31/01/2005

EC making increasing use of merger simulation techniques in antitrust probes; market definition taking back seat – analysis

Proprietary Intelligence

The European Commission is making use of increasingly sophisticated economic analysis tools and merger simulation techniques in its scrutiny of mergers, according to economists, competition lawyers and members of the EC's Directorate General (DG) for Competition. Traditional market definition is playing a much smaller role these days, they say.

Lars Kjoelbye, an official at the DG Competition, said that the EC is increasingly inclined to take an economic approach to merger regulation, adding that the Commission's analysis of cases dating back over four or five years was "not likely to be entirely satisfactory."

"There is no guarantee that the Commission would now approach, for example, a five-year-old decision in the same way," Kjoelbye said, speaking at the Brussels-based IBC conference 'The use of economics in competition law.'

Mark Williams, a director at economics consultancy firm NERA, said that there was a "gently rising tide" of economic analysis in competition law and that market share analysis was not a substitute for economic analysis.

This opinion was echoed by Michael Katz, professor of economics at the University of California. Katz also served in the Bush administration as Deputy Assistant Attorney General for Economic Analysis in the antitrust division of the US Department of Justice.

"Formal market definition has taken on a life of its own and this formalism attempts to impose sharp boundaries even where they do not exist. Particularly in differentiated products markets, mechanical market definition risks weakening the analysis rather than strengthening it and there are risks of misleading conclusions," Katz said.

NERA's Williams said that economic analysis has to be evidence-based and not just based on economic theory.

"It is pretty evident that if we use them correctly, they [merger simulation models] should form part of the tools we have available – the gut feeling of a case handler is often not attractive," Bengtsson said.

Mike Walker, vice president of Charles River Associates in London, said that merger simulation models are used extensively in the US by both the regulators and the merging parties and that they are starting to be used in Europe by the EC, the UK's Office of Fair Trading (OFT), the Swedish competition authority and that the German, Dutch and Irish competition authorities are interested in using such techniques.

"The traditional standard for judging a merger was whether it created or enhanced a dominant position, and dominance has been primarily a question of market shares, which put the emphasis on market definition. The new merger standard is whether a merger is likely to lead to a significant impediment to effective competition, which focuses on consumer harm. So tests that directly measure post-merger price increases are now more relevant than in the past," Walker said.

Walker went on to explain that a merger simulation model is a model of competition in an

industry that allows the effect on prices of increased concentration to be measured directly. Necessary inputs are pre-merger elasticities, marginal costs and prices.
Walker agreed that there is a role for merger simulation models, but said that they are much more limited than often claimed, that they cannot be used "off the shelf" and require bespoke models.
"A common claim is that merger simulation allows one to dispense with market definition and competitive effects analysis and instead go straight to the answer, but merger simulations omit important factors [including] barriers to entry and expansion; buyer power and the potential for post-merger coordination."
"They [merger simulation models] can add confidence to the results of the competitive effects analysis, but are not a substitute for the competitive effects analysis," Walker said.
However, Claes Bengtsson, of the EC's chief economist's team said "Merger simulation models are a very complicated version of the 'if...then...' scenario, but they help focus attention on important questions and of course we should use them."

Source: mergermarket