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The Contribution of Competition Agencies to Formulating Industrial Policy – Note by William E. Kovacic

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The Contribution of Competition Agencies to Formulating Industrial Policy

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Introduction

1. The Background Note prepared by the OECD Competition Committee Secretariat demonstrates that governments in myriad ways affect the development of industries operating within their borders.[2] Generations of commentators have recognized that in sectors such as aerospace, agriculture, energy, healthcare, and defense the government's involvement in determining the fate of entire industries and its individual business constituents is pervasive.[3] In the defense industry, for example, commercial outcomes are as attributable to public intervention as they are to the exercise of private initiative.[4]

2. Whether governments execute such measures quietly or loudly, their influence on commerce often is profound and ubiquitous. The aggregation of such involvement constitutes an "industrial policy." To ask whether a nation has an industrial policy is like asking whether a bakery uses flour to make bread. Most bakeries do. In making bread or industrial policy, the interesting question is not *whether* but rather *what kind* or *how much*.

3. Are competition law and policy relevant to answering these queries? They already are. Like many forms of economic regulation, competition law influences business behavior and interacts with numerous other public policies to shape the enabling

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[2] Wouter Meester, OECD Competition Committee Secretariat, *Pro-Competitive Industrial Policy* (2024) (hereinafter *Pro-Competitive Industrial Policy*).

[3] *See* Committee on the Judiciary, U.S. Senate, REPORT NO. 94-1005 ON S. 2387 -- THE PETROLEUM INDUSTRY COMPETITION ACT OF 1976, at 71-124 (June 28, 1976) (recounting influence one volution of U.S. petroleum sector of government policies such as conservation, international diplomacy, taxation, public lands management, import controls, price controls, and antitrust enforcement); Merton J. Peck & Frederic M. Scherer, THE WEAPONS ACQUISITION PROCESS: AN ECONOMIC ANALYSIS 583 (Harvard 1962) (in discussing U.S. defense procurement, observing that "the non-market character of the relationship between the government and its weapons vendors implies in many ways the arsenalizing or socialization of private firms").

[4] Defense-related industrial policy tools for encouraging innovation include holding design and development weapon system competitions that anticipate full production programs; issuing research and development (R&D) contracts and contracts to build weapon system prototypes for which fully production is not certain; choosing a variety of contract pricing formulas (e.g., relying chiefly on cost-reimbursement formulae for risk-intensive R&D projects); providing subsidies to contractors to develop or maintain capabilities; adjusting profit policy; varying the degree of regulatory oversight according to the nature of the contract at issue. William E. Kovacic, *Government Support for Research and Development*, in THE SHRINKING INDUSTRIAL BASE: RESTRUCTURING THE DEFENSE INDUSTRY AND ENSURING AMERICAN COMPETITIVENESS FOR THE 1990S (American Bar Association, Section of Public Contract Law, Aug. 1990).

environment for commerce.[5] For example, competition agencies routinely challenge collusion that distorts the operation of the public procurement system, one of the most important forms of industrial policy.[6] Competition agencies frequently engage in advocacy that encourages various government officials (such as legislators and ministers) to adopt procompetitive policies in the application of industrial policy initiatives. Industrial policy concerns have hovered over a number of high-profile proposed mergers, forcing competition agencies to do their work in a politically charged environment.[7]

4. Economic shocks occasioned by recession, technology-induced disruption, the threat or reality of armed conflict, and major shifts in global trade patterns periodically have focused close attention on the relationship of industrial policy and competition policy.[8] So it is today. As the Secretariat's Note convincingly points out, a modern avalanche of industrial policy initiatives – notably, subsidy programs to spur recovery, attain resilience in the face of supply chain shocks, and expanded restrictions on imports – ensure that fuller competition agency engagement in this realm is not only relevant but inevitable.[9]

5. This paper suggests how, through an elaboration of these roles, competition agencies can inform government decisions about the design and implementation of industrial policy. It addresses the topic in four parts. Part One identifies a key attribute of competition agencies -- the accumulation of deep economic knowledge through the application of various policy tools -- that enables them to provide useful guidance to governments about the content and application of industrial policy. Part Two describes

[5] See, e.g., Robert D. Anderson, William E. Kovacic, Anna Caroline Müller & Nadezhda Sporysheva, *Competition Policy and the Global Economy: Current Developments and Issues for Reflection*, 88 GEORGE WASHINGTON LAW REVIEW 1421 (2018) (describing linkages among competition policy, trade policy, and public procurement policy); William E. Kovacic, *Intellectual Property Policy and Competition Policy*, 66 ANNUAL SURVEY OF AMERICAN LAW 421 (2011) (describing connections between competition policy and intellectual property policy).

[6] Robert D. Anderson, Alison Jones & William E. Kovacic, COMBATTING CORRUPTION AND COLLUSION IN PUBLIC PROCUREMENT: A CHALLENGE FOR GOVERNMENTS WORLDWIDE (Oxford 2024).

[7] *See, e.g.*, Alex Noury & Dani Rabinowitz, European Champions: what now for EU merger control after Siemens/Alstom?, 41 EUROPEAN COMPETITION LAW REVIEW 116 (2020) (discussing Siemens/Alstom transaction); William E. Kovacic, *Transatlantic Turbulence: The Boeing-McDonnell Douglas Merger and International Competition Policy*, 68 ANTITRUST LAW JOURNAL 805 (2001) (discussing Boeing/McDonnell Douglas transaction).

[8] *See* Robert Higgs, CRISIS AND LEVIATHAN (1987) (tracing expansions in U.S. government involvement in the economy to economic and military crises). In the 1980s, for example, debates raged over how the United States should recover from a sustained period of stagnant growth and respond to the economic ascent of Japan and other nations that appear to have used various industrial policy tools to achieve high levels of growth. *See* James C. Miller III, Thomas F. Walton, William E. Kovacic & Jeremy A. Rabkin, *Industrial Policy: Reindustrialization Through Competition or Coordinated Action?*, 2 YALE JOURNAL ON REGULATION 1, 1-4 (1984) (recounting U.S. policy debates in the 1980s). Many notable commentators proposed recourse to expanded industrial policy intervention to emulate foreign experience to arrest economic decline and spur growth. See, e.g., Stuart E. Eisenstadt, *Reindustrialization Through Coordination or Chaos*, 2 YALE JOURNAL ON REGULATION 39 (1984) (making the case for fuller government involvement to improve performance in various industries and the economy generally).

[9] *Pro-Competitive Industrial Policy*, at 15-21.

potentially valuable contributions that competition agencies can make to formulate industrial policy interventions. Part Three presents practical approaches for competition agencies to increase their effectiveness in deliberations about industrial policy. Part Four offers cautions that competition agencies might consider in performing the suggested roles.

6. To illustrate its principal points, the paper addresses experience with public procurement (again, an especially powerful and universal industrial policy instrument) and draws upon experience in the aerospace, defense, and energy sectors in the United States. The aerospace and energy sector illustrations used here are admittedly somewhat idiosyncratic. They do not encompass the experience of all nations with industrial policy in all economic sectors.

7. Despite these limits, the aerospace and energy sectors offer useful perspectives upon how governments should devise industrial policy measures. They are important if only because they appear frequently in contemporary discussions about industrial policy as a spur to growth. For example, the vocabulary of modern discourse about the beneficial possibilities associated with industrial policy borrows heavily from the experience with the U.S. space program from the 1960s and early 1970. Scholars use the Apollo program as an informing example of how the government intervention to promote initiatives such as the adoption of green energy technology might accomplish policy "moonshots" that rival the success of efforts to send humans to the moon and return them safely to earth.[10] Another body of research points to the work of the U.S. Defense Advanced Research Projects Agency (DARPA) as a possible model for civilian industrial policy investments.[11]

8. In suggesting lessons to derive from the sector-specific examples, I do not attempt to resolve the longstanding debate among commentators about the economic effects that specific industrial policies have had in practice.

1. Competition Agencies as Expert Industrial and Economic Policy Analysts

9. In many countries, the competition authorities accumulate extensive knowledge about the forces that shape the economy. Through investigations, cases, market studies, and public consultations, competition agencies build a deep understanding of the mix of private decision making and government involvement that has shaped individual industries and determined patterns of entry and exit in specific sectors. When they retain knowledge gained through their experience, agencies assemble what might be called "industry biographies." These industry biographies help explain current developments within a sector and suggest broader lessons about how various types of government involvement affect economic performance.

10. In many instances, competition agencies have made investments in developing deep industry expertise and applied their knowledge to inform government deliberations about industrial policy. Several examples, older and newer, make the point. In the United States in the 1920s and the 1930s, for example, the Federal Trade Commission (FTC) conducted years of hearings on the structure and operation of electric and gas utility companies. The Commission's deliberations provided the foundation for sweeping reforms of the legislative framework for regulating major energy companies and the securities

[10] A particularly notable and influential contribution to the literature is Mariana Mazzucato, MISSION ECONOMY – A MOONSHOT GUIDE TO CHANGING CAPITALISM (Harper 2021).

[11] *Procompetitive Industrial Policy*, at 31 (recounting commentary)..

sector.[12] In the early 2000s, the FTC, the Department of Justice (DOJ), and the Patent and Trademark Office conducted hearings on potential procompetitive reforms of the patent rights-granting process. The proceedings resulted in an FTC report that helped inspire reforms to the patent system and informed judicial judgments about refinements in doctrine related to patent remedies.[13] In the past decade, the U.K. Competition and Markets Authority (CMA) conducted a market student that made recommendations to government about policies affecting the construction of charging station networks for electric vehicles in the United Kingdom.[14]

11. The competition agency expertise brought to bear in the initiatives sketched above has been derived from a variety of litigation and non-litigation activities. Investigations and cases often bring competition agencies face to face with government policies that determine which actors can participate in a market and how they can operate.[15] The learning from these case-related activities often informs the selection of matters for market studies, public consultations, and advocacy.

12. A crucial element of learning that competition agencies – especially older agencies – can distill from their experience is how various forms of industrial policy affect commerce and how effective specific instruments are in achieving their stated goals. A competition agency with a generally adequate institutional memory will recall how earlier episodes of industrial policy have operated in practice. This memory should equip the competition agency to give public officials useful advice about the strengths and weaknesses of a new round of intervention. A proficient competition agency will recall that the new industrial policy proposals (e.g., a subsidy program) inevitably recycle techniques tested previously. The competition agency has seen this movie before; it knows the essential plot of earlier iterations, and it should recall how the previous versions ended. This experience supplies a reliable intuition about the intended and unintended consequences of specific policy measures.

13. Of all of the policy tools at its disposal, the market study is perhaps the vehicle best suited for a competition agency to analyze all of the elements of the enabling environment and to prepare recommendations concerning the design and application of industrial policies. A notable feature of the U.K. markets regime applied in the charging stations study is the deliberate mandate it provides to the CMA to identify the full range of factors –

[12] *See* William E. Kovacic, *Designing Antitrust Remedies for Dominant Firm Misconduct*, 31 CONNECTICUT LAW REVIEW 1285, 1307-10 (1999) (recounting experience with the FTC's hearings on public utility holding companies).

[13] Federal Trade Commission, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* (Oct. 2003). *See also* Kovacic, *Intellectual Property Policy and Competition Policy*, *supra* at 426-33 (discussing impact of FTC report *To Promote Innovation*).

[14] Competition & Markets Authority, *Electric Vehicle Charging Market Study* (2021).

[15] In pursuing anticompetitive conduct and merger cases in the health care sector, competition agencies regularly observe the extraordinary role of government involvement in the form of public health insurance programs and restrictions on entry. Department of Justice & Federal Trade Commission, *Improving Health Care: A Dose of Competition* (July 2004). Likewise, in scrutinizing mergers in the defense sector, competition agencies must account for a bewildering array of collateral government procurement policies that determine which firms can participate as defense contractors. William E. Kovacic, *Competition Policy in the Post-Consolidation Defense Industry*, 44 ANTITRUST BULLETIN 421 (1999).

private behavior and public interventions that we might label industrial policy – that affect competition in the market.

2. Contributions to Deliberations Regarding Industrial Policy

14. Drawing upon the base of knowledge identified above, competition agencies can play a valuable role in informing government decisions about the design and application of industrial policy tools. Possibilities for informative contributions are summarized below.

15. *Promoting the Philosophy of the OECD Competition Assessment Toolkit*. As described in the Secretariat Background Note, the OECD *Competition Assessment Toolkit* provides a useful framework for competition agency engagement on industrial policy issues. The essence of the *Toolkit* and the OECD guidance documents that elaborate its analytical framework can be distilled into three basic questions. First, what are the goals of the suggested method of government intervention? Second, is there a good fit between the stated objectives and the means chosen to achieve them? Third, is the implementation of the program realizing its goals – in short, is the intervention working?

16. As condensed into this abbreviated form, the Toolkit queries perform several valuable functions. The bring into the open the aims that motivate the application of the industrial policy tool(s). This permits an honest discussion of the purposes of a chosen intervention and the identification of tensions that may arise in the execution of the program. For example, a number of goals have guided the adoption of the U.S. development programs (e.g., the Inflation Reduction Act) established in recent years. The paramount aim of these projects is the improvement of U.S. infrastructure and the deployment of green energy systems. Another major concern is employment. The new initiatives include domestic content requirements. The domestic content restrictions sometimes will reduce competition in ways that can raise the price that public authorities pay for infrastructure projects.

17. The *Toolkit* queries underscore the importance of proportionality and direct attention to the use of measures that achieve program objectives with the fewest restrictions on competition. The queries do not oblige a public authority to given preeminence to competition as an organizing principle for the industrial policy intervention. They do help illuminate the cost of suppressing rivalry as a stimulus for better project performance.

18. Finally, the *Toolkit* queries press government bodies to establish metrics for measuring program effectiveness and to track progress to achieving program goals. This query brings needed discipline to the initial program design (to know that there will be a reckoning about results) and provides a basis for making better judgments about future interventions.

19. *Encouraging the Integration of Competition Policy Considerations into the Design of Industrial Policy Interventions*. Government expenditures on industrial policy projects can be structured to promote competition. A question for consideration by agencies responsible for implementing industrial policy is whether the execution of projects seeks to expand the range of firms that participate in the market. When governments dispense subsidies, do they organize funding tournaments, look to support new entrants, or enhance opportunities for smaller enterprises? Are procompetitive considerations factoring into the decisions of U.S. authorities responsible for distributing subsidies for semiconductor production or infrastructure reconstruction? Do the teams entrusted with allocating funds have competition policy expertise or do they consult the competition agencie

20. The FTC's experience with the formation of the United Launch Alliance (ULA) in 2006 shows the benefits that can flow from bringing competition policy considerations into decisions that occur in the realm of industrial policy.[16] The ULA joint venture combined the only suppliers (Boeing and Lockheed Martin) of launch vehicles and related services for national security payloads. The transaction proceeded with the support of the U.S. national security community (including the Department of Defense) despite FTC concerns that the creation of a monopoly supplier would expose the government to competitive harms. Unwilling to oppose the national security agencies in a litigated merger challenge, the FTC allowed the transaction to proceed subject to a consent decree that addressed some of the ULA's vertical features.

21. The review of the ULA deal began a conversation between the FTC and various government agencies about the future of the launch services business. In these conversations, the FTC suggested that the government purchasers of launch services consider what might happen if their sole remaining supplier failed to perform acceptably. Did the government buyers have in mind any fallback plan to qualify an additional source? The National Aeronautics and Space Administration (NASA) took this concern to heart and began to give a new start-up enterprise, SpaceX, funding to advance its early efforts to develop a new, innovative family of launch vehicles. Combined with funds that SpaceX received from its founder (Elon Musk), NASA's support was indispensable to the formation of what today is an extraordinarily successful supplier of launch services. NASA's intervention created a powerful competitive alternative in a sector that was believed to be impervious to new entry.

22. NASA's encouragement of SpaceX found support in congressional guidance that supported the establishment of an alternative to ULA. The qualification of a second supplier required NASA to accept significant risks of program failure (SpaceX experienced numerous launch failures before it placed a test payload in the proper earth orbit). A risk-preferring entrepreneurial philosophy was necessary for NASA to play this role.

23. The risk appetite that NASA embraced in supporting entry by SpaceX is rarely seen in public administration, where innovation is applauded only when it yields immediate success. Because the process of innovation routinely involves failure and learning from failure, a 100% success rate is perfectly unattainable. Agency leaders know that political retribution and personal disgrace typically accompany failure (especially expensive failures), and therefore they are wary of moving outside long-accepted pathways of behavior.

24. The acceptance of risk raises an interesting question about whether DARPA is a good model for industrial policy involving civilian applications of new technology. The DARPA model is uniquely and deliberately non-transparent. Its funding and operation decisions are shielded from the type of public scrutiny that would accompany nonmilitary programs. We have some accounts of DARPA's successes. We know relatively little about its failures. Congressional oversight of DARPA takes place in a less intrusive, more private manner. The conscious purpose of this design is to give the DARPA the ability to engage in risky projects that involve periods of failure before successful approaches emerge. One wonders if this approach would be seen as legitimate and acceptable for nonmilitary industrial policy programs.

[16] The discussion here is based partly upon William E. Kovacic, *Competition Policy Retrospective: The Formation of the United Launch Alliance and the Ascent of SpaceX*, 27 GEORGE MASON LAW REVIEW 863 (2020).

25. *Fostering Attention to the Full Consequences of Government Industrial Policy Intervention*. By compiling the industry biographies mentioned above, competition agencies stand in a position to understand the full range of effects associated with a specific form of government intervention. Competition agencies study supply chains in many cases and market studies. These activities have alerted agencies to the manner in which changes in one dimension of a value chain have flow through effects upon other levels of the value chain. Past experience also has attuned competition agencies to the incident of unforeseen consequences – effects not clearly anticipated when an industrial policy initiative commences. A lesson from this learning is the importance of having industrial policymakers think broadly about potential effects – to imagine successful outcomes but to speculate widely about what might go wrong.

26. The experience with the development of the civilian nuclear power industry in the United States after World War II. Beginning in the 1950s, government policy in the new Atomic Age actively strived to encourage the development of fission-based electricity generation capacity. The perhaps apocryphal slogan that electricity would become "too cheap to meter" heralded an era of cheap, abundant energy.

27. A host of industrial policy interventions sought this end. The federal government funded theoretical and applied research in the federal national laboratories. Congress adopted legislation (the Price-Anderson Act) that placed a cap on the liability of electric utilities in the case of an accident resulting from the operation of a fission-based generation system. The program to develop submarines with nuclear propulsion systems had the byproducts of extending the state of the art of fission reactor design and of training a cadre of engineers who were expert in the operation of nuclear reactors. Basic decisions about the creation of a permanent facility for storing nuclear waste from generation facilities were deferred.

28. The government's effort to promote the rapid deployment of the fission fuel cycle for electricity production had major unintended effects. The program succeeded in accelerating the construction and operation of fission-based plants, but at a significant cost. The swift roll-out of the new source of power meant that deployment took place with the more deliberate process of prototyping, testing, and incremental expansion that ordinarily accompanies the application of a new technology. The number of new facilities also outran the industry's ability to obtain adequate numbers of skilled operators. The accelerated deployment schedule arguably led to incidents at Three Mile Island near Harrisburg, Pennsylvania and Fermi-I near Detroit, Michigan that, though not catastrophic, raised troubling features about the maturity of the technology and the capability of the utility operators. The vexing question of permanent waste storage also continues to be deferred to a future resolution. The introduction of new fission-based productive capacity stalled in the 1970s. Only lately has greater reliance upon the fission fuel cycle returned to the energy policy agenda.

29. An intriguing counterfactual is what might have happened with a more deliberate introduction of fission technology in the electric power sector. For example, without the artificial cap on tort liability, one images that the utilities would have moved more slowly and would have followed a more cautious path of prototyping and gradual expansion. This process might have placed the adoption of the technology on a more sustainable path.

30. *Drawing Attention to Government Policymaking Capability*. Competition agencies can help focus attention on how a number of what are regarded as being industrial policy successes (e.g., the Apollo program) required the development of strong personnel teams within the government. Recruiting and retaining highly skilled teams would be essential predicates for success in public programs to plan and executive ambitious industrial policy interventions.

3. Practical Techniques

31. As practiced by most competition agencies, advocacy operates by persuasion, not compulsion. Competition agencies ordinarily lack the power to force other public institutions to embrace their views. Their effectiveness depends on persuading various audiences that their policy recommendations warrant adoption. A major challenge in this and other areas of advocacy is to devise strategies and tactics that elicit consent through persuasion. Effective advocacy in this policy domain requires that an agency make good judgments about *what* to say and *how* to say it.

32. The foundations for an agency to work effectively in industrial policy discussions is to operated within a demonstrated base of industry expertise. This requires drawing upon agency experience in building cases and conducting market studies.

4. Cautions

33. The performance of the industrial policy role sketched above comes with cautions. First, the recipients of the agency's advice may not like it, especially where the competition authority is pointing out problems that can arise in the performance of an industrial policy intervention that enjoys broad political support. For example, in the 1980s a group of FTC researchers issued papers that documented the cost of each domestic job preserved by reason of higher tariffs on imports of steel produced outside the United States. The calculations suggested that the cost of preserving each job were extraordinary. Congress suggested that the FTC discontinue these reports, and the FTC stood down.

34. The use of guardrails and conditionalities in the operation of subsidy programs raises the question of whether these commitments will be credible. The recipients of funds may prove to be adroit in sustaining political support for subsidy and related programs even when they have breached guardrails or failed to fulfill conditionalities.