Overview

- What is competition law?
- Merger control
- Article 82 EC - Abuse of dominance
- Article 81 EC - Horizontal Agreements
- Cartels: the ‘supreme evil’
- International challenges
What is Competition Law?

Senator John Sherman
(Ohio)
1823-1900
What is Competition Law?

Law, Economics & Politics

- **ECONOMICS**
  - What should be prohibited
  - Tools of analysis
  - Design of Policy

- **COMPETITION LAW**
  - Stepped up Enforcement

- **POLITICS**
  - Case Selection
  - Fines & Exceptions
Basic Demand Theory

Price

Quantity

Given price

HAPPY

UNHAPPY

ANDREAS

MICHAEL

LINDSAY

PINAR

Demand Curve

Cost (Supply)

Marginal Cost

What determines shape of MC curve?

• Input Prices
• Technology
• Opportunity Cost
Welfare: gains from trade

- What is the economic concept of welfare?
- We assume rational buyers / sellers
- S will not sell for less than cost of producing it
- B will not buy for more than reservation price
- But because of different willingness to pay / different MC for each unit, S will sell some units for more than cost of production; B will buy some products for less than their reservation price.
- This gives rise to economic surplus, or welfare

Whose welfare?

- **CONSUMER SURPLUS** - (or consumer welfare) is the aggregate difference between the actual price paid by consumers and the maximum price they are willing to pay for a given good. It is thus the saving - how much less than they were willing to pay, they actually paid. It is their gains from trade.

- **PRODUCER SURPLUS** - is the aggregate difference between actual price of goods sold by producers and the marginal cost of producing those goods. This is also an amount of money; a profit. It is the producers' gains from trade.

- **SOCIAL (TOTAL) SURPLUS** - the sum of consumer surplus and producer surplus. It expresses the difference between how cheaply society produced given goods, as compared to how much they valued them overall.

- Which one should we maximise?
A (perfectly) competitive market

- There is no unsatisfied demand.
- No unsold output.
- Unrestricted market forces will always move towards equilibrium.
- At equilibrium welfare is maximised.
- Buyers consume only as much as they are willing to pay for.
- Producers only earn normal profits; prices approx. = costs.
- Pareto Efficient (allocative efficiency) – cannot make anyone better off, without making someone else worse off.

The importance of market structure

- Firm's conduct and their performance largely depends on the market structure.
- E.g. number and (relative) size of producers / suppliers; entry barriers
- Conduct includes: pricing, investment, strategic behaviour
- Performance: How much, or how well, is produced from a given quantity of resources
Monopoly: Single Price

- Deadweight Loss from Monopoly (loss of welfare)
- Thus, monopoly is likely to result in less produced for a higher price

Market Power & Competitive Pressure

- The ability to raise prices above competitive levels on a long term basis without making losses is called market power
- Question is not whether a firm has market power, but how much market power a firm has and how it uses it.
- In PC there is no market power, in Monopoly it is total; monopoly prices charged; welfare loss at its greatest.
- Market power also means wealth transfer to firms; exploitation?
- The greater the competitive pressure on a firm, the harder it is to raise prices.
Market Power as a ‘reward’ of competition

- Market power can be increased through growth and better performance.

- Although it will increase a firm’s ability to raise prices, the pursuit of market power encourages firms to improve their performance, producing cheaper or at better quality than their competitors (this in itself can increase profits without an increase in price).

- Better performance increases market power, (but also increases welfare) - this is realised through the process of competition.

- Market power in this respect can be a reward of competition.

Market Power through the restriction of competition

- On the other hand market power can be increased by restricting competition: collusive agreements with competitors; predatory practices to eliminate competition in the market; preventing new firms from entering a market.

- Such practices may include tying, refusing access to an essential facility, price discrimination, sales channels etc.

- The extent of the market power already enjoyed in order for these practices to be successful will depend on the industry.

- Unfortunately it is not always easy to distinguish between the two. Practices such as tying goods may be a means for increasing competition and efficiency, but may equally serve to restrict competition. This is why it is usually the effect and not the intention.
Barriers to Entry & Substitutability

• Market power and ability to raise prices must be considered beyond the number of firms and their respective market shares.
• There may only be one firm producing a given product and selling it at the competitive price.
• That monopolist will not be able to raise price above competitive level if no barriers to entry or high substitutability
• Why? Either a new firm will enter the market and undercut incumbent firm or buyers will switch to cheaper alternatives.

• Importance of actual and potential competition
• Examining a market over time to determine its true structure
• Monopoly power may only be a temporary situation

Oligopoly

• Small number of firms
• Aware of interdependence in market
• Form of rivalry depends on nature of market; in particular how similar rival products are (the more similar, the harder it is to avoid price competition - unless firms can constrain capacity).

• Price competition can be dangerous, so firms may choose to coordinate pricing (tacit collusion)
Oligopoly: conscious parallelism

FIRM A
34%
€5 / kg
€4 / kg↓

FIRM B
32%
€4,99 / kg
€3,99 / kg↓

FIRM C
30%
€4,95 / kg
€3,95 / kg↓

FIRMS D & E
4%
€5,10 / kg
€4,10 / kg↓

RESULT: Lower prices; same market share

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RESULT: Higher prices; same market share
Efficiencies

“Competition law is about protecting competition, not competitors”

• It is not the role of competition law to keep as many firms active in an industry as possible. Where these firms are inefficient, they may be driven out by more efficient competitors.

• As a result there may be fewer firms in the industry, but they are on aggregate producing the same quantity of goods as before at a lower cost. Furthermore, new firms may replace those exiting the market.

• In economic theory, efficiency generally means producing the most goods (output) possible out of a given quantity of resources, or producing a given quantity of goods (output) using the smallest possible quantity of resources.

Static Efficiency vs Dynamic Efficiency

• A large scale R&D project may require large joint ventures between competitors to pool resources, or may only take place if generous Intellectual Property Rights are awarded.

• An increase in dynamic efficiency in the long run requires a sacrifice of allocative efficiency in the short run.

• Think about intellectual property right: short term harm to consumer, but long term gain

• Important trade-off vis-à-vis Microsoft
Welfare and efficiency as objectives of competition law

- To ensure that a broad range of quality products are available to consumers at low prices. Competition law also promotes competitiveness (through increased efficiency), ultimately promoting economic growth and employment; standard of living.

- A more accurately defined goal might be social (total surplus) or consumer surplus. As it is important to consider markets over time and dynamic as well as static changes, long-term social surplus or long-term consumer welfare may be the ultimate objective. This also helps us in dealing with the tensions between productive and allocative efficiencies and between static and dynamic efficiencies.

- Competition law intervenes in the market structure and in firm conduct, not in performance. Market mechanisms create efficiencies, not competition authority interventions.

Tools of Competition Law

**STRUCTURAL CONTROL** - making changes to the structure of the market. This may include breaking up firms; divesting part of their operations; prohibiting a planned merger

**BEHAVIOURAL CONTROL** - intervening directly in the behaviour of firms. Prohibiting abuse of a dominant position, or price fixing.

The former is generally preferred by competition authorities as it does not interfere directly with firms’ decisions and does not require long-term monitoring / investigating.
1. Merger Control

- Regulation 139/2004 (ECMR) - applies where concentration has a ‘community dimension’ (turnover thresholds)
- Notion of ‘significant impediment to effective competition’ (art 2(2) and (3))
- Firms merge to increase profits.
- If this will be done through efficiencies, then fine.
- If merger likely to result in greater exercise of market power / profitably increase prices (Non-Coordinated Effects) or through conscious parallelism or tacit collusion (Coordinated Effects), then merger may be blocked.
- Importance of market definition and difficulty of predicting the future.
- Standard of economic analysis important - more sophisticated than in Art 81 or 82 - market definition of particular importance.

2. Article 82 EC (unilateral)

- Applies to abuses by undertakings in dominant position.
- Dominance determined by market power
- Dominant position must be ‘substantial part’ of the single market, and effect on trade between member states.
- Not illegal to hold dominance, only to abuse it. Firms hold a ‘special responsibility’
- Includes exclusionary and exploitative abuses
- Pricing abuses: predatory pricing (prices too low); Excessive Prices (hard to determine); Discriminatory pricing (may increase output; but also wealth transfers)
- Non pricing abuses: (refusal to supply; refusal to deal; essential facilities)
- … except where ‘objectively justifiable’ essentially where efficiencies outweigh harm to competition.
So much hinges on market definition

*Defining the market is a sequential process - the competition authority:*

1. Consider each product sold by relevant firm(s).

1. Asks: “*would it be profitable for a hypothetical monopolist, controlling the pricing of these products, to raise price for a non-trivial period of time by five per cent?*”

If the answer is yes, then we have got the market definition right first time.
The Hypothetical Monopolist

If the answer is “no”, i.e.
3. ...if it would be unprofitable for the hypothetical monopolist
to raise prices, this implies that the market has not yet been
fully defined; Sales are moving elsewhere.
   - Physical Leakage: indicates the existence of close
     substitutes which are not yet included in an appropriate
     market definition.
   - Geographical Leakage: products from an area outside the
     one chosen compete with the ones included in the market
     definition.
4. Definition Widened accordingly; test is re-run until answer is
   YES (i.e. a hypothetical monopolist would raise prices and
   profit thereby) both in the physical and in the geographical
   dimension.

The market has now been defined.

Weaknesses in the SSNIP Test

The Cellophane Fallacy

- Where price is already at or close to the monopoly level;
  monopoly profits already maximised.
- Any further increase in price beyond the monopoly level will
  not be profitable.
- May result in Competition authority adding more goods to
  market definition in error - when they are not substitutes at all.
  Such products are not substitutes.
- The cellophane fallacy reminds us that it matters which baseline
  prices are used in the analysis.
- Example: if competitive price of train is £30, but actual price
  £35, lots of people will already have switched to bus (cheaper)
  and air (more expensive) - but operator hasn’t raised it higher
  than £35 because not profitable
3. Article 81 EC (bilateral)

- Affect on trade between Member States (cf. Chapter I prohibition)
- Agreement, concerted practice between undertakings (commercial activity)
- Appreciable effect on competition (*de minimis*)
- Horizontal and vertical agreements
- Tacit collusion is not illegal under Article 81

**What the Commission must prove**

- **OBJECT** (restriction on competition assumed) – e.g. price fixing, market sharing, quantity restrictions, minimum RPM, export bans. OR
- **EFFECT** (full economic analysis required)

**The efficiency ‘defence’ - Article 81 (3)**

- Balancing of pro- and anti-competitive practices

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**What kind of collusion is caught by Article 81 / Chapter I?**

<table>
<thead>
<tr>
<th>Cartels (Agreements)</th>
<th>Concerted practices</th>
<th>Conscious Parallelism</th>
</tr>
</thead>
<tbody>
<tr>
<td>YES</td>
<td>YES</td>
<td>NO*</td>
</tr>
</tbody>
</table>

* The difficulty is distinguishing those cases where firms are truly acting in parallel pursuant to a concerted practice from those in which firms are acting independently.

* Although firms may be collectively dominant under Article 82
Article 81 (Chapter I) applies to *vertical* as well as *horizontal* agreements

Why can *vertical* agreements be anticompetitive?

**KEY DANGER 1: Helping horizontal collusion**
Why can *vertical* agreements be anticompetitive?

**KEY DANGER 2: Foreclosure**

![Diagram](image)

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**4. Cartels: the ‘supreme evil’**

<table>
<thead>
<tr>
<th>YEAR</th>
<th>CASE</th>
<th>Fine €</th>
<th>COMPANY</th>
<th>Fine €</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>Car Glass</td>
<td>1,383,896,000</td>
<td>Saint-Gobain</td>
<td>896,000,000</td>
</tr>
<tr>
<td>2007</td>
<td>Lifts &amp; Escalators</td>
<td>912,312,200</td>
<td>Hoffmann-La Roche</td>
<td>462,000,000</td>
</tr>
<tr>
<td>2001</td>
<td>Vitamins</td>
<td>855,230,000</td>
<td>Siemens Germany</td>
<td>396,562,500</td>
</tr>
<tr>
<td>2007</td>
<td>Gas Insulated Switchgear</td>
<td>750,712,500</td>
<td>ThyssenKrupp</td>
<td>374,220,000</td>
</tr>
<tr>
<td>2008</td>
<td>Paraffin Wax</td>
<td>676,011,400</td>
<td>Pilkington</td>
<td>370,000,000</td>
</tr>
<tr>
<td>2006</td>
<td>Synthetic Rubber</td>
<td>519,050,000</td>
<td>Sasol</td>
<td>318,200,000</td>
</tr>
<tr>
<td>2007</td>
<td>Flat Glass</td>
<td>486,900,000</td>
<td>BASF AG</td>
<td>296,160,000</td>
</tr>
</tbody>
</table>
What is ‘hardcore’ cartel conduct?

- **Price fixing**
  (either by raising prices or suppressing discounts)

- **Sales / production quotas**
  (reduced output, higher prices)

- **Market and consumer sharing**

- **Bid-rigging**

Why do firms have to meet in a cartel?

- **Agreement** on prices, sales quantities etc
  (particularly if goods and costs are not completely homogenous)

- **Implement and Monitor** the agreement: detecting and punishing cheaters

- **Adjusting** for fluctuating currency prices (arbitrage) and cost shocks
Why do firms have to meet in a cartel?

Concerted Practices, Tacit Collusion (e.g. parallel pricing etc) is 'safer' but harder to form and maintain

Mechanics of a Typical Cartel

1. Frequent Meetings - agree and monitor
2. Exchange of information
3. Buying each other’s excess produce
4. Planning price rises so as not to arouse suspicion
5. Keep over-zealous sales reps in line
The Tools of Cartel Enforcement

- **Investigations** (Complaints, Monitoring, Dawn Raids)
- **Leniency Programmes** (immunity, fine discounts)
- **Fines** (transferred to treasury / member states)
- **Imprisonment of individuals** (criminal offence)
- **Direct Settlements** (Plea bargains in US)
- **Private Enforcement** (Claims for damages by Private Parties)

Beware of moving potted plants

- Lysine is an amino acid (essential building blocks of protein) used in Animal Feeds.
- Typical characteristics of industries with cartel.
- Succeeded in doubling prices between 1981-88.
- Coordinated through regular meetings of top executives and regional managers.
- Revealed to FBI by ADM supergrass Mark Whitacre.
- Hotel meetings filmed by camera in potted plant...
5. International Challenges

- Boundaries of markets and legal jurisdictions do not coincide.
- There is no ‘international’ competition law. Need for harmonisation and cooperation
- But there is an explosion in the number of jurisdictions with competition laws.
- Hugely challenging for multinational firms (e.g. leniency).

5. International Challenges: Mergers


- Minority of cases, but nevertheless worrying
- Reflect differences in substantive tests
- Multinational firms face the administrative cost of defending a merger in a large number of jurisdictions, potentially only to have it blocked outright by one jurisdiction.
5. International Challenges: Cartels

- Need for one-stop-shop for leniency programmes (even within EU).
- Deterrence gap. Fines only imposed by handful of jurisdictions.
- Unlikely to outweigh illegal profits earned (not every infringement caught; time lapse; lack of individual sanctions).
- Criminalisation

5. International Challenges: ‘Competition Culture’

*BA executive facing charges is promoted*

By Michael Pest, Legal Correspondent
Published: November 27 2008 23:31 | Last updated: November 27 2008 23:31

A senior British Airways executive facing the threat of jail for allegedly dishonestly fixing fuel prices has been promoted to the company’s management board as part of a restructuring programme.

- The difficulty of identifying a victim.
Price Fixers

Does jail really have a deterrent effect?

**Ashland, Ky**

Population: 1,295

Prisoner Perk: Inmates can partake in Ashland’s “wellness” programme, which focuses on nutrition, aerobic exercise and stress reduction.

**Lompoc, CA**

Population: 1,520

Prisoner Perk: Full gym and tennis courts.

Sources: Allan Ellis, “The Federal Prison Guidebook”; Federal Bureau of Prisons
Export Cartels

- Typically exempt from competition laws
- Protect domestic producers
- Harm felt in foreign jurisdictions - wealth transfer into home jurisdiction
- However, can also increase competition by helping producers enter new markets (less anticompetitive than alternative: merger?)

5. International Challenges
Ways forward for International Enforcement

1. APPLYING EU-US COMPETITION LAWS EXTRA-TERRITORIALLY

- Competition Authorities tend to calculate fines according to the harm caused within their respective jurisdictions.

- The principle of Comity in law enforcement. Courts / agencies should not act in a way that demeans the jurisdiction, laws or judicial decisions of another country.

- The US Supreme Court’s decision in Empagran SA

- In the UK case Provimi Ltd v Aventis

- If Empagran were reversed, it might seriously reduce the effectiveness of the US Corporate Leniency Program (remember claimants can sue for treble damages in the US).

2. CREATION OF A SUPER-NATIONAL AUTHORITY

- European Union is the only real example of this. It is unusual in that its member states have agreed to sacrifice significant aspects of their sovereignty by integrating super-national EU Law into domestic legal systems and recognising the binding precedents of the European Courts of Justice.

- There is a limit to how big the EU can grow

- Even if such an authority were possible on a greater scale, who would pay for it?
Ways forward for International Enforcement

3. MULTILATERAL AGREEMENTS

- These can be effective where every jurisdiction subscribes to the agreement or treaty wholeheartedly. However, two key problems exist:

  1. Encouraging countries to commit to such an agreement in the first place;

  2. Having an effective mechanism in place to deal with breaches of the agreement. Countries usually have no choice but to resort to economic sanctions, the effectiveness of which depends largely on the size of the protagonists.

Ways forward for International Enforcement

4. VOLUNTARY BILATERAL OR REGIONAL AGREEMENTS

- Can also be effective to a limited extent.

- These are usually formed between countries of a similar size and level of development.

- They are also only invoked where there is strong mutual interest.
Ways forward for International Enforcement

5. FORUMS FOR INT. COOPERATION AND HARMONISATION

1. World Trade Association (WTO)
2. Organisation for Economic Co-operation and Development (OECD)
3. United Nations Conference on Trade and Development (UNCTAD)
4. International Competition Network (ICN)
5. European Competition Network (ECN)

Why might countries be reluctant to cooperate?

- Why should one jurisdiction consider a merger and not another?
- Loss of sovereignty - fear for domestic firms.
- Protection of confidential information; in particular leniency applications.
- Economic downturn - tendency towards protectionist measures.
- Existing disputes about trade, subsidies etc.
- Can you think of any others?
Challenges for Developing Countries

Political and Economic Obstacles to Antitrust

- Who holds economic and political power?
- Businesses may have strong political influence (particularly foreign firms).
- Long term benefits vs short term political interests.
- Countries induced into adopting competition laws as a prerequisite to a development loan.

Institutional and Organisational Issues

- Weak judicial and executive institutions; corruption
- Competition law enforcement can only be as effective as all law enforcement
- Regulatory Capture
- Under-funded competition authorities that lack independence
- Drawing resources away from more pressing reforms?