

Economic methods and concepts in the competition analysis of the new EU Member States: Lessons from Latvia

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Motivation

- EU Twinning Project for the European Commission and the Ministry of Finance of the Republic of Latvia done by the ZEW in cooperation with the Federal Cartel Office of Germany in May-September 2009
- Objective of the project: support the Latvian Competition Council (CC) in the extension of use of theoretical and empirical methods of competition policy analysis

In particular:

- derive recommendations for creation and maintenance of a measurable indicators' system for long-term evaluation of competition policy effects
- develop guidelines for improvement of theoretical and practical techniques and methods for selection and analysis of economic sectors and relevant markets
- derive recommendations for institutional and informational/IT support for internal procedures of dealing with analytical information in the CC

Objective of my today's presentation: share some experiences on the use of economic methods and tools by the CC in its everyday practice, in particular in the field of market studies/sector inquiries (focus on the last two points above)

Objectives of my today's talk

- Review CC's approach to market studies/sector inquiries in recent years
- Assess CC's current progress in the application of economic methods and tools in its competition practice, especially in the field of market studies:
 - This review is done on the general background of a more “economic” approach pursued by the European Commission in its competition policy
 - In line with this approach, the CC has its own Chief Economist and aims to introduce more economic methods and tools into its everyday practice
- Point out major recommendations for the improvement of the application of economic methods and tools in CC's market studies practice

Competition policy in Latvia: brief outlook

- The CC was established based on the Committee for Control of Monopolistic Practices (1998)
- Tasks and rights of the CC described in the Competition Law (CL) (approved in 2001, in force since 2002, with amendments into the CL in 2004 and 2008)
 - 2004 amendments: introduced the possibility to conduct dawn raids (in force since 2005)
 - 2008 amendments: abolished market share threshold for merger notifications (re-established in 2009), introduced short form of merger notifications, etc.; introduced prohibition to abuse dominant position in retail trade
- Advertising Law (approved in 1999)
- Decree of the Cabinet of Ministers “Operational Strategy of the Competition Council 2007-2009” (a medium-term operational strategy prepared by the CC in 2005, adopted in 2006) with the aim to improve the CC’s efficiency
- Regulation related to market studies “The Competition Council’s Procedures for Implementation of Industry Monitoring and Market Surveillance Activities and Research Organization” (approved in 2007, referred to as “2007 Market Regulation”)

CC's market studies (1/6): recent practice priority (1/2)

The CC takes a proactive approach in detecting most severe CL violations (one of medium-term priorities in Operational Strategy for 2007-2009)

Proactive (use of economics (market or industry studies or inquiries, market screening, collusion factors); case analysis; industry monitoring; agency cooperation)

vs reactive (complaints; other external information; leniency applications)

methods to establish antitrust infringements:

proactive methods have gained importance in CC's policy in recent years (esp. market/industry studies or inquiries as well as industry monitoring)

CC's market studies (2/6): recent practice priority (2/2)

Several reasons to conduct market studies by the CC (ECN, 2010)

- important source of information and tool for detecting infringements (in 2009 4 out of 6 cartel decisions and 6 out of 7 in 2008 launched on CC's own initiative after information collected in sector inquiries)
- enhance the CC's ability to prevent or terminate distortions of competition in sectors with most impact on consumers and national economy

2010: individual households (medicine, baby food, sugar production, retail market of day-to-day goods, fuel retail) and businesses (land survey, railroad freight traffic, road construction, fuel retail))

- provide opportunity for ex-post evaluation of CC's decisions as well as collect supplementary information for further action in those sectors where there already have been CC's decisions
- help both entrepreneurs and economists understand situation in markets concerned

CC's market studies (3/6): types of industry/market studies

Generally, the CC distinguishes between three types of studies (2007 Market Regulation):

- *Monitoring*: regular and systematic observation of market situation in a chosen industry over a defined period
 - NACE sector classification
 - based on publicly available information
 - objective to get an initial picture of a sector/market, base for launching a market study (sometimes an enforcement case)
 - choice of markets based on actual relevance of the market, direct or indirect signs of infringement, etc.)
- *Market surveillance*: in-depth examination and assessment of competition in a market/sector
 - involve an information request, obligatory visits of companies
 - choice of markets based on public importance of a sector/market, economic importance (as measured by turnover), not previously studied markets, signals from the market about a possible infringement
 - objectives: market definition, establishment of market shares, checking for possible CL violations, previous and possible further substantial changes in market structureSimilar to sector inquiries by DG Comp and UK OFT (without visits to companies)
- *Research*: examination of market situation by attracting external resources – experts, research firms

CC's market studies (4/6): market studies vs case handling

- Initiation of a competition case (abuse of dominance or restricted agreement): complaints (“passive”) or ex-officio (“active”); in case of cartel cases: leniency applications (no leniency application has yet been submitted to the CC (OECD, 2009))
- Trade-off between launching cases based on complaints and cases based on ex-officio investigations: implementation of pro-active activities by the CC directly depends on the number of submitted complaints, the CC has to examine all (CC's Annual Report 2006) (often related to “lighter” violations of the CL, or market players' statements about suspected infringements)
- Since 2009 unfair competition cases and advertising (which doesn't cause significant harm to competition) are left for courts' decisions
- Order of work priority by the CC: examination of complaints and initiated cases, implementation of surveillance activities, and monitoring
- 2010 – focus on targeted sector inquiries: 12 new sector inquiries were launched, in addition to 8 that were already running (ECN, 2010)

Table 1. CC: market studies vs competition casework

	2005	2006	2007	2008	2009
No completed sector inquiries/market studies	2	5+7	8+2	11	9
No decisions	68	90	183	111	41
Abuse of dominant position	5(2)	11(4)	13(2)	18(5)	19(3)
Prohibited agreements	7(1)	10(5)	12(5)	18(7)	9(6)
Mergers	17(2)	28(4)	82(3)	57(5)	12(1)
Unfair competition	23(1)	16(3)	18	7	1
Violation of Advertising Law	16(10)	25(9)	18(6)	10(8)	0

CC's market studies (5/6): sectors, competition concerns, tools&techniques

- Recent market studies: e.g., cement, fuel, retail, dairy, bread, print media, etc. markets
- Repeated market surveillances (in “most sensitive markets”, or markets important for consumers): e.g., fuel, print media, cement markets
- Purpose of market/industry studies and inquiries: e.g., assessment of competition, market monitoring based on past cases (e.g., print media), market analysis to suggest proposals for regulatory amendments
- Most common competition concerns in those studies: e.g., presence of a dominant market player, risk of abuse of collective dominant position, suspicion of coordinated behaviour and prohibited agreements
- Major practical and theoretical techniques, methods and concepts applied in those studies: e.g., analysis of barriers to entry, analysis of capacity restraints, price analysis, analysis of market shares, analysis of imports, distribution of market power between producers and retailers (e.g., bread, milk and cottage cheese), etc.

CC's market studies (6/6): findings & outcome

- Typical findings: often no evidence for CL violation (although e.g., risk of abuse of dominant position in cement market), implications for drafting legislation, also often basis for launching enforcement cases
- Those cases reflect CC's efforts to fight cartels: while the CC decided only 1 cartel case in 2005, in 2008-2009 this number increased to 6-7, e.g., architect services (2007), construction (2009), home appliances (2009)
- Launching competition cases related to abuse of dominant position following market studies on own initiative: e.g., retail (2010, 2011)
- As related to merger control: detection of unreported mergers in fuel market (2005)), but typically conducted for market definition or competition assessment purposes in a merger case (e.g., in 2006 broad market research within several merger cases in bread, fish oil, construction materials wholesale and retail markets)

Example: fuel market study (1 / 2)

(based on CC's Annual Reports 2005, 2006, 2007)

- Repeated market surveillance (started before 2005)
- Economic methods/concepts used

2005: analysis of imports structure and major players, market definition, analysis of factors facilitating coordinated behaviour, wholesale market structure (categories of players and market shares)

2006: analysis of market structure (risk of abuse of collective dominant position by three market leaders), special offers for consumers

2007: analysis of market structure, definition of relevant geographical (regional) markets, structure of fuel imports, special offers for consumers

- Competition focus: e.g., risk of abuse of dominant position, risk of coordinated behaviour, on-going merger process
- Results: undetected mergers, but in general regular monitoring of the market, no trends different from those in the EU MSs

Example: fuel market study (2/2)

Some thoughts:

- Desirable to build a consistent database for the Latvian fuel market (especially in view of repeated market surveillances)
- Potential empirical techniques that could be used by the CC in fuel market: e.g., econometric analysis of prices, variance screens (Abrantes-Metz et al., 2006), econometric analysis of factors facilitating coordinated behaviour
- Examples of market studies by other competition authorities in the fuel market: Austrian competition authority (variance screen), US FTC (econometric analysis of prices), concerns of the German Federal Cartel Office (idea of market screening)

IT support in the CC (especially as related to market studies)

We review current informational/IT basis for internal procedures of dealing with analytical information in the CC as well as its human qualifications for performing economic analysis:

- Case handlers equipped with MS-Office software, Internet and e-mail services, daily press service, availability of competition literature
- However, apparently no comprehensive collection of data, literature, past cases, handbooks and guides and any internal information available to all case handlers (form of centralized server), although it has been partly solved
- Partially limited competence for English with some case handlers
- Availability of training for staff in economic theory and methods (at least possible within past Twinning projects)
- Desirable to appoint a couple of internal data analysis experts (without hiring at least one econometrician or statistician)
- Knowing Excel seems to be sufficient to know for current purposes of the CC (more advanced software such as STATA or SAS if an econometrician is recruited)

Our major findings (1/2)

General findings:

- We find that in general the CC shows progress with application of economic methods&tools although it has little experiences with the application of econometric/statistical techniques in its current practice
- This may be to a certain degree attributed to the short time period of the CC's existence, the lack of necessary skills and education of case handlers and absence of any qualified statisticians/econometricians who could support the case handlers
- In its turn this is linked to the rather unsatisfactory financial as well as technical and material resources of the Latvian CC due to lack of adequate funding in a couple of last years

The CC's efforts to use more advanced economic techniques are thus confronted with the lack of sufficient resources, both human and technical, in reality to implement those techniques

Our major findings (2/2)

Findings as related to market studies:

- In general we find the increasing role of the use of economics in fighting cartels
- Quite a high number of studies/research studies for such a small competition authority (apply the instrument of market studies much more intensively than e.g., by the Federal Cartel Office of Germany)
- Effectiveness of market/industry studies and external research: several competition cases have been launched
- One of challenges for empirical analysis: not long enough time data series (this highlights the importance of creating a comprehensive database that will be regularly updated)
- Number of econometric techniques that may be useful for the CC to learn:
 - Simple empirical techniques: e.g., price correlation analysis (e.g., for market definition purposes), etc.
 - More advanced economic techniques: e.g., variance screens (behavioural screening), econometric analysis of prices
 - More advanced economic tools: e.g., assessment of buyer power in retail markets, analysis of predatory pricing

Policy implications (1/2)

- Comparing the experiences of the Latvian CC with those of the advanced and experienced competition agencies such as e.g., US and European Commission competition agencies, we have developed recommendations for the improvement of theoretical and practical techniques and suggested methods for the selection and analysis of economic sectors and relevant markets by the Latvian CC
- We have described the major steps of conducting a market study and elaborate in more detail on practical and theoretical techniques and methods that may be used by the CC in the implementation of a market study, depending on the focus of the market investigation
- It should be clear that the core of competition policy is enforcing competition law in single cases. This casework can be complemented by other types of policy enforcement such as market studies and competition advocacy
- Economic theory and methods should be applied not only in terms of finding facts (e.g., market structure, analysis of dominant position) but also in terms of evaluation of the effects of a behaviour or an agreement on competition (the CC's current focus is rather on finding facts)

Policy implications (2/2)

- Furthermore, we have suggested more general policy recommendations how to improve the current work and strengthen the economic capacity of the Latvian Competition Council, in particular:
 - the CC must qualify its personnel, ask for and collect relevant data and utilize the available MS Office or equivalent programmes or if necessary more powerful programs for dealing with large amounts of data
 - market studies and earlier casework should be easily available for work in latter cases. To assure the availability of previous investigations, the documentation in the CC should be improved
 - carefully design and conduct market studies (e.g., based on competition focus and planned analysis, carefully choose the data that may be needed and its time and firm coverage)

These recommendations together may help improve the image and reputation of the Latvian CC in front of consumers and businesses and increase the efficiency of its competition advocacy efforts