means most notably that the Italian Zanussi plants have managed to avoid being on the international list of cuts decided by Electrolux' (Paparella, 1997).
[24] See Marginson and Schulten (1999) in general, and Hall (1998) concerning the German car producer BMW.
[25] See Lommerud, Straume and Sørgard (2006). Be aware that we apply the total welfare standard, where there is no genuine value associated with having a trade union that leads to high wages. If high wages is beneficial seen from a distributional aspect, then a domestic merger is more favourable than seen from a total welfare standard.

resources out of the host countries. For example, the head quarter could be moved to a foreign country. Another argument would be that one should permit domestic firms to acquire other domestic firms, in order to avoid foreign firms from 'grabbing' domestic firms at a rather low price.

It is an empirical question whether domestic firms that are acquired by foreigners move resources out of the country. One study has described the amount of foreign ownership in Norway, and analysed the effects of such ownership.[26] It is found that most foreign owned firms start out by acquiring or merge with a domestic firm. The main motive seems to be market access in a cost efficient way. A large number of the firms in the study were characterised as 'independent daughters', because the subsidiary in the host country acted rather independent from its foreign owners. Most of the people in key positions were Norwegians, and the study found no difference between domestic owned and foreign owned firms concerning the amount of local deliveries of goods and services. Although they found some examples of firms moving R&D abroad, the general picture was a substantial R&D activity in the subsidiary. This is in line with the study mentioned earlier, where they did not find any systematic difference between domestic owned and foreign owned firms.[27]

Despite such findings, it might be that foreign owners transfer wealth from it subsidiary to its foreign owners. This can be done through, for example, the transfer pricing of internal transactions. If this is a significant problem, one should observe that the value of minority shares in such companies after a foreign owner has gained control would fall. However, empirical studies does not support such a hypothesis. In fact, it has been found that the value of minority shares typically increases following a majority owner gaining control in a company (see Eckbo, 1983 and Eckbo, 1988).

Finally, it might be that foreign owners could end up paying a low price when acquiring a domestic firm. Again, it is hard to find empirical evidence for such a hypothesis. Numerous studies find that the acquiring firm has to pay a higher price for the acquired firm than the initial value of the firm.[28] Often the acquiring firm pays a 30-40 % premium above the initial stock value of the firm that is being acquired. This indicates clearly that there is no systematic

[26] See Rusten, Kvinge and Jakobsen (1999).
[27] See Simpson (1994).
[28] See, for example, Jarell et al (1988).

tendency for firms being acquired at a low price, but rather that the opposite is true. Two empirical studies find that the same is true in Norway.[29]

In all, the empirical studies do not give any support to a policy of blocking foreign owners from acquiring domestic firms to stop a transfer of wealth out of the country. The fact that it is typically the acquired firm that gains from acquisitions is an argument for permitting rather than blocking foreign owners from acquiring domestic firms. One of the empirical studies in Norway finds that when a foreign owner is acquiring a domestic firm the price for acquiring the domestic firm is typically higher than when a domestic firm is acquiring another domestic firm.[30] One reason could be that when foreign firms are willing to acquire a domestic firm, this leads to competition for acquiring the domestic firm and a high price paid for the acquired firm.

7. Some concluding remarks

National champions are often popular among politicians. No wonder, since support to national champions – as the notion in itself indicate – apparently is good for not only the large domestic firms but also for the nation. But I have argued that we should view with scepticisms such a simple argument, because it is often misguided. In fact, many economists do warn against pursuing a policy that favours national champions.[31] A national champion policy might often be a part of what is called an industrial policy. If this is true, the next question is what should be the goal of industrial policy? It cannot be a goal in itself to promote national champions, but it should rather be to increase welfare and pass on gains to the consumers. If this is the goal of industrial policy, we are close to the goal of competition policy.

The main idea behind competition policy is to spur rivalry between firms. This drives prices down, but even more importantly it also leads to lower costs and more innovation. Firms strive to capture market shares from their rivals and earn profits, and this competitive process leads to lower costs and better products. One natural way to succeed is that firms have to face a challenge from rivals in the national market in order to later on succeed in an international

[29] See Svænnes and Thallhaug (1991) and Eckbo and Solibakke (1991)
[30] See Eckbo and Solibakke (1991).
[31] See, for example, Geroski (2005), who argues along some of the same lines as I do here.

market. A lax competition policy in the domestic market would lead to the opposite.[32] Let me end this talk by presenting two examples from Norway that illustrate this.

As mentioned previously, the farmed salmon industry in Norway has had a tremendous growth since its start in the early 80s. For example, from 1990 to 2001 production tripled. It is operating in a global market. We have witnessed a technological change with the result of lower costs that are passed on to the consumers through lower prices. This remarkable development has been possible despite quite restrictive regulation on the concentration of ownership. Lately we have seen several mergers and acquisition, which seems necessary in order to exploit new technology with a larger potential for exploiting economies of scale both in production and marketing. However, the Norwegian farmed salmon industry has still a rather low concentration. It illustrates that technological progress and growth is made possible in a rather competitive environment.

In contrast, the Norwegian cement industry faced a very lax competition policy. In the early 20s three domestic firms established a price cartel in the domestic market by having a joint sales office. Quotas in the domestic market were distributed according to each firm's share of total capacity in the domestic market. By investing in capacity each firm could increase its sale in the cartelized domestic market, and then sell the remaining production in the export market. After World War II each of the three firms made large investments in capacity. From each firm's perspective this made sense, since each firm captured a larger share of the monopolised domestic market than they otherwise would have done. From a joint perspective this did not make sense for the firms, and we observed a large excess capacity in the Norwegian cement industry. The capacity that exceeded the domestic consumption could be used to produce for exports, but the price in the world market was low and did not cover total costs. The price cartel had then a two-fold negative impact on welfare. First, it had a traditional price raising effect in the domestic market. Second, it led to overinvestment in capacity and thereby to a cost increase.[33]

While the experience from the farmed salmon industry shows that a competitive pressure in the domestic market may spur technological change and lower prices for the consumers, the

[32] A competitive environment at home in order to build competence for competing abroad later on is also in line with the ideas presented in Porter (1990).
[33] In Röller and Steen (2006) the welfare loss associated with the price cartel in the Norwegian cement market is quantified.

opposite is true for the Norwegian cement market. A lax competition policy may lead to higher costs, higher prices and less innovation. One important lesson should be that we should be sceptical to the establishment of national champions, for example through a lax competition policy. At the moment the two Norwegian oil companies Statoil and Hydro has decided to merge. The Commission will have to deal with this merger since it affects not only the Norwegian market. Hopefully the Commission will make a careful investigation into the possible effects of such a merger, and leave aside – in my view misguided – arguments related to the creation of a national champion.

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