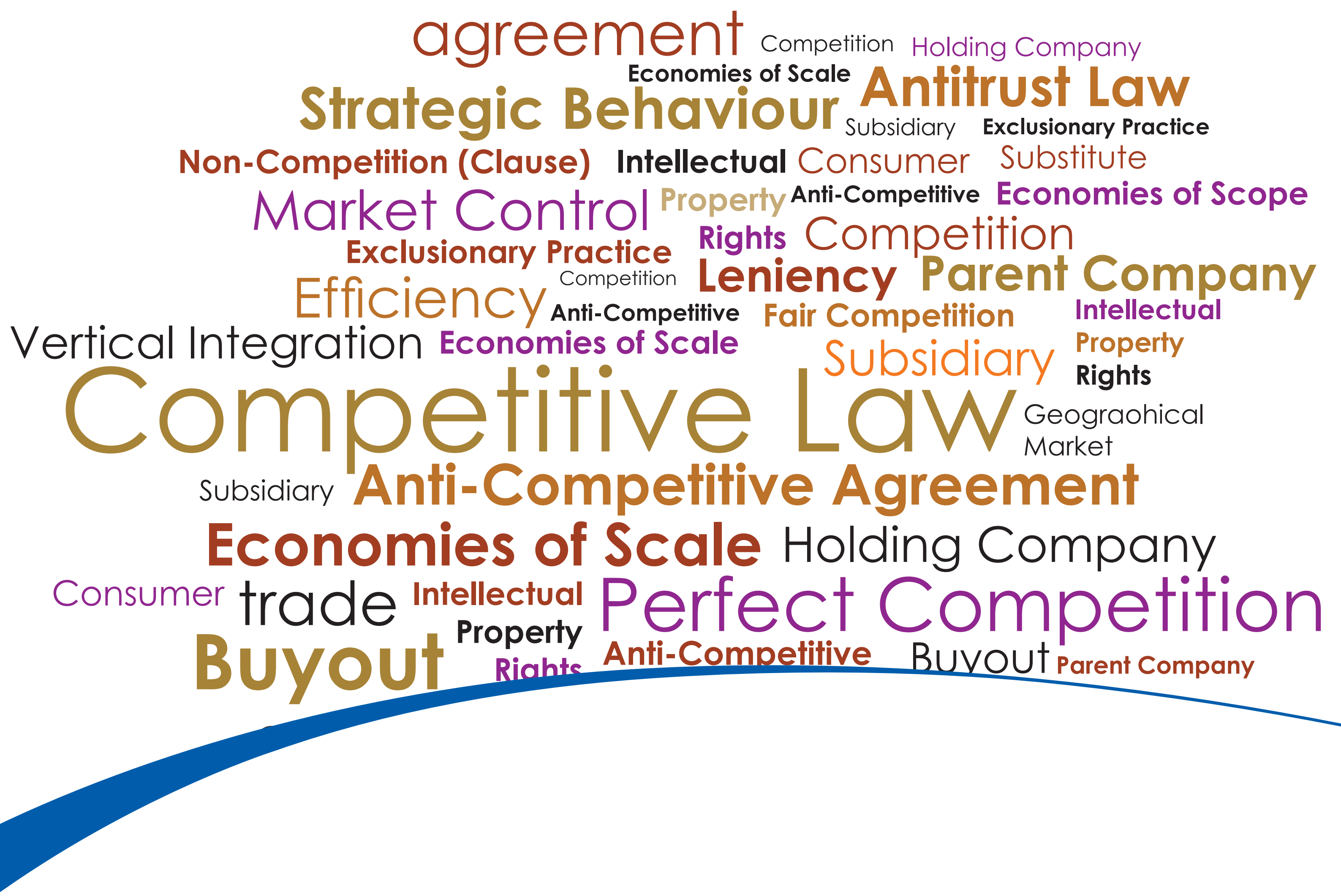

ANNEX IV

Glossary of Competition Law Terminologies for ASEAN

@ ASEAN, November 2017

A

Abuse of Bargaining Position

Anti-competitive practices which a firm with an upper-hand (superior) position may use its position to improperly exploit consumers (competitor or end-consumer) in order to maintain or increase its position in the market.

Abuse of Dominant Position

A dominant firm may use its substantial market power to stop efficient competitors from entering a market, to drive existing efficient competitors out of the market o or to charge a high price. Using substantial market power to stop new entry or to drive competitors out of business is called exclusionary conduct. Using substantial market power to prevent competition that allows the dominant firm to charge higher prices is called exploitative conduct. In Europe and in countries that follow the European competition law exclusionary and exploitative conduct by a firm with substantial market power is called abuse of a dominant position. Exclusionary conduct in the United States is called monopolisation.

In developed competition law jurisdictions, economics determines what is abusive conduct. For example, the following kinds of exclusionary practices have been found to be abusive conduct: price discrimination, predatory pricing, price squeezing by vertically integrated firms, refusals to deal or sell, tied selling. **See Anti-competitive practices**.

Absolute Teritorrial Protection

Practice by manufacturers or suppliers relating to the resale of their products and leading to a separation of markets or territories. Under absolute territorial protection, a single distributor obtains the rights from a manufacturer to market a product in a certain territory and other distributors are prohibited to sell actively or passively into this territory. (Definition by European Commission).

Acquisition

Refers to obtaining ownership and control by one firm, in whole or in part, of another firm or business entity. As distinct from a **merger**, an acquisition does not necessarily entail *amalgamation* or **consolidation** of the firms. An acquisition, even when there is complete change in control, may lead the firms involved to continue to operate as separate entities. Nevertheless, joint control implies joint profit maximization and is a potential source of concern to antitrust authorities. See also **Takeover**.

Agreement (to lessen or restrict competition)

Agreement refers to an explicit or implicit arrangement between firms normally in competition with each other to their mutual benefit. Agreements to restrict competition may cover such matters as prices, production, markets and customers. These types of agreements are often equated with the formation of **cartels** or **collusion** and in most jurisdictions are treated as violations of competition legislation because of their effect of increasing prices, restricting output and other adverse economic consequences.

Agreements may be arrived at in an extensive formal manner, and their terms and conditions are explicitly written down by the parties involved; or they may be implicit, and their boundaries are nevertheless understood and observed by convention among the different members. An explicit agreement may not necessarily be an "overt" agreement, that is one which can be openly observed by those not party to the agreement. Indeed, most agreements which give rise to **anticompetitive practices** tend to be covert arrangements that are not easily detected by competition authorities.

Not all agreements between firms are necessarily harmful of competition or proscribed by competition laws. In several countries, competition legislation provides exemptions for certain cooperative arrangements between firms which may facilitate efficiency and dynamic change in the marketplace. For example, agreements between firms may be permitted to develop uniform product standards in order to promote **economies of scale**, increased use of the product and diffusion of technology. Similarly, firms may be allowed to engage in cooperative research and development (R&D), exchange statistics or form **joint ventures** to share risks and pool capital in large industrial projects. These exemptions, however, are generally granted with the proviso that the agreement or arrangement does not form the basis for **price fixing** or other practices restrictive of competition.

Anti-Competitive Agreement

Anti-competitive agreement refers to an explicit or implicit arrangement between firms, normally in competition with each other, which prevents entry by new firms, raises price or restricts output. Agreements to restrict competition may cover such matters as collectively setting prices, introducing production quotas which has the effect of increasing prices or dividing markets geographically or by customers. Anti-competitive agreements violate competition law because they increase prices to business and final consumers directly, or indirectly by restricting output.

Agreements may be formal, with their terms and conditions explicitly written down in a contract between the parties involved or informal through a verbal agreement. Agreements may also be implicit where there is no formal communication between them at all. For example, anti-competitive practices by customs where competitors understand the terms of the agreement through convention and practices in the market. Alternatively, competitors in a market learn how other competitors react to changes in price which results in higher prices even though there is no communication between them. Agreements, whether formal, informal or implicit are usually secret and so not easily detected by competition authorities.

Not all anti-competitive agreements are prohibited by competition laws. Some countries allow for exemptions for anti-competitive agreements which provide benefits greater than the anti-competitive effect. Benefits can include improving firm efficiency or promoting technological change which benefits consumers either in the short or long-term. For example, agreements between firms to develop uniform product standards that benefit consumers or agreements that allow faster diffusion of new technology may be permitted by competition authorities because the benefits are greater than the anti-competitive impact. Similarly, competing firms may be allowed to engage in cooperative research and development (R&D), to exchange statistics on past sales or to form joint ventures to share risks and pool capital in large industrial projects. These exemptions, however, are generally granted on the condition that the agreements are the least restrictive way of achieving those benefits.

Anti-Competitive Practices

This refers to a wide range of business practices in which either a single firm or a group of firms act in ways which restrict competition. Restricting competition leads to higher prices and less production or output in the market.

In a competitive market firm try to beat competitors by offering lower prices (due to being more efficient in production) or by offering better quality products. Anti-competitive practices artificially limit competition resulting in higher prices and lower quality products.

Many competition law jurisdictions make a distinction between anti-competitive practices which are per se illegal those which are examined under a rule of reason. Under a per se rule the conduct is presumed to be illegal without examining the actual effects in a particular case. Under a rule of reason the effect of the conduct on competition (e.g. whether the conduct leads to higher prices or lower output) is examined. For example, resale price maintenance is usually per se illegal in most countries but exclusive dealing is usually subject to a rule of reason.

Anti-competitive practices can be are broadly divided into horizontal and vertical restraints on competition. Anti-competitive horizontal restraints are between firms that operate at the same level in the production chain (e.g. between manufacturers or between wholesalers or between retailers). They include price-fixing between competitors (in a cartel) and a merger between competitors. Vertical restraints are between sellers and buyers (i.e. at different levels of the production chain).

This can include a seller signing an exclusive dealing contract with a buyer or only allowing the buyer to resell within a particular geographic area, market restrictions, resale price maintenance and tied selling. Economists generally believe horizontal restrictions to have a greater impact on competition than vertical restrictions. Sometimes the difference between horizontal and vertical restraints on competition is not always clear. For example competitors in the same market may agree to place restrictions in a downstream market.

Antitrust Law

Antitrust law refers to laws dealing with monopoly and monopolistic practices. The terms antitrust law and antitrust policy are used mainly in the United States. In most other countries the terms competition law or policy are used. Some countries also use the terms Fair Trading or Antimonopoly law.

The economic basis for antitrust economics or policy is the *industrial organization* specialisation in economics which looks at the conduct of firms operating in different market structures (from monopoly to many competitors) and the effect this has on economic performance.

B

Barriers to Entry

Barriers to entry are factors, which prevent or deter the entry of new firms into a market. Entry barriers limit competition. There are three broad classes of barriers: legal (where governments restrict entry into a market (to protect state-owned enterprises, for example), economic (which refer to cost conditions that impede entry) and behavioural barriers to entry (where a dominant firm acts to prevent new entry).

Economic barriers to entry arise from basic market characteristics such as technology, costs and demand. There is some debate over what factors constitute structural barriers that are relevant to competition law. The widest definition is given by Bain who argues that barriers to entry include the following: product differentiation, absolute cost advantages of incumbents, and economies of scale. Product differentiation makes it harder for new entrants because entrants must overcome the existing, accumulated, brand loyalty of existing products (not all economists see this as something competition law should worry about because existing firms have spent considerable money to gain loyal customers). Incumbent absolute cost advantages mean that the entrant will face higher costs at every rate of output than the incumbent. Higher costs could result from new entrant having higher input costs. Scale economies mean that bigger firms have lower costs. Because an incumbent firm has had time to grow and achieve lower costs because of economies of scale, potential new entrants may decide not to enter because it takes time to achieve the same costs of incumbents.

Strategic entry deterrence involves some kind of pre-emptive behaviour by incumbents. One example is where an incumbent over-invests in existing capacity in order to *signal* to new entrants that it has the capacity to expand production and charge low prices to drive the new entrant out of business. Another is the artificial creation of new brands and products in a market in order to limit the size of a new entrants part of the market. There is considerable debate among economists about the importance of strategic entry deterrence.

It should also be noted that probably the most important source of entry barriers can be the government restricting entry into markets by licensing and other regulations.

Bid Rigging

Bid rigging is a form of price-fixing. Here, firms agree on who will win the bid for government and non-government contracts, with the same effect as the firms agreeing on the price. There are a number of ways in which tenders can bee rigged. For example, firms agree on which firm will offer the lowest price. The firms then take turns to win contracts. Bid rigging is one of the most widely prosecuted forms of collusion.

Bilateral Monopoly/Oligopoly

A situation where there is a single (or few) buyer(s) and seller(s) of a given product in a **market.** The level of **concentration** in the sale of purchase of the product results in a mutual inter-dependence between the seller(s) and buyer(s). Under certain circumstances the buyer(s) can exercise countervailing power to constrain the **market pow**er of a single or few large sellers in the **market** and result in greater output and lower prices than would prevail under **monopoly** or **oligopoly**. This would particularly be the case when: the "upstream" supply of the product is elastic, i.e. fairly responsive to price changes and not subject to production bottlenecks; the buyers can substantially influence downwards the prices of monopolistic sellers because of the size of their purchases; and the buyers themselves are faced with price competition in the "downstream" markets (see **vertical integration** for discussion of terms upstream-downstream). Such a situation is particularly likely in the case of purchase of an intermediate product. However, if the supply of the product upstream is restricted and there is no effective competition downstream, the bilateral monopoly/oligopoly may result in joint profit maximization between sellers-buyers to the detriment of consumers.

Block Exemption

The Block Exemption Regulation is an exemption in a business line or industry, which debars organizations in the industry from some business activities in order to create competition. The regulation issued by the European Commission, specifying the conditions under which certain types of agreements are exempted from the prohibition on restrictive agreements. When an agreement fulfils the conditions set out in a block exemption regulation, individual notification of that agreement is not necessary: the agreement is automatically valid and enforceable.

These block exemption regulations are particularly useful for small and medium enterprises (SMEs) and were in many respects specifically designed for their benefit.

Bundling

Bundling is related to the concept of **tied selling**. For example, a car manufacturer may offer a complete package including automatic transmission, radio and air conditioning because consumers on average want them and because the final price to the consumer is lower than if all the different products were supplied or bought separately. However, bundling may be anticompetitive if it makes it difficult for a new firm to enter any of these different product markets. For example, a car air-conditioning firm may not be able to enter if existing car manufacturers have long-term contracts with existing car air-conditioning firms. The competition implications of bundling, including that of tied selling generally, are complex and need to be evaluated on a case by case basis adopting a rule of reason approach. See also **Tied Selling**.

Buyout

Refers to a situation where the existing owners of a firm are "bought out" by another group, usually management and/or workers of that firm. A buyout may be for the whole firm or a division or a plant as the case applies. The financing of the buyout can be structured in various ways such as bank loans or through the issuance of bonds. In a leveraged buyout for example, a fairly large proportion of debt in relation to the asset value of the firm is incurred. Because buyouts lead to replacing publicly traded equity with debt (in the form of bonds backed by assets and other guarantees) the firms are often viewed as "going private" since its shares may no longer be listed on the stock exchange. Buyouts are viewed as an integral part of the market for corporate control and the re-deployment of assets from lower to higher valued uses.

C

Cartel

A cartel is an agreement between firms in a market to set prices or the amount of market output, allocate customers or geographic areas between them, engage in bid-rigging, divide profits etc. Cartels try to maximise cartel profits in the same way that a monopolist restricts market output, or raises or fixes prices in order to earn higher profits.

Some cartels are controlled by governments. Here, the government may establish and enforce rules relating to prices, output and other such matters. Some cartels may be exempted from, or not covered by, competition laws. Normally competition law only prohibits anti-competitive conduct that had an adverse on competition and prices in the home country. Export cartels may be exempted from competition law or be outside a country's competition law because the effect (e.g. higher prices) only affects consumers overseas.

In some countries, depression cartels have been permitted in industries where governments feel price and production stability is important or to allow the rationalization of the industry and reduction in excess capacity during economic downturns. In Japan for example, such arrangements have been permitted in the steel, aluminium smelting, ship building and various chemical industries. Cartels were also permitted in the United States during the depression in the 1930s and continued to exist for some time after World War II in industries such as coal mining and oil production. Cartels have also played an extensive role in the German economy during the inter-war period. International commodity agreements covering products such as coffee, sugar, tin and oil (i.e. OPEC – the Organization of Petroleum Exporting Countries) are examples of international cartels between different national governments and so outside any country's competition laws.

Collusion

Collusion refers to either formal or informal agreements between sellers to raise or fix prices or to reduce output in order to increase joint profits. Normally the term cartel refers to a formal agreement. However, collusion does not necessarily require a formal agreement and can occur informally where a 'wink' or 'nod' or simply following a *market leader* occurs. However, the economic effects of formal and informal collusion are the same and often the terms are used interchangeably.

Collusion between firms to raise or fix prices and reduce output are viewed by most authorities as the single most serious violation of competition laws. Collusion is usually easier when there are a few sellers who sell homogenous products. This happens because it is easier to get agreement on a single product if there are only a few sellers involved but it is also easier to monitor each other member of the agreement if there are only a few sellers. A cartel is more difficult to form and maintain if there is a large number of members selling different products. However, price fixing as also been found in the sale of complex products with a large number of members. An example is the electrical equipment industry in the United States which involved 29 different companies selling diverse technical products such as turbine generators, transformers, switch gears, insulators, controls and condensers. Similarly, through agreement on product specification details and standards, American steel producers were able to collude successfully for some time.

Combination

In the parlance of competition law and policy, the term combination refers to firms organized together to form a **monopoly, cartel** or **agreement** to raise or fix prices and restrict output in order to earn higher profits. This term has been interchangeably used with **conspiracy** and **collusion** as well.

Competition

Competition exists when sellers in a market *independently* try to win customers from other sellers through lower prices, better quality products or service. Competition here means *rivalry* between two or more firms.

Competition forces firms to be internally efficient ***(productive efficiency)*** and at least to match the price and quality of products offered by other firms. Competition, by ensuring the best prices are offered at the lowest possible price, ensures that consumer welfare is maximised and that a country's resources are allocated to their best uses ***(allocative efficiency)***. Competition also ensures that firms innovate to the extent that consumers want by developing better products and production methods – called ***dynamic efficiency.***

Competition law

A competition law is a law that promotes or maintains healthy market competition by stopping anti-competitive conduct. Usually, a competition law has three main elements:

(1) prohibiting agreements or practices (such as price-fixing) that restrict competition in markets.

(2) banning abusive conduct by a firm that has substantial market power (i.e. is dominant). Abusive conduct may include predatory pricing, tying, price gouging, refusing to deal and many others;

(3) controlling mergers and acquisitions, including some joint ventures, that are likely to reduce market competition in the future (because the merger etc leads to a firm with substantial market power or creates conditions that make it easier to collude).

Mergers can be prohibited altogether, or approved subject to conditions such as an obligation to divest part of the merged business or to offer licenses or access to facilities to enable other businesses to continue competing.

Competition policy

Competition policy means any government policy aimed at increasing competition. Competition policy covers trade policies (lower tariffs mean more competition from overseas), privatisation policies (privatising government monopolies and allowing for private sector competition) and reducing licensing requirements (which allows more firms into the market) as well as competition law (which regulates competitor conduct). So competition policy is a broader concept than competition law.

Concentration

Market Concentration (also often referred to as *seller concentration*) measures the size distribution of firms in a market. Economic theory suggests that, other things being equal, higher levels of market concentration are more likely to lead to anti-competitive conduct. Market concentration is used as a possible indicator of market power.

Concentration Indexes

Various concentration indexes are used to describe market structure (the size distribution of firms) as a prima facie indicator of market power in a market. Essentially, concentration indexes attempt to measure the number and relative size of firms. The most frequently used measures are:

- *Market Concentration Ratio*: The percentage of total industry output (or other such measure of economic activity, e.g., sales revenue, employment) accounted for by a given number of the largest firms in a particular market. For example, the four-firm concentration ratio (CR_4) measures the proportion of total market output accounted for by the four largest firms. Similarly, CR_3, CR_5, CR_8, etc may be computed. However, concentration ratios may not adequately reflect the level of competition in a market. For example, two markets with the same CR_4 levels of 75 percent may differ considerably if in one market the remaining 25% is held by one firm but in the other there are 25 firms with 1% each.
- *Herfindahl-Hirschman Index* (HHI): This measure takes account of the total number and size distribution of firms in the market. It is computed as the sum of the square of the relative size of all firms in the market. Algebraically it is:

$$\mathbf{HHI} = \sum_{i=1}^{n} (\mathbf{S}_i)^2 \quad ; \quad \textbf{where} \sum_{i=1}^{n} \mathbf{S}_i = 1$$

$\mathbf{S}_i$ is the relative output (or other measures of economic activity such as sales or capacity) of the $\mathbf{i}^{\text{th}}$ firm, and **n** is the total number of firms in the industry.

In a market with only one firm (monopoly), the HHI measure will be equal to 1. In a duopoly with two equal sized firms, the HHI measure will be:

$$(0.5)^2 + (0.5)^2 = 0.50$$

The index is used by many competition authorities. For example, the United States Department of Justice Antitrust Division uses the HHI in its Merger Guidelines to screen mergers that may warrant further examination for their effects on competition. The HHI has several mathematical and economic theoretic properties which make it a desirable concentration measure.

Conglomerate

A firm or business enterprise having different economic activities in different unrelated markets. Competition law may be concerned that conglomerates may be able to act anti-competitively by subsidising a member of the group to price below cost to drive out competitors. See also **Merger**.

Consolidation

Generally refers to combination or *amalgamation* of two or more firms into one new firm through the transfer of net assets. The new firm may be specially organized to distinguish it from a merger.

Conspiracy

Normally a covert or secret arrangement between competing firms in order to earn higher profits by entering into an **agreement** to fix prices and restrict output. The terms **combination, conspiracy, agreement** and **collusion** are often used interchangeably. For further details see discussion under these headings.

Consumers' Surplus

Consumers' surplus is a measure of consumer welfare. It is defined as the difference between what consumers are willing to pay for a product less the amount they actually have to pay.

In the diagram below, the market demand curve for good X is drawn as AC. At price = P0, Q0 units of X are purchased by consumers. However, given the demand curve, there are some consumers who would be prepared to pay a higher price for X. These consumers receive a benefit from the fact that they actually pay only P0. The dollar value of the benefit to all such consumers is given by the area of the triangle P0AB which is the dollar measure of consumers' surplus.

Consumer Welfare

Consumer welfare refers to the individual benefits derived from the consumption of goods and services. In theory, individual welfare is defined by an individual's own assessment of his/her satisfaction, given prices and income. Exact measurement of consumer welfare therefore requires information about individual preferences.

In practice, applied welfare economics uses the notion of consumer surplus to measure consumer welfare. When measured over all consumers, **consumers' surplus** is a measure of aggregate consumer welfare. In anti-trust applications, some argue that the goal is to maximize consumers' surplus, while others argue that producer benefits should also be counted. See **Consumers' Surplus, Deadweight Welfare Loss.**

Consumer Protection Policy

Consumer protection policy is a body of legal rules enforced to ensure that consumers can make well-informed decisions about their choices and that sellers will fulfil their promises about the products they offer. In other words, consumer protection policy prevents producers from engaging in unfair practices while seeking to increase their sales.

Contestability / Contestable Market

A contestable market is a theoretical market where the following conditions are satisfied:

a) there are no barriers to entry or exit;

b) all firms, both incumbent and potential entrants, have access to the same production technology;

c) all consumers and firms have perfect information on prices;

d) entrants can enter and exit before incumbents can adjust prices.

While similar to the theoretical model of **perfect competition**, the difference is that while perfectly competitive markets have large numbers of firms, a contestable market may have any number of firms (including only one or a few) and these firms need not be price-takers. The analysis of contestable markets is designed for cases iwhere market conditions (such as the existence of scale economies) precludes a large number of competitors.

Contestable markets theory suggests that economic efficiency is possible even in a market consisting of one or a few firms. The basic idea is that incumbent firms will maintain prices close to the competitive level because of the threat posed by potential entrants. If incumbents raise price, entry will occur (because there are no **barriers to entry**), and the entrants will be able to produce as efficiently as incumbents (same access to technology). Moreover, if price declines as a result of the entry, the entrant will be able to exit the industry quickly and costlessly (there are no barriers to exit). This is known as "hit and run" entry. It is the fear of "hit and run" entry which motivates even a monopolist to maintain prices close to average cost.

Control of Enterprises

A shareholder (or group of shareholders) with more than 50% of the shares of a firm can exercise control over the firm. However, "effective control" may be exercised with less than 50% share ownership. It may be possible to control a firm with 20% share ownership when the remaining shares are widely held by many small investors who do not vote at firm general meetings. Control of enterprises may also be exercised through interlocking directorates and inter-corporate ownership links between firms as happens in **conglomerates**.

Costs

Costs may be fixed or variable. Fixed costs are costs that must be paid even if nothing is produced. Examples are interest on debt, property taxes and rent. Variable costs are costs that vary with the amount produced. Examples are materials, fuel, labour and maintenance. As the relevant time period is extended, more costs become variable.

Total costs refer to the sum of fixed and variable costs. Average costs refer to total costs divided by output. *Marginal cost* is the addition to total cost that results from producing an additional unit of output. Marginal cost is a function of variable costs alone, since fixed costs do not change as output increases.

Marginal cost has a particular importance in economic theory. In theory, the profit maximizing firms will maximise profits by producing the output where marginal cost equals marginal revenue. In practice, determining marginal costs and revenues are difficult and average costs and revenues may be used instead.

D

Deadweight Welfare Loss

The deadweight welfare loss is the dollar value of consumers' surplus lost (but not transferred to producers) as a consequence of a price increase. Consider the following diagram:

It is assumed that the industry is originally in a state of **perfect competition**, such that price equals marginal cost (Pc = MC), where the latter is assumed to be constant (constant returns to scale). Market output is therefore Qc and consumers' surplus is triangle PcAC. Now compare this with the situation where the market is controlled by a monopolist. The monopoly price (Pm) exceeds marginal costs. Market output is now reduced to Qm and **consumers' surplus** is PmAB, a reduction of PcPmBC. However, a portion of the lost consumer surplus, PcPmBD, is transferred to producers in the form of additional profits, referred to as producers' surplus (PcPmBE). The remainder, the triangle BCE, is referred to as a deadweight welfare loss and is a measure of lost **allocative efficiency** i.e. the loss of benefits in the economy due to the presence of a monopoly rather than competition.

Deconcentration

A policy of breaking up and divesting operations of large firms in order to reduce the degree of concentration in an industry. This policy has been advocated from time to time in different countries particularly in periods of high levels of merger activity. Lower industry concentration levels and increase in the number of firms are viewed as being conducive to stimulating competition. There are however inherent risks in adopting this policy as a general approach to resolving competition problems that may be associated with high industry concentration levels. A structural deconcentration policy may result in significant loss in economic efficiency. Large firms may be large because of economies of scale, superior technology and innovation which may not be divisible without high costs. This is more likely to be the case where firms have attained their respective size in response to market conditions and opportunities. However, in several countries, particularly in Eastern European economies, growth of industrial concentration and large firm size have been encouraged by deliberate government policy. Deconcentration policies in such an environment may be appropriate in order to promote market oriented firm behaviour and efficiency.

Diversification

The term refers to the expansion of an existing firm into another product line or market. Diversification may be related or unrelated. Related diversification occurs when the firm expands into similar product lines. For example, an automobile manufacturer may engage in production of passenger vehicles and light trucks. Unrelated diversification takes place when the products are very different from each other, for example a food processing firm manufacturing leather footwear as well. Diversification may arise for a variety of reasons: to take advantage of complementarities in production and existing technology; to exploit economies of scope; to reduce exposure to risk; to stabilize earnings and overcome cyclical business conditions; etc. There is mounting evidence that related diversification may be more profitable than unrelated diversification.

Divestiture

Refers to firms selling part of their current operations, divisions or subsidiaries. Divestiture may take place as a result of firms restructuring their business in order to concentrate on certain products or markets. It may also be imposed upon them by competition authorities as a result of a merger or acquisition which is likely to reduce competition substantially. Divestiture under these latter circumstances is aimed at maintaining existing competition in the market. Divestiture may also form a part of a policy to deconcentrate an industry.

Dominant Firm

A dominant firm is one which has some control over a market e.g. influences or controls the price, the quality of products and the way business is conducted. Competition authorities often use market share as a proxy for market power. In some jurisdictions there is a presumption that a firm is dominant if it has a **market share** of more than 40 per cent. In other jurisdictions the presumption arises when the market share is more than 60%. The competition law concern is that dominant firms have market power i.e. the power to set prices independently.

Like a monopolist, a dominant firm faces a downward sloping demand curve. However, unlike the monopolist, the dominant firm must take into account competitors in making its price/output decisions.

Dumping in Overseas Markets

This is the practice of selling products abroad at prices below prices in the home market. This price discrimination could also be **predatory pricing** if the price in the overseas market is below the cost of production in the home market. Economists argue that pricing lower in overseas markets benefits consumers in the overseas market and should be allowed as long as the price is above the exporter's production and selling costs.

Under the General Agreement on Tariffs and Trade (GATT) rules, dumping is discouraged and firms may apply to their respective government to impose tariffs and other measures to obtain competitive relief. As in the case of **predatory pricing** or selling below costs (see discussion under these headings).

Duopoly

A duopoly is a market consisting of two sellers.

E

Economies of Scale

Economies of scale occur when the average cost or production goes down as the size of the production plant or firm gets bigger. When the minimum average cost is reached, the size of plant or firm is called the minimum efficient scale (MES). At some point after MES average costs will start to increase (called diseconomies of scale) or stay the same (called constant returns to scale).

If market demand is small relative to MES then only a few firms can compete efficiently and so competition law problems may arise.

Economies of Scope

Economies of scope exist when it is cheaper to produce two products together (joint production) than to produce them separately. For example, it may be less costly to provide air service from point A to points B and C with one aircraft than to have two separate air flights from A to B and then another flight to C.

While factors such as technology may explain economies of scope, of particular importance is the presence of common input(s) and/or complementarities in production.

Effect Doctrine

According to this doctrine, domestic competition laws are applicable to foreign firms - but also to domestic firms located outside the state's territory, when their behaviour or transactions produce an "effect" within the domestic territory. The "nationality" of firms is irrelevant for the purposes of antitrust enforcement and the effects doctrine covers all firms irrespective of their nationality.

The "effects doctrine" was embraced by the Court of First Instance in Gencor when stating that the application of the Merger Regulation to a merger between companies located outside EU territory "is justified under public international law when it is foreseeable that a proposed concentration will have an immediate and substantial effect in the Community."

Efficiency

The term in economics refers to three kinds of efficiency:

1. Productive or internal efficiency within the firm.
2. Allocative efficiency which refers to the efficient allocation of scarce resources (the allocation that maximises the value of those resources).
3. Dynamic efficiency which refers to the efficient use of resources over time.

Economists agree that competition promotes all three kinds of efficiency. Competition forces firms to be internally efficient otherwise they go out of business. Firms competing with each other force price down to cost which ensures allocative efficiency. Competition ensures that firms engage in innovation to improve products and production processes that give consumers what they want over time.

Elasticity of Demand (Price)

The price elasticity of demand measures how demand changes as price changes. If price increases by 1 per cent and demand decreases by 50 per cent then demand is *elastic*. Consumers are sensitive to price and, importantly for competition law, it means consumers are willing to switch to other products. This means sellers do not have market power (the ability to control price).

On the other hand, if price increases by 1 per cent and demand decreases by only 0.5 per cent then consumers do not have other choices - they must buy the product. In this case demand is *inelastic* and so sellers have considerable control over the price because they do not lose many sales if they increase price.

Technically, price-elasticity of demand is defined as the percentage change in quantity demanded divided by the percentage change in price. Since the demand curve is normally downward sloping, the price elasticity of demand is usually a negative number. However, the negative sign is usually omitted.

In principle, the price elasticity may vary from (minus) infinity to zero. The closer to infinity, the more elastic is demand; and the closer to zero, the more inelastic is demand. If demand is inelastic a price increase will increase total revenues while if demand is elastic, a price increase will decrease revenues.

The price elasticity of demand is determined by a number of factors, including the degree to which substitute products exist see cross price elasticity of demand). When there are few substitutes, demand tend to be inelastic. Thus firms have some power over price. When there are many substitutes, demand tends to be elastic and firms have limited control over price.

Enterprise

A term in the commercial world used to describe a project or venture undertaken for gain. It is often used with the word "business" as in "business enterprise". Usually, by extension, it refers to the business entity carrying out the enterprise and is thus synonymous with "undertaking", "company" or "firm". See also **holding company**.

Entry Barriers

Barriers to entry are factors which prevent or hinder companies from entering a specific market. Entry barriers may result for instance from a particular market structure or the behaviour of incumbent firms. It is important to add that governments can also be a source of entry barriers.

Excess Capacity

A situation where a firm is producing at a lower scale of output than it has been designed for. It exists when marginal cost is less than average cost and it is still possible to decrease average (unit) cost by producing more goods and services.

Excess capacity is a characteristic of natural monopoly or monopolistic competition. It may arise because as demand increases, firms have to invest and expand capacity in lumpy or indivisible portions.

Excess Prices

Refers to prices set significantly above competitive levels as a result of **monopoly** or **market power**. However, in practice, in absence of a **conspiracy** or **price fixing agreement** or evidence of market power stemming from high concentration, it is very difficult to establish a threshold beyond which a price may be considered excessive or unreasonable.

Exclusionary Practice

Practice by (mostly) a dominant firm that tends to impair the opportunities of competitors based on considerations other than competition on the merits. An example would be the decision, by a dominant on the market for production of a certain product, not to supply a client, because he is a competitor active in the market for distribution of this product. In Indonesian competition law, exclusionary practice considers part of abuse of dominant provisions, as well as certain prohibited agreement provisions. See also **Exclusive Dealings** and **Exclusive Distribution**.

Exclusive Dealings

Exclusive dealing refers to an arrangement whereby a retailer or wholesaler is 'tied' to purchase from a supplier on the understanding that no other distributor will be appointed or receive supplies in a given area. It occurs when one person trading with another imposes some restrictions on the other's freedom to choose with whom, in what, or where they deal. Most types of exclusive dealing are against the law only when they substantially lessen competition, although some types are prohibited outright.

Exclusive dealing can be divided into two broad categories, third line forcing and other types of exclusive dealing. Third line forcing occurs when a business will only supply goods or services, or give a particular price or discount on the condition that the purchaser buys goods or services from a particular third party. If the buyer refuses to comply with this condition, the business will refuse to supply them with goods or services. Other types of exclusive dealing, including conduct known as full line forcing, involve a supplier refusing to supply goods or a service unless the intending purchaser agrees not to buy goods of a particular kind or description from a competitor, or resupply goods of a particular kind or description acquired from a competitor, or resupply goods of a particular kind acquired from the company to a particular place or classes of places.

Exclusive Distribution

A distribution system, in which a company grants exclusive rights on its products or services to another company. See also **Exclusive Dealings**.

Export Cartel

Agreement or arrangement between firms to charge a specified export price and/or to divide export markets. Many competition law statutes exempt such agreements from competition law as long as the cartel does not affect competition in the home market.

Extraterritorial Jurisdiction

Extraterritorial jurisdiction is the legal ability of a government to exercise authority beyond its normal boundaries.

F

Fair Competition

Competition between companies or business based on the factors of price, quality, and service; and not on practices, which is condemned by public or law like abuse of monopoly powers, competitor bashing, predatory pricing, etc.

Foreclosure

Strategic behaviour by a firm or group of firms to restrict market access possibilities of potential competitors either upstream or downstream. Foreclosure can take different forms, from absolute refusal to deal to more subtle forms of discrimination such as the degradation of the quality of access. A firm may, for example, preempt important sources of raw material supply and/or distribution channels through exclusivity contracts, thereby causing a foreclosure of competitors.

Foreclosure

Strategic behaviour by a firm or group of firms to restrict market access possibilities of potential competitors either upstream or downstream. Foreclosure can take different forms, from absolute refusal to deal to more subtle forms of discrimination such as the degradation of the quality of access. A firm may, for example, preempt important sources of raw material supply and/or distribution channels through exclusivity contracts, thereby causing a foreclosure of competitors.

Franchises

A special type of vertical contractual relationship between two firms. The franchisor supplies a proven product, trademark or business method and ancillary services to the individual franchisee in return for royalties and other payments. The contractual relationship may cover such matters as product prices, advertising, location, type of distribution outlets, geographic area in which the franchisee may operate, etc.

Franchise agreements are generally subject to competition laws as they include provisions that restrict the ability of the franchisee to set price, advertise or the area in which the franchisee can compete. Franchise agreements do not pose competition law problems if there are other products or franchises that compete.

Full Cost Pricing

This is a practice where the price of a product is calculated by a firm on the basis of its direct costs per unit of output plus a markup to cover overhead costs and profits. The overhead costs are generally calculated assuming less than full capacity operation of a plant in order to allow for fluctuating levels of production and costs. Full cost pricing is often used by firms as it is very difficult to calculate the precise demand for a product and establish a market price. Empirical studies indicate that full cost pricing methods are widely employed by business firms.

G

Geograohical Market

Geographical market is that "section of the country" where a firm can increase its price without attracting new sellers or without losing many customers to alternative suppliers outside that area. But if either response occurs (when prices are raised above marginal cost), then a larger market should be drawn to include the sellers.

H

Holding Company

A holding company is set up to acquire interests (normally controlling interests) in a number of operating companies. Although the purpose of a holding company is mainly to gain control and not to operate other companies, it will typically appoint directors to the boards of operating firms.

Horizontal Merger

A horizontal merger is a merger or business consolidation that occurs between firms that operate in the same space, as competition tends to be higher and the synergies and potential gains in market share are much greater for merging firms in such an industry. Horizontal mergers help companies gain advantages over competitors. For example, if one firm sells products similar to the other, the combined sales of a horizontal merger give the new company a greater share of the market. If one firm manufactures products complementary to the other, the newly merged firm may offer a wider range of products to customers. Merging with a firm offering different products to a different sector of the marketplace helps the new firm diversify its offerings and enter new markets. See also **Merger**.

I

Import Cartel

Import cartels are agreements between domestic importers in order to gain control over some specific import markets and to act as a counterbalance against export cartels. See also Export cartels.

Income Elasticity of Demand

The demand for certain products may be sensitive to changes in income. The concept of income elasticity of demand measures the percentage change in quantity demanded of a given product resulting from a percentage change in income.

Income elasticity of demand may be either positive or negative. If, as a result of an increase in income, the quantity demanded of a particular product decreases, the product is called an "inferior" good. If demand goes up the product is called a "normal" good. Margarine has in past studies been found to have a negative income elasticity of demand indicating that as family income increases, its consumption decreases possibly due to substitution of butter.

Industry Concentration

Concentration refers to the extent to which a small number of firms or enterprises account for a large proportion of economic activity such as total sales, assets or employment. Industry or market concentration (also often referred to as seller concentration) is distinct concept embodied within the term concentration which measures the relative position of large enterprises in the provision of specific goods or services such as automobiles or mortgage loans. The rationale underlying the measurement of industry or market concentration is the industrial organization economic theory which suggests that, other things being equal, high levels of market concentration are more conducive to firms engaging in monopolistic practices which leads to misallocation of resources and poor economic performance. Market concentration in this context is used as on possible indicator of market power.

Intellectual Property Rights

IPRs are rights established by government to encourage innovation. Patents protects ideas, copyright protects expressions and trademarks protect brand image. IPRs give the right to exclude others from using the idea, expression or trademark but do not usually confer market power. For example, copyright may allow the author of a book to stop others from copying his book but does not give market power because there are many other competing books in the market for books.

J

Joint Profit Maximization

A situation where members of a **cartel, duopoly, oligopoly** or similar market condition engage in pricing-output decisions designed to maximize the groups' profits as a whole. In essence, the member firms seek to act as a **monopoly**. Note should be made that joint profit maximization does not necessarily entail **collusion** or an **agreement** among firms. The firms may independently adopt price-output strategies which take into account rival firms' reactions and thereby produce joint profit maximization.

Joint Venture

A joint venture is an agreement between firms or individuals to undertake a specific business project together. It is similar to a partnership, but limited to a specific project such as producing a specific product or doing research in a specific area. Joint ventures can become an issue for competition policy when they are established by competing firms. For example, competing minerals companies might form a joint venture to build a port or railway line.

Competition law may permit joint ventures where the benefits of the joint venture outweigh the anti-competitive costs. Some jurisdictions apply different rules to short and long-term joint ventures.

K

L

Leniency

Leniency is a generic term used to describe a system of partial or total amnesty from the penalties that would otherwise be applicable to a cartel member, which reports its cartel membership to a competition authority. In addition, competition authority decisions that could be considered lenient treatment include agreeing to pursue a reduction in penalties or not to refer a matter for criminal prosecution. The term leniency, thus, could be used to refer to total immunity and "lenient treatment", which means less than full immunity.

Lerner Index

A measure proposed by economist A.P. Lerner to measure **monopoly** or **market power**. The Lerner Index (LI) is:

$$LI = \frac{\text{Price - Marginal Cost}}{\text{Price}} = -\frac{1}{E}$$

where E is the price elasticity of demand

In perfect competition, where price equals marginal cost, the LI is equal to zero. A firm facing a downward sloping demand curve will maximize profits where marginal revenue equals marginal cost and the LI is equal to the inverse of the **elasticity of demand**.

The LI measures market power at a particular point of time (i.e. is a short-term concept) and makes no judgement about whether the markup (the difference between price and marginal cost) is justified or not - for example, a high markup could be due to the firm innovating or having lower production costs and so represents an appropriate reward.

Licensing

Refers to granting legal permission to do something, such as producing or using a product. Some licenses are granted free of charge, but most require payment. Licenses are legal agreements which may contain restrictions as to how the license is employed.

Governments may give licenses to companies to operate in certain markets. Licensing systems exist in many communication markets (radio and T.V. broadcasting), professions (doctors) and services (banking, liquor outlets). The terms of licenses vary, but they are often accompanied by various restrictions on the lessee. Those restrictions (or regulations) may apply to price, quality or amount of service. Because a firm cannot operate in these markets without a government licence, the licensing represents a *barrier to entry.* IPR licensing is also common for patents, copyright and trademarks.

Limit Pricing

Limit pricing refers to the pricing by incumbent firm(s) to deter or inhibit entry or the expansion of fringe firms. The limit price is below the short-run profit-maximizing price but above the competitive level.

Loss-Leader Selling

A marketing practice of selling a product or service at a loss in order to attract customers to buy other products at regular prices. Although this practice is illegal in some jurisdictions, in others it is viewed benevolently as a promotional device that has the procompetitive effect of increasing total sales and benefitting consumers. However, it could also be used by an incumbent to prevent entry or to drive competitors out of business – see *predatory pricing*.

M

Market

A market is understood by most people to be a place where buyers and sellers exchange goods and services for a price. Markets may be local, regional, national or international. Buyers and sellers do not necessarily have to meet or communicate directly with each other in a physical location. Markets can be defined in situations where buying and selling is done over a telephone or the internet.

Defining a market is very important in competition law. The main purpose for defining a market in competition law is to determine who competes with the supplier of the product being investigated. So market definition for competition law has a specialised meaning and may be different from a market used in everyday language or in marketing. By identifying all the products and firms that compete with each other it is possible to determine whether a firm or group of firms has market power. See also **market definition**.

Market Allocation

Market allocation or sometime calls market division, is agreement in which competitors divide markets among themselves. In such schemes, competing firms allocate specific customers or types of customers, products, or territories among themselves. For example, one competitor will be allowed to sell to, or bid on contracts let by, certain customers or types of customers. In return, he or she will not sell to, or bid on contracts let by, customers allocated to the other competitors. In other schemes, competitors agree to sell only to customers in certain geographic areas and refuse to sell to, or quote intentionally high prices to, customers in geographic areas allocated to conspirator companies.

Market Allocating

Market allocating (or *'customer sharing'*) refers to cartel agreements that divide markets by territory or by customers among competitors.

Market Control

Market control is the ability of buyers or sellers to influence the price or quantity of goods, services, or commodities in a market.

Market Definition

The starting point for most competition analysis is the definition of what is called in competition law *the relevant market.* The relevant market comprises both a relevant product market and a relevant geographic market. The term relevant is used to indicate that the market is being defined in relation to the anti-competitive conduct being complained about.

The relevant product market includes all the products than compete (are substitutable for) the product under investigation. By *compete* we mean determining whether consumers see the different products as being substitutable. If consumers see low price and high-priced cars as substitutable then producers of low cost cars compete with the producers of high cost cars. Different products may compete with each other in a particular geographic area (e.g. a city or country). Therefore, we need to determine not only what products are substitutable but also the geographic area where suppliers come from.

Market definition takes into account both demand and supply considerations. On the demand side, sellers of products are included in the market if they are substitutable from the buyer's point of view with the product being investigated (the *relevant product*). On the supply side, sellers are included who produce or could easily switch production to the relevant product or close substitutes. Substitutable products and/ or the ability of a supplier to switch to supplying the relevant product limit the ability of the supplier of the product being investigated to charge what it likes (i.e. the presence of substitute products of potential new suppliers limits the market power of the firm being investigated).

If relevant markets are defined too narrowly in either product or geographic terms, actual competition may be excluded from the analysis. On the other hand, if the product and geographic markets are too broadly defined, the degree of competition may be overstated.

Market Failure

A general term describing situations in which market outcomes are not **Pareto efficient**. Market failures provide a rationale for government intervention. There are a number of sources of market failure. For the purposes of competition policy, the most relevant of these is the existence of **market power**, or the absence of **perfect competition**. However, there are other types of market failure which may justify regulation or public ownership.

When individuals or firms impose costs or benefits on others for which the market assigns no price, then an externality exists. Negative externalities arise when an individual or firm does not bear the costs of the harm it imposes (pollution, for example). Positive externalities arise when an individual or firm provides benefits for which it is not compensated.

Finally, there are cases in which goods or services are not supplied by markets (or are supplied in insufficient quantities). This may arise because of the nature of the product, such as goods which have zero or low marginal costs and which it is difficult to exclude people from using (called public goods; for example, a lighthouse or national defense). It may also arise because of the nature of some markets, where risk is present (called incomplete markets; for example, certain types of medical insurance).

Market Power

Market power is the ability of a firm (or group of firms) to set price above the competitive level (sometimes called monopoly power). Setting a high price means output must be reduced and so there is a loss of economic welfare (loss of consumer surplus).

Tthe actual measurement of market power is not easy. One approach that has been suggested is the **Lerner Index**, i.e., the extent to which price exceeds marginal cost. However, marginal cost is not easy to measure empirically, and so an alternative is to measure price minus average variable cost. Another approach is to measure consumer substitutability through the firm's price **elasticity of demand**. However, this measure is also difficult to compute.

Market Share

Measure of the relative size of a firm in a market. This could be measured by the percentage of sales or productive capacity of the firm compared to the total sales or productive capacity in the relevant market.

Merger

An amalgamation or joining together of two or more firms into an existing firm or to form a new firm. Competition authorities have to determine whether a merger is occurring to lower costs (to rationalise distribution networks for example) and/or to simply obtain **market power.** Three kinds of mergers can be identified:

Horizontal Merger: A merger between firms that that compete at the same level of production (production, wholesale or retail level). The main problem for competition law are mergers between competitors in the same market i.e. who produce and sell the same products.

Vertical Merger: Merger between firms operating at different stages of production. An example would be a steel manufacturer merging with an iron ore producer. Vertical mergers usually increase economic efficiency, although they may sometimes have an anticompetitive effect. See also Vertical Integration.

Conglomerate Merger: Merger between firms in unrelated business, e.g., between an automobile manufacturer and a food processing firm. Usually, conglomerate mergers do not lead to increased market power in any relevant market.

Merger Control

Merger control procedure is procedure to review merger activities.

Monopolistic Competition

Monopolistic competition describes an industry structure combining elements of both **monopoly** and **perfect competitio**n. As in perfect competition, there are many sellers and entry and exit is relatively easy. However, unlike the situation in perfect competition, products are somewhat differentiated. As a consequence, each firm faces a downward sloping demand curve which gives it some power over price. In this sense the firm is like a **monopolist, although the demand curve is more elastic than that of the monopolist (see elasticity** of demand). In essence, although the product is differentiated, it does have substitutes so that the demand curve facing the firm will depend on the prices charged by rivals producing similar products.

Monopolistic competition is probably the most prevalent market structure, particularly in services industries. Although it can be shown that monopolistic competition is Pareto inefficient because equilibrium price exceeds marginal cost, this inefficiency is the result of producing a variety of products. Because there are many firms and free entry/exit, monopolistic competition is not usually considered a problem for competition policy. In equilibrium, monopolistic competitors earn zero or low economic profits.

Monopolization

This is the term used in the United States to describe both conduct that leads to a dominant position and the abuse of a firm who is already in a dominant position. In Europe abuse of a dominant position only covers predatory conduct by firms who are already dominant. See also discussion under **abuse of dominant position.**

Monopoly

Monopoly describes a situation where there is a single seller in the relevant market. In conventional economic analysis, the monopoly case is taken as the direct opposite of **perfect competition** where there are many firms. As there is only one firm in the relevant market, the monopolist's demand curve is the market demand curve – which is downward sloping. Therefpre, a monopolist has power over the price set in the market – called market power.

Economic theory shows that monopolists charge a price to maximise profits which is a price higher than the price set through competition. To set a higher price a monopolist sells less – as a result the monopolist makes economic profits and consumers lose consumer surplus.

Monopoly power describes the ability of a single seller to determine price. Market power describes the ability of any firm to set its own price even when there are competitor in the relevant market. For example, a petrol station may be able to charge more than other petrol stations in a geographic area because local consumers do not want to travel to buy petrol.

Monopolies can only continue to exist if new firms cannot enter i.e. there are **barriers to entry.** An important barrier to entry is granted by government e.g. monopoly licenses. Other monopolies can be created and sustained through the monopolist's predatory or strategic behaviour or through economies of scale – here market demand is not sufficient to have more than one firm – called natural monopolies.

Sometimes (particularly in the United States) monopoly power is used synonymously with market power (i.e. where a firm has less than 100 per cent market share).

Monopsony

A monopsony consists of a market with a single buyer. When there are only a few buyers, the market is defined as an oligopsony. In general, when buyers have some influence over the price of the inputs they buy they are said to have monopsony power.

Monopsony power may be relevant in assessing market power. For example, where monopoly power on the selling side may be offset by powerful buyers. This is sometimes referred to as countervailing power. The ability of a firm to raise prices, even when it is a monopolist, can be reduced or eliminated where buyers have monopsony or oligopsony power.

N

Natural Monopoly

A natural monopoly where a single firm can supply that market at a lower cost than two or more firms. Natural monopolies arise because of declining long-run average cost in relation to the size of market demand. There is room for only one firm to fully exploit available economies of scale and supply the available market.

Natural monopolies exist in electricity, railroads, natural gas, and telecommunications supply. Because productive efficiency requires that only one firm exist, natural monopolies are typically subject to government regulation. Regulations may include price, quality, and/or entry conditions.

Non-Competition (Clause)

Non-competition clause is a contractual clause bringing about a direct or indirect obligation causing the parties to an acquisition agreement, or at least one of them, not to manufacture, purchase, sell or resell independently goods or services which compete with the contract goods or services. Such an obligation on the seller of the assets guarantees that the acquirer receives the full value of the assets transferred and hence is normally considered as ancillary to the main agreement.

Non-Price Predation

Non-price predation is a form of strategic behaviour that involves raising rivals' costs. For example, a dominant firm could disadvantage competitors by using government processes (e.g. setting product standards in a way that disadvantages competitors) or using the legal system (to force a smaller competitor with less resources into litigation).

Notification

Notification or merger notification is a formal information provided by business entities to the Competition Authority under competition law in certain situations and that concern merger agreements they plan or have concluded.

O

Oligopoly

An oligopoly is a market characterized by a small number of firms (up to about 8-10) who realize that their competitors will respond if they change their price or marketing strategies.

There are several types of oligopoly. When all firms are of (roughly) equal size, the oligopoly is said to be symmetric. When this is not the case, the oligopoly is asymmetric. One typical asymmetric oligopoly is where one firm in the market is dominant.

Oligopolies can also lead to problems of tacit collusion i.e. where the competitors learn to collude without actually communicating with each other. This situation can create problems of proof for a competition regulator.

Oligopsony

Oligopsony is similar to an oligopoly (few sellers), this is a market in which there are only a few large buyers for a product or service. This allows the buyers to exert a great deal of control over the sellers and can effectively drive down prices.

Opportunity Costs (or Alternative Costs)

This is nn important concept in economics. Opportunity costs are the costs of using resources in one use rather than another. In other words, it is the benefits given up by using the resources in the current use compared to the next best use. If for example, a consumer buys an apple, the opportunity cost is the benefits lost from buying something else (e.g. a banana). See also **Costs.**

P

Per se rule

Per se rule is a regulatory approach by which some certain business practices are conclusively presumed to impose unreasonable restraint on the competitive process and thus anticompetitive, or can be held as illegal by themselves, without further defence. See also Rule of Reason.

Parent Company

A parent company is one that owns or operates subsidiary companies, known as **subsidiaries.** A parent company can be a **holding company** – which does not operate only controls its operating subsidiary companies.

Pareto Efficiency

Pareto efficiency, also referred to as allocative efficiency, occurs when resources are allocated, at a particular point in time, so that it is not possible to make anyone better off unless someone else is made worse off. It is usually assumed that products are being produced in the most efficient (least cost) way.

Deadweight welfare loss is a measure of allocative inefficiency. In the case considered above under that heading, the total loss of consumer surplus involved in moving from competition to monopoly was PcPmBC of which BCE was deadweight loss and PcPmBE was producers' profit. Now consider the movement from monopoly to competition. The gain in consumers' surplus is PPBC, while producers lose PcPmBE. However, it is potentially possible for consumers to compensate producers by this amount and still retain BCE. Thus, consumers are potentially better off, producers are no worse off and so the movement to competition represents a Pareto improvement and competition is said to be Pareto efficient.

This result has been termed "the first theorem of welfare economics" and it states that an economy characterized by **perfect competition** in all markets will always be Pareto efficient, if there are no **market failures**.

Patents

Patents give inventors property rights over an idea. This means the patent holder can stop others from using the new idea described in the patent. Exclusive rights to produce and distribute mean that the patent allows higher than normal profits. But this is not normally the case as the product created from a new mousetrap patent still competes with existing mousetraps. The possibility of making above normal profits from obtaining a patent stimulates research nd development. Without a patent (the ability to exclude others from using the idea without permission) would mean that others could imitate and so above normal profits would not be made and there would not be the same incentive to innovate.

Investments in research and development are are **sunk costs**. That is the costs cannot be recovered if the research and development is unsuccessful. See discussion under **Intellectual Property Rights** and **Licensing.**

Perfect Competition

Perfect competition is a theoretical model of market structure which does not exist in the real world. It is usually defined by four assumptions:

1. There a very large number of buyers and sellers so that none can individually affect the market price. Price is set by the market. As a result the demand curve facing an individual firm is a horizontal line at the market price. If a firm sets a price higher than the market price it will not be able to sell anything.
2. In the long run, resources are freely mobile, meaning that there are no **barriers to entry** and exit.
3. All market participants (buyers and sellers) must have perfect knowledge. So consumers knows what price every seller sells at and has perfect knowledge of product qualities and characteristics. Sellers have the same knowledge plus knowledge of other firm production processes and technology.
4. The product is homogenous – this assumption is rarely found in practice – even commodities such as rice have differences in quality.

If these theoretical conditions are met, the market is said to be perfectly competitive; when they are fulfilled in all markets, the economy is perfectly competitive.

if the assumptions of perfect competition hold then it can be shown that the market is **Pareto efficient** and the price of the goods produced = *marginal cost.* If all markets are perfectly competitive then resources in the economy are allocated efficiently.

Because perfect competition is only a theoretical construct, economists generally use a more practical model for evaluating competition – the model of workable competition.

Predatory Pricing

A deliberate strategy by a dominant firm to drive competitors out of the market by setting a price below cost (usually competition authorities use average variable cost but other cost measures can be used). Once the predator has successfully driven out existing competitors and deterred the entry of new firms, it can raise prices and earn higher profits.

However, many economists argue that predatory pricing is not rational because it is unlikely the predator can recover lost profits from pricing below cost. It is only a rational strategy if the predator can recoup the lost profits later - which can only happen if new firms do not enter (or old firms re-enter).

Price Discrimination

Price discrimination occurs when a firm charges different prices for the same product or service to customers in different parts of the market (e.g. different geographic location, different time of day etc) where the price difference is unrelated to the cost of supply. Price discrimination only works where customers cannot profitably re-sell the goods or services to other customers who are paying a higher price (i.e. no arbitration is possible).

Price discrimination can be pro-competitive (it increases output) or can be anti-competitive. For example, **dominant firms** may lower prices in particular parts of the market in order to eliminate vigorous local competitors.

Price-Fixing Agreement

An agreement between sellers to raise or fix prices in order to restrict inter-firm competition and earn higher profits. Price fixing agreements are formed by firms in an attempt to collectively behave as a **monopoly.** For further details see discussion under **agreement, cartel** and **collusion**.

Price Leadership

This occurs where firms in a market follow the prices of a price leader. If all the firms in the market know the price leader and always follow the leader then prices will be higher than if there were competition. In some counties, price leadership may be caught by competition law as it represents a form of tacit collusion.

Q

Quasi Competitive

Quasi competitive can be defines as pertaining to be competitive, or having partially consider as competitive. In quasi-competitive model, price is assumed to be took by all firms (each firm is assumed to be a price taker).

R

Refusal to Deal/Sell

The practice of refusing or denying supply of a product to a buyer, usually a retailer or wholesaler. Competition law may prohibit refusals to deal/sell by a dominant firm where it has an adverse impact on competition. For example, a dominant firm may refuse to deal/sell with a butter unless the buyer accepts the dominant firm's resale price – **resale price maintenance (RPM)**. A dominant firm may refuse to supply a producer with an input which is essential to production – thereby driving the downstream firm out of business. However, not all refusal to deal/sell are bad – a dominant firm may refuse to deal/sell to a buyer who is not paying his bills, or fails to provide adequate sales service, product advertising and display, etc. The competitive effects of a refusal to deal/sell by a dominant firm have to be assessed on a case-by-case basis.

Relevant Market

Relevant market is a tool to identify and define the boundaries of competition between firms. It is a market in which a particular product or service is sold. A relevant market is defined according to both product and geographic factors.

Rent

In modern economics, rent refers to the earnings of factors of production (land, labour, capital) which are fixed in supply. Thus, raising the price of such factors will not cause an increase in availability but will increase the return to the factor. This differs from the more common usage of the term, whereby rent refers to payments for the use of a resource.

Economists use the term economic rent to denote the payment to factors which are permanently in fixed supply and quasi-rent to denote payments for factors which are temporarily in fixed supply. The presence of economic rents implies that the factor can neither be destroyed nor augmented. Quasi-rents exist when factors can be augmented over time, or when their supply can be reduced over time through depreciation. Factors which earn economic or quasi-rents typically are paid an amount in excess of their **opportunity costs.**

Rent Seeking

The opportunity to capture monopoly rents (see Rents) provides firms with an incentive to use scarce resources to secure the right to become a monopolist. Such activity is referred to as rent-seeking. Rent-seeking is normally associated with expenditures designed to persuade governments to impose regulations which create monopolies. Examples are entry restrictions and import controls. However, rent-seeking may also refer to expenditures to create private monopolies.

Resale Price Maintenance

Agreements or concerted practices between a supplier and a dealer with the object of directly or indirectly establishing a fixed or minimum price or price level to be observed by the dealer when reselling a product/ service to his customers). If a reseller refuses to maintain prices, either openly or covertly, the manufacturer may stop doing business with it. A provision, which foresees resale price maintenance, will generally be considered to constitute a hard-core restriction.

Rule of Reason

An approach by competition authorities or the courts where an attempt is made to evaluate the pro-competitive features of a restrictive business practice against its anticompetitive effects in order to decide whether or not the practice should be prohibited. Some market restrictions which prima facie give rise to competition issues may on further examination be found to have valid efficiency-enhancing benefits. For example, competitors may get together to form a joint venture to produce a particular input which will be used by all of them. Technically, the agreement (which could include a price agreement) would seem to breach competition law – however, the joint venture may lead to lower costs of supply and so to lower prices to consumers. Hence the anti-competitive agreement is overall pro-competitive.

S

Strategic Behaviour

Strategic behaviour is the general term for actions taken by firms which are intended to influence the market environment in which they compete. Strategic behaviour includes actions to influence rivals to act cooperatively so as to raise joint profits, as well as noncooperative actions to raise the firm's profits at the expense of rivals. Various types of **collusion** are examples of cooperative strategic behaviour. Examples of noncooperative strategic behaviour include preemption of facilities, price and **non-price predation** and creation of artificial **barriers to entry**. Strategic behaviour is more likely to occur in industries with small numbers of buyers and sellers.

Subsidiary

A company controlled by another company. Control occurs when the controlling company owns more than 50 per cent of the common shares. When the parent owns 100 per cent of the common shares, the subsidiary is said to be wholly-owned. When the subsidiary operates in a different country, it is called a foreign subsidiary. The controlling company is called a **holding company** or **parent**.

Substitute

Substitute is a product which, by its characteristics, price, intended use and customers' patterns of purchases, can serve as a substitute for another (relevant) product thereby satisfying the equivalent need of the customers.

Sunk Costs

Sunk costs are costs which, once committed, cannot be recovered. Sunk costs arise because some activities require specialized assets that cannot readily be diverted to other uses.

Examples of sunk costs are investments in equipment, which can only produce a specific product, or products that can only be used by specific customers. If the customer goes out of business the equipment used to make the specialised product cannot be sold. Other examples include advertising expenditures and R&D expenditures – they are non-recoverable if the advertising or the R&D is not successful.

When considering entry into a market, a firm will consider whether its investment is sunk or not. When sunk costs are present, failure means sunk costs will not be recovered and so the firm may not wish to invest. So the presence of sunk costs can be a **barrier to entry** and affect the contestability of the market.

T

Tacit Collusion

Is a circumstance where two companies agree upon a certain strategy without putting it in writing or spelling out the strategy explicitly. Tacit collusion (or price leadership) happen when other businesses usually accept price changes established by a dominant firm and which other firms then follow. When price leadership is adopted to facilitate tacit (or silent) collusion, the price leader will generally tend to set a price high enough that the least costefficient firm in the market may earn some return above the competitive level.

Takeover

The acquisition of control of one company by another or occasionally by an individual or group of investors. Takeovers are usually instituted by purchasing shares at a "premium" over existing prices and may be financed in a variety of ways including cash payment and/or with shares of the acquiring company. While the terms **mergers, acquisitions** and takeover are often used interchangeably, there are subtle differences between them. A takeover may be complete or partial and may not necessarily involve merging the operations of the acquired and acquiring firms. The fact that joint ownership and control may arise from a takeover implies that the companies could maximize joint profits, which can be a source of concern to competition authorities.

Tied Selling

Refers to situations a seller will only sell product X if the buyer takes product Y. One variant is full-line forcing in which a seller forces a complete line of products on a buyer who is only interested in taking one specific product.

Tied selling is sometimes used as a means of price discrimination. For example, a printer manufacturer will force the buyer to but its own paper. The more paper the buyer uses the higher the amount paid to the seller – which is similar to charging heavy users of the printer a higher price.

Tying may foreclose market opportunities for other firms. For example, if a dominant firm has 80% of the market for product X then forcing buyers to buy product Y will mean there may be little of market Y left for other suppliers. On the other hand, tying could be used to reduce the costs of producing and distributing the line of products and ensuring that like quality products are used to complement the product being sold. For example, a computer manufacturer may require purchase of disks in order to prevent damage to or poor performance of his equipment by the use of substitute lower quality disks. There is increasing recognition that depending on different market situations, tied selling arrangements may have a valid business rationale. Economists suggest adopting a **rule of reason** approach to tied selling rather than a **per se**.

Trade Mark

Trade mark refers to words, symbols or other marks which are used by firms to distinguish their products or services from those offered by others. A trade mark may often become equated with the product itself and may be a source of competitive advantage. For example, “kleenex” as a trade mark name is used to refer to “tissue “handkerchiefs”; “Xerox” in place of “photocopying”; “Coke” instead of a “cola drink”. Trade marks may communicate information about the quality of a good or service to consumers. Firms which license their trade marks to retailers may thus require conditions in the licensing contract assuring uniform quality. Economists generally see trade marks as promoting competition because they give consumers information about the quality of products. See **Intellectual Property Rights, Licensing**.

Transaction Costs

Transaction costs refer to the costs involved in market exchange. These include the costs of discovering market prices and the costs of writing and enforcing contracts.

Transaction cost economics, as developed primarily by economists Coase and Williamson, suggests that economic organizations emerge from cost-minimizing behaviour (including transaction costs) in a world of limited information and opportunism.

Transaction-cost analysis has been used to provide efficiency explanations for why firms integrate vertically (e.g. a buyer and seller merge) and franchising.

U

Unfair Trade Practices

Unfair trade practices encompass a broad array of torts, all of which involve economic injury brought on by deceptive or wrongful conduct. The legal theories that can be asserted include claims such as trade secret misappropriation, unfair competition, false advertising, palming-off, dilution and disparagement.

Unilateral Conduct

Unilateral conduct also known as single firm conduct, whether by the holder of an undoubted monopoly or substantial market power, can damage the competitive process in ways that are reachable by competition law. The conduct mostly relates to monopolization or abuse of dominant position.

V

Vertical Integration

Describes merger of firms operating at different stages of the production chain, e.g., petroleum refining firms buying “downstream” terminal storage and retail gasoline distribution facilities and “upstream” crude oil field wells and transportation pipelines. An important motive for vertical integration is efficiencies and minimization of **transaction costs.**

W

X

X-Inefficiency

While monopolists raise price above the competitive level, a lack of competition also means that firms have less pressure to be internally efficient. As a result, a firm's costs are higher than they would be with competition. Leibenstein coined the term X-inefficiency to refer to these additional costs. They include wasteful expenditures such as the maintenance of excess capacity, luxurious executive benefits, political lobbying seeking protection from competition and favourable regulations, and litigation.

Y

Z

This page is intentionally left blank