ASEAN-Australia-New Zealand Free Trade Area (AANZFTA)
Economic Cooperation Support Program (AECSP)

Competition Primers for ASEAN Judges

Developed as part of the AANZFTA Competition Law Implementation Program

Economics for judges in the competition law context

1. Introduction

1.1 This primer is intended to:

a. be a principles-based document for use by members of the judiciary in each of the Member States of the Association of Southeast Asian Nations ('ASEAN');

b. provide a practical and informative guide for judges focusing on challenges and issues faced in evaluating complex expert evidence in the course of making and reviewing decisions under competition laws in ASEAN Member States; and

c. assist in developing competition law precedent, which increases legal certainty, promotes efficiency and fosters consistency and predictability within ASEAN Member States, and ultimately contributes to shaping sound competition policy.

1.2 The primer has been developed in the context of the differences in and the varying stages of development of competition laws in the ASEAN Member States. It is not intended to provide country-specific information.

1.3 This primer has been developed by judges of the Federal Court of Australia for judges in the ASEAN Member States, in close cooperation with the OECD. It is one in a series of competition law primers developed at the initiative of the ASEAN Australia New Zealand Free Trade Area Competition Committee as a part of the Competition Law Implementation Program ('CLIP').

2. What is economics and why is it important in competition law?

2.1 Economics can be defined as a "social science concerned with the production, distribution and consumption of goods and services". Economics is regarded as a social science because it applies scientific methods to study society and social relationships. Economics is a powerful tool for assessing the effect of conduct and arrangements on markets.

2.2 Competition is an economic concept characterising a market process of rivalry between sellers to increase their profits by offering to the buyers a better combination of price, quality, and service than the combinations offered by competitors.

2.3 The introduction of competition laws provides the market with a set of "rules of the game" that protect the competition process itself, rather than protecting competitors in the market. In this way, the pursuit of fair or effective competition can contribute to improvements in (economic) welfare, efficiency, and economic growth and development.

2.4 Welfare is a standard concept used in economics which aggregates the welfare (or surplus) of different groups in the economy. In a given industry, welfare can be measured by total surplus, which is the sum of consumer surplus (the difference between what all consumers are willing to pay for a product and what it actually costs them) and the producer surplus (the sum of all profits made by producers in the industry). Such measures of welfare are standard concepts in assessing the effect of conduct and arrangements on markets.

2.5 In the context of competition law, economics provides a rigorous framework for analysing markets and the effect of conduct on markets, including (the effects of) unilateral or coordinated conduct of market participants (competitive effects). Economic analysis can also be a useful tool to identify and evaluate the relevant facts in competition cases. Around the world, economic evidence is often given by economic experts on behalf of the parties in competition law cases.

2.6 Economic evidence can assist courts by explaining and applying economic concepts that may be embedded within competition laws, such as:

a. competition, namely rivalry in price, quality, service and other variables of value to consumers so as to achieve business objectives, such as maximising profits;

b. welfare, including subjective value, well-being and preference-satisfaction; and

c. efficiency, namely static efficiency (the level of efficiency at one point in time, focusing on existing products, processes or capabilities) and dynamic efficiency (the level of efficiency over time as this changes through innovation, leading to new or better products, processes or capabilities). The two main types of static efficiency are the allocation of available resources to their highest possible value (allocative efficiency) and the maximisation of output from the available resources at the lowest possible cost (productive efficiency).

2.7 Competition can promote both welfare and efficiency by increasing value and encouraging optimal allocation and use of resources. These economic concepts generally underpin and inform the objectives of competition laws.

3. Economic terms and concepts for assessing competition

3.1 A market is made up of buyers and sellers transacting in goods and services. A market is the field of rivalry, or a potential field of rivalry, between sellers to sell their products or services. If a seller increases its price (relative to its cost) of a product or service, the profit for every unit sold will increase, but sales to certain customers may be lost if they are not willing to buy the given product or service for the increased price and instead switch to another seller, product or service.

3.2 The exercise of establishing the relevant market, called market definition, provides an analytical framework for the ultimate inquiry of whether particular conduct or a particular transaction is likely to produce anticompetitive effects.

3.3 A market may be defined having regard to its product and geographic dimensions, including by considering economic substitutes in supply and demand. The product dimension defines the different competing products that should be considered as being in the same market; the geographic dimension defines the extent of the geographic areas that should be considered as being in the same market. For example, a town may only have one pizza shop, but this is unlikely to be a monopoly because if it raises its prices substantially, consumers might switch to burgers or a neighbouring town's pizza shop might expand its delivery area. If substitution to burgers and/or pizza sellers in other towns prevented the pizza shop owner from profitably raising prices, those products and sellers would be included in the so-called relevant market.

3.4 Market power is another core concept in competition law and in economics. It is commonly defined as a firm's ability to sustain prices above, or quality levels below, competitive levels. The benefits of market power provide strong incentives for firms to compete to acquire it. Market power may be acquired, maintained and used without falling foul of competition laws. Competition laws are generally only engaged when market power is acquired, maintained and/or used in an anti-competitive way.

3.5 A firm's degree of market power is not easy to measure objectively. Market share is often relatively easy to measure and is therefore sometimes used as an indicator of, or a proxy for, market power. However, care should be taken with this approach as market share may provide only an incomplete or temporary picture of a firm's market power. Other relevant factors may include:

a. barriers to entry and/or expansion, namely the ease with which new competitors can enter, or existing competitors can expand, into the market if prices in that market rise above competitive levels. This possibility of new firms entering the market, or current rivals expanding, prevents or makes it more difficult for firms to charge prices above competitive levels. Consequently, if barriers to entry and expansion are low, then incumbent firms will not be able to sustainably exercise market power even if they have a large market share;

b. 'countervailing' (buyer) power, namely the buyer's bargaining strength in its negotiations with the seller. The ability of buyers to negotiate with sellers, for instance due to the buyer's size, its commercial importance to the seller, or its ability to self-supply or sponsor new entry of another seller, acts as a disciplining force and promotes competitive behaviour on the supply side;

c. economic regulation can be a relevant factor in sectors where for instance price and/or quality levels are subject to controls by a government regulator. This can limit the extent to which firms can exploit their market power; and

d. the characteristics of the particular firm and market, including having regard to the appropriate market structure.

4. Economic models for assessing competitive effects

4.1 Economists often use economic models to explain the real world through a number of simplifications and abstractions. There are different economic market models that may be used for assessing competitive effects. The suitable model will depend on the facts of the particular case. Four of the basic economic market models, which differ in terms of the amount of competition that occurs in the market, are described in more detail below.

4.2 The (hypothetical) perfect competition model describes a market structure where competition is at its greatest possible level. It is defined by several idealised market conditions including that, for instance, perfect information is available to all consumers and producers, there are no entry or exit barriers, and there is a large number of buyers and sellers of homogenous goods or services who all act perfectly rationally. In this model, no firm has substantial market power or an ability to influence prices. This model produces optimal outcomes in terms of welfare and efficiency and is the benchmark for assessing the effects of conduct in imperfectly competitive market structures.

4.3 The monopolistic competition model also assumes a large number of buyers and sellers that can easily enter and exit, but the products in this model are not homogenous. Product differentiation allows firms to exercise some market power and make independent price decisions, potentially leading to higher prices or idle capacity compared to a situation of perfect competition.

4.4 In an oligopoly model there are only a few sellers of significant size. These firms are aware of, and take account of, each other's actions and expected reactions when making pricing and other competitive decisions. Firms in oligopoly markets are therefore interdependent. In an oligopoly situation, the degree of competition may differ substantially, depending significantly on the specific circumstances of the market. The sellers may compete fiercely, or individual firms can have significant market power and an ability to interact tacitly, combining market power to drive up prices and profits to the detriment of efficiency and welfare (and consumers). As a result, oligopoly outcomes can look similar to monopoly.

4.5 In a monopoly model, there is only one seller with effective control over the whole market. That seller can use its monopoly market power to maintain prices and profits above efficient levels and to produce less than the optimal amount. Competition laws do not generally prohibit monopolies themselves, only the use of monopoly power to harm competition. Competition laws may also prevent monopolies from forming as a result of a transaction (merger or acquisition) or anti-competitive conduct.

4.6 Competition laws predominantly target conduct by firms that operate in oligopoly or monopoly markets. This is because firms operating in these types of markets have the greatest potential to use their market power to harm competition.

5. Assessing competitive effects

5.1 An assessment of competitive effects is generally not necessary in cartel cases because cartel agreements are ordinarily considered the most egregious violations of competition law and are generally prohibited without having to take into account the specific effects of the cartel. Cartels almost invariably injure consumers by raising prices and restricting supply, thus making goods and services completely unavailable to some purchasers and unnecessarily expensive for others.

5.2 By contrast, an assessment of competitive effects is more commonly required in considering other (non-cartel) forms of conduct or arrangements, in particular in considering the approval of mergers and acquisitions, in assessing agreements that may substantially lessen competition, and in evaluating abuse of dominance cases, in which a finding of liability usually requires both a substantial degree of market power and an anticompetitive object or effect.

5.3 In assessing competitive effects, economists generally focus on the state of competition in a market as a whole, rather than the effect of the conduct on particular competitors. Of particular relevance is considering whether the conduct creates, increases or maintains market power in the market by, for example, increasing barriers to entry and expansion or excluding rivals from competing effectively in the market. There are several tests that may be useful in assessing competitive effects, including:

a. the ‘with or without’ test, which compares the likely state of competition in a market with the tested conduct to the state of competition in that market without the tested conduct;

b. the ‘(no) economic sense’ test, which asks whether the tested conduct would still make economic sense absent any anticompetitive purpose or effect; and

c. the ‘as efficient competitor’ test, which considers whether the tested conduct tends to exclude even those competitors that are at least as efficient as the firm engaging in the tested conduct, in a way which harms competition in the market as a whole.

5.4 The application of the above tests to assess competitive effects is rarely straight forward and may require expert economic analysis and evidence. For example, in applying a ‘with or without’ test to a merger approval it may not be possible to simply assume that the current state of competition in the market would be preserved ‘without’ the merger. In a recent Australian merger approval involving marine freight services, it was found that without the merger the target's existing freight services would cease and the prospective purchaser would in any event be able to secure all of the customer contracts that made the freight services viable. In the circumstances, the merger was approved subject to conditions, commitments and undertakings to reduce its anti-competitive effects.

5.5 It is always necessary to consider the competitive effects keeping in mind the legislation to be applied and the purpose of that legislation. Economic analysis and evidence can assist in bringing to light the effects on competition and market outcomes of the conduct or arrangements in question. At the same time, it is important not to let technical economic concepts replace the language of the legislation.

6. Related information sources

6.1 The following resources provide further information in relation to economics in a competition law context. The material may be useful as a general reference for judges in the ASEAN Member States:

a. OECD, *Recommendation of the OECD Council Concerning Effective Action Against Hard Core Cartels*, 1998

b. Massimo Motta, *Competition Policy; Theory and Practice*, 2004

c. OECD Competition Policy Roundtables, *Barriers to entry*, 2005

d. OECD Competition Policy Roundtables, *Quantification of harm to competition by national courts and competition agencies*, 2011

e. OECD Competition Policy Roundtables, *Market definition*, 2012

f. OECD, *Glossary of statistical terms*

g. International Competition Network, *Training on demand*, including modules on market power, competitive effects, and economics of dominance