

USE OF ECONOMIC EVIDENCE IN MERGER CONTROL
HUNGARY
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Introduction

1. It seems to be useful to begin with some remarks in order to help the better understanding of the specific answers to the questions included by the Secretariat's questionnaire. In the jurisdiction of the Gazdasági Versenyhivatal (GVH, the Hungarian competition authority) two areas – both belonging to the use of economic evidences, analyses and economists in merger cases – can be distinguished. First, one could mention the “soft” side, namely the application of economic concepts and doctrines (this issue could be labelled e.g. as *economic thinking*). Second, one could think of the use of the “hard side”, namely tools such as statistics and econometrics based on data in order to check hypotheses on certain issues such as demand substitutability for market definition, or the price effects of a merger (this issue could be labelled e.g. as *measurement*). Naturally the two areas may overlap and should be connected to each other moreover, both require the application of economic theory and the involvement of economists. Nevertheless, we prefer to make a distinction in this submission, since the GVH has different experiences and practice depending on which area is in question.

2. As far as economic thinking is concerned, the basic attitude of the GVH has been always pursuing to deal with cases in a way which is based on sound economics. Clearly, this is sometimes made to be difficult by the legalistic traditions of the Hungarian public service; also the GVH might make mistakes due to incomplete knowledge in economics. Nevertheless, the GVH is open to apply economic concepts and economics based doctrines and to incorporate them into decision making as well as to learn and to improve its capability to do so.

3. On the other hand, the GVH has very little experience with measurement, and while the issue is on the agenda, the GVH is at a very early stage. Consequently, measurement currently is a capacity building issue rather than a case handling issue for the GVH.

Specific answers

1. ***Organization and involvement of economists in the decision making process: How are economists integrated in the decision making process (e.g., part of a case team, separate unit)? Is their participation in every merger case mandatory?***

Presence of in-house economists

4. For a proper answer it worth to draw up briefly the organisation of the GVH as well as the categories of the GVH staff. The units and sections of the GVH can be sorted into three groups: (1) case handlers/investigators, (2) the Competition Council, (3) general sections. Case handlers deal with cases collecting information, making analysis and proposal for the Competition Council. They are working under a Vice-President of the GVH. The Competition Council is the decision making body of the GVH its members are full time public officials, and its president is the other Vice-President of the GVH. The Competition Council – unlike the Danish or the French Competition Councils – is part of the authority, nevertheless its members are independent by law regarding their decision making in cases. The general

sections (e.g. the International Section, or the Competition Policy Section) are working directly under the President of the GVH and – at least in the context of casework – their task is to support the work of case handlers and the Competition Council.

5. Most of the GVH staff (not mentioning the assistance personnel) is consisted of three categories regarding their professional background: (1) lawyers, (2) *old-school economists*, (3) *new-school economists*. The difference between *old-school* and *new-school economists* has historical background – old-school economists were educated before transition therefore they studied Marxist political-economy instead of micro economics, industrial organisation (IO) or corporate finance and they are usually relatively weak in mathematics. Old-school economists – with a few exceptions – usually can be strong as a generalist based on their experiences, and not as economist. The GVH has about 10 new-school economists (approximately 10% of the staff), and the number (and percentage) of lawyers is increasing in rest of the staff.

6. *New-school economists* are present in many units and sections. They are working as case handlers, and within the general sections or the Competition Council as well. In addition, the President of the GVH and a Vice-President have traditional economic, financial, or business background (while the Chairman of the Competition Council is a lawyer. Nevertheless, *new-school economists* are not spread evenly within the GVH: some case handler units has more of them than others (some has not any at all), and it is fair to say that IO oriented *new-school economists* are certainly over-represented in the Competition Policy Section. There is no a special department for economists within the GVH.

Involvement of in-house economists

7. Economists are integrated into in the decision making process in different ways. First of all, two of the seven members of the Competition Council are economists with academic experience in the field of microeconomics or IO, and an other member is also an economist. There is no rule on this matter, but the Competition Council usually works on cases in panels consisted by three members, involving at least one of the three economists.

8. Second, there are *new-school economists* among case handlers, working on cases. There are no rules on team-work within the GVH, and the frequency of team-work depends very much on the particular case-handler unit's habits. Even when team-work occurs, to involve a *new-school economist* into the team is not a primary consideration. Teams are formulated on the basis of the officials' experiences rather than on the basis of their professional background.

9. Third, there is a mandatory system to incorporate the International and the Competition Policy Section (including their economists) into the investigation of antitrust cases. This is usually a consultative process between these Sections and the case handlers or the Competition Council, but sometimes economists of the Competition Policy Section become member of the case handler team. The Competition Policy Section has to comment on the early stage concept papers of cases, including "second phase" merger cases. This process makes possible to involve *new-school economists*.

2. *Have steps been undertaken to improve an agency's economic expertise in merger control?*

10. The GVH introduced the in-house consultative process mentioned in the response for question number 1 with the intention to improve its capability to deal with cases, and to use its economic expertise more effectively as well as to improve it (learning by doing). Beyond this, trainings (in relation with *economic thinking*) and the GVH project on preparation for measurement in antitrust cases (in relation with *measurement*) can be mentioned.

11. The GVH organised an economics of antitrust training for its officials, with the following aims: Through the knowledge provided by the course the case handlers can get acquainted with the special economic concepts and their backgrounds, that can be used in antitrust analysis during our investigations. This knowledge also helps them to analyse the market structures, the behaviour of competitors, and makes it easier to identify certain competition concerns.

12. The training is studiously theoretical, so it does not give any technical help (such as knowledge relating to document handling or investigative techniques) to case handlers, but tries to bring them closer to the economic background. The learning material is more intuitive than formal, it includes many examples and case studies for a better understanding. The training runs in a seminar-like rather than a lecture-like form, thus it requires an active participation from the case handlers, which makes the training more intensive.

13. The lecturers are experts in Industrial Organisation from various universities. The course lasts 10 weeks, one full day per week for each particular topic. The training is essentially based on books on Industrial Organization, competition economics and regulation, but the teachers prepared their own reading, which better suits the needs of the GVH. (During the design of this training we studied the British (OFT) example, but finally we preferred to use a different structure.)

14. The training includes the following topics:

- Costs and profits, efficiency (cost types, efficiency of scale and scope, asymmetric information, moral hazard, adverse selection, etc.)
- Companies and their motives in economic decision-making (market forms, monopoly, duopoly, monopolistic competition, contestable markets, etc.)
- Horizontal relationships (market power, market cooperation, cartels, conscious parallelism, tacit collusion, concentration and its measurement, etc.)
- Vertical relationships (double marginalization, various vertical externalities, hold-up problem, franchise, retail price maintenance, etc.)
- Product differentiation (first-mover advantage, innovation, R&D, patents, product variety, etc.)
- Essential facilities (natural monopolies, sunk costs, network externalities, network effects etc.)
- Goods, advertising (search, experience, credence goods, etc.)
- Price discrimination (first, second, and third degree price discrimination)
- Restriction of competition, barriers to entry (predatory pricing, exclusionary pricing, limit pricing, Areeda-Turner rule, etc.)
- Relevant market (geographic market, product market, substitution, complements, etc.)
- Concentrations in EC competition policy
- Various case types of EC competition policy

15. The training ends with an exam covering theoretical and practical questions, the latter in a form of a case study.

16. The first training was held in Spring 2002, and since there remained only 19 case handlers, who have not participated yet (including the 11 case handlers from the ongoing 7th training), but partly this is because only 10-12 people can attend a course at the same time, in order to exploit the advantages of small group work.

17. The GVH organised a project on the measurement in competition policy to explore this area for the GVH with the participation of a small number of its new-school economists.

18. As a first step a self educating course was organised, which was based on a book from Simon Bishop and Mike Walker: *Economics of EC Competition Law: Concepts, Application and Measurement* (2nd edition). During the course, the participants held presentations on the topics and discussed the various issues arising during the lectures.

19. The course proved to be a good start, as the participants became familiar with the most important cases of EC Competition Law from an economic perspective, increasing their knowledge about the use and constraints of econometrics in those cases.

20. The GVH is planning to continue this project, since the final objective is to be able to use quantitative methodology in certain cases when it is appropriate. The next stage should be to try our knowledge in an appropriate historic GVH case in order to test our skills and to deepen our knowledge in the formal techniques of econometric analysis. It is clear that the GVH would like very much to build up relations with authorities which are more developed in this respect (such as the EC DG Competition chief economist and his/her staff, and the US competition agencies' economist departments).

3. *Are outside economists used, and if so, in what circumstances?*

21. Outside economists are not used for *economic thinking* issues in the current GVH practice. The GVH used outside economists in a few occasions for *measurement* issues. One occasion was the investigation into the Hungarian mobile telephony, where the GVH asked data from the parties, and commissioned two outside economists to analyse them in order to have a picture on the demand substitutability between fixed and mobile services (calls), between prepaid and postpaid mobile services (calls), and to find out whether fixed-mobile calls belong to mobile or fixed markets. First, this analysis quantified product specific consumer habits by a set of variables such as monthly revenue per subscriber, average monthly call minutes per subscriber, call durations, average price level and made comparisons between them. According to the hypothesis, same consumer habit patterns of different calls suggest that those calls belong to the same product market. As a second step, these results were tested by a price-correlation analysis, which confirmed them. In another occasion the GVH anticipated difficult bank mergers, and as part of the preparation for the expected cases, it commissioned a study on the structure of the Hungarian retail banking markets (especially regarding geographic markets), based on retail banking data from a research institution. Actually, this latter was a mixture of *economic thinking* and *measurement*.

22. The use of outside economists can be an issue when the GVH does have the intention but does not have the capacity to make economic analyses, which can be the case regarding certain special industries. A condition for using outside economists is the existence of the market of such economists and industry experts available for the GVH, which is unfortunately still premature except for certain industries. Another difficulty with an outside expert is about deadlines, especially in merger cases – not only the analyses and its utilisation, but also the tender for getting outside expertise must be covered by the given time frame.

23. In addition, time to time – an increasingly – the GVH commissioners surveys among consumers on their historical or hypothetical choices and preferences, sometimes simulating SSNIP test, in order to be able to base its decisions on empirical data (especially regarding market definition). However, these surveys are not made by economists.

4. *What type of economic evidence is typically used in merger cases?*

24. The GVH relies mostly company documents required by the notification form in merger cases. These documents may include contracts, standard corporate analyses and reports, basic data on prices and sales. The nature of these documents and whether they can be regarded as “economic evidence”, changes case by case. Even if they include “economic evidences”, usually those evidences are not sufficient and appropriate for sophisticated quantitative analyses.

25. In the above mentioned inquiry into the sector of mobile telephony the GVH asked detailed data from mobile operators for quantitative analyses both on their traffic and on their revenues from mobile services. The GVH asked for the following information: number of subscribers, per service packages; number of calls in peak-time and in off-peak periods, per service packages; duration of calls in peak-time and in off-peak periods, per service packages; call tariffs for each service package, both in peak and in off-peak periods; and revenue from call services in peak-time and in off-peak periods, per service packages. Call number, duration, tariffs and revenue data had been provided for all call types separately, i.e. for on-net calls, calls to fixed networks, calls to mobile networks, calls from fixed networks, calls from other mobile networks, international calls and for roaming services. The GVH asked similar set of data from local fixed line operators too. All the requested data had to be submitted for each month of the time period examined from January 1998 till March 2001.

5. *What is the experience in obtaining data required to carry out economic analysis, from the parties or from third parties?*

26. The GVH has strong powers to obtain information in merger cases as well. Parties and third parties have to provide any data necessary for the assessment of the transaction. The notification form already requires the submission of certain data and during the proceedings, the GVH may ask further information. Until now there were no problems regarding the parties attitude to provide information or data required by the notification form or the GVH.

27. However, the GVH does not have much experience regarding the acquisition of data for *measurement* purposes and it even had some problems in obtaining information. Regarding the bank sector study the GVH obtained data from the financial supervisory authority, which was not easy given due to the confidentiality of those kind of data, and to the fact, that the request of information was submitted in a general inquiry and not in a normal procedure against certain undertakings. Regarding the mobile sector research, the GVH had strong powers, nevertheless it needed to reach an agreement with the parties on the exact coverage and aggregation of the data required. It also had to take into consideration that what can be still regarded as proportionate regarding the efforts the collection of data from the IT systems meant for the mobile carriers. In this latter case the exact form and platform of providing electronic data was subject to a deal between the GVH and the mobile carriers. These experience indicates that quantitative analyses requires much larger amount, detailed and specified data than those which are used in the traditional GVH practice, and this might cause difficulties in future (especially taking into account the strict deadlines for mergers).

6. *How have courts assessed the agencies' use of economic analysis, from the parties review decisions by an agency?*

28. Parties appeal only exceptionally against the GVH decisions on mergers, therefore there is no much experience with courts in merger cases. Regarding *economic thinking*, experience in non-merger cases is mixed, but the overall picture is positive rather than negative. Hungarian courts seem to be open for economics based explanations. Nevertheless, they are usually not focusing on the economic aspects of the case and their understanding regarding economics is not always perfect. There is no experience with courts regarding *measurement*, since the GVH has not used *measurement* methodology in cases.