# Key Economic Concepts for the Competition Lawyer in Litigation

by

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## A. INTRODUCTION

There have been three great inventions since the beginning of time: fire, the wheel and competition law. In this the second decade of the twenty first century, any lawyer's foray into competition law would be humbling without a solid understanding of mainstream economic principles; regardless of whether the lawyer is fresh out of Law School or an accomplished Queen's Counsel.

The collaboration between competition law and economics was inevitable given the preoccupation of economists with competitive markets. Surprisingly, competition law advanced independently of economics for as much as seventy years after the first competition legislation was enacted by Canada in 1889. With the development of the economics sub-disciplines of Industrial Organisation (IO) and Econometrics in the second half of the twentieth century, however, economics became increasingly important in competition law enforcement. IO studies enterprises and the effect of their behavior on the performance of markets while econometrics applies statistical methods to test economic relationships.

Needless to say, an understanding of economics is indispensable for lawyers participating in competition law enforcement. In fact, it is common for competition lawyers practicing in first world countries to take graduate courses in economics just to remain relevant. The remainder of this paper will expose the economics foundations underpinning competition law.

## B. THE OBJECTIVE OF COMPETITION LAW

Competition statutes have been enforced in more than 100 jurisdictions with many other jurisdictions in the process of doing the same. Given the prevalence of this type of legislation, it is reasonable to ponder about the purpose of competition law.

> "We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are life, liberty and the pursuit of happiness.- That to secure these rights, Governments are instituted among men."- The Declaration of Independence, 1776.

> "I say that the mission of my generation was to win self-government for Jamaica, to win political power which is the final power for the black masses of my country from which I spring. I am proud to stand here today and say to you who fought that fight with me, say it with gladness and pride, mission accomplished for my generation….And what is the

> mission of this generation? It is reconstructing the social and economic society and life of Jamaica."- The Rt. Hon. Norman Manley, National Hero of Jamaica, 1969.[2]

These views on the purpose of governments were uttered by the founding fathers of the United States of America (USA) and Jamaica respectively. Despite that fact that these notions were expressed almost two centuries apart, they both argue that economic welfare ought to be the central to any policy implemented by the government.

It would be reasonable to assume that the purpose of implementing competition law is to promote and preserve a competitive environment in which goods are traded. In fact most jurisdictions point out that competition law is designed to protect competition and not competitors. The International Competition Network (ICN) surveyed its members in 2007 to document, among other things, their objectives of implementing competition statutes.[3] The thirty three agencies which responded to this question stated at least one of the following ten objectives (with the number of respondents in the brackets):

- Efficiency
  - Ensure an effective competitive process in domestic markets (32);
  - Maximize efficiency (20);
- Consumer Protection
  - Promote consumer welfare (30);
  - Ensure economic freedom (13);
  - Promote consumer choice (5);
- Equity
  - Ensure a level playing field for small to medium sized enterprises (7) ;
  - Promote fairness and equality (6);
- Political
  - Achieve market integration (4);

[2] Source: http://www.jis.gov.jm/special_sections/Heroes/Heroes.htm (accessed: October 14, 2014)

[3] See ICN, Report on the Objectives of Unilateral Conduct laws, Assessment of Dominance/Substantial Market Power and State-Created Monopolies, 2007, Annex A. The questionnaire actually sought responses regarding the objectives of implementing specific provisions (unilateral conduct) of competition law and not the law itself.

- Other
    - Facilitate privatization and market liberalization (2); and
    - Promote competitiveness in international markets (2).

The list above shows that 32 of the 33 respondents cited the protection of an 'effective competitive process' as one of the objectives in implementing competition law.[4] It should be noted also that 30 of the 33 agencies cited the 'promotion of consumer welfare' as an objective of implementing competition law. These results are representative of the wider competition law community.

Given that the protection of the competitive process is a common objective across jurisdiction, one is left pondering the reason that the competitive process is held in such high esteem.

## C. COMPETITION AS AN IDEAL MARKET STRUCTURE

Economists assume that society requires goods and services ('goods') to be happy, with most persons being better off the more goods they consume. Invariably, these goods must be produced utilizing scarce productive resources. The problem is that society desires unlimited supplies of goods but limited resources with which to produce them. The economics science exists to assist us in figuring out how best use allocate these scarce resources to maximize the benefits society enjoys from consuming goods. Since productive resources are scarce, society must devise a means of deciding which goods are produced, how the goods are produced, and the prices at which the goods are sold. In a *command* economy, these key economic decisions are made by a central authority, usually the government. In a *market* economy, however, these decisions are made jointly through the interaction of consumers and enterprises. From both conceptual and practical points of view, market economies in general have been found to outperform command economies. It has been shown also that some market economies outperform other market economies.

The Perfectly Competitive market structure is idealistic in the sense that no market could ever satisfy all its assumptions in the real world. An understanding of the competitive market is still

[4] See clarification in footnote 1.

useful, however, because it serves as a benchmark against which all real world markets are assessed. As mentioned above, the goal of competition policy is to promote and preserve the competitive environment in which products are traded within and across national borders. To assess the legitimacy and feasibility of pursuing this goal, one would need to understand what is meant by a "competitive market" and appreciate the public benefits generated by competitive markets, relative to benefits generated by alternative mechanisms through which products are traded. The theory of perfectly competitive markets has been rigorously developed by economists since as early as the eighteenth century.[5] The main alternative market structures are now described.

**Table 1** *Characteristics and economic performance of Alternative Market Structures*

| | **Competitive** | **Monopoly** | **Monopolistic Competition** | **Oligopoly** |
|---|---|---|---|---|
| A. *Characteristics* | | | | |
| (i) # of enterprises | Many | One | many | Few |
| (ii) Barriers to entry/ exit | None | High | Low | Medium |
| (iii) information | Perfect | --- | --- | --- |
| (iv) Product differentiation | Homogenous (no difference) | --- | Differentiated | --- |
| B. *Measures of economic performance* | | | | |
| Allocative efficiency | Yes | No | No | No |
| Productive efficiency | Yes | No | No | No |
| Maximum Social Surplus | Yes | Usually not | No | No |

*Panel A* in the table above shows that a *competitive market* structure is one in which there are many enterprises and consumers; there are no factors obstructing enterprises from entering or leaving the market; consumers are perfectly informed about the goods available in the market; and consumers do no perceive any difference in the goods supplied by different enterprises in the market. This structure contrasts with a *monopoly market* structure in which there is only one enterprise of the good for which there is no close substitute available to consumers.

Further, *Panel B s*hows that competitive markets achieve allocative efficiency, productive efficiency and generates a level of social surplus which is not exceeded by any other structure.

[5] See Chapter 1 of Carton, Dennis and Jeffery Perloff (2005). Modern Industrial Organization. 4th Edition. Boston, Pearson Addison Wesley for an excellent description of the alternative market structures.

Economics ranks market structures based on *efficiency* criteria. In general, efficiency refers to the extent to which currently available scarce resources can be reallocated to create more (or better quality) goods. There are various but distinct concepts of economic efficiency. The main ones are defined below:

- *Allocative efficiency* is achieved when the price of the good reflects only the cost incurred in producing the last unit of the good (i.e. marginal cost);
- *Productive efficiency* is achieved when the goods are produced at the lowest cost per unit (i.e. average total cost);
- *Dynamic efficiency* is achieved when a new (or vastly improved) good is created; or when a cheaper means of producing an existing good is discovered.
- *Consumer surplus* refers to the difference between the value a consumer places on a unit of a good and the price the consumer pays for it. This is an economic measure of consumer welfare;
- *Producer surplus* refers to the difference between the price enterprises receive for supplying a good and the variable unit cost of supplying it. This is an economic measure of enterprise welfare; and
- *Social surplus* is the sum of consumer and enterprise surplus. This is a measure of social welfare.

The understanding of competitive markets is important because it allows policymakers to shape the structural characteristics of markets in a way which would promote competition. In fact, most conduct frowned upon by competition law can be shown to erode the structural features of the market which are known to facilitate competition. Through a seminal paper published by economist Joseph Bertrand, economists have long known that there are markets with structural features which differ from those of the competitive market but which nonetheless results in the competitive outcome. This is to say that there are markets which do not share the structural characteristics of the competitive market which nonetheless perform equally efficient.[6]

[6] Specifically, Bertrand shows that in markets where there are only two suppliers of identical goods, and suppliers compete on prices, then the price will reflect only the (marginal) cost of supplying the product.

The fact that the structural features of competitive markets are not necessary to achieve the desirable "competitive outcome" is the basis for the "efficiency defense" available to enterprises whose conduct erodes the features of a market normally associated with competitive markets.

## D. DISTINGUISHING COMPETITION LAW FROM ECONOMICS

One important precursor to appreciating the contribution of economists to competition law enforcement is to distinguish between terms commonly used in competition law. In economics, the *market* comprises a group of consumers and suppliers of a particular good or service. The comparable term in competition law is *relevant market*. In both instances, these terms describes the boundaries within which competition takes place. The legal term of relevant market, however, adds to the economic concept of markets by including a geographic dimension and in some instances, a temporal dimension. This effectively means that in attempting to establish the boundaries of competition, competition law considers not only the product being traded, but also the geographic regions in which the goods are traded and possibly the time period in which the products are sold. Discussion into the relevant market goes into greater detail in Section F of this paper.

Another common term used in competition law is monopoly power. This term has its foundation in the economic concept of market power. In competition law, monopoly power refers to the ability of an enterprise to sell its product <u>significantly</u> above the competitive level for a sustained period. In reconciling the two concepts, one could say that monopoly power is simply a high degree of market power.

Another term used in competition law is that of *dominant enterprise*. In competition law, an enterprise is considered to be dominant if it can act independently of rival enterprises. In economics, the concept which most closely parallels a dominant enterprise is that of a monopolist. A monopolist is an enterprise which sells a product for which there is no close substitute in the foreseeable future. A key distinction in the two terms is that while an enterprise can be considered dominant in a market in which there is more than one seller, an

enterprise could not be considered a monopolist in a market when there is more than one seller.

Generally speaking, abuse of dominance as used in competition law refers to a class of conduct carried out by a dominant enterprise which has the effect of a substantial lessening of competition.[7] The corresponding term from economics is unilateral effects which refer to the conduct of a single enterprise, irrespective of its effect on competition.

Another concept which was created in law is that of *collusion* which refers to situations in which two or more enterprises formally or informally enter into a clandestine agreement. In economics, conduct carried out by two or more separate enterprises is referred to as coordinated conduct.

Finally, the most important concept in competition law is the effect of *substantially lessening competition* which describes the effect of a given conduct on a relevant market. Its importance lies in the fact that a wide class of conduct is prohibited in competition only to the extent that it can be demonstrated that a specified conduct is likely to have this effect.[8] The comparable term in economics is anticompetitive effect which typically refers to conduct which results in a market moving "further away" from the competitive benchmark. To conclude that a challenged conduct is anticompetitive, and therefore support a claim of substantially lessening of competition, economists will seek evidence to establish that the conduct is likely will harm both competitors and consumers.

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[7] One exception to this general rule is observed in Jamaica's competition legislation, the Fair Competition Act, in which conduct are considered to be abusive even before their effect on competition is assessed.
[8] The class is described in competition law as *rule of reason* conduct.

**Table 2** *Comparable terms Used in Competition Law and Economics*

| Competition Law Concepts | Parallel Economics Concepts |
|---|---|
| **Relevant Market** | Market |
| **Monopoly power** | Market Power |
| **Dominant enterprise** | Monopolist |
| **Abuse of Dominance** | Unilateral Effects |
| **Collusion (or agreements which lead to the substantial lessening of competition)** | Coordinated Effects |
| **The effect of Substantially lessening Competition** | Anticompetitive effect |

## E. ECONOMICS AND THE MAIN PILLARS OF COMPETITITON LAW ENFORCEMENT

In this section, we describe the main categories of conduct which are scrutinized under competition law. We further highlight the influence of economics on competition law by identifying the structural characteristics of the perfectly competitive market which would be eroded if the conduct was left unchecked.

Conduct reviewable under competition legislation can be classified in two broad categories: anticompetitive and anticonsumer:

i. Anticompetitive conducts

An anticompetitive conduct is one which has an adverse effect on the competitive process. This category of conduct may be further classified as follows:

- Abuse of Dominance (unilateral conduct);
- Agreements with the effect of Substantially Lessening Competition (coordinated conduct); and
- mergers and acquisitions. [9]

Unilateral Conduct

Economists have shown that unilateral conduct is potentially anticompetitive because, *inter alia*, it could lead to the raising of existing rivals' costs of production or exclude a potential rival

[9] M&A are a distinct class of reviewable conduct because it is the only provision whereby conduct is reviewed prospectively.

from entering.[10] This results in the erosion of characteristic (ii) of the competitive market structure outlined in the Table 1 above. Coordinated conduct is potentially anti-competitive because it reduces the number of (independent) enterprises and result in the erosion of characteristic (i) and possibly characteristics (ii), (iii) and (iv) of the competitive market structure outlined in the Table 1. Mergers and acquisitions are potentially anti-competitive because, like coordinated conduct, they reduce the number of independent enterprises and result in the erosion of characteristic (i), and possibly characteristics (ii) and (iii) of competitive market structure outlined in the Table 1.

Coordinated Conduct

The coordination of the activities of independent enterprises has been extensively studied by economists under the heading of coordinated conduct. The group of enterprises which enters into these agreements is referred to cartels. Coordination among horizontally related enterprises poses a greater threat to competition than coordination among vertically related enterprises. An example of a cartel is OPEC- the Organization of Petroleum Exporting Countries. The practice whereby OPEC coordinates the production decisions of its member countries is not reviewable under competition legislation, however, because the agreement is established among sovereign nations and not among enterprises.

Arrangements by competing enterprises to coordinate on prices, output or territory are the most damaging types of coordinated conduct and are usually referred to as "hard core" collusion. Since most cartel arrangements are executed in secrecy, coordination represents a double threat to competition law. In the first instance, it is difficult to detect and secondly even when detected gathering direct evidence of the agreement is almost an impossible task. The OECD (2002) estimates that only one of every six collusive agreements is detected.[11]

[10] For a more detailed discussion of unilateral conduct, see Krattenmaker, Thomas and Steven Salop (1986) "Anticompetitive Exclusion: Raising Rivals' Costs to achieve Power over Price," *Yale Law Journal*, Vol. 96 (2): 209-294.

[11] OECD (2002), "Report on the nature and impact of hard core cartels and sanctions against cartels under national competition laws"

Direct evidence of coordination refers to documents which outline the arrangement or refer to the arrangement. The major tools for gathering direct evidence are:

- leniency programs;
- dawn raids (surprise inspections); and
- punitive sanctions.[12]

Gathering indirect or economic evidence of coordinated conduct involves the use of market or empirical data to demonstrate that the conduct of enterprises over the period could have resulted only from a co-ordination among the alleged cartel members. For instance, the fact that enterprises charge identical prices is not sufficient evidence of coordination since it could have resulted from legitimate competition among the enterprises.

At this time, it is important to make a distinction between *parallel behavior* and coordinated conduct. Parallel behavior refers to situations in which each enterprise when deciding its prices and other market strategies, independently takes into consideration the likely reactions and counteractions of its competitors to its own moves. Parallel behavior, without more, is not anticompetitive, as it is a legitimate occurrence in markets with only a few suppliers.

When analyzing cartel arrangements, one must compare the incentives by each enterprise to stick to the (higher) cartel price or cheat and under-cut the price. If one enterprise cheats while the others maintain the higher collusive price, the deviant enterprises stand to gain higher profits than if it had maintained the cartel price. The higher profits come at the expense of the other cartel members who maintained the collusive price and so these cartel members are likely to retaliate when they discover the deviation in the future. In contemplating whether to cheat, the enterprise must consider how the other cartel member(s) will react. If the losses suffered from future retaliation exceeds the immediate gains from cheating, then the cartel arrangement is likely to be sustained; otherwise collusion is unlikely.

[12] In Jamaica, only civil sanctions are imposed for contravening competition legislation. A fine of up to JMD 1 million can be imposed on an individual and up to JMD 5 million on an enterprise (Section 47, JFCA). In Barbados, a fine of up to BBD 150, 000 can be imposed on an individual and up to BBD 500,000 or 10% of turnover (whichever is greater) on an enterprise (Section 15, BFCA).

The first step in gathering economic evidence is to assess whether the structural characteristics of the market under investigation is conducive to collusive arrangements; the second step is to develop a theory of the collusive arrangement which in turn must be tested with market data against the alternative hypothesis of no collusion. Care must be taken in crafting the theory of, and designing the test for collusion as some theories of collusion include periodic but temporary bouts of "no collusion".

STEP 1: Assessing the structural characteristics which facilitate coordinated conduct

The following summarizes the various characteristics of the market which economists have determined may facilitate coordinated conduct:

- Fewer competitors facilitate coordinated conduct;
- Entry barriers facilitate coordinated conduct;
- Frequent interactions facilitate coordinated conduct;
- Market transparency facilitate coordinated conduct (e.g. trade associations);
- Demand growth facilitate coordinated conduct;
- Business cycles and demand fluctuations hinder coordinated conduct;
- coordinated conduct is more difficult in innovative markets;
- Cost asymmetries hinder coordinated conduct;
- Asymmetries in capacity constraints hinder coordinated conduct; and
- Greater differentiation of "quality" hinders coordinated conduct.

STEP 2: Confronting theory with data

One method is to establish a "non-collusive" equilibrium outcome for the enterprises. That is, we should know what prices to expect in the absence of any coordinated arrangement and use this as a benchmark for actual (observed) price data. If the data are consistent, we must then conclude that there is insufficient evidence of coordinated conduct in the market. If the observed data are inconsistent the benchmark scenario, we must test them against alternative theories of coordinated conduct. Unfortunately, any elaboration of these methods is outside of the scope of this paper.

It is difficult to use econometric techniques to conclusively prove coordinated conduct. At best econometric tests for coordinated conduct should complement and not substitute hard direct evidence of an agreement. To this extent, tools such as leniency programs and dawn raids which are geared towards discovered direct evidence are more effective than the use of market data to prove coordinated conduct.

### Mergers and Acquisitions

For the purpose of economic analysis, the use of Mergers and Acquisitions (M&As) refers to a situation in which at least two hitherto distinct enterprises become a single enterprise. M&As are subject to the review of competition agencies in most countries. It is well established in economics that M&As may promote competition, retard competition as well has have no effect on competition. M&As could promote competition by, say, allowing the merging parties to exploit economies of scale. They could have an adverse effect on competition in the post-merger market if the merging parties were key rivals in the pre-merger market.

### ii. Anti-consumer Conduct

Anti-consumer conduct refers to conduct which directly reduces consumer welfare (but may not adversely affect competition). Such harm would ultimately manifest in higher prices and or reduced product choice. The list of such conduct includes (i) misleading representation; (ii) bait-and-switch and (iii) double-ticketing.

### Competition advocacy

Although competition advocacy is not an enforcement activity, it is nonetheless another important role played by competition agency. Cooper, Paulter and Zywicki (2005) defines the US FTC efforts in competition advocacy as "…the use of FTC expertise in competition, economics and consumer protection to persuade government actors at all levels of the political system and in all branches of government to design policies that further competition and consumer choice…" Competition advocacy efforts range from appearing before Parliament to render an opinion on the implication for competition enforcement of proposed legislation, to

appearing before sector regulatory boards extolling the virtues of competition. Information is an important feature of competitive markets. A lack of information serves to increase market friction/ transactions cost and hence erodes characteristic (iii) in Table 2.1 above. Competition advocacy serves to, among other things, lower the transaction costs through the dissemination of important information to the major players in the market. Advocacy is often used to lower artificial barriers to entry/ exit and thereby increase the number of competitors.

### F. TECHNICAL ECONOMIC ANALYSIS

We now describe a few of the technical analyses undertaken by economists in support of competition law investigations.

Market Definition

Considerable attention is paid by competition law enforcers to explicitly defining the market even before any assessment of competitive effects is undertaken. The gold standard for defining the relevant market is known as the Small but Significant Non-transitory Increase in Price (SSNIP) Test, which was developed by the competition authorities in the United States of America in the late twentieth century. Broadly speaking, the relevant market represents a group of goods which consumers consider to be suitable alternatives for each other. Economists have developed numerous quantitative tools of gathering objective evidence to establish the economic relationship, if any, between two or more goods. These tools are used by economists to support the cases being carried by competition lawyers.

One such empirical tool of analysis relies on the concept of cross price elasticity of demand. In economics, two goods are defined to be substitutes in demand they have a measured cross-price elasticity of demand greater than zero. That is, the goods are substitutes if an increase in the price of the first good results in an increase in the demand for the second good.[13]

Another empirical tool available to economists for the purpose of supporting a particular definition of the relevant market is *price correlation analyses* which measures the extent to which the movements in the price of the first good is associated with movements in the price of

[13] If the cross price elasticity (CPE) of demand with respect to both goods is strictly negative, then the goods are said to be complements in demand (for example bread and butter) and if the CPE is zero, the goods are said to be unrelated in demand (such as toothpaste and motor oil).

the second good. A priori, one would expect that the prices of substitutable goods would move in sync with each together. As a crude benchmark, once the price correlation analysis indicates that movement in price of the first good explains less than 80% of the movement in price of the second good, it would be difficult for the economist to support the claim that the products compete in the same market.[14]

Market Power Assessment

The technical analyses conducted by the economists in support of market power assessments are largely quantitative in nature.

In economics, market power refers to the ability of an enterprise to sell its product at a price above the competitive level for a sustained period. The extent to which enterprises exercise market power is used as an indicator of the performance of markets. Indeed, a market is said to be achieve allocative efficiency if no enterprise is able to exercise market power in that market. There is an inverse relationship between the degree of market power exercised by an enterprise and the intensity of competition faced by the enterprise. Indeed, in a competitive market firms face competition from numerous rivals to the extent that they exercise no market power whilst a monopolist who faces no competition, exercises the highest possible degree of market power. In conducting the analysis to establish the extent power exercised by the enterprise being reviewed, the economists will conduct qualitative assessments of a variety of factors which could influence the degree of competition faced from three sources: trading partners (i.e. suppliers and customers); current rivals; and future rivals.

Competition from future rivals [assessing Impediments to entry]

“Impediments to entry” refer to factors which makes it more difficult for enterprises to enter and compete in the market. It is widely regarded as the single most important factor in assessing market power. All other things held constant, enterprises in markets without impediments to entry are unlikely to be assessed as having significant market power.

[14] See a discussion on this issue at http://ec.europa.eu/competition/publications/cpn/2009_1_12.pdf (accessed October 10, 2013)

Impediments to entry have assumed such a critical role in market power assessment due to, in part, the *contestable market hypothesis* which showed that the *threat* of competition (i.e. competition from potential rivals) is almost as effective as actual competition (i.e. competition from existing rivals) in restraining market power. Examples of impediments include i) large start-up capital requirements; ii) onerous government license/ permit; iii) inadequate access to essential inputs; iv) an incumbent enterprise with a reputation for unduly driving out entrants; v) economies of scale; and vi) network effects.

Assessing competition from existing rivals [Market Concentration]

An assessment of market concentration is also heavily studied by IO economists. They measure the competitiveness of markets using a single index based on the distribution of market shares. The market concentration level by itself is an unreliable measure of the market power. All other things constant, the less concentrated the market is, the more competitive it is regarded to be and, therefore, the less likely it is that enterprises would be considered to have market power. The most popular measures of market concentration are:

- The *Herfindahl-Hirschman Index* (HHI). This index is calculated by squaring the market shares of each enterprise in the market and finding the sum of the squared shares.[15]

The HHI ranges from 0 (the case of the perfectly competitive market) to 10,000 (the case of the monopoly market structure). The following guidelines are offered to aid in the interpretation of the HHI: A market is considered to be unconcentrated if its HHH is less than 1,500; it is considered to me moderately concentrated if the HHH is between 1,500 and 2,500; a market in which the HHI exceeds 2,500 is considered to be highly concentrated.

- The *m-enterprise Concentration Ratio* (denoted CR*m*). This index is the joint market share of the enterprises with the *m* highest market shares. For example, a *4-enterprise concentration ratio* (CR4) is the joint market share of the enterprises with the four highest market shares.

[15] US Department of Justice and Federal Trade Commission (2010) "Horizontal Merger Guidelines," http://ftc.gov/os/2010/08/100819hmg.pdf (accessed October 10, 2013)

The Concentration Ratio ranges from a minimum of 0 percent (the case of the perfectly competitive market) to a maximum of 100 percent (the case of the monopoly market structure). The following guidelines are offered to aid in the interpretation of concentration ratios: A markets is considered to be unconcentrated if its concentration ratio is less than 50 percent; it is considered to me moderately concentrated if its ratio is between 50 and 80 percent; a market in the concentration ratio exceeds 80 percent is considered to be highly concentrated.

Countervailing Buyer Power [constraints imposed by consumers]
In addition to competitors, a powerful consumer, or group of consumers, could restrict the ability of enterprises to exercise market power.

### G. First Principles Approach to Economic Analysis[16]

- Defining antitrust Market(s);
- Assessing market power; and
- Assessing the likely effects of a challenged conduct;

The ultimate objective of competition law enforcement activity is to establish whether a challenged conduct is likely to allow an individual enterprise, or a group of enterprises, to exercise monopoly power and have the effect of substantially lessening competition in the relevant market(s). This underscores the prominence of three distinct but related technical analyses: (i) defining the relevant market; (ii) assessing market power; and (iii) assessing competitive effects in competition law enforcement. In support of the litigated matter, the expert economists would be required to assess the market power of the enterprise which is the subject of the investigation and the extent to which the challenged conduct is likely to have anticompetitive effects in the market.

The important lesson to be learnt in this regard is that defining the relevant market; assessing monopoly power; and assessing competitive effects are usually undertaken by

[16] This section draws heavily on a seminal paper by Steven Salop (2001), "The First Principles Approach to Antitrust, Kodak, and Antitrust at the Millennium," *Antitrust Law Journal* Vol. 68, p.188-202.

lawyers sequentially in that order, and considered three distinct tasks. You could then have a litigated matter which is decided based on arguments presented on market definition and market power assessment only. A more useful procedure, however, would be to undertake the three tasks simultaneously. In other words, no conclusion about the likely effects of any challenged conduct should be deduced without an assessment of these effects. Unless the assessments of competitive effects and market power are integrated with market definition, competition lawyers could fall into one of the following five analytical traps:

(i) The Marginal Cost Trap: Mistaking an enterprise's inability to profitably raise price above its marginal cost for an inability to exercise market power by excluding rivals.

(ii) The Cellophane Trap: Mistaking an enterprise's inability to raise prices above the current price for an inability to have already exercised market power by raising price to the current level, thereby mislabeling a completed anticompetitive conduct as a lack of market power.

(iii) The Price-Up Trap: Mistaking an enterprise's inability to profitably raise price above its current level for an inability to exercise market power by preventing a rival's conduct that would otherwise reduce price below current level, thereby mislabeling the maintenance of market power as a lack of market power.

(iv) The Threshold Test Trap: Mistaking an enterprise's inability to profitably raise price above its current level because of current competitive constraints from rivals, for an inability to exercise market power even after those rivals are excluded.

(v) The Unilateral SSNIP Trap: Mistaking an enterprise's inability to profitably raise price above its current level unilaterally for an inability to exercise market power by conduct that affects rivals' output and price responses.

**CONCLUDING REMARKS**

Competition law enforcement activity is likely to increase exponentially in CARICOM within the next five years as other member states enact competition legislation. We have seen that economics is being routinely incorporated into competition law. While competition lawyers are

not expected to carry out economic analyses, they must be able to interpret such analyses to properly marshal the requisite evidence in the Court.