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Some remarks on institutional limitations of small agencies on the use of wide-scale economic analysis tools in case analysis

Mika Oinonen (Finnish Competition Authority, Finland) · Thursday, September 6th, 2012

Many new economic analysis tools have been introduced, particularly for merger analysis during the last decade. Some of these tools have also raised considerable public interest. For instance, probably not many have avoided hearing of the UPP test, and undoubtedly many are already familiar with the meaning of the abbreviations GUPPI, IPR and CMCR. The discussion has been manifold. It has often revolved around different theoretical issues, but to some extent it has also drawn on the experiences gained from merger assessment praxis.

One central theme in this discussion is related to the role of market definition in the application of the new economic tools. Indeed, many new economic tools have often been justified by the drawbacks of traditional market delineation, particularly in cases relating to differentiated product markets, two-sided markets, or sectors with considerable R&D activity. One has even discussed the possibility of substituting the concept of relevant market with the new economic analysis tools applied to measure market power directly. After a somewhat confused initial stage, it now seems to have become settled that these new tools should not be seen as substitutes, but rather as complements to market definition. Relevant market is still maintaining its role as one necessary part of merger analysis.

The discussion regarding the new analysis tools has still been rather general, though it has contained both theoretical and practical aspects. For obvious reasons, this discussion has largely been pioneered and led by the people working for larger, internationally more influential competition authorities, such as it has been the UPP test. Perhaps for this reason, certain issues have attracted only marginal interest. One such issue relates to the potential problems faced by small competition authorities due to the institutional limitations in the application of the new economic tools. One exception is the recent OECD meeting on market definition (held on June 2012), in which this issue was briefly touched upon.(1) I will concentrate on this issue in this post and correspondingly bypass elsewhere widely discussed issues as to the more general theoretical feasibility and practical applicability of the new economic tests. My views reflect Finnish experiences to a considerable degree.(2)

Characteristic of a small competition agency is the obviously narrower resource base compared to a large competition agency. This is so at least when measured by the number of persons working with the competition cases (e.g. mergers). Small agencies employ dozens of people, while large agencies employ hundreds. This also affects the number of specialized staff, e.g. PhD economists working with quantitative analysis. Whereas in a large agency there might be dozens of such persons, in small agency there may be only a few specialists, even only one or two.

Another characteristic of a small agency is the small size of the market and the correspondingly low number of cases handled each year. As a rule, the overall number of cases is considerably lower in small markets than in large markets. This easily also affects the number of cases with novel or otherwise difficult competition issues, in which one truly has to sit down with an economic frame of the question or the application of more sophisticated economic methods. A small agency may very well face only one or two such cases (e.g. mergers) per year, or even none.

Scarce resources, particularly the number of specialized economists, create a few basic problems. First of all, the overall *number* of economists may generally be too low. Although the number of economists is hardly a quality in itself, it is difficult to perform sophisticated economic (especially quantitative) analysis in a rigorous manner if there are not even enough people to collect and analyse the relevant data. This is an especially important issue regarding merger analysis due to its strict time limits.

Secondly, it also means that there is less *know-how* to apply the so-called more sophisticated economic tools in practice. A wide-scale use of sophisticated quantitative analysis tools, for instance, in terms of a full scale merger simulation, requires much deeper knowledge than is acquired from a basic economic education or a legal education.

Thirdly, the use of such sophisticated tools also often requires that persons with more profound economic knowledge should be *available* when the time comes to actually do the analysis. If there are only 1 or 2 experienced expert economists who actually possess the much needed knowledge, it is often the case that they are not available since they have work to do on cases other than mergers. In a small agency, it is practically impossible to specialize on just a few subjects. This again especially relates to merger analysis, which often requires quick reactions from the competition authority.

One may think that this problem could be easily solved just by considerably increasing the number of specialized economic staff in the agency. The issue is not that simple.

First of all, one must consider regarding the best number of specialized economic staff, whether one talks about a *wide-scale use* of sophisticated quantitative analysis in a *general* case assessment, or merely about a few potential *individual* cases. If such or any other new economic tools introduced in the future are going to have a wide-scale impact on the traditional way of analysing mergers, one may also be able to justify the need for a number of experienced expert economists. In this case, one new recruitment may not be enough to make that difference, although it is a step in the right direction. If not, one seriously needs to consider how much to invest in such personnel in recruiting. It is clear that no agency can simply afford to have an idle “reserve” of experts waiting for something relevant to come along.

Even more so, the question of putting scarce resources to the best possible use becomes ever more important in (small) markets, where the number of cases requiring more profound economic understanding will anyway be low. Namely, even if the hiring of number of new specialized economists could somehow be justified, e.g. with an aim to start using more profound economic analysis in the general case assessment, one still faces the fact that there are only a very few problematic major mergers per year where one may even potentially need more profound economic understanding. If this is the case, one may very well question the need for such a large team of expert economists. Again, it is difficult, particularly in these economically challenging times, to justify any recruit who cannot give full input to the agency, e.g. due to fact that there are not enough cases in which he or she could prove to be an asset for the agency.

Here we come to the key element of the problem: the breath and depth of expertise required vis-à-vis the low number of (even potential) cases. You should have enough specialized staff (in this case, senior economists) in order to be able to tackle cases with sophisticated quantitative analysis. But at the same time, you face the fact that such a need may only relate to a few (if indeed any) cases per year. From the agency's point of view, when this is the case, you more easily allocate your scarce resources to officials (such as general case-handlers) who may be used to all kinds of case-related work, some of which does not even relate to economics. You simply must be able to make the best possible use of your scarce resources and avoid overkill.

Finally, it would be unfair to blame the new sophisticated methods themselves or persons participating in their development for the challenges facing the small market competition authorities. Clearly, one also has to start the development somewhere, and general issues typically need to be discussed first. In the future, more attention should be paid to more specific issues (the perspective of small competition authorities, for example) that considerably affect the degree to which new more sophisticated economic methods gain importance for such authorities. For a small agency, it is particularly important to pay enough attention to the costs and benefits of adopting new innovative (economic) analysis tools. It is a question of striking the right balance.

One could hope for more attention to this issue in the general discussion. Obviously it also requires more active participation from small agencies, which may remain marginal due to limited resources. Yet it seems clear that should we want these new tools to become fully applicable and more generally applied among small authorities, we must also pay adequate attention to the possible institutional limitations facing the small agencies.

(1) OECD, Roundtable on Market Definition, Background paper, DAF/COMP(2012)13.
(2) They may not though necessarily represent the Finnish Competition Authority's official view.

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“>Mergers
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