

Competition and Innovation

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1 Introduction

Ladies and Gentlemen,

I would like to thank Cristina Caffarra for inviting me to open the CRA annual conference. It is a pleasure to address this expert audience and a privilege to share the stage with so many leading figures in the competition-enforcement community.

I only regret that my schedule does not allow me to stay and attend the different sessions of this conference. I hope I will be able to do so on future occasions.

I noticed that a topic runs through many of the issues that will be debated today to explore the economic side of competition enforcement – and this topic is innovation. It is – of course – a key factor for the success of the Commission's agenda for growth and jobs.

So, I would like to devote my remarks to the different ways in which competition policy can protect and support innovation in Europe.

Already the Lisbon strategy and, later, the EU 2020 strategy stressed that Europe must do more to promote research and innovation. I will give you just one figure.

R&D spending in the EU lags behind our global partners. It now stands a touch above 2% of GDP, compared to around 3% in the US and Japan. Interestingly, the gap is mainly due to lower levels of private investment.

It is clear that we need to promote research and innovation if we are serious about sustaining growth in Europe.

Boosting growth and jobs in Europe without creating new debt is the top priority of the Juncker Commission. Public policies must converge on these goals: we need structural reforms; we need to keep public finances in check; and we need more investment.

So, it is not surprising that research and innovation have pride of place in the Investment Plan for Europe that the Commission unveiled in the summer.

I am aware of the debate on the proper role of government here. Some say that the entrepreneurial state is the main driver of innovation. Others, that the state has no business in this business.

Leaving aside the more fundamental debate, I would think that one thing is certain: regardless of whether the state should intervene in the economy, public policies can do a lot to improve the *conditions* for businesses to innovate and flourish.

And this is where competition policy enters the scene – but not without its own debate. What is the best environment for innovation?

Some – basing themselves on Kenneth Arrow – have argued that product-market competition spurs innovation. In open and competitive markets, firms strive to develop new products and services to outperform their rivals.

Conversely, others see a trade-off between competition and innovation – at least in technology-intensive sectors. This thinking is usually based on Joseph Schumpeter's theory of continuous innovation and creative destruction. According to these views, market concentration increases the reward of the innovator, so innovation would be driven by large companies with market power.

Who's right and who's wrong in this scholarly controversy? Empirical research points to a positive effect that competition has in fostering productivity thanks to higher investments, better managerial organisation, and – yes – innovation.

At any rate, it is safe to say that a well-designed and well-applied competition policy has a positive impact on innovation.

On the strength of this indication, I would like to survey in some detail what EU competition policy is doing to promote innovation.

I will first give a look at our legal framework; then I will draw a few examples from our enforcement work.

2 The legal framework

The legal framework of EU competition policy fosters innovation across our instruments; that is, antitrust enforcement, merger control and State aid discipline.

Competition policy allows competitors to cooperate on innovation without misusing such cooperation to anti-competitive ends; it makes sure that mergers do not reduce or harm innovation; and it enables EU governments to contribute to private-sector investments in innovation.

I would like to say a few words on each of these aspects.

2.1 Agreements between competitors

In antitrust policy, there are three main tools that encourage competitors to cooperate. These are the Research and Development Block Exemption Regulation, the Horizontal Cooperation Guidelines, and the Technology Transfer Block Exemption Regulation – also known as TTBER. Let me focus on the latter, which was updated last year.

The transfer of technology is an important channel of cooperation for businesses. Around 20% of Europe's companies holding industrial intellectual property rights are licensing them to non-affiliated companies.

Licensing can bring several benefits to our economies and societies. It helps spread a technology; it lowers the barriers to entry; and it spurs future innovation.

How does this work in practice? For example, two competitors can license their complementary technologies to each other to enter new markets.

To see the benefits of this provision, just imagine a situation in which neither company could have developed new products without the cross-license agreement.

Let me add here that we keep a close eye on these agreements, because they can be misused to facilitate collusion; partition markets; or foreclose competitors and new technologies.

2.2 Protecting innovation in merger policy

Moving on to the legal framework for merger policy, the rules stress the importance of assessing a merger's effects on innovation.

Our Horizontal and Non-Horizontal Guidelines put the competitive harm caused by a reduction of innovation on an equal footing with higher prices or lower output.

The Horizontal Guidelines specify that the Commission should intervene if a merger combines two important innovators – or eliminates a firm with promising pipeline products – and the deal thus hinders effective competition. We can take into account the innovation potential of the merging firms regardless of their current market position. This means that a competition problem may arise when innovative firms have only a small market presence or are not even present in a market yet, but are potential competitors.

The Non-Horizontal Merger Guidelines have a similar framework for innovation effects.

For instance, our Non-Horizontal Guidelines say that vertical and conglomerate mergers are more likely to create efficiencies than mergers between rivals because they typically integrate complementary activities.

Later on I will give you some examples of how we have applied these principles reviewing mergers in the pharmaceutical sector.

2.3 Public contribution to private sector investments in innovation

The State aid instrument will close this quick review of the pro-innovation aspects of our legal framework.

The sweeping reform of State aid rules introduced last year were designed – among other things – to help EU governments make better use of taxpayers’ money to support growth.

Smart and sustainable growth crucially depends on R&D and on the ability to turn innovative ideas into the products and services that will strengthen our competitiveness.

Several of the revised rules are innovation-friendly, including the new General Block Exemption Regulation and – for cases outside its scope – the revised framework for Research, Development and Innovation.

We also have new Risk Finance guidelines which make it easier for small and medium innovative companies to gain adequate access to finance.

The main rationale behind all these rules is that State aid should address genuine market failures.

Government support must make the difference. This means that it should persuade private investors to finance projects they would not have financed otherwise.

Beyond the guidelines, there are the new standalone rules on Important Projects of Common European Interest – or IPCEI. These rules encourage EU governments to channel spending on large, transnational projects that make a clear contribution to growth, jobs and competitiveness.

Finally, let me mention the European Fund for Strategic Investments, which will mobilise fresh investment in the real economy – including for research and innovation projects – from the European Investment Bank and other resources.

EFSI funding is not subject to State aid control, but any co-funding provided by Member States is. To help these investments reach the real economy as quickly as possible, we will fast track adoption of the State aid that will accompany EFSI funding. The target is to take positive decisions within six weeks of notification.

3 Enforcement work

Ladies and Gentlemen:

I will now turn to our enforcement practice and its potential to foster innovation, starting with antitrust and merger control.

3.1 Antitrust enforcement and merger control

Our case enforcement here is guided by two general principles.

First, we regard innovation as one of the efficiencies that may justify agreements or mergers that would be anti-competitive otherwise.

Second, in the interest of competition and consumers, we must protect dynamic industries from mergers and anti-competitive practices that may threaten their efforts to innovate.

3.1.1 Recognising positive effects on innovation in merger and antitrust cases

On the first point, let me say that we generally assess the positive effects for innovation in the context of efficiencies.

In these cases, the companies involved have to show that these efficiencies are real and that they offset any anti-competitive effect.

In the TomTom/TeleAtlas merger, which the Commission cleared in 2008, the decision acknowledged efficiencies related to innovation as being partly merger-specific and beneficial to consumers.

The same principle applies to antitrust cases, of course, where we would recognise innovation-related efficiencies. However, there have not been many actual decisions with successful efficiency defences.

The reason is quite simple. When companies have a strong efficiency defence, we don't run the antitrust cases in the first place.

3.1.2 Stopping anticompetitive practices and mergers that harm innovation

The second point was about anti-competitive practices or mergers that can hamper innovation in the market – and there is no dearth of examples in our practice.

3.1.2.1 Preventing loss of innovation due to horizontal consolidation or coordination

For instance, most cartels undermine innovation – and this point is not made often enough. In the comfort zone of their illegal agreements, cartelists have little incentive to invest in innovation or promote it.

As to mergers, the best examples come from the pharmaceutical and medical devices sectors – industries in which innovation can literally be a matter of life or death.

Among the deals we have reviewed over the last year, we have found quite a few that would have resulted in a loss of innovation.

For example, in the Pfizer/Hospira and Medtronic/Covidien mergers, one of the merging companies was selling a drug, whereas the other was at a late stage of development of a competing drug.

It is likely that the companies resulting from these mergers would have dropped the development of the competing drugs.

We identified this concern and we cleared the deals when the companies committed to divest the drugs under development to third parties.

Novartis' acquisition of the oncology business of GlaxoSmithKline makes for an even clearer example, since the parties' competing drugs were still in the pipeline – some only in early trials.

Novartis would likely have stopped developing two innovative drugs to treat certain cancers when acquiring similar drugs from GSK.

Eventually, the clearance included a novel remedy. Not only did the companies divest the drugs of concern and the clinical trial programme, but Novartis committed to co-fund the clinical trials. This being said, innovation is a crucial competitive factor beyond the pharmaceutical industry.

Take General Electric's takeover of Alstom, a leading innovator in gas turbines. To make sure that innovation would continue in this sector, we cleared the deal on condition that Alstom divests its key technology to produce heavy duty gas turbines to Ansaldo.

3.1.2.2 Safeguarding the ability of rivals to innovate

Mergers or business practices can also be a concern when they hamper the ability of rivals to innovate.

In this context, let me mention in passing the landmark Microsoft case. It's exactly 20 years since Microsoft began to tie Internet Explorer to Windows to foreclose competition on the merits between web browsers.

I would like to make one point clear at the outset. When we look into the practices of dominant companies, we need to strike a careful balance. What we don't want to do is diminish their incentives to invest and innovate.

The starting point – and I am stating the obvious here – is that companies large and small must be free to choose their trading partners and dispose of their property. But we have to intervene when they break the rules in the process.

We have a number of ongoing cases, such as the Amazon e-books and the two Qualcomm cases, in which we investigate whether the behaviour of dominant companies could threaten innovative new entrants.

We have also seen dominant firms breaking the rules and threatening innovation by refusing to license intellectual property to other companies that are willing to buy it.

This is especially bad when the technology is necessary to use a certain standard – a Standard Essential Patent, as it's called.

We're looking at another balance here. On the one hand, patent holders should be fairly remunerated; on the other hand, the companies that implement the standards should get access to the technology on FRAND terms.

The Court in the important Huawei ruling of last July confirmed that the approach the Commission adopted in the Samsung and Motorola decisions was the right one.

3.2 State Aid case practice

Keeping good conditions for innovation in the markets is also a factor in State aid decisions.

Before last year's reform, the Commission had approved around 55 large individual aid measures worth about €2.5 billion and over 250 aid schemes.

Around 80% of the large aid projects involved key enabling technologies in such areas as advanced materials, micro- and nano-electronics, and industrial biotechnologies.

State aid awarded under the old rules for research, development and innovation amounted to an estimated €62.4 billion in total.

Under the new rules, although they've been in use for just over a year, the Commission has already taken a few significant decisions.

One is the over €70 million grant that the UK intends to provide for the design of the SABRE space launcher engine, which would power a reusable airframe to launch satellites into low Earth orbit.

Another is France's €85 million aid for its SuperGrid research programme to develop innovative energy-transmission networks. The project is also interesting in its setup; it will bring together six private and six public partners and the patent licences will be sold on market terms.

So, State aid policy does its bit to promote innovation. At the same time, we remain alert that the rules are not used as an excuse to get a more lenient scrutiny of subsidies that have nothing to do with innovation.

We will cut red tape for public projects that contribute to the agenda of the Juncker Commission but we will continue to make sure that government subsidies do not harm competition and waste taxpayers' money.

4 Close

Ladies and Gentlemen:

I will come back to the initial questions to conclude. Do we need the state in the business to innovate?

Our experience shows that the answer is a qualified yes – and we are here to make sure that governments do not tilt the level playing field or disrupt the competitive process, for example by attempting to ‘pick winners’ among competing technologies as they intervene in R&D.

The other big question was whether innovation is better promoted by competition or market power.

As I mentioned, this question is often framed as a contest between Arrow and Schumpeter. But there have been attempts to find a middle ground between these two schools of thought.

One of these attempts is by Carl Shapiro, who argues that Schumpeter and Arrow are compatible. Both scholars would converge on a number of principles, including the principle that markets need to remain contestable.

Following Shapiro, one could say that Arrow focusses on the ex-ante perspective – namely, what is the best environment to promote innovation – and suggests that it is in a competitive environment that firms innovate more. Schumpeter focusses instead on the ex-post perspective – namely, that it is only if firms can expect to appropriate the fruits of their innovations that they will invest in them.

Therefore, as long as competition policy does not negatively affect equitable appropriability – for instance, as long as it respects IPRs – it will be compatible with both Arrow and Schumpeter.

It is not by accident that this position has also been held for some time by Massimo Motta, the chief economist of DG Competition.

I hope that with these sketchy remarks I have been able to show that the Commission’s approach to competition and innovation is able to strike the right balance between protecting the process of innovation; keeping markets open and contestable for the innovators and disruptors of today and of tomorrow; and allowing for an adequate return on investment.

Thank you for your attention. I look forward to engaging with you on these and other issues in times to come.

And now it is my pleasure to yield the floor –precisely – to Massimo Motta.