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Competition Policy Analysis

An Integrated Approach

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I shall be telling this with a sigh.
Somewhere ages and ages hence:
Two roads diverged in a wood, and I –
I took the one less traveled by,
And that has made all the difference.

Robert Frost (1874-1963)
The Road Not Taken

Foreword

Competition policy is an integral and prominent part of economic policy-making in the European Union. The EU Treaty prescribes its member states to conduct economic policy 'in accordance with the principle of an open market economy with free competition'. More precisely, the goal of EU competition policy is "to defend and develop effective competition in the common market" (European Commission, 2000: 7). Under its Commissioners van Miert, Monti and, most recently, Kroes the EU Commission has stepped up its effort to pursue and achieve the aforementioned goal. A number of so-called hard-core cartels, such as the notorious "vitamin cartel" led by Roche, have been detected, tried in violation of Art. 81 of the Maastricht Accord and punished with severe fines. Also Microsoft was hit hard by the strong hand of the Commission having been severely fined for exploiting a dominant market position.

Economic analysis has been playing an increasingly significant role in the Commission's examination of competition law cases. This holds true in particular for merger control. Here, however, the Commission has had to accept some poignant defeats in court, such as the Court's reversals of Airtours-First Choice or GE-Honeywell. Among other things, the European Court of Justice found the economic analysis as conducted by the EU's Directorate General for Competition to be flawed and the conclusions drawn not to be convincing. These rejections by the courts have stirred up the scholarly debate on the conceptual foundations of European competition policy.

Against this background Kai Hüschelrath applies theoretical reasoning to conceptualize an economic analysis that may better serve the needs of competition policy. Hüschelrath claims that, in order to be coherent and consistent, competition policy needs "the design of a progression of compulsory analytical steps to effectively constrain the strategies available to firms aiming at maximising the total welfare contribution for a given enforcement budget". Therefore, in Chapter 2 he develops a three-layered integrated approach to competition analysis. As the first and fundamental layer, policymakers should clearly define the purpose, goals and instruments of competition policy by applying microeconomic reasoning. On the second layer, the strategic behaviour of firms should be carefully analysed using theoretical and empirical tools to evaluate potential welfare effects and effects of alternative measures of policy intervention. The third layer refers to the critical operational tasks, such as the delineation of the relevant market, both in principle and case-based, or the measurement of market power.

In applying his approach Hüschelrath focuses on the strategic behaviour of oligopolistic firms. Using game theory, Chapter 3 discusses the welfare effects of strategically acting incumbents when faced with potential entrants. The theoretical and simulation results show that the overall welfare effects of strategic firm behaviour are in fact indeterminate under most circumstances, in particular if the entrant is not facing an incumbent monopolist but an oligopoly market. To avoid negative welfare effects of strategic firm behaviour, Hüschelrath therefore suggests that competition policy pursue a rule-of-reason approach to rein in strategic firm behaviour rather than a per-se rule.

Predation is a type of an incumbent's strategic behaviour that has been extensively and controversially discussed in the literature. In Chapter 4 Hüschelrath provides a very balanced and highly stimulating review of the existing literature and concludes that predatory behaviour can indeed be rational and profitable, Selten's chain-store paradox notwithstanding. Hüschelrath continues with a theoretical analysis revealing that the welfare effects of predatory behaviour are highly likely to be exclusively negative. Competition policy should thus take a tough stance and intervene accordingly and appropriately. Based on his theoretical and simulation assessment of potential countermeasures, Hüschelrath suggests a predation enforcement framework which promises to be valuable for practical application.

In the concluding chapter Hüschelrath critically reflects on his findings and provides the reader with an outlook on the shape of things to come.

Summing up, this book not only provides a state-of-art discussion of contemporary competition policy analysis but offers a host of new insights – some may be controversial, pending real-life testing, but they are definitely challenging discussion. Competition Policy Analysis is an invaluable read for everybody interested in the theory and practice of competition policy.

Vallendar, April 2008

Jürgen Weigand
Professor of Economics
Otto Beisheim School of Management

Preface

In a recent working paper, Gregory Mankiw (2006) divided the family of macroeconomists into two classes: *Scientists* and *Engineers.* While the scientist tries to understand how the world works, the engineer tries to solve practical problems. According to Mankiw, the class of scientists currently has a substantially larger population than the class of engineers. As a consequence, when it comes to providing practical policy advice, this asymmetry might create substantial problems and intensifies the desire for a class of *Scienteers,* which internalises both views and is therefore able to give applicable scientific-based policy advice.

Applying Mankiw's taxonomy to microeconomics, this book follows a Scienteer approach by developing an integrated approach of competition policy analysis. Based on the assumption that the deterrence of anticompetitive behaviour is the fundamental aim of competition policy rules and their enforcement, three pivotal levels of such an integrated approach are identified: a fundamental level, a strategic level and an operational level. After developing the approach, it is then applied to three traditional areas of competition policy – hard core cartels, horizontal mergers and predation – to draw conclusions on how to ameliorate current competition policy. The innovative idea of the book is its coverage of the entire process of designing and implementing competition rules. Past research has largely concentrated on particular aspects of the integrated approach (such as investigations of welfare effects or the development of detection strategies), but these were at the expense of practicability issues. The book proposes ways in which this divergence can be narrowed.

The content of the book was accepted in September 2007 as a doctoral dissertation at the WHU Otto Beisheim School of Management in Vallendar, Germany. During the research and writing process I profited from the support of many people and would like to take this opportunity to acknowledge them. Among all contributors, my supervisor and mentor, Professor Dr. Jürgen Weigand, was certainly the most important. Apart from the very productive working environment at his Institute for Industrial Organization and countless discussions on various aspects of competition policy, the most formative influence was his continuous encouragement to participate in the activities the academic community has to offer. I am exceptionally grateful for these important experiences.

I am also deeply indebted to Professor Dr. Michael Frenkel, not only for his role as second supervisor of the thesis, but also for easing my integration into the WHU in those early days. The thesis definitely profited from the very productive research environment at WHU, and I would like to thank especially my colleagues Regine Braun, Dr. Alexandra Groß-Schuler, Ansgar Kirchheim, Claus Neuser,

Christian Steiner, Irene Delzer, Professor Dr. Ralf Fendel, Professor Dr. Wolf-Heimo Grieben, Dr. Günter Schmidt and Christoph Swonke for their contribution to this environment. Special thanks go to PD Dr. Georg Stadtmann not only for more than two years of companionship at the Institute for Industrial Organization but especially for creating constant pressure to take that last step and finally submit the thesis. Elisabeth Pirsch was always very helpful in guiding me through the administrative jungle.

A significant part of the study was written at the Centre for European Economic Research (ZEW), which I joined in October 2006. I am especially thankful to Professor Dr. Dr. h.c. mult. Wolfgang Franz not only for his agreement to publish the thesis in his series 'ZEW Economic Studies' but especially for creating and maintaining an unparalleled research environment at the ZEW. Furthermore, I am exceptionally thankful to Dr. Georg Licht for his support thoughout the important final months of the project. Special thanks go to Dr. Patrick Beschorner for very valuable comments on a draft version of the thesis and to my colleagues in the competition policy team at ZEW consisting of Martina Lauk, Dr. Nina Leheyda, Hannes Ullrich and Tobias Veith for their support. I am very grateful to Janine Micunek Fuchs for editing the manuscript. Romy Weiland was especially helpful in managing the publication process.

Furthermore, the project profited from a number of research stays, and I would like to thank Professor Dr. Alari Purju (Tallinn University of Technology), Lea Tonston (Estonian Competition Board), Professor Peter Møllgaard PhD (Copenhagen Business School), Professor Margaret Slade PhD (University of Warwick), and Adrian Raass (Swiss Competition Commission) for their hospitality and support. I am especially indebted to Professor Daniel Rubinfeld PhD (University of California at Berkeley) and Professor Thomas W. Ross PhD (University of British Columbia), not only for making exceptional research stays at two of the leading universities in North America possible but also for providing the opportunity to attend a couple of high-level graduate courses. Professor Norbert Schulz PhD from the University of Würzburg provided me with the necessary tools to undertake research in the area of competition policy and guided me in taking some first steps into the academic community. Special thanks go to Dr. Christian Köberlein, Professor Jürgen Müller PhD and Professor Dr. Hans-Martin Niemeier for their companionship and guidance throughout my academic development.

Last but certainly not least, I would like to thank my family for their continuous and overwhelming support. My girlfriend Diana was always supportive and motivating throughout the project and exceptionally generous in sacrificing countless weekends and holidays. Of all the support I received from my parents, my grandparents and my brother, probably the most valuable was the advice to concentrate on the important things in life and to follow each goal with maximum dedication.

Mannheim, August 2008 *Kai Hüschelrath*

Table of Contents

1 Introduction 1
1.1 Motivation and Objectives 1
1.2 Structure 6

2 Competition Policy Analysis – An Integrated Approach 11
2.1 Introduction 11
2.2 Fundamental Level 12
2.2.1 Competition Is Worth Protecting 12
2.2.2 Competition Needs Protection 24
2.2.3 Competition Policy Is Worth It 31
2.3 Strategic Level 45
2.3.1 Characterisation and Rationalisation 51
2.3.2 Welfare Effects 62
2.3.3 Enforcement 80
2.4 Operational Level 148
2.4.1 Identifying the Relevant Market 158
2.4.2 Assessing Market Power 170
2.4.3 Applying Economic Frameworks 195
2.5 Summary and Conclusion 199

3 Strategic Behaviour of Incumbents – Rationality, Welfare and Competition Policy 213
3.1 Introduction 213
3.2 Characterising Strategic Behaviour 213
3.3 Rationalising Strategic Behaviour 215
3.3.1 Entry and Strategic (Re)Actions to Entry 216
3.3.2 Advantages of Incumbents 223
3.4 Welfare Effects of Strategic Behaviour 227
3.4.1 Characterising the Competitive Benchmark 227
3.4.2 Characterising the Welfare Effects of Strategic Behaviour 232
3.5 Strategic Behaviour and Antitrust Enforcement 236
3.5.1 Essential Features of Antitrust Policy 236
3.5.2 Antitrust Enforcement Options Towards Strategic Behaviour 237
3.6 Summary and Conclusion 246

4 Fighting Predation 249
4.1 Introduction 249
4.2 Characterising Predation 250
4.3 Rationalising Predation 253
4.4 Welfare Effects of Predation 257
4.5 Enforcing Predation 260
4.5.1 Enforcement in Various Legislations 260
4.5.2 Characterising Enforcement Stages 271
4.5.3 Evaluating Enforcement Options in a Linear Duopoly Predation Model 283
4.5.4 Towards a Policy Framework to Enforce Predation 327
4.6 Summary and Conclusion 334

5 Conclusions 339

6 Annex 357
6.1 Estimating Customer Losses Due to Cartelisation – Evidence from the Lysine Cartel in the United States 357
6.2 Estimating the Potential Welfare Effects of a Merger – Evidence from the *Nuon-Reliant* Case in the Netherlands 367
6.3 Antitrust Implications of Franchise Agreements 372
6.3.1 Characterising Franchise Agreements 373
6.3.2 Rationality of Franchise Agreements 379
6.3.3 Franchise Agreements and Potential Antitrust Conflicts 382
6.3.4 Summary and Conclusion 389
6.4 Critical Loss Analysis in Market Definition and Merger Control 390
6.4.1 Definition and Economic Foundations 391
6.4.2 Important Properties of Critical Loss Analysis 394
6.4.3 Applications of Critical Loss Analyses 399
6.4.4 Summary and Conclusion 403
6.5 The *Lufthansa-Germania* Case at a Glance 404
6.5.1 Introduction 404
6.5.2 The Facts 405
6.5.3 The Antitrust Case 406
6.5.4 Outlook 411
6.6 Proofs 412
6.6.1 Allocative and Productive Inefficiencies in Monopoly 412
6.6.2 Instability of Cartels in One-Shot Games 414
6.6.3 Stability of Cartels in Supergames 417
6.6.4 Resource Allocation by an Antitrust Authority 419
6.6.5 Profitability of a Price Increase 420
6.6.6 Deriving the Price-Cost Margin for a Differentiated Good 421
6.6.7 Price Effects of Mergers in a Differentiated Bertrand Model 422
6.6.8 Sufficient Percentage Cost Reduction to Prevent Price Increases in a Homogenous Product Merger 425

6.6.9 Sufficient Percentage Cost Reduction to Prevent Price Increases in a Differentiated Products Merger 426
6.6.10 Assessment of Market Power 427
6.6.11 Proof of Inequality (75) in Section 4.4 430
6.6.12 Proof of Inequality (76) in Section 4.4 431
6.6.13 Proof of Inequalities (79) and (80) in Section 4.5.2.2 432
6.6.14 Proof of Inequality (83) in Section 4.5.2.2 434
6.6.15 Proof of Inequality (85) in Section 4.5.2.2 435
6.7 Data Tables 437

List of Figures 477

List of Tables 481

List of Boxes 485

List of Abbreviations 487

List of Mathematical Symbols 489

References 493