

The Competition Law and Policy Roundtable Series – Ex-post Economic Evaluation of Competition Policy Enforcement, University of Zagreb-Faculty of Economics and Business, 12 February 2019

The Competition Law and Policy Roundtable Series (<https://pptn-tribina.net.efzg.hr/>) started in early 2018 as a joint project of the University of Zagreb-Faculty of Economics and Business (EFZG), the Croatian Competition Agency (AZTN), the newly formed Croatian Association of Competition Law and Policy (HDPPTN), and the European Documentation Centres at the University of Zagreb Faculty of Law and EFZG. The roundtables take place at EFZG, and around four roundtable events annually are being organised, focusing on hot topics in competition law and policy. Jasminka Pecotić Kaufman (EFZG) acts as the moderator. The first meeting was held in April 2018 with a focus on the issue of minority shareholdings and merger control, and its possible impact on the intensity of market competition in the context of increasing market concentration. The second meeting, held in October 2018, was on the standard of proof in cartel cases as defined by Croatian courts, organised as a reaction to several controversial judgements adopted by the Croatian Constitutional Court and the High Administrative Court. The third roundtable took place in November 2018, with Dr Marek Martyniszyn presenting his research on three decades of competition system development in Poland.

The fourth roundtable, held in February 2019, focused on *ex-ante* economic analysis of antitrust enforcement, and is the object of this report. The panellists were Dr Marko Družić (EFZG) and Dr Velibor Mačkić (EFZG), two microeconomists; Dr Vladimir Arčabić (EFZG), macroeconomist; and Mr Dejan Garić, economist case handler from AZTN.

In his introductory presentation, Dr Mačkić pointed out that, from a political economy point of view, *ex-post* economic evaluation of competition policy enforcement is an essential part of the architecture of a successful economic model of a contemporary economy. Namely, it provides incentives and constraints for the economic agents operating on the market. Since productivity is a *condicio sine qua non* of a competitive economy, it requires a market that has freedom of entry, low level of crony relationship with public officials, and going after abuses of market dominance and cartels. Analysing regulations and interventions, which ensures right incentives

in a market economy, requires constant evaluation of ongoing public policies as the main goal of *ex-post* economic evaluation of competition policy enforcement. As Dr Mačkić pointed out, two sub-goals can be identified: (1) assessment of the effect of public policies (desired vs achieved) and (2) development of better regulations and policies.

Defining the evaluation as a systematic identification of the effects of a specific intervention or policy, Dr Mačkić distinguished between *ex-ante* and *ex-post* evaluation. An *ex-post* evaluation, or a retrospective economic evaluation, looks at the economic effects of competition policy enforcement in terms of prices, mark-ups (microeconomic effects) and ultimately productivity and growth (macroeconomic effects). It is evidence based, critical and looks at causality links. Dr Mačkić emphasised that its quantitative importance can be summarized as the estimation of (1) the change in market behaviour of economic agents, (2) expected changes on the market and (3) unintended and unexpected changes on the market. The impact on the conditions of competition can be either direct (merger control and anti-trust decisions) and/or indirect (deterrent effects that prohibit cartels and similar illegal agreements). There are three channels by which the effects of competition policies are translated into the economy: (1) allocative, (2) productive and (3) dynamic efficiency, thus leading to change in prices/costs of production and the change in quality and variety of goods and services in the market. These are, in essence, the price and non-price aspects of the competitiveness of contemporary economies. If one of them is operating sub-optimally, the competitiveness level of the economy will not ensure convergence.

Dr Mačkić said that, since *ex-post* economic evaluation implies the existence of competition agencies and their decisions, there are three main outputs of the evaluation. First, the definition of the competition policy regulatory framework (legislation, guidelines, notice, etc.). Second, decisions taken in the different areas of competition policy (mergers, cartels, abuse of dominance and state aid control). Third, market studies or sector inquiries, advocacy actions and international collaboration with other competition agencies. He furthermore pointed out that *ex-post* economic evaluation activities can be assessed at the level of the market (the impact of a specific decision or competition policy rule on the functioning of a well-specified market), the sector (performances of particular sectors) and the macroeconomic level (welfare, productivity and growth). Having that in mind, one can distinguish between microeconomic (the effect on prices, mark-ups, market power, entries on the market) and macroeconomic (e.g. the customer's benefits of all merger decisions) *ex-post* economic evaluation. Most of the existing work has been done in microeconomic evaluation due to demand, available data and empirical methods available.

Finally, Dr Mačkić noted that, with respect to the practice, literature points out that the optimal approach is continuous evaluation as opposed to evaluation triggered by an omission in competition policy. Three main steps can be distinguished in an *ex-post* evaluation project: preparation, execution and exploitation of the

results. These, however, depend on the resources available since not all competition agencies have them at their disposal and, more importantly, not all governments see competition policies as a tool in boosting the competitive position of their respective economies.

For the next speaker, Dr Družić, the goal of his presentation was to give an introduction to the lens through which microeconomists view *ex-post* analysis, or more generally, the job that Competition Authorities (hereinafter: CAs) do. Specifically, the goal was to answer two main questions: 1) why is the topic of *ex-post* analysis interesting from a microeconomic point of view, and 2) what type of work has recently been done by microeconomists on this topic, and what conclusions did it reach. The answer to the first question is that *ex-post* analysis of CAs' decisions provides a very interesting testing ground for microeconomic theories, and also for methods frequently used in microeconomic analysis. Furthermore, *ex-post* evaluations simultaneously benefit CAs by providing feedback on the quality of decisions. They also have 'reputation enhancing' qualities for CAs, by making them more transparent and giving them the ability to communicate positive results. In conclusion, *ex-post* analysis provides an environment in which microeconomic theory and regulatory practice can both thrive in synergy with each other.

Furthermore, Dr Družić pointed out that the majority of *ex-post* evaluations done by microeconomists in the last ten years were on the subjects of mergers and cartels. Mergers present a problem because in theory the effects of mergers can be positive or negative, depending on the relative strength of efficiency-enhancing effects (economies of scale etc.), and price-raising effects (too much market power gained by the merged entity). The research done suggests that the answer to 'which effect prevails' varies from sector to sector, and even from case to case.

He noted that when looking at mergers with remedies, it was found that structural remedies are found to be far more efficient than behavioural remedies. An interesting conclusion arrived at by some papers suggests that CAs, by defining and executing a transparent, consistent and predictable policy, create a very powerful deterrent effect (a study done in the UK suggests that 4/5 harmful mergers are stopped without the need for the CA's intervention).

As he pointed out, when looking at cartels, the main problem is detection, as studies suggest that as much as 4/5 cartels remain unnoticed. The main detection tool is the comparison between the observed and competitive price (a price that simulations suggest would prevail if the market was competitive). Finally, he noted that it was found that in cartels the average observed price is 15–20% higher than the competitive price, and that the difference between the prices is substantially higher outside the USA and EU.

Speaking on macroeconomic effects of competition policy, Dr Arčabić, noted that the purpose of macroeconomic evaluation of competition policy was twofold. First, the positive effects of competition policy on the aggregate level justify the legitimacy and purpose of competition authorities. Second, *ex-post* evaluation and measuring is

useful for quality control and provides important feedback for competition authorities. Macroeconomic effects of competition policies can be measured using a bottom-up approach, measuring the direct benefits of competition policy for consumers. This is a simple and direct measuring method usually used by competition authorities. The benefit is calculated as price decrease times duration of the decrease. This approach varies substantially across different competition authorities and the OECD made a proposal to unify the measurement. The main benefit of this approach is its simplicity and the fact that it starts from actual cases. The disadvantage of this approach is that it shows only direct benefits, so results are always very modest. The second method is measuring both direct and indirect effects of competition policy at the aggregate macroeconomic level. This approach is usually used by the academic community. It is more complex, but also more precise. The research in this area is not very wide, but in general competition policy increases competition which, in turn, positively affects economic growth. This way of measuring typically shows larger benefits of competition policy.

He pointed out that, in that regard, it is very important to measure the strength of competition policy. Usually, it consists of two parts: competition policy laws and institutions, and competition policy enforcement. The stronger the competition policy, the bigger the effect on competition. The biggest challenge here is measuring the strength of competition policy where different indicators are used. Indicators are based on surveys or on objective indicators such as competition authority budget and staff.

Dr Arčabić furthermore noted that, in empirical literature, the effect of competition policy on the competition itself is positive, but it is not very strong, and there is a pronounced endogeneity problem in measurement. Competition policy also has a positive effect on macroeconomic performance, but the endogeneity problem persists. In empirical literature, it is possible to identify a positive effect of competition policy on GDP growth, productivity, investment, and a number of firms, while it also decreases mark-ups. These results are beneficial.

Finally, he noted that higher competition stimulates economic growth via three main transmission mechanisms. First, it increases *allocation efficiency* by increasing business dynamism and decreasing mark-ups. This channel is empirically confirmed. Second, it increases *productive efficiency* by stimulating management quality. This channel has been empirically confirmed as well. Finally, the third mechanism is dynamic efficiency related to innovation. This mechanism is hard to analyse empirically, and results are inconclusive. Typically, an inverse U-shaped relationship is found, where both low and high competition have a negative effect on innovation. A medium level of competition is beneficial for innovation.

In the last presentation, Dejan Garić discussed in more details the qualitative and quantitative methods for *ex-post* analysis of merger and cartel decisions, in particular surveys and peer reviews, event studies, estimations and simulations, and quasi-experimental methods. He noted that the Croatian Competition Agency informs the public on its enforcement efforts through its annual reports, and that smaller agencies,

with scarce resources, are limited in engaging in *ex post* evaluation exercises of their own decisions.

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