Global Competition Policy

Abigail Tay and Gerald Willmann

Motivation

- Globalization creates a global market place — yet there is no global competition authority.
- It’s tempting to think that the lack of such an institution leads to too lax a policy because national authorities don’t consider international externalities.
- This is the case only if the national authorities don’t act internationally.

Motivation II

- As soon as they assume extra-territorial powers, policy can be too restritive.
- One example is the proposed merger of G.E. und Honeywell in the U.S.
- The American authority had authorized this merger, but the Europeans blocked it.

Motivation III

- Both sides had investigated the merger, and one of them ultimately took issue.
- We want to explain how this can happen, even when both authorities have the same information and the same objective.
- This also allows us to analyze how a (hypothetical) global competition authority would have ruled.

Roadmap

- Institutional Background
- Theoretical framework
- Potential for Conflict
- Different Policy Scenarios
- Further Research

Institutional Background

Two big players: the U.S. and the EU,
plus a fringe of smaller actors.

American Competition Policy:

- Two Actors: DoJ und FTC.
- Legal Basis: Clayton Act and the Hart-Scott-Rodino Antitrust Improvements Act.

Institutional Background II

- Obligation to notify mergers if:
  - one company has more than 100 mill. Dollar Revenue or Assets,
  - and the second company more than 10 mill. Dollar,
  - stake exceeds 15 mill. Dollar or 50% if total over 25 mill.

Institutional Background III

- Both have to file and pay a fee.
- Cases are allocated to the DoJ or the FTC according to their respective experience and expertise.
- After a 30 day period these can demand more information ("second request").

Institutional Background IV

- "Horizontal Merger Guidelines":
  1. relevant market — product/geographical,
  2. HHI index: 1000, 1800; or Δ of 50, 100
  3. market entry barriers,
  4. effects on competition,
  5. efficiency gains/synergies.
- Finally: Injunction or order to desist (only FTC)

Institutional Background V

EU Competition Policy:

- Legal basis: European merger guidelines from 1989, based on articles 85, 86, 89, 90 of the treaty of Rome.
- Creation of Directorate General IV Competition, in addition to national authorities.

Institutional Background VI

- Criteria for the commission to take a case:
  - combined world-wide turnover exceeds 5 billion Euro
  - community-wide turnover exceeds 250 million Euro,
  - not more than 2/3 of each from a single country.

Institutional Background VII

- Notification and second request as in the U.S.
- Substantive test focuses on potential dominance.
- orders have to be appealed before the European Court of Justice.

Institutioneller Hintergrund VIII

- Reforms under Mario Monti:
  - retain dominance vs. SLC
  - more consideration for merging parties and consumers
  - extend economic expertise
  - clear best practice rules
  - flexible timing
  - more scope for referral of cases between EU and national authorities

Institutional Background IX

International cooperation:

- OECD global forum: mainly talk
- Global Comp Network: technical assistance
- bilateral agreements of US w/ other countries
- cooperation between US and EU
  - information sharing, if companies agree
  - coordination of timing
  - convergence of objectives

Our Modelling Framework

Consider a horizontal merger in a particular market. We can distinguish 3 groups of market participants:

- merging companies or insiders (two in most cases)
- other suppliers or outsiders
- “consumers”

The total effect of the merger can thus be decomposed into 3 parts: Π_{in}, Π_{out}, and CS

Modelling Framework II

According to the literature, the competition authority's objective function could depend on:

- CS only
- the external effect
- mainly profits
- plain welfare

We do not take a stand and leave this to the data.

Modelling Framework III

In a global context, the merger potentially affects many countries.

There are 2 additional aspects to consider:

- country where transaction takes place (if markets are segmented),
- country of residence of the agents involved.

Modelling Framework IV

We denote the share of a surplus that arises in country j by s^j_{in}, s^j_{out}, and s^j_{cs} (s for source). Re the 2nd aspect, we denote the share of a surplus that accrues to residents of country j by d^j_{in}, d^j_{out}, and d^j_{cs} (d for destination). The two competition authorities have the following general objective functions:

$$F^j(\Pi_{in}, \Pi_{out}, CS; S^j) \qquad j = EU, US$$

Modelling Framework V

As an example, consider national welfare maximization:

$$F^j = d^j_{in}\Pi_{in} + d^j_{out}\Pi_{out} + d^j_{cs}CS$$

the source of a surplus becomes important if there are taxes, spill-overs, unemployment ...

Conflict of Interest

There are two potential sources for disagreement:

- The objective functions of the U.S. and EU authorities could be different,
- but even with identical objectives there is scope for conflict because the shares (S^j und D^j bzw. S^{-j} und D^{-j}) enter with opposite signs.

Conflict of Interest II

- profits from domestic and foreign market might be weighted differently for tax, employment, or other reasons.
- surpluses of domestic and foreign agents are weighted differently

We will analyze how these conflicts play out under different policy regimes.

Different Policy Regimes

We consider four possible regimes:

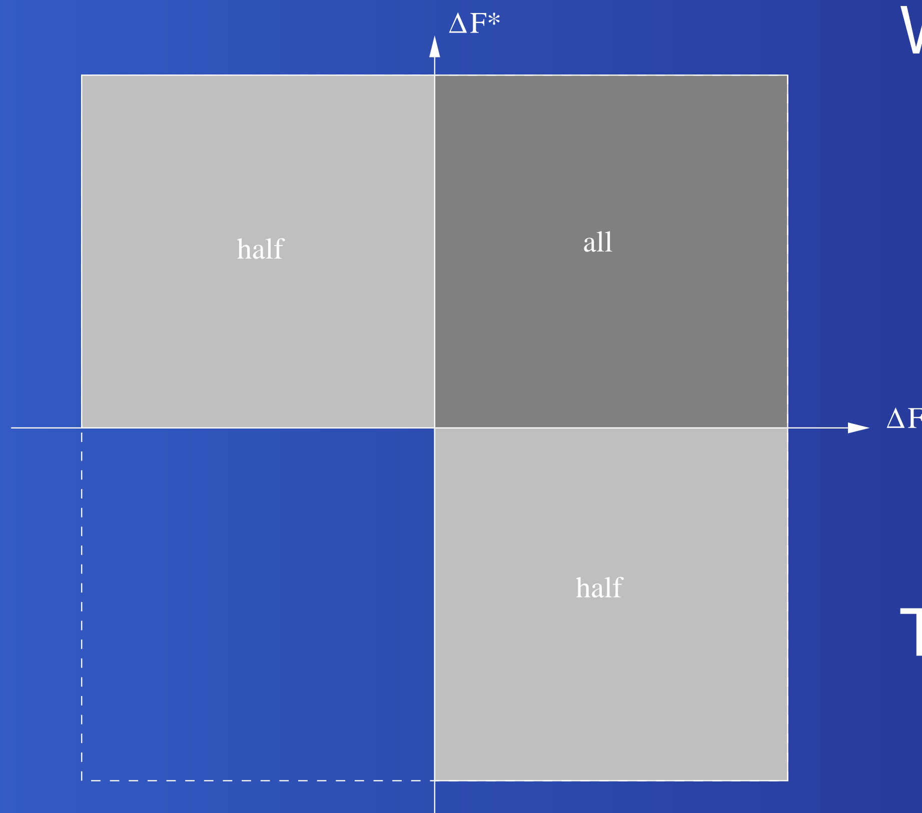
1. territoriality principle
2. extra-territorial powers
3. global authority
4. territoriality vs extra-territorial

Different Policy Regimes II

Our way of formalizing mergers:

- Let us consider possible mergers of the form $(\Delta F, \Delta F^*)$
- distributed uniformly over the square $[-1, 1]^2$.
- Suppose that half of them fall under the territorial jurisdiction of each country.

Territoriality Principle



Welfare per country:

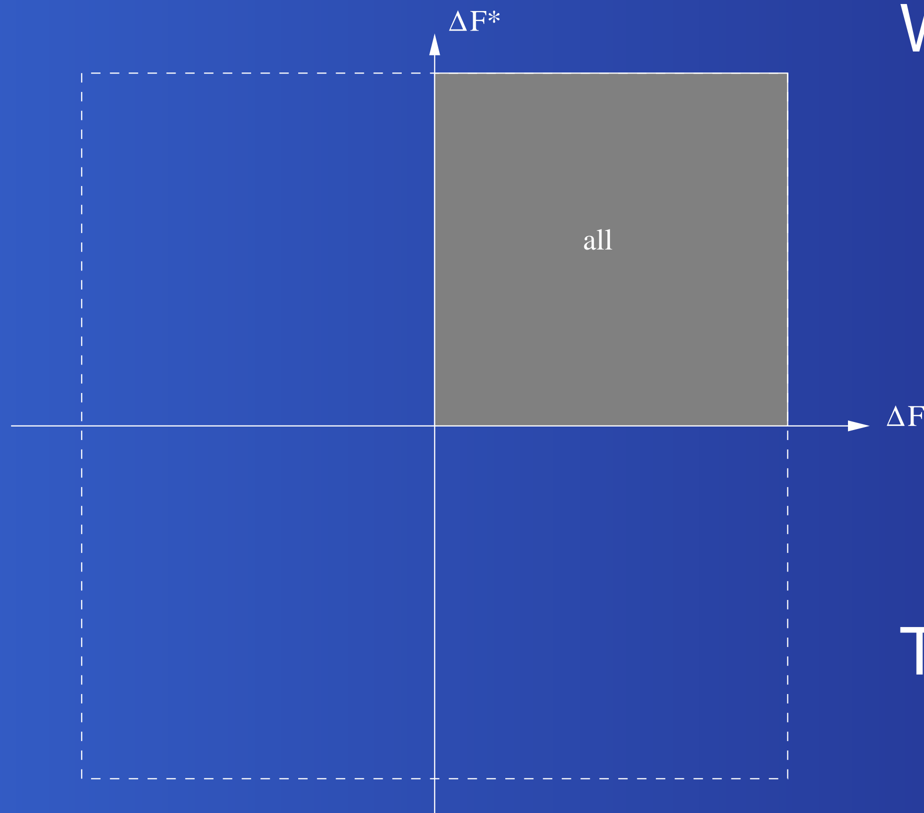
$$E(\Delta F) = E(\Delta F^*) =$$

$$1/8 + 1/16 - 1/16 = 1/8$$

Total Welfare:

$$E(\Delta F + \Delta F^*) = 1/4$$

Extra-territorial Powers



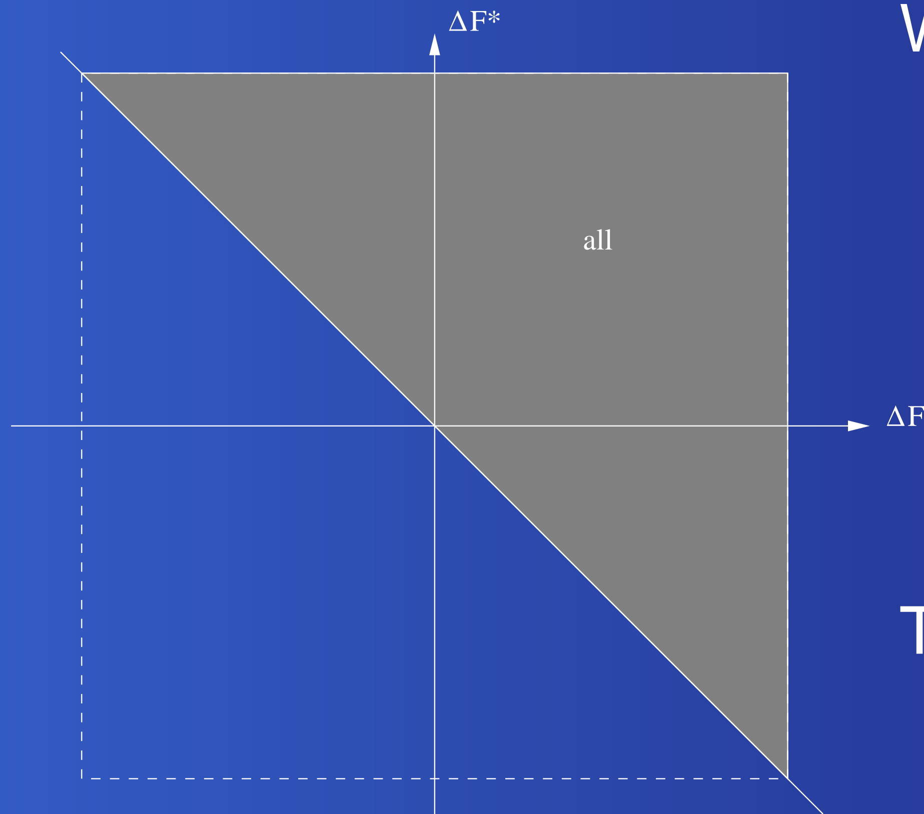
Welfare per country:

$$E(\Delta F) = E(\Delta F^*) = 1/8$$

Total Welfare:

$$E(\Delta F + \Delta F^*) = 1/4$$

Global Authority



Welfare per country:

$$E(\Delta F) = E(\Delta F^*) =$$

$$1/8 + 1/12 - 1/24 = 1/6$$

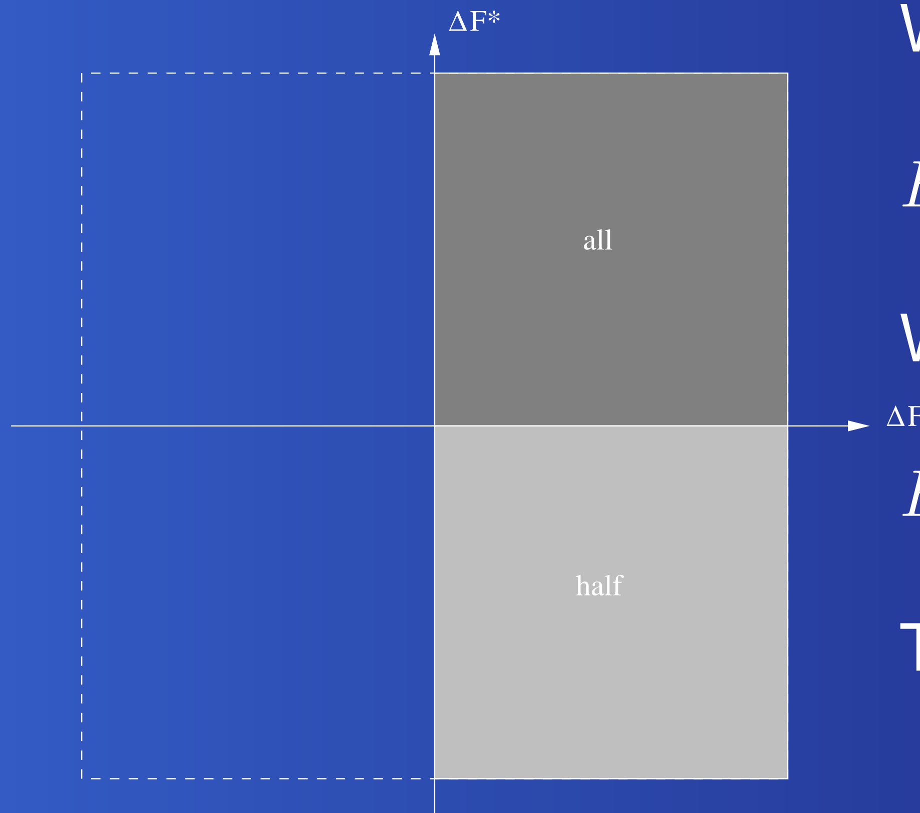
Total Welfare:

$$E(\Delta F + \Delta F^*) = 1/3 > 1/4$$

What have we learnt

- territoriality as well as extra-territorial powers give rise to the same welfare levels
- both are suboptimal
- a global authority is first best and leads to strict welfare gains
- territoriality implies a suboptimally lax global competition policy
- extra-territorial powers a suboptimally strict global competition policy

Territoriality vs Extra-territorial



Welfare at home:

$$E(\Delta F) = 1/8 + 1/16 = 3/16 > 1/6$$

Welfare abroad:

$$E(\Delta F^*) = 1/8 - 1/16 = 1/16 < 1/$$

Total Welfare:

$$E(\Delta F + \Delta F^*) = 1/4$$

Conclusions

- asymmetric case: extra-territorial power dominates territoriality
- neither heavy-weight happy about the other assuming extra-territorial power
- gains from global authority distributed unevenly
- EU and US would prefer cooperation only among themselves