

**FUNDAMENTAL PRINCIPLES OF
COMPETITION POLICY AS APPLIED BY
THE HUNGARIAN COMPETITION
AUTHORITY (GVH)**



GAZDASÁGI
VERSENYHIVATAL

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Fundamental Principles of Competition Policy as Applied by the Hungarian Competition Authority (GVH)

The Hungarian Competition Authority (GVH), 8 May 2007.

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I. PRINCIPLES

1.1. This document outlines the principles which underpin the activities of the Hungarian Competition Authority. These principles describe the general competition policy approach and considerations of the GVH. The GVH explains and publishes these principles in order to promote transparency and predictability in its operations, thereby increasing legal certainty and promoting competition culture in Hungary.

1.2. Substantively, the activities of the GVH rest on three major pillars. These are: (1) competition law enforcement proceedings; (2) competition advocacy; and (3) promoting competition culture.¹ The substantive principles underpinning these pillars will be discussed individually. Although most of these principles relate to all three pillars, their relevance can vary according to the nature of each particular activity. However, in order to avoid repetition these principles are presented only once, under the chapter on competition law enforcement proceedings. This is followed by a discussion of the operational and institutional principles and how they relate to the application of the substantive principles .

1.3. This document is structured as follows: In the remainder of Section I, the substantive principles, the institutional and operational principles are introduced in a brief discussion. Section II² then explains the principles in detail; outlining the underlying considerations of each one, and assisting in their correct interpretation. Section III³ presents the relevant background information, giving an overview of the underlying concepts and contexts. Further clarification is provided by a set of diagrams presented at the end of this document.

Substantive principles

Competition law enforcement and general principles

Objectives

1.4. The role of the GVH is to ensure the sound operation of markets (i.e. that they promote competition and benefit consumers). For this purpose – in relation to the freedom of competition – the GVH enforces the competition rules under its competence, in the public's interest, in a manner that enhances long-term consumer welfare and therefore competitiveness. Its role is also to support competition in general, employing all available means, and to facilitate government regulation aimed at creating or substituting competition where competition is not currently possible.

1.5. In a market economy, competition is generally considered to be the best mechanism for signalling society's needs to firms and for increasing efficiency, thereby benefiting consumers. The ultimate goals are long-term consumer welfare and efficiency. The consequent increase in competitiveness should stimulate economic growth and employment, resulting in an increase in the standard of living. Competition is the instrument for achieving these.⁴ The GVH is entrusted to safeguard the proper operation of this mechanism and to prevent its restriction or distortion. On the

¹ The main activities of the GVH in relation to the freedom of competition are illustrated by Figure 4.

² Section II – Explanations to principles

³ Section III – Background note to the principles and their explanation

⁴ The objectives of competition policy in general are illustrated in Figure 1

other hand, in cases of market failure, competition does not provide the best result, and efforts to promote it may actually reduce welfare and efficiency.

1.6. Competition policy is concerned with promoting welfare. The term competitiveness in the GVH's interpretation will always refer to efficiency and/or efficiency benefits. For the same reason, by 'anticompetitive practices' the GVH means the unreasonable restriction of the competitive process; therefore the GVH protects competition (that is, the competitive process) and not the failing individual market players or a market structure that is considered to be competitive. Another consequence is that practices, which are simple contractual disputes or merely changes in the distribution of income between two (or more) firms or between different levels of the vertical chain without affecting long-term consumer welfare, are basically irrelevant from a competition policy perspective. All this does not preclude measures taken in defence of competition in a given case from having a positive impact on individual market players as well. In other words, competition policy is to protect the public interest related to competition, but individual interests may coincide with this interest from time to time.

1.7. As a national competition authority, the activities of the GVH focus on the long-term welfare of all consumers in Hungary and not just that of one individual group. However, where trade between EU Member States is affected (and Community competition law applies) the GVH acts to promote the long-term welfare of EU consumers as a whole.

1.8. When trade between EU Member States is affected, and Community competition law applies, the welfare/efficiency goal is supplemented with the integration objective. This is a well-established underlying consideration in Community competition law, according to which its application is a means, not only for increasing welfare, but also for creating a single market.

Restriction of competition and its possible positive impacts: assessment

1.9. When the GVH assess the benefits and disadvantages of a particular practice, the primary disadvantage it takes into account is the restriction on competition. In addition to the effects that have actually occurred, the GVH considers likely detrimental effects in the future as well. In evaluating effects on competition, the GVH pays special attention to restrictions on prices, and generally considers these restrictions to be particularly sensitive.

1.10. The GVH considers the benefits to be any pro-competitive and efficiency improving effects. The concept of efficiency is used in a broad sense, incorporating allocative, productive and dynamic efficiencies.

1.11. When considering a particular practice, the GVH evaluates these opposing effects from the perspective of long-term consumer welfare. Restrictions on competition generally reduce welfare, and therefore may expect to receive an unfavourable evaluation. However, a practice that contains restrictive elements may still be evaluated favourably if its overall effect strengthens competition and therefore increases welfare. Similarly, a practice restricting competition will still be evaluated positively if it gives rise to considerable direct efficiency benefits, which outweigh its negative impacts in terms of welfare.⁵

1.12. Even if an anticompetitive practice carries beneficial effects, it is highly doubtful that they will be realised if the anticompetitive effect is so strong that it leads to the complete elimination of effective competition. In these cases it is unlikely that the GVH would conclude that the beneficial consequences outweigh the anticompetitive effects. Such conduct may only be treated favourably in extreme cases such as a natural monopoly where the benefits of an anticompetitive conduct are so

⁵ The direct and indirect effect on welfare and the general scheme of GVH's competitive assessment are illustrated in Figure 18.

great that, even in the absence of competition, the realised benefits outweigh the losses incurred due to the elimination of competition.

1.13. The GVH will oppose a restriction of competition in cases where a positive impact on efficiency is theoretically possible but its realisation and scale are doubtful, making an accurate assessment difficult. Thus in its competition policy interventions, the GVH prefers to risk losing efficiency benefits rather than risking a restriction of competition being realised without any efficiency benefits taking place.

1.14. In the case of hardcore cartels, the serious and unjustifiable restriction of competition and damage to the long-term consumer welfare are regarded as certain, without the need for detailed competition policy analysis. Therefore the GVH considers these practices to be the most serious violations of competition law, and are at the forefront of its enforcement efforts.

Dynamic approach

1.15. In its work the GVH applies a dynamic approach, which is expressed in many ways. The GVH attributes great importance to considering potential competition in connection with both assessing the market position of the firm being investigated (when the question is the degree of its market power) and in cases where the question is whether the practice investigated restricts competition. The typical form of potential competition is the possibility of a new entry into a market or a threat of entry, hence the GVH considers it important to analyse the scope for new entry. The GVH does not narrow its understanding of entry barriers to administrative restrictions (such as statutory rules). Thus it does not automatically consider a market to be contestable where such barriers to entry are non-existent or do not have a significant impact.

1.16. Following from the openness of the Hungarian economy and the country's small size, the GVH attributes particular importance to import competition, which applies to both the competitive pressure exerted by imports and the impact of policy on import competition.

1.17. In its analysis, the GVH also takes into account future competition where it is relevant; this is particularly true for sectors where the market has been opened up, is being opened up or is expected to be opened up.

1.18. The GVH attributes equal importance to dynamic efficiency (i.e. to innovation and adaptability), and to static forms of efficiency such as allocative and productive.

The minimum necessary intervention

1.19. The GVH aims for an effective but minimal intervention to the market. It does so by recognising the importance of free market mechanisms, as opposed to interventionist command mechanisms, and carefully avoids interfering in the functioning of markets without good reason.

1.20. In cases where it is difficult to assess whether a practice constitutes effective competition or is anticompetitive, the GVH considers the practice in question to be a normal part of the competitive process. In other words, the GVH would rather risk considering the practice in a borderline case as competitive (even if it is anticompetitive), than risk deeming it anticompetitive (even if it is competitive), in order to avoid unnecessary interventions to the market. However, practices of firms previously protected from competition by government instruments are investigated in a 'market opening' context and constitute an exception from this general approach. This is because in such cases the risk that the GVH would interfere with market mechanisms is substantially smaller.

1.21. In competition law enforcement, protecting competition basically means *maintaining* competition (instead of its artificial intensification). Proceedings dealing with firms in the context of

market opening, where these were previously protected from competition by government instruments, are exceptions to this; in these cases, protecting competition also includes the protection of the emergence and intensification of competition.

1.22. In order to realise the aims of competition policy, the GVH employs both structural and behavioural remedies. Of these, the GVH generally prefers interventions that are aimed to affect market structure rather than firm behaviour, as it considers the former to be more consistent with free market processes.

1.23. The GVH seeks to apply flexible and pragmatic solutions, and prefers to remedy competition related problems, rather than merely sanctioning them. This is provided a remedy is consistent with the GVH's intentions in the case at issue, and that it does not threaten legal certainty, or general deterrence.

Tools and the limits of the analysis

1.24. The GVH strives to ensure that its competition policy analysis and decisions encompass a sensible interpretation of economics, wherever possible employing empirical methods. However the GVH has a clear understanding of the limitations and dangers of applying such methods, and considers that empirical methods should not be relied upon in isolation.

1.25. Due to the estimative and predictive nature of competition policy analysis in general, the GVH considers a market impact to be proven if there is a sound basis to hold that it has occurred or is likely to occur.

1.26. In performing its activities, the GVH relies on the analytical, competition assessment and decision-making principles developed in the international practice of competition policy. It also develops such principles while trying to ensure that their application occurs on a case-by-case basis.

Competition advocacy principles

1.27. The design and implementation of public policies and specific administrative decisions often directly impact competitive conditions (i.e. market structure) and the conduct of firms. Competition advocacy is an activity by which the GVH aims to influence these with a view to making them pro-competitive. The substantive principles described in connection with competition law enforcement – with the appropriate adjustments – are also valid for the GVH's competition advocacy activity.

1.28. Pursuant to its competition advocacy activities, the GVH will exercise all available powers under the Competition Act. Other available tools include the publication of its views, and as a last resort in limited circumstances contesting secondary legislation that conflicts with the Competition Act before the Constitutional Court. The GVH is aware that its competition advocacy activity might result in conflicts with other government bodies, or with certain government representatives, but it accepts this risk in the interest of competition. At the same time, the GVH is ready to accept compromise in its competition advocacy activities, provided that this will serve the case of competition better than refusal.

1.29. As a matter of routine, the GVH will identify any negative effects on competition caused by the public policy or government intervention. Where such effects arise, they are brought to the attention of the relevant decision-makers. Where the GVH considers there to be an unreasonable restriction of competition, having taken into account both effects on competition and other effects, the GVH will seek not only to bring these concerns to the attention of the relevant decision makers, but also to convince them that these concerns are serious.

1.30. In its competition advocacy activity the GVH uses a deregulatory approach, which means that government interventions in the market are generally considered as acceptable only in the case of market failure. Where interventions do occur, these should be proportionate to the stated goal, meaning that there should be no unreasonable restriction of competition.

1.31. The GVH prefers government measures which stimulate competition to those which attempt to tackle the negative effects of limited or non-existent competition. At the same time measures aimed at the protection of consumers (from the consequences of weak competition) are encouraged by the GVH, provided that their cost does not outweigh the averted consumer harm. The GVH deems regulations and government measures to be more appropriate for dealing with such exploitation than its own competition law enforcement proceedings..

Competition culture principles

1.32. The existence of a strong competition culture in Hungary is considered very important by the GVH and so its promotion is held as a central task. However, the GVH does not consider itself to have exclusive responsibility for promoting competition culture. The attitudes and behaviour of the business community, administration, political decision-makers, the media and ordinary citizens are all important to society's acceptance of competition. These factors are as important to a strong competition culture as academic discussion on competition policy issues. Although the GVH is active in promoting competition in all these areas, it attributes special importance to contributions by the academic community..

1.33. The GVH believes that corporate compliance programmes are an important and beneficial part of competition culture. Nevertheless, due to potential conflicts of interest, the GVH will not participate in the development or organisation of such programmes. This does not preclude lobbying or consultations with firms, which the GVH considers to be an unrelated activity.

1.34. In addition to specific efforts aimed at the promotion of competition culture, the GVH considers all its other activities, including competition law enforcement proceedings and competition advocacy, as activities that also promote competition culture.

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1.35. In the GVH's view competition law enforcement, competition advocacy, and the promotion of competition culture are three equally important pillars of its activities. In its work the GVH seeks to harmonise these activities, as well as to exploit the synergies that exist between them, for example by combining the different tools that belong to each individual pillars in order to achieve more.

Institutional and operational principles

Priorities and resource allocation

1.36. The GVH strives to use its resources efficiently; mindful that it is in the public interest to achieve the highest possible "competitive result" with the public resources it is entrusted with, and having regard to the fact that private enforcement of competition law is possible in Hungary. In allocating resources between tasks, the GVH primarily takes into account the following factors:

1.37. In relation to competition law enforcement:

- How strong is the presumable effect on competition?
- Is it likely to have spill-over effects hindering the competitiveness of other sectors?
- How large is the group of presumably affected consumers?
- Is the GVH likely to be able to remedy potential problems with the instruments available?
- Is it an important issue with regard to the evolution of competition law?
- Could the GVH's proceedings be considered as exemplary or indicative to market actors? (for example enforcement activities may be capable of shaping case law)
- Does the issue require the GVH's intervention, or is it likely to be solved in another way (e.g. by private law enforcement) in the absence of such intervention?

1.38. In relation to competition advocacy:

- How strong is the presumable effect on competition?
- Is it likely to have spill-over effects hindering the competitiveness of other sectors?
- How large is the group of presumably affected consumers?
- Resource and time constraints
- Could the GVH's advocacy action be considered exemplary or indicative to market actors or policy makers?
- Will the GVH's intervention prevent further competition law enforcement actions or additional anticompetitive state interventions Will certain business practices likely become easier to investigate?
- Does the issue require a GVH intervention, or will it presumably be solved in another way without such intervention?

Independence and co-operation

1.39. The GVH is an independent competition authority. It views its independence from government and from firms as one of the most important institutional guarantees for the realisation of competition policy objectives.

1.40. Therefore, the GVH performs its tasks autonomously, exclusively based on competition policy factors and independent of politics or the government's daily economic policy considerations. The GVH is willing to defend its independence to achieve its desired goals, even if this involves the risk of clashes with other administrative authorities. Furthermore, it is not merely its actual independence but also the credibility of its independent operations that matter.

1.41. The GVH does however take into consideration the general economic policy environment, policy intentions and plans. Furthermore, in competition policy issues the GVH co-operates with other administrative bodies where this contributes to the realisation of competition policy goals, or if it helps to achieve the other co-operating party's goals, so long as there is not a negative effect on competition or interference with GVH activities in protecting competition. In this respect, the GVH regards sectoral regulatory authorities, which are responsible for the economic regulation of certain sectors, as special partners. It seeks to co-operate with them in a number of ways including the harmonisation of measures taken to address specific problems, and the pooling of resources and tools available to the authorities in question.

1.42. The GVH closely follows the operation of other organisations dealing with competition policy, and draws from their experiences. These organisations include various Hungarian sectoral regulatory authorities, foreign competition authorities, foreign sectoral regulators, and also certain international organisations. Due to their international standing, particular attention is paid to the competition authority of the European Union, the federal competition authorities of the United States of America, the OECD, and the International Competition Network (ICN).

1.43. Making use of international experience does not mean copying without reflection. Rather it means adapting and applying observed relationships, approaches, and methods where these are deemed appropriate. Although, there may be circumstances where it is reasonable to adopt a certain method or outcome in its entirety.

Transparency and openness

1.44. The GVH is committed to operating in the most transparent possible manner, and to making its operation known to the professional and wider public. On the one hand, transparency and openness are demanded by principles of good administration, and on the other, they promote legal certainty, predictability, law enforcement, compliance, and the competition policy related activities of the GVH. Therefore, transparency and openness are not only required of the GVH, but it is also in their interest to ensure them. The GVH believes its transparency and comprehensive information practices also help to maintain the credibility of its autonomy, and are essential for the effective scrutiny of the body by external professionals dealing with competition issues. Such scrutiny is important to an independent competition authority, and the GVH is open to receiving observations and constructive criticism.

1.45. The GVH seeks to improve transparency, predictability, legal certainty, and the consistency of law enforcement, by occasionally summarising its practices. These are published in the form of notices or other means, and concern issues relating to various economic sectors, and to certain areas of competition policy or competition law.

1.46. Notwithstanding the importance of transparency and openness, there are other considerations that limit their scope, especially the GVH's obligation to protect business secrets, and in the interest of the successful conduct of its proceedings.

International co-operation

1.47. In order to face the challenges posed by a globalising world economy and by the issue of cross-border competition, the GVH is open to participation in international co-operation arrangements. These aim to exchange knowledge, to handle competition law enforcement and other competition policy issues and to provide technical assistance to other authorities, so long as these arrangements contribute to the realisation of GVH goals, or help others in realising their own goals without hindering those of the GVH. Notwithstanding this, the GVH is committed to becoming a reliable member of the European Competition Network, which co-ordinates the enforcement of Community competition law.

Training

1.48. The GVH places great emphasis on the continuous training of its employees. This is important because of the evolving nature of business practices and market phenomena relevant to competition policy, and considering the continuous development of competition policy approaches, methods, and procedural techniques.

II. EXPLANATIONS TO THE PRINCIPLES

2.1. In two documents: "*Fundamental Principles of Competition Policy as Applied by the Hungarian Competition Authority (GVH)*" and "*Fundamental Principles of Consumer Policy as Applied by the Hungarian Competition Authority (GVH)*" the Hungarian Competition Authority (GVH) sets out the fundamental principles underlying its general practice, analysis, decisions and its entire operation.

2.2. It is appropriate that the principles relating to the freedom of competition and the principles relating to the freedom of consumer choice are set out in two separate documents, as these are different in nature. The first document basically deals with the area traditionally called *competition policy* or *antitrust policy*, as well as with institutional and operational issues. The second deals with substantive issues relating to the freedom of consumer choice (i.e. with the overlapping areas of fair competition and consumer protection), and discusses institutional and operational issues only where there is a divergence in this respect between the two documents.

2.3. By publishing two papers and presenting the fundamental principles in a systematic way, the GVH intends to make its operation more transparent and consistent, thereby strengthening legal certainty. This way, it may be easier for the professional community to understand why the GVH behaves as it does in its operations. This is further strengthened by the fact that instead of merely publishing a list of principles, the GVH discloses detailed explanations and background notes to these principles. The GVH hopes that in presenting the principles in a manner that is as comprehensive as possible (given the complexity of some of the issues) it will serve to strengthen competition culture in Hungary.

2.4. This part II (Explanations) of the document entitled "*Fundamental Principles of Competition Policy as Applied by the Hungarian Competition Authority (GVH)*" contains explanations to the first part of the document (Principles). The purpose of the Explanations is to help in the correct interpretation of the Principles by detailing the considerations underlying each principle. Part III of the document (Background note) explains the meaning and background of the issues and terms contained in the Principles and the Explanations parts of the document. It is intended for readers who have only limited knowledge of competition policy.

1. Substantive Principles

2.5. In Hungary, the tasks of the competition authority are performed by the GVH. The basic provisions of Hungarian competition law are laid down in the Hungarian Competition Act.^{6 7} The provisions of the Competition Act – and through them, the legislator – determine both the substantive and procedural framework of the GVH's activities, and lay down certain principles and detailed rules. These provisions follow patterns and terminology used in Europe and in the European Union. Nevertheless, in line with the general nature of competition law, the Competition Act confers the GVH with considerable discretion; its phrasing allows – in fact even requires – the GVH to develop and to apply a modern and progressive general enforcement philosophy, policy, or set of principles that reflect international as well as domestic experience and best practice.

⁶ Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices (Competition Act)

⁷ There are also some other pieces of legislation that contain competition rules – Government Decrees on block exemptions – these, however, can be derived from the provisions of the Competition Act.

In addition to competition law, certain other legislation – mostly the laws and regulations applicable to regulated sectors, such as the Act on Electronic Communications – also contain rules applicable to competition, which have a background in competition policy. The Constitution of Hungary also recognises and supports the freedom of competition.

2.6. Naturally, these principles are not binding on courts that review the decisions of the GVH or that are involved in the private enforcement of competition law alongside the GVH's procedures.⁸ Nevertheless, the principles followed and presented by the GVH, together with the framework outlined by the explanations and the background note related to the principles, may serve as guidance for courts.⁹ In developing this framework the GVH has naturally taken into account existing case law.

2.7. In terms of substantive issues this document deals only with competition policy matters, i.e. issues that fall within the scope of antitrust – or, as phrased by the Competition Act, the 'freedom of competition'. The Competition Act also contains provisions aimed at protecting the freedom of consumer choice. The enforcement of these provisions falls within the GVH's competence; however the principles relevant to this area, along with corresponding explanations and background information are detailed in a separate document.¹⁰ This is justified by key differences between the two issues.¹¹

2.8. Furthermore, the Competition Act deals with the issue of unfair competition; these are business practices such as slander, imitation or violation of business secrets. Enforcement of these provisions does not fall within the competence of the GVH; they are applied only in the framework of private law enforcement by the courts.¹²

2.9. In addition to the Competition Act, EU competition law provides a significant part of the competition rules applicable in Hungary. The enforcement of these rules – which apply in cases where the examined business practice affects trade between EU Member States – is entrusted to the GVH in certain cases. The GVH is also a member of the network of European competition authorities set up for enforcing EU competition law (ECN).¹³ The GVH is not the only actor in enforcing EU competition law, and it must take into account the principles reflected in the Community's case law. It follows from this that the Principles are not unconditionally applicable to the enforcement of EU law by the GVH, but only to the extent that they do not contradict community jurisprudence.¹⁴ On the other hand, as a Member State's competition authority, the GVH also shapes EU competition law and policy by virtue of

⁸ Although the GVH is the principal actor in competition policy in Hungary, the Hungarian legal system also allows the private enforcement of competition law. However, the private enforcement of competition law is not completely isolated and may be influenced by the activities of the GVH (particularly by its activities performed as *amicus curiae*), and its leading cases. (More on this: III. Background note paragraph 3.112, and particularly the footnote to that paragraph)

⁹ The notices and guidelines issued by the European Commission or the federal competition authorities of the United States, which play a similar role, are not binding on the Community courts or on US federal courts either. However, in their judiciary practice, these courts regularly rely on these documents, and have expressed on several occasions that these are useful because they provide great assistance to both the courts and those who were seeking compliance.

¹⁰ The document entitled "*Fundamental Principles related to the freedom of consumer choice followed by the GVH*".

¹¹ However, the GVH considers the understanding of the market (and competition) described here as its starting point also in defending the freedom of consumer choice, and seeks to achieve the same ultimate goal – the goal of maximising long-term consumer welfare – in both areas. Accordingly, in its consumer protection activities, the GVH expects the effects that are beneficial for consumers mostly from market mechanisms, and aims at their perfection, rather than elimination or substitution. The task of the GVH in both cases is to promote the sound (and preferably competitive) operation of markets to the benefit of consumers.

On the other hand, in principle, the GVH is able to look together at both issues – which are otherwise separate – and is able to take into account the nexus between the two areas. Accordingly, the GVH may be able to avoid cases where its intervention or initiative would promote one area but also disproportionately deteriorate the other area, so that overall, the intervention would not serve the interests of consumers (long-term consumer welfare). (For instance, the general aims of informing customers and ensuring market transparency in order to promote the freedom of consumer choice may facilitate practices that restrict competition, and may cause more damage than benefits to consumers.) Another example for this sort of trade-off is when provisions to ensure the freedom of choice for consumers create barriers to enter into the market.

¹² The protection of the freedom of competition in the system of the Hungarian Competition Act is illustrated by Figure 19.

¹³ European Competition Network

¹⁴ However, in general, taking into account also its trends, community jurisprudence and the content of the Principles (including the related Explanations and Background note) appear to be compatible.

its activities performed in various advisory bodies and in the ECN. In the course of this – to the extent of its possibilities – it strives to promote the principles described herein to encourage their prevalence in the EU's jurisprudence and competition policy to the greatest possible extent.

2.10. The Competition Act allows the GVH to issue notices describing its practices pursuant to the application of competition law, and to publish documents presenting its general considerations with respect to competition advocacy issues. At the time of writing, examples of such guidelines include the GVH's notices on the imposition of fines or on its leniency policy aimed at detecting cartels. Beyond simply presenting the methodology, enforcement technique, etc. applicable to the given topic, these documents may also reflect certain strategic considerations. They are relevant under the circumstances prevailing at the time of their drafting or for the GVH's programme and priorities developed for the given period, but may be revised from time to time to reflect changes in circumstances or priorities. Therefore, these documents may be reviewed in the medium term, although their content is, of course, more general than that of the specific decisions. For instance, in 2004 the GVH modified its notice on leniency, temporarily increasing the level of fine reductions available to co-operating firms subject to successful participation in the programme, in order to provide greater incentives for firms wishing to self-report infringements.¹⁵

2.11. The Principles (including the accompanying explanations and background note) are more general and more constant than the guidelines mentioned above. They describe the GVH's basic approach and attitude to competition policy in general. Therefore, the principles laid down in this document are reflected in the GVH's every notice and guideline, and permeate all competition related activities of the GVH.¹⁶

2.12. As regards their content, the Principles reflect a progressive approach that corresponds to the mainstream of contemporary thinking on competition policy. The transition from a planned economy to a market economy has been completed in Hungary, so there is no need for a special approach tailored to the particular features of a transition economy. Some say that all economies are "in transition" in the sense that they are affected by changes such as various market openings, dynamic technological development affecting the functioning of markets, by the quick expansion of innovative industries or by globalisation. The progressive mainstream approach taken by this document is meant to reflect these characteristics.¹⁷ In addition, the Principles take into account that Hungary is a small open economy, which also forms part of larger economic integration.

2.13. The rest of Part II of this document sets out detailed explanations of the Principles followed by the GVH in protecting the freedom of competition. These are broken down according to each of the GVH's activities. The vast majority of the principles discussed in connection with competition law enforcement also apply to competition advocacy, although they are not repeated in the discussion of the latter. They also permeate the activities of the GVH in promoting competition culture.

¹⁵ The guidelines and notices issued by the European Commission or the federal competition authorities of the United States, which fulfil a similar function, are also reviewed from time to time. For instance, the European Commission's first leniency notice on sanctioning cartels was published in 1996, and in 2002 and 2006 new notices were published after comprehensive reviews of preceding jurisprudence. The notice detailing the European Commission's fining policy was originally published in 1998, and after revision its new version was issued in 2006.

The horizontal merger guidelines issued jointly by the federal competition authorities of the United States were published in 1992; the 1997 version of the guidelines represented further refining, and in 2006, a more detailed commentary was published. (The jointly issued 1992 guidelines replaced the guidelines published separately by each competition authority in 1984 (one of them was originally published in 1967 and modified in 1982).)

¹⁶ The relation between the Principles and other GVH documents is illustrated by Figure 21.

¹⁷ For instance, the Principles (as well as the Explanations and the Background note) refer to the contexts of market opening and globalisation several times.

1.1. Principles: Competition law enforcement

1.1.2. Principles related to goals

2.14. The GVH's mission is to protect competition in the interest of long-term consumer welfare.¹⁸ The fundamental task of the GVH, as of any competition authority, is to protect and promote competition. However, competition in Hungary is not a goal *per se*, but a means to achieving the benefits that result from competition.¹⁹ The Competition Act explicitly states that in order to achieve efficiency and promote consumer interests, competition requires protection. In a market economy competition usually leads to lower prices, better quality and a greater range of products and services (i.e. better services and products for consumers). In other words, competition drives the efficient operation and development of firms and the economy and consequently enhances consumer welfare. In this way, competition policy contributes to the achievement of economic policy goals which are acknowledged and understood by the broader public. These include economic growth, employment, increasing the standard of living, all of which can be derived from competitiveness.^{20 21 22}

2.15. However, in the case of market failure, competition does not lead to the social optimum and may actually cause efficiency and welfare losses. Therefore, the role of Hungarian competition law and the GVH is not to blindly protect competition but to safeguard it as appropriate, with efficiency and consumer welfare as their ultimate goals.²³ Therefore, the GVH needs to protect competition from *unreasonable* restrictions; not *all* restrictions. The task of the GVH is to help ensure that markets operate for the benefit of consumers and by encouraging efficiency; this can be achieved primarily by protecting competition.

2.16. As the central goal of competition law, *welfare* requires a precise definition, especially given that there are several categories of welfare, each of which can be increased to the others detriment.²⁴ One option is to focus on long-term consumer welfare, which still allows preference to be given to producer welfare on a temporary basis, provided that this yields consumer welfare in the longer term.²⁵ The GVH will thus evaluate different market developments and any subsequent efficiency gains with a view to maximising long-term consumer welfare.²⁶

2.17. The Principles also declare that the GVH should focus on the welfare of domestic consumers and thus include the *domestic consumers principle*.^{27 28} When the examined practice does not affect trade between EU Member States, i.e. when the GVH applies national competition law, it focuses on

¹⁸ I. Principles paragraph 1.4

¹⁹ More on competition not being a goal *per se*: III. Background note section 2.1 (Objectives of competition policy), particularly paragraphs 3.99-3.100

²⁰ This is also the case even if economic growth, employment or the standard of living are not explicit priorities of the GVH, because these objectives can only be achieved by promoting competition and encouraging efficiency.

²¹ More on this: III. Background note paragraphs 3.95-3.99

²² This can be seen in Figure 1 which illustrates the objectives of competition policy in general.

²³ I. Principles paragraph 1.5

²⁴ More on the concept of welfare and the different categories of welfare: III. Background note section 1.5.2 (Welfare)

More on trade-offs between different categories of welfare: III. Background note section 1.6.3 (Efficiency and welfare trade-offs)

²⁵ More on a precise welfare objective: III. Background note section 2.1 (Objectives of competition policy), particularly paragraphs 3.102-3.104

²⁶ I. Principles paragraph 1.4

²⁷ More on domestic consumer principle: III. Background note paragraph 3.198

²⁸ I. Principles paragraph 1.7

the welfare of consumers in Hungary instead of consumers generally in the EU. The same essentially applies to cases in which the GVH plays an advisory role in the application of EU competition law by assisting another authority. On such occasions, the GVH will inform the competent authority about market developments in Hungary, and will encourage it to consider the effects on Hungarian consumers. In contrast, when the GVH applies EU competition law, the scope of domestic consumer interests represented by the GVH includes the welfare of consumers throughout the entire EU.

2.18. In the context of competition policy the GVH interprets competitiveness as efficiency and/or efficiency benefits.²⁹ Although, depending on the situation, an individual firm's temporary success relative to its competitors may be ensured by a number of other circumstances such as state subsidies, corruption, real sustainable competitiveness that is beneficial for the society may only stem from efficiency.^{30 31}

2.19. The phrase *freedom of competition*, used in the Competition Act, is also interpreted in line with a competition policy that is aimed at welfare and efficiency, as presented above. This is also set out in the Principles.³² According to this, violation of the freedom of competition is the same as an unreasonable restriction of competition. In accordance with the above, unreasonable restriction of competition means a restriction that is not outweighed by efficiency benefits. Therefore, the freedom of competition is not a "right" of firms to operate in the market and conclude transactions under all circumstances. The process whereby inefficient firms are driven out of the market is a natural trait of competition and, therefore, cannot be deemed to be a violation of the freedom of competition.

2.20. Similarly, freedom of competition does not mean that individual market players should have unrestrained freedom to act. In the competitive process, certain practices such as vertical restraints, limit others' freedom to act. For instance, an exclusive purchase agreement does not allow the buyer to purchase contracted goods from any other supplier. Such practices may result in restricting competition but may also bring about an increase in efficiency, and may even strengthen competition.³³

2.21. The Principles state that the activities of the GVH are aimed at protecting competition instead of automatically protecting competitors or the competitive market structure from competition.³⁴ A market structure that is favourable for sustained competition is naturally also important to the GVH. Protecting a market structure in this way is not necessarily the same as protecting current competitors or firms just entering the market.³⁵ Furthermore, the protection of a competitive structure is a means of protecting competition. However, when restructuring is efficiency enhancing and is realised through the competitive process, there is no reason for the GVH to intervene.³⁶ The GVH by no means wants to discourage firms from competing fiercely, even where these have significant market power and are

²⁹ I. Principles paragraph 1.6

³⁰ More on the interpretation of competitiveness and its relationship with competition: III. Background note paragraphs 3.95-3.97

³¹ This is relevant also in relation to objectives, because the Competition Act repeatedly mentions competitiveness as a factor that should be considered in the assessment of certain business practices. Later, it will be clarified also in more general terms that the effects the GVH considers to be beneficial in its competition policy analysis are limited to the increase of efficiency and competition. (II. Explanations, paragraph 2.25)

³² I. Principles paragraph 1.6

³³ The meaning of the freedom of competition in the Hungarian Competition Act is illustrated by Figure 20.

³⁴ I. Principles paragraph 1.6

³⁵ More on this: III. Background note paragraphs 3.91-3.93 and 3.199

³⁶ This is not necessarily the case in sectors where the market is either just being opened up, has been recently opened up or is expected to be opened up in the near future, and the investigation concerns the behaviour of a firm that had earlier been protected by government measures. (More on this: III. Background note paragraph 3.199, and particularly the footnote to it)

dominant in the market. All this follows the guiding principle that the GVH should strive for *long-term consumer welfare*.

2.22. As the GVH's activities are motivated by welfare (as declared in the Principles), it does not deal with simple contractual disputes between firms; these are not considered to fall within the ambit of competition policy.³⁷ The same pertains to business disputes that concern the distribution of income between firms but have no bearing on final consumer prices, on output volume or on competition, and therefore no bearing on welfare either.³⁸

2.23. It is also clear from the above that the GVH's task is to protect the public interest in relation to competition rather than individual interests. Naturally, there may be some overlap between public interest and individual interests; this may assist the GVH in its work, for example, through the participation of injured firms or consumers.³⁹

2.24. In cases where the investigated practice affects trade between EU Member States, i.e. when the GVH applies community competition law, there is one more goal that applies in addition to those discussed above. This is the integration objective in community competition law; an effort to ensure that a single European market, or at least markets independent of national borders within the European Union, emerge instead of the fragmented markets of the Member States.⁴⁰

1.1.2. Restriction of competition and its possible positive impacts

2.25. In assessing mergers and agreements which restrict competition, the Competition Act requires that both the benefits and costs be considered. Under the Principles, the GVH should weigh the negative effects on competition against the positive impacts, where the latter includes any efficiency gains.⁴¹ This is again consistent with the GVH's emphasis on long-term consumer welfare.

2.26. It is clear from the wording of the Competition Act that the assessment of cases of abuse of a dominant position depends on, not only the nature of the practice, but also whether the practice is reasonable or not. This again constitutes a balancing of the beneficial and detrimental effects, although the Competition Act uses somewhat different wording: the restrictive practice of a dominant firm, constitutes an abuse if it is not 'justified' by resulting efficiency gains. Therefore, an exclusionary abuse is that which unreasonably restricts competition, on the same criteria as described above in relation to mergers and agreements. Only the wording is different. Once again, this is consistent with the GVH's ultimate goal of long-term consumer welfare.

2.27. For the purposes of competition policy analysis, it is not only effects on competition that have already occurred that are relevant, but also future threats to competition (i.e. the risk of an actual restriction on competition occurring).⁴² Accordingly, the GVH looks beyond the impact that has already occurred, as is declared in the Principles.⁴³

³⁷ I. Principles paragraph 1.6

³⁸ More on this: III. Background note paragraph 3.94

³⁹ This also holds for the private enforcement of competition law, where the private interests of the parties play an important role but the intervention criteria do not differ from those applied in the competition authority's proceedings. (More on this: III. Background note paragraph 3.200)

⁴⁰ I. Principles paragraph 1.8

⁴¹ I. Principles paragraphs 1.9-1.11

⁴² More on this: III. Background note paragraph 3.143

⁴³ I. Principles paragraph 1.9

2.28. In certain cases, a partial restriction can prevent some market failure, and lead to an overall increase in competition, by increasing efficiency.⁴⁴ There are also cases where overall competition decreases due to some restriction, but long-term consumer welfare nevertheless increases by virtue of an improvement in efficiency. Thus some restrictions can be justified on welfare grounds.

2.29. However, the GVH does not believe that efficiency can justify all restrictions on competition.⁴⁵ Firstly, restrictions on competition will, in many cases, not result in considerable increases in efficiency. Secondly, even where considerable efficiency gains are realised, a substantial restriction on competition is only justified if overall long-term consumer welfare will increase.⁴⁶ In situations where the intensity of competition has decreased below the level of effective competition, long-term consumer welfare will only increase in exceptional cases. Therefore, apart from exceptional cases such as that of natural monopolies, the GVH does not consider restrictions on competition leading to the elimination of effective competition to be desirable for welfare purposes, as stated in the Principles.⁴⁷

2.30. Where there is doubt as to whether efficiency benefits will compensate for the losses arising out of the restriction on competition, the GVH will assume that the expected benefit in efficiency will not be sufficient to make the restriction on competition justifiable.⁴⁸ Once the ultimate goal of competition policy is defined, in principle, the outcome of the assessment will be clear in all cases: the GVH considers a restriction on competition to be reasonable if there is likely to be a net increase in long-term consumer welfare (arising from efficiency gains) as compared to if the restriction on competition (and the benefits arising out of it) does not take place. Therefore, the theoretical criteria for this analysis is clear, but its application in practice is not always simple and clear cut.

2.31. In many cases, the effect of a restrictive practice on competition will be clear and the assessment of efficiency effects simple. In others, although the restrictive effect on competition may be clear, measuring the extent of possible efficiency gains may be problematic. The different effects can rarely be quantified or compared with certainty. In addition, efficiency benefits may be possible but their likelihood less clear. There is a danger in such cases, that the GVH (without being at fault) allows a restrictive practice on the expectation of efficiency gains that never materialise. The negative impact of the restriction on competition is not compensated for and competition is harmed. The risk of the opposite also exists; the GVH may prohibit a practice which could have resulted in substantial efficiency gains and an increase in long-term consumer welfare, even though competition would have been restricted. Naturally, the GVH tries to avoid both types of error, however, beyond a certain point, the possibility of one error occurring can only be reduced by increasing the likelihood of the other.⁴⁹

2.32. It should be noted that one type of error is more likely than the other. The firms involved in a particular case possess the most accurate information available about the potential efficiency benefits of their practice, and it is in their interest to reveal this information to the GVH. Therefore, the private interest in disclosing efficiency benefits coincides with the public interest. This substantially reduces the likelihood of the second type of error (blocking a welfare-enhancing practice) occurring. The GVH should therefore concentrate its efforts on avoiding the first type of error; where the realisation of

⁴⁴ More on this: III. Background note 3.85-3.88, particularly paragraphs 3.82 and 3.88

⁴⁵ More on this: III. Background note paragraphs 3.144 and 3.104

⁴⁶ The direct and indirect effect on welfare and the general scheme of the GVH's competitive assessment are illustrated by Figure 18.

⁴⁷ I. Principles paragraph 1.12

⁴⁸ I. Principles paragraph 1.13

⁴⁹ More on this: III. Background note paragraphs 3.130 and 3.196-3.197

efficiency benefits is questionable, it is reasonable to take a position opposing the restriction on competition in question.

2.33. Although the GVH takes efficiency benefits into consideration, it does not necessarily assume a responsibility to explore these benefits in full. Given the incentives described above, it could be said that the GVH is open to arguments of efficiency benefits from firms in its competition policy analysis.

2.34. In conducting its competition policy analysis, the GVH exercises particular attention and sensitivity to restrictions on price.⁵⁰ There are a number of factors underlying this.⁵¹ First, competition is often dominated by price competition; secondly, price competition can be restricted more effectively than other aspects of competition. Consequently restrictions on price constitute a strong restriction of competition. The operation of pricing and price signals are particularly important to the functioning of an economy. Any distortion in prices will lead to further distortions downstream. Maintaining price competition is thus of particular importance. Naturally, this does not mean that the GVH focuses solely on price competition in its analysis or automatically attributes overarching importance to it in all cases, without considering the particular circumstances of the case; in particular other relevant characteristics of competition.

2.35. As it is not possible to provide a preliminary assessment of the various business practices due to their diversity and the variety of circumstances, an assessment on a cases-by-case basis is generally needed. Hardcore cartels constitute the most damaging restriction on competition and are extremely unlikely to result in significant efficiency gains.⁵² Therefore the GVH considers hardcore cartels to be the most serious violations of competition law. As indicated in the Principles, they are at the forefront of the GVH's enforcement efforts because of the relatively low rate of discovery due to the secretive nature of such practices.⁵³

1.1.3. Dynamic approach

2.36. The GVH applies a dynamic approach in its activities, as directed by the Principles. The word *dynamic* – as opposed to *static* – appears in a number of contexts in competition policy. This dynamic approach concentrates on efficiency gains, entry, and potential competition in the future.⁵⁴ It is discussed in more detail below.

2.37. First, the GVH considers it important to take into account *potential* competition in its competition policy analysis; in particular the competitive threat of new entry into a market. Considering potential competition in competition policy analysis assists in determining whether a particular firm has significant market power. If the GVH fails to consider the competitive pressure arising out of potential competition, market power would appear to be greater than it actually is, and consequently the analysis would be distorted. If a particular firm does not have significant market power; its conduct is less likely to restrict competition unless it is a hardcore cartel. Accordingly, in these cases GVH intervention is less likely to be needed, so taking into account potential competition in this regard will reduce the likelihood of GVH intervention.

⁵⁰ I. Principles paragraph 1.9

⁵¹ More on this: III. Background note paragraphs 3.81 and 3.85-3.87

⁵² More on cartels, their effect and treatment: III. Background note paragraphs 3.134-3.135

⁵³ I. Principles paragraph 1.14

⁵⁴ More on potential competition: III. Background note section 1.3.2 (Entry into the market), and paragraphs 3.19
More on dynamic efficiency: III. Background note 1.5.1 (Efficiency), particularly paragraph 3.57

2.38. Considering potential competition also helps to evaluate the impact on competition of a particular business practice. In this context, the dynamic approach demands that impeding or restricting potential competition (e.g. by artificially increasing entry barriers) is deemed to be a restriction on competition, and is treated in the same way as a restriction on actual competition (that already exist in the market). Thus, for instance, erecting barriers to prevent new entry into a market is deemed to be as much a restriction of competition, as driving existing firms out of the market. Mergers between potential competitors are considered by the GVH as mergers between competitors. Taking into account potential competition in this way increases the likelihood that the GVH will intervene, because the scope of practices giving rise to concerns and to be assessed for competition policy purposes is broader than would otherwise be the case.

2.39. Secondly, under the dynamic approach the GVH also takes into account future competition when making its competition policy analysis and its decisions. When evaluating a particular practice the GVH not only reflects on the actual market situation, but also on the changes that are likely to take place in the future, to the extent that this is reasonably possible. In other words, the GVH performs a forward-looking analysis in its assessment of mergers and in general for the investigation of practices that are relevant for future competition. When restructuring is taking place or about to take place in the market, expected events must be taken into account in examining the effect of a practice on competition and welfare. This is the only way to form a realistic picture of potential competition and the nature of competition. This is particularly important where the GVH is considering firms operating in a market that is opening up, about to be opened up or has recently been opened up.

2.40. Thirdly, the GVH attributes great importance to dynamic efficiency, because it considers the ultimate goal of its activities to be long-term consumer welfare. Therefore, in examining the impact of a given practice on efficiency the GVH considers, not only static efficiency, but also factors that influence – among others – the development of technologies and the flexibility of firms. Naturally, dynamic efficiency cannot be estimated as easily as productive efficiency, and competition policy must rely on more subjective analysis. This does not mean that while considering dynamic efficiency the GVH will rely purely on speculative statements made by the firms. Arguments relating to dynamic efficiency must be well-founded, however, the GVH does not rule out these arguments.

2.41. The Principles state that the GVH attributes special importance to imports.⁵⁵ This is justified by the openness and size of the Hungarian economy as well as by its geographic size. Hungarian consumers are often buyers in markets that transcend Hungary's national borders; where Hungarian firms compete with foreign firms. In light of this, failing to take into account imports would result in a distorted picture of the market; it would appear more concentrated, and in many cases, significantly more concentrated than it actually is. Experience, such as development following import liberalisation in the early 1990's, also confirms that the competitive pressure set by imports plays a critical role in maintaining and strengthening competition in a number of areas. Therefore, imports form an important part of the GVH's competition policy analysis, determining both the competitive pressure they exert in the market and the impact of the examined practice on them (so that, for instance, a restriction on imports is also deemed to be a restriction on competition) in line with the above.

2.42. When evaluating the likelihood of entry into a market, the GVH considers barriers to entry to consist, not only of administrative barriers, but also of economic barriers. In order to form a more accurate picture of the competitive pressure exerted by potential competition.^{56 57} All this is also set out in the Principles.⁵⁸

⁵⁵ I. Principles paragraph 1.16

⁵⁶ For instance, in the case of import barriers, it is not only administrative barriers (such as import restrictions or import tariffs) that are relevant for the competition policy analysis; barriers to import should include all economic factors that impede or prevent import (such as different consumer habits or language barriers).

1.1.4. The minimum necessary intervention

2.43. Under the principle of minimum necessary intervention, the GVH strives to interfere in the natural functioning of markets with its interventions to the minimum extent necessary.⁵⁹ Markets and competition create self-correction mechanisms of remarkable strength. Firms often use the same means for both competing and for restricting competition. Moreover, the results of competition cannot be imitated by any means available to the GVH (or to competition authorities in general) without substantial distortions and/or excessive costs.⁶⁰ Consequently the GVH has good reason to have basic faith in, and rely on, market mechanisms to tackle problems. It also has good reason to doubt the effectiveness and efficiency of state intervention (including competition policy intervention) and the ability of public interventions to solve problems in the market.⁶¹

2.44. The GVH intervenes to promote the well functioning of markets and competition. It does so when it believes that welfare losses would arise in the absence of intervention, and when it is convinced that intervention can help in achieving its given competition related goals. Nevertheless, this still constitutes an external intervention into market processes, so out of the alternatives available, the GVH will always choose the one that is expected to address the problem with minimum intervention in the functioning of the market. The Principles emphasise GVH interventions are neither intended to replace nor to command competition.⁶² The GVH does not wish to control market processes or attempt to set a competitive result instead of competition. Such a misinterpretation of the GVH's role would impede market processes and competition.⁶³ Therefore, the principle of minimum intervention generally means achieving an objective whilst avoiding unnecessary intervention. It also gives rise to some additional considerations.

2.45. In the competitive process, the same instruments of competition (such as lowering prices) can be used to both restrict and enhance it.⁶⁴ Consequently, it is in practice difficult to distinguish between vigorous competition and restrictions of competition. There is thus a risk that the GVH will inadvertently deem a practice to be anticompetitive, when it is actually competitive, and visa versa. In the first case the GVH's intervention in market processes is unjustified, while in the other, it fails to intervene when it is necessary.⁶⁵ In this second situation, the possibility of intervention will still exist later (when the restriction of competition becomes clearer), but there may be circumstances where later intervention would be too late.

⁵⁷ More on this details: III. Background note section 1.3.2 (Entry into the market)

⁵⁸ I. Principles paragraph 1.15

⁵⁹ I. Principles paragraph 1.19

⁶⁰ More on the self-correcting mechanisms: III. Background note paragraphs 3.80-3.81

More on the similarity of practices used for competition and for restricting competition: III. Background note section 1.4.2 (Retaining and increasing market power), and particularly paragraph 3.51

More on "simulating" the competitive outcome: III. Background note paragraphs 3.131 and 3.110

⁶¹ Certainly, the market is not able to manage all problems and certain state intervention may be necessary, just as the immune system does not defend the human body from all diseases, and it may prove necessary to administer drugs. However, drugs may have unpleasant or serious side effects, and may even weaken the defensive ability of the natural immune system. Therefore, administering drugs requires care, and in many cases it is better to avoid the use of drugs – particularly of strong ones – to avoid a cure that is worse than the disease. Similar caution is required with regulatory intervention, as it may also have unintended side effects and may weaken the market's self-correcting ability. Negative side effects should be considered to be a cost of regulation just as much as the administrative costs.

⁶² I. Principles paragraph 1.19

⁶³ This relationship is well illustrated by an everyday experience: children learn to bike faster if left to their own devices and if parents are able to resist the temptation to balance for them by using some method or accessory, trying to save the child from the initial failures.

⁶⁴ More on this: III. Background note paragraphs 3.130 and 3.51

⁶⁵ More on this: III. Background note paragraphs 3.130 and 3.196-3.197

2.46. In an ideal world the GVH would not commit either mistake, but in practice, the possibility for both errors exists; the only question is how frequently they occur. Beyond a certain point, the probability of the two types of errors occurring may be reduced only to each other's detriment. However, based on the above, the GVH is not equally concerned about both types of errors; the unnecessary interference with the normal operation of the market and competition is far more of a concern than failing to act against a small unreasonable restriction on competition. Accordingly, whenever there is doubt as to whether a particular practice or market process unreasonably restricts competition or is just a manifestation of fierce competition, the GVH tends to consider it a competitive practice. This is an application of the principle of minimum necessary intervention, as set out in the Principles.⁶⁶⁶⁷

2.47. On the other hand, this approach does not hold in the context of market opening (emerging markets). In such cases, the seeds of competition are highly vulnerable after the market has become competitive (in legal terms) but effective competition has not yet developed. In addition, the market position of the former monopolist (the incumbent) has not developed pursuant to the operation of market forces and the functioning of competition. Moreover, the former monopoly often enjoys advantages even *vis-à-vis* those new entrants who are more efficient in technological terms, just because of its assets and its ensuing size. Therefore, in such cases, the rule of thumb described above is reversed; in contentious cases, the GVH will generally deem a practice to unreasonably restrict competition, rather than consider it competitive.

2.48. In connection with the aforementioned, there are cases where it is doubtful whether self-correcting market mechanisms are able to remedy some of the competition related problems, and further intervention may be needed. In these cases, pursuant to the principle of minimum intervention, the GVH prefers to nevertheless take the position that the market is able to remedy the problem and that no intervention is necessary. Competition is generally more likely to result through the functioning of markets, than through intervention that modifies the operation of markets.

2.49. Structural remedies are generally preferred by the GVH as a more appropriate form of competition policy intervention than behavioural remedies. This is set out in the Principles⁶⁸ and holds for a number of reasons⁶⁹, one of which is the principle of minimum intervention.⁷⁰ The benefit of structural intervention lies in the fact that due to the (usually one-shot) intervention, the desired result is produced by market mechanisms. Whereas behavioural remedies seek to change the behaviour that is determined by the structure of the market, introducing a behaviour that might not optimally fit the given market structure. The preference for structural control naturally does not represent an absolute priority because in certain situations behavioural control offers a better overall solution.

2.50. For competition law enforcement, protecting competition usually means maintaining competition and preserving the competitive *status quo*. This is not appropriate in the case of emerging (opening) markets or where firms formerly enjoyed some protection or support from the state.⁷¹ Accordingly, as included in the Principles, the GVH works on maintaining competition, but in the case

⁶⁶ I. Principles paragraph 1.20

⁶⁷ This principle is applied jointly with the principle according to which the GVH disregards efficiency gains if they are possible but their likelihood is very small (see, I. Principles, paragraph 1.13, and II. Explanation to the principles, paragraphs 2.30 – 2.32). Hence, in the above example, the GVH does not consider the given conduct as competitive in cases where the effects on competition and welfare are doubtful given that there is a restriction to competition and where the size of scope of the efficiency increase that could outweigh this restriction is uncertain.

⁶⁸ I. Principles paragraph 1.22

⁶⁹ More on this: III. Background note paragraphs 3.107-3.109

⁷⁰ Although from one perspective, intervention into the structure is deeper than the control of conduct, because it may, for example, affect the ownership rights and relations.

⁷¹ More on this: III. Background note paragraphs 3.145-3.149

of sectors that have recently undergone, are currently undergoing or will soon undergo market opening, its focus is also on the intention to introduce and encourage competition.⁷²

2.51. In a second reference to minimum intervention, the Principles state that the GVH is open to pragmatic and flexible remedies, provided that these ensure that the GVH's objectives relating to the given issue are realised more effectively (e.g. more easily, faster or more completely).⁷³ The GVH is interested in protecting competition and eliminating practices that restrict competition. This means eliminating behaviour that violates the Competition Act and remedying the consequences of such practices, rather than merely imposing sanctions. An instrument for achieving this is also conferred by the Competition Act in the form of commitments.

2.52. Where it is difficult to determine whether a practice unreasonably restricts competition without lengthy and complicated consideration, it may be better for the GVH to focus on terminating the practice rather than sanctioning it. In certain cases where remedying the consequences of a violation depends to a considerable extent on the voluntary co-operation of the firm infringing the law, it is not reasonable to focus on sanctioning. In such cases, the co-operation of the wrongdoer may be motivated by a desire to avoid sanctions. This is similar to the incentives that underpin leniency programmes in cartel cases.⁷⁴ Co-operation by cartel members quitting the cartel is ensured by the prospect of waived or reduced sanctions. In this case, co-operation helps in detecting the abuse and in sanctioning the other cartel members.

2.53. However, infringing firms cannot abuse the GVH's openness to flexible solutions by pursuing anti-competitive practices, then avoiding sanctions by cooperating in bringing the practice to an end. Sanctioning (sometimes of very severe magnitude) is an integral part of ensuring deterrence in competition law enforcement, especially in the case of cartels, but also in other types of violations, with the exception of mergers. The GVH is open to co-operation and to waiving or mitigating sanctions only if this appreciably assists the GVH in achieving its goals, and when waiving deterrence is not deemed counter-productive.

2.54. The GVH's approach as described above is clearly consistent with the principle of minimum intervention. It seeks to further the public interest in relation to competition as efficiently as possible, rather than protecting the interests of the firms concerned.

1.1.5. The tools of analysis and their limits

2.55. The Principles state that the GVH strives to deliver interpretations and results that are based on sound economic rationale.⁷⁵ Thus the GVH requires that the practice of competition policy (including interventions) should always be based on reasoning that makes economic sense.⁷⁶

2.56. Under the Principles, the GVH seeks to base its decisions on empirical evidence.⁷⁷ Naturally, this does not imply that the GVH applies empirical methods in each and every procedure. Empirical methods are not applicable in all cases; for instance, the data or instruments required for performing the analysis may not be available, may be impossible to produce, or perhaps would be too lengthy or

⁷² I. Principles paragraph 1.21

⁷³ I. Principles paragraph 1.23

⁷⁴ More on the concept of leniency policy: III. Background note paragraph 3.135

⁷⁵ I. Principles paragraph 1.24

⁷⁶ More on this: III. Background note paragraph 3.188

⁷⁷ I. Principles paragraph 1.24

costly.⁷⁸ Furthermore, if empirical methods are misapplied, they can lead to perverse results.⁷⁹ With an understanding of such limitations, the GVH seeks the use of empirical instruments in its decisions, where this is reasonable, and intends to increase the use of such instruments over time. The GVH does not exclusively rely on its own empirical analysis, and encourages firms to support or supplement their applications, complaints or explanation of a given practice with empirical analysis of adequate quality. This may serve to restrain subjective elements present in competition law enforcement proceedings within reasonable bounds.

2.57. Competition policy often involves estimation and prediction. Despite the relative strength of general principles, their application in practice entails a degree of uncertainty due to the problems of accurately investigating and measuring.⁸⁰ The GVH and the firms concerned may seek to prove conflicting sets of legal facts in the course of competition law proceedings. The characteristics mentioned above have direct implications for when facts concerning the effects of a given practice are proven. Therefore – as set out in the Principles – the GVH considers a market effect to be proven if there is a sound basis for stating that it has occurred or is likely to occur.⁸¹ The point at which such a statement can be made with good grounds depends on the methodology employed in a particular case. To put it differently, when identifying market effects, the GVH does not necessarily take a position with absolute certainty, nor does it rely on mere speculation. It follows from this that the arguments and positions submitted by firms involved in proceedings do not necessarily have to be absolutely certain in order to be considered on their merits. On the other hand purely speculative arguments and positions will unquestionably be disregarded by the GVH.

2.58. In competition policy analysis, the general principles have to be interpreted and applied on a case-by-case basis, which often requires balancing. In this field, as well as in decision-making, the so-called ‘rules of thumb’ play an important role.⁸² Like other competition authorities around the world, the GVH applies generally accepted rules of thumb, and develops some in its own practice (this document contains some of the broader examples).⁸³ These rules of thumb produce the desired outcome in most but not all cases, so their application calls for some flexibility. This is reflected in the GVH's practices, as declared in the Principles.⁸⁴

1.2. Principles: Competition advocacy

2.59. The Competition Act also entrusts the GVH with competition advocacy tasks. The substantive principles relating to competition law enforcement described above are also generally applied⁸⁵ in the GVH's competition advocacy work. Naturally, these principles are subject to small adjustments

⁷⁸ It may also be the case that, due to the (lack of) available data, instruments, time or other resources, only the relatively less reliable of the various empirical methods potentially applicable, can be employed. On such occasions the GVH needs to decide whether the application of a relatively less reliable method is advantageous enough as compared to a situation where no empirical methods are applied at all.

⁷⁹ When applied improperly, quantitative and empirical methods may easily produce results that appear accurate, but are actually misleading and false. Thus the GVH does not consider that such instruments should be exclusively employed, nor does it consider their application to be a goal per se. In connection with the application of these methods, the GVH is aware that in many respects, competition policy today is still more art than science, and that in this sense, subjective elements may also have their reasonable role in competition policy analysis and decision-making.

⁸⁰ More on this: III. Background note paragraphs 3.191-3.195

⁸¹ I. Principles paragraph 1.25

⁸² More on rules of thumb: III. Background note paragraphs 3.191-3.193

⁸³ For instance: I. Principles paragraphs 1.13, 1.14 and 1.22

⁸⁴ I. Principles paragraph 1.26

⁸⁵ More on competition advocacy: III. Background note section 2.3.2 (competition advocacy)

according to the particular features of competition advocacy, but these will not affect their substance. Therefore, although these principles are relevant to this section, it is not necessary to discuss them a second time.

2.60. The GVH uses various instruments for its competition advocacy activities, in part provided by the Competition Act. Thus, for instance, most draft legislation and measures affecting competition must be presented to the GVH for comments. In addition, the President of the GVH may attend sessions of Parliament and of Government when the agenda includes issues that hold implications for competition. Under the Principles, the GVH can also employ other instruments where necessary for effective competition advocacy.⁸⁶ For instance, the GVH may develop a general competition advocacy position in relation to a certain topic, and communicate that position to political decision-makers or the public. Indeed, where it is reasonable and in the interest of competition, it may seek the support of political decision-makers or the public. In the course of competition advocacy the GVH may refer to general constitutional guarantees that relate to competition. As an option of last resort in special cases, the President of the GVH can petition the Constitutional Court to review a piece of lower level legislation which may contradict the Competition Act.

2.61. When the GVH applies these instruments it sometimes risks conflicting with administrative bodies managing other public policies. The Principles state the GVH is willing to engage in such conflicts where necessary, if this is deemed to be in the interest of competition.⁸⁷

2.62. In its competition advocacy, a competition authority is unlikely to be able to complete comprehensive analysis in each case, depending on the nature and purpose of other public policies as well as on other circumstances.⁸⁸ Moreover, given that the formulation and application of other public policies is not the task and responsibility of a competition authority, it generally plays only a type of advisory role for policymakers in this respect.⁸⁹ The role of the GVH in Hungary is no different.

2.63. Accordingly, the GVH is aware that it is not always possible to produce a complete analysis of a government measure and to succeed with competition advocacy. This would require the GVH to accurately analyse the effects of every government intervention and convince decision-makers to accept its conclusions. This outcome represents the full potential of competition advocacy, but in effect acts only as a benchmark. At the other extreme, once the GVH directs the attention of decision-makers to possible negative impacts on competition, it is left to the decision-makers to decide, based on their own criteria, whether to rely on the GVH's opinion or not. The GVH strives to provide as comprehensive an analysis as it can, and at the very least identify the effects on competition. This is declared in the Principles, when describing the GVH's minimum and maximum competition advocacy programme.⁹⁰

2.64. To this end, the GVH is willing to accept compromises in competition advocacy (as described in the Principles) provided these are likely to lead to greater competition and higher consumer welfare, than would otherwise be the case.⁹¹ The design and implementation of other public policies are complex and ultimately political; compromises are thus inherent. Consultations and discussions usually take place in multiple rounds and between multiple participants, often not without conflicts. During the consultation process, situations may arise where the GVH has achieved some (but not all)

⁸⁶ I. Principles paragraph 1.28

⁸⁷ I. Principles paragraph 1.28

⁸⁸ More on this: III. Background note paragraphs 3.159-3.160

⁸⁹ More on this: III. Background note paragraph 3.161

⁹⁰ I. Principles paragraph 1.29

⁹¹ I. Principles paragraph 1.28

of its goals, but where pressing to achieve more would jeopardise its influence over the process altogether. If we assume, for instance, that a planned package of measures restricts competition and the submitter has been persuaded to accept a package of measures which will result in fewer restrictions on competition but which will not prevent restrictions all together. In this case the GVH may decide that the results achieved are not satisfactory and may raise the stakes by attempting to convince more powerful decision-makers. However, if this attempt fails, the submitter may now be unwilling to accept the original package of measures. From time to time, the GVH may thus be put into a "double or nothing" situation, where it has to decide whether it wishes to achieve a more complete but less certain result or to accept a less complete but more certain result. The latter option may or may not be reasonable depending on the circumstances.

2.65. Being open to compromise does not indicate a softening of competition advocacy: The GVH will not accept a compromise if it believes that there is a reasonable likelihood of achieving more by pressing the advocacy case further. Moreover, the GVH will not accept a compromise if the result is likely to be so minimal (the recurring situation is so anticompetitive) that it is deemed unacceptable. In such cases the GVH considers adopting a strategy of "the worse the better" in order to make the negative impacts of the particular state intervention obvious to the general public, and thus in the long run, creating a situation which is more favourable for competition advocacy remedies.

2.66. As has already been mentioned, the GVH generally applies the same principles to competition advocacy as it does to competition law enforcement, with some subtle differences. This is also true in assessing whether restrictions on competition are justifiable. In competition advocacy the GVH assesses interventions based on their effects on competition and on efficiency, with the above limitations. In doing so, it assumes that welfare will result from the functioning of markets and market mechanisms, unless there is a market failure. In the case of state interventions, this demands a deregulatory approach; that is, the first question of analysis is always whether a given state intervention is necessary at all, and whether the market and competition are able to give a better or simpler solution. This would include whether there is market failure that requires state intervention, and whether the ultimate welfare benefits of the intervention are greater than the direct and indirect welfare losses caused by it. This approach associated with state interventions is thus deregulatory, as set out in the Principles.⁹²

2.67. On the other hand, competition advocacy (as with competition law enforcement) may not only be aimed at preventing restrictions of competition, but also at preventing the exploitation of consumers by significant market power. Moreover, competition law enforcement proceedings are usually unable to stop exploitative abuses in practice, while other state interventions, namely regulation, may be better suited for those purposes.^{93 94} This is why the GVH's competition advocacy places special emphasis on encouraging the use of regulatory means to combat exploitative abuses, where this is cost effective and only in areas where no effective competition is feasible.⁹⁵

2.68. The GVH also supports the introduction of regulations to prevent exploitative abuses in markets where, although competition is theoretically possible, it is restricted or not effective due to state intervention (typically other forms of regulation). Nevertheless, the GVH's competition advocacy in such cases is primarily aimed at introducing competition, creating effective competition and in supporting the development of competition. This is important because, whereas the protection of

⁹² I. Principles paragraph 1.30

⁹³ More on this: III. Background note paragraph 3.131

⁹⁴ There are also limitations to achieving this task by regulation, which may not be effective enough, or which may be regulatory failures.

⁹⁵ I. Principles paragraph 1.31

competition in competition law enforcement cases primarily refers to the maintenance of competition, in advocacy cases it also includes the introduction, development and strengthening of competition.⁹⁶

2.69. Accordingly, the GVH considers the correct way of dealing with exploitative abuses to be: primarily the creation of effective competition and the protection of competition, or where this is not possible, regulation (instead of competition law enforcement which is usually unable to deal directly with exploitation). This is set out in the Principles.⁹⁷

1.3. Principles: The promotion of competition culture

2.70. Promoting competition culture is different in nature to competition law enforcement or competition advocacy. For instance the GVH does not undertake market analysis or welfare assessments for the purposes of this activity. Accordingly the principles explained with respect to the two latter activities do not apply to promoting competition culture. Nevertheless, the GVH's activities in promoting competition culture do reflect the nature of the above mentioned principles. On the top of that, certain principles are associated explicitly with the GVH's activities in promoting competition culture in Hungary.

2.71. The Principles declare that the GVH assumes a responsibility for the promotion of competition culture in Hungary, and makes efforts to contribute to it,⁹⁸ although it takes the position that the GVH's activities are just one of several factors which affect competition culture.⁹⁹ The competition authority must not ignore the state of competition culture for a number of reasons.¹⁰⁰ Still, a competition authority's role in promoting competition culture is limited as compared to its role in competition law enforcement or competition advocacy.¹⁰¹ The GVH is aware that this holds true for Hungary as well. It is committed in contributing to the promotion of competition culture; to the emergence and maintenance of a strong competition culture. However, no matter how much effort the GVH is prepared to make in promoting competition culture, it can only contribute to it. It is not able to determine it so as to reflect its own preferences.

2.72. There are several sides to competition culture and several target groups relevant to its promotion.¹⁰² Accordingly, the Principles state that the GVH pays attention to all aspects mentioned in connection with competition culture, i.e. the general awareness of competition law and competition policy, the general attitude to competition, and the academic community which deals with competition issues.¹⁰³

2.73. The academic community that deals with competition has a role that extends beyond other elements of competition culture. This is the "soft professional control" of the often independent competition authority, exercised through the reputation effect.¹⁰⁴ Comments on the competition authority's work are not always positive and may be uncomfortable for the competition authority in the short run. However, as an independent competition authority, the GVH believes that constructive

⁹⁶ More on this: III Background note paragraph 3.156

⁹⁷ I. Principles paragraph 1.31

⁹⁸ The Competition Act also calls for the GVH to promote competition culture in Hungary.

⁹⁹ I. Principles paragraph 1.32

¹⁰⁰ More on this: III. Background note section 2.3.3 (Promoting competition culture), and particularly paragraphs 3.164-3.172

¹⁰¹ More on this: III. Background note paragraph 3.172

¹⁰² More on this: III. Background note paragraph 3.168

¹⁰³ I. Principles paragraph 1.32

¹⁰⁴ More on this: III. Background note paragraph 3.162

professional criticism of a high standard is very beneficial for the authority, as this motivates it to address weaknesses that in some cases may stem from its 'monopoly of knowledge'. These criticisms may also make the authority change or defend its position or drive it to substantiate its decisions in a more persuasive way. Therefore, the Principles declare that the GVH is open to constructive criticism and will try to benefit from such criticism when applying its procedures.¹⁰⁵ As the competition focused academic community is likely to make a particularly important contribution to this end, the Principles also state that the relationship with this community plays a special role in the GVH's activities aimed at promoting competition culture.¹⁰⁶

2.74. The GVH consciously avoids certain areas of competition culture if they are incompatible or hardly compatible with its other main activities. Thus, the GVH does not organise training courses on competition law or competition policy for firms or their staff, and does not directly participate in such courses. Such involvement would undermine the authority's impartiality when dealing with a competition law enforcement proceeding involving a previously trained firm.¹⁰⁷

2.75. The GVH does not consider consultations with firms during proceedings (even preliminary consultations) or consultations in relation to lobbying as constituting part of its activities in promoting competition culture.^{108 109 110}

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2.76. The GVH considers the activities reviewed above (conducting competition law enforcement proceedings, competition advocacy and the promotion of competition culture) as three equally important pillars of its operations, as set out in the Principles.¹¹¹ Of course, equal significance does not mean that resources should be divided equally between the three activities. The distribution of resources depends on the nature of the challenges arising within each activity. For example, certain problems require competition law enforcement, whereas competition advocacy is more appropriate in others, and the promotion of competition culture strengthens competition more generally.

2.77. Several synergies exist between these activities.¹¹² As set out in the Principles, the GVH recognises these synergies and strives to make its three major activities as consistent with each other as possible. The GVH also makes efforts to ensure that synergies are realised to the largest extent possible, including the handling of certain problems by combining the different instruments together.¹¹³

2.78. For instance, in undertaking any of its activities (including competition law enforcement and competition advocacy) the GVH takes into account their impact on competition culture and seeks to ensure that this impact is as positive as possible.¹¹⁴ Naturally, this does not mean that the GVH's other activities are subordinated to the promotion of competition culture or that the assessment of any

¹⁰⁵ I. Principles paragraph 1.44

¹⁰⁶ I. Principles paragraph 1.32

¹⁰⁷ I. Principles paragraph 1.33

¹⁰⁸ In spite of this, the GVH considers consultations with firms to be highly important, no matter whether they take place as part of lobbying activities or prior to competition law enforcement proceedings. The GVH believes they contribute significantly to the success of competition law enforcement and competition advocacy, helping the GVH to obtain information on the functioning of markets.

¹⁰⁹ I. Principles paragraph 1.33

¹¹⁰ More on this: III. Background note paragraph 3.174

¹¹¹ I. Principles paragraph 1.35

¹¹² More on this: III. Background note section 2.3.4 (Synergies)

¹¹³ I. Principles paragraph 1.35

¹¹⁴ I. Principles paragraph 1.34

business practice would be affected by considerations relating to it.¹¹⁵ Nevertheless, all the GVH's procedures should exemplify the benefits competition policy brings in an accessible way, and this can only serve to significantly improve competition culture.¹¹⁶ These might include communicating its decisions to the broader public, or drafting its decisions so as to demonstrate the advantages of competition in a manner that can be easily understood.

2. Institutional and operational principles

2.79. In addition to the substantive principles detailed above, there are some institutional and operational principles which are followed by the GVH. These are essentially general principles of good administration, and help ensure that the fundamental objectives of the GVH are realised through the high standards of its performance and operations.

2.1. Priorities and resource allocation

2.80. Like all competition authorities, the GVH has only finite resources with which to achieve its objectives: the protection of competition, long-term consumer welfare, and essentially the public interest relating to competition. It follows from this limitation of resources that the GVH is not able to identify every anticompetitive business practice or state intervention. Neither is it able to pursue every case with the same intensity, or promote competition culture beyond reasonable limits. As with regulation, there is also a danger that the cost of competition investigations, both to the authority and market agents, will outweigh the welfare loss caused by the investigated practice in the first place. Accordingly, it is in the public interest for the GVH to employ its resources as efficiently as possible so as to ensure that the welfare benefit achieved and the welfare loss averted are both maximised.¹¹⁷ This requires the GVH to be selective about which cases/issues it addresses, and about how resources should be divided between them. In other words, in order to efficiently use its resources in the interest of consumers, the GVH needs to set priorities, and needs to develop criteria for allocating its resources.¹¹⁸

2.81. A similar conclusion can be drawn from the fact that competition policy, as enforced by the GVH, is a public policy. This is obvious in the case of competition advocacy or in connection with the promotion of competition culture, but is also true for competition law enforcement. Competition law enforcement cannot be considered a perfunctory application of rules such as the issuing of passports or building permits. There the authority performs a type of administrative service based on a relatively simple algorithm, well-defined by legislation and with only very limited room for discretion. The responsibility of the GVH cannot be to pay equal attention to all potential competition problems that it comes across, nor can it be to investigate and address all complaints. Instead it has to focus on effectively (and efficiently) tackling the most important problems and issues, those which cannot otherwise be addressed by means such as private law enforcement, and to shape the jurisprudence accordingly. This is particularly true in the Hungarian system of competition law where there is scope for the private enforcement. Although this does not require the direct involvement of the GVH, it is important that it should exert indirect influence on how the courts' apply competition law by focusing

¹¹⁵ Although, the strength of competition culture may also affect the GVH's competition law enforcement and advocacy activities. Thus, for instance, the possible targets to be reached for competition advocacy and the applied reasoning also depend on the recipients' knowledge on competition policy and their attitude to competition.

¹¹⁶ More on this: III. Background note paragraph 3.181

¹¹⁷ More on this: III. Background note paragraph 3.201

¹¹⁸ This is not true for private enforcement of competition law, because the concern of wasting public resources is much lower, given the financial involvement of the parties. (More on this: III. Background note paragraph 3.200)

on cases that are significant in terms of economic impact, market effects or the development of jurisprudence. Therefore, the enforcement of competition policy as a public policy also calls for the setting of priorities.

2.82. The setting of priorities requires that the GVH divide its resources unevenly between its activities. Given differences in the expected welfare benefit, it might be more beneficial to concentrate resources on tackling one particular problem over another, although the GVH will still address the latter to some extent. However, it may be reasonable for the GVH not to address certain issues where this would divert valuable resources from other more important cases. Thus, the efficient use of resources also implies some case selection.

2.83. The Principles outline the criteria which the GVH primarily takes into account when prioritising how its resources should be allocated in the context of competition law enforcement. These factors are as follows:

- How strong is the likely effect on competition?
 - ⇒ What type of practice is being examined?
 - ⇒ Which aspect of competition does the possible restriction involve and how important is it? (including effects that are passed on to competition in other industries downstream)
 - ⇒ Size of the sector in question, expected scope and magnitude of the practice
- Is it likely to have spill-over effects damaging the competitiveness of other sectors?
- How large is the group of affected consumers likely to be?
- Is the GVH likely to be able to remedy potential problems with the instruments available?
 - ⇒ What are the resource requirements of remedying the problem?
 - ⇒ Does the GVH have the resources expected to be necessary, or is it able to mobilise such resources?
 - ⇒ Is sufficient time available?
 - ⇒ Does the GVH have the necessary means to adequately remedy these problems?
- Is it an important issue with regard to the development of jurisprudence?
- Could the GVH's proceedings be considered as exemplary or indicative? (for example enforcement activities may be capable of shaping case law)
- Does the issue require the GVH's intervention, or is it likely to be solved in its absence (e.g. by private law enforcement)?

2.84. The criteria for the allocation of resources is slightly different for competition advocacy, as it is different in nature to competition law enforcement:

- How strong is the likely effect on competition?
 - ⇒ What type of state intervention does the case concern (in particular: does it restrict entry into the market; does it infringe competitive neutrality)?
 - ⇒ Which aspect of competition is affected by the possible restriction and what is its relative importance?
 - ⇒ Size of the sector concerned, scope and magnitude of the intervention
- Is it likely to have spill-over effects that damage the competitiveness of other sectors?
- How large is the group of affected consumers likely to be?
- What are the likely resource and time constraints.
- Could the GVH's advocacy action be considered exemplary or indicative to market players or policy makers?
- Are competition law enforcement proceedings or additional anticompetitive state interventions likely to become avoidable in light of advocacy action by the GVH? Are certain business practices likely to become easier to investigate?
- Does the issue require a GVH intervention, or is it likely to be solved in another way without such intervention?

2.85. The factors listed above reflect principles and considerations detailed earlier in this document. It is also obvious that the criteria listed in the Principles are general in nature and serve merely as guidance. Their relevance and applicability will vary depending on the circumstances of each particular case. The GVH may develop more specific criteria for particular competition policy issues or sectors and its priorities may vary accordingly. Naturally, the GVH may identify competition law enforcement priorities only within the scope allowed by legislation.

2.2. Independence and co-operation

2.86. As a competition authority, the GVH is independent from both market players and public administration. Pursuant to the relevant provisions of the Competition Act, the independence of the GVH is also relatively strong by international comparison, although there is no such thing as a totally independent competition authority. The GVH does not regard its independence as a goal per se, or as equivalent to general isolation. Rather, it considers independence to be a condition of its operations and an important guarantee of its autonomy in performing its tasks and in pursuing competition policy goals.¹¹⁹

2.87. On the one hand, the GVH thus exercises its independence and acts as an independent authority, as set out in the Principles.¹²⁰ This means that it values its independence, which contributes to the smooth performance of its tasks, in the interest of competition. In the short term, competition policy objectives may conflict with economic policy. Its independence ensures the GVH acts autonomously in such situations, and should not sacrifice the public interest in relation to competition for the sake of daily economic policy considerations.¹²¹ Therefore, the GVH is ready to exercise its

¹¹⁹ More on the independence of competition authorities: III. Background note paragraphs 3.202-3.204

¹²⁰ I. Principles paragraph 1.40

¹²¹ More on this: III. Background note paragraph 3.202

independence against certain short-run economic policy demands, if this is necessary in protecting the public interest in relation to competition. Conflicts with other public administrative bodies may be inevitable, but it is important that the GVH defends its position in the interest of competition and long-term consumer welfare. This is also pursuant to the GVH preserving the credibility of its independence.¹²²

2.88. On the other hand, the GVH does not consider independence to be equivalent to general isolation. Thus the GVH will take into consideration government intentions concerning various markets. In the context of market analysis, this already occurs pursuant to the dynamic approach taken by the GVH. Neither will it refuse to conduct a specific intervention in a way that accommodates certain government intentions, provided that they do not harm the GVH's central goals, as mentioned in the Principles.¹²³

2.89. Under the Principles, the GVH is willing to co-operate with various government bodies both on its own initiative and upon request from these bodies.¹²⁴ This may be pursuant to either competition law enforcement, competition advocacy or the promotion of competition culture. Such co-operation may further the objectives of the GVH (i.e. competition and consumer welfare), or may serve to realise the objectives of the other administrative agency. Naturally, in the latter case, the GVH will only get involved in a co-operation if the detriment of the GVH objectives is unlikely.

2.90. The Principles state that co-operation with sector-specific regulatory authorities (or regulators) is particularly important¹²⁵, and can be explained by a number of reasons.

2.91. First, conducting competition law enforcement or competition advocacy requires a good understanding of the characteristics, operation, regulation and possibly even the technology of the sector involved. This is the only way to adequately evaluate a particular business practice or state intervention, and to assess its impact on competition and welfare. In sectors subject to regulation, this knowledge is usually more complex and less obvious than usual. However, sectoral regulatory authorities typically possess this knowledge as well as substantial data on the sector in question. They are thus clearly able to provide the GVH with useful information. The GVH's work also benefits from views forwarded by the regulator in connection to effects on the market and on efficiency.

2.92. Second, in institutional terms, the regulatory authorities referred to above are in a position that is similar to that of the GVH: in Hungary they are administrative bodies that operate more or less autonomously pursuant to a relatively low number of quite well-defined goals.

2.93. Third, sectoral regulatory authorities are often responsible for enforcing sector-specific regulations that form a part of competition policy in a broader sense. Moreover, in Europe as well as in Hungary their responsibilities are based explicitly on concepts of competition law. Their activities may broadly overlap with the activities of the competition authority.¹²⁶ In addition, legislation obliges the GVH to cooperate with industry-specific regulators in certain circumstances.

2.94. Based on all this, the GVH considers the sector-specific regulatory authorities to be its most important potential allies within public administration, and seeks to co-operate with them in the interest of competition and consumer welfare, as set out in the Principles. Such co-operation between the GVH and the regulators may include the usual exchange of information, and ensuring consistency between the authorities' general activities (e.g. by the exchange of views on sectoral competition

¹²² That is, to avoid a situation where observers would wrongly question its independence.

¹²³ I. Principles paragraph 1.41

¹²⁴ I. Principles paragraph 1.41

¹²⁵ I. Principles paragraph 1.41

¹²⁶ More on this: III. Background note paragraphs 3.152-3.153

policy issues). In addition to this, the GVH is open to joint analysis and joint action in competition advocacy, and even to harmonising enforcement practices so as to undertake certain market interventions in a complementary manner; ensuring common goals are achieved effectively and efficiently.

2.95. The GVH's independence may not prevent it (as declared by the Principles) from monitoring the operations of other agencies that deal with competition policy issues or from drawing on their experience to shape its own operation in competition law enforcement, in competition advocacy and in promoting competition culture.¹²⁷

2.96. Those organisations whose experience may be relevant for the GVH can basically be divided into two groups. One group contains the sector-specific regulatory authorities in Hungary. The special relationships between the GVH and these authorities and its background have already been discussed. Through co-operation, the respective authorities can learn from each others experience. The GVH also monitors the activities of these authorities to gain from their experience even outside the scope of mutually beneficial co-operation.

2.97. The other group includes foreign competition authorities and foreign sectoral regulators. Based on the above, it is quite natural that the GVH is interested in the experience of these counterpart authorities and seeks to learn from their experiences. Some foreign agencies' operations deserve special GVH attention for various reasons. Such authorities include the federal competition authorities of the United States: the Federal Trade Commission and the U.S. Department of Justice's Antitrust Division. They have vast experience and play a pre-eminent role globally in shaping competition policy. Also, several methodological tools or widely applied analytical doctrines have evolved in their practices. It is no wonder competition authorities all over the world pay special attention to their activities.

2.98. The OECD's¹²⁸ Competition Division and Competition Committee, although not a competition authority, is one of the most important sources of experience for the GVH. The OECD monitors the work of competition authorities operating in the world's most developed market economies, including some leading authorities. It collects and sorts this experience and supplements it with its own analysis. The International Competition Network is an international venue for co-operation between competition authorities and plays a similar role.

2.99. The European Union's competition authority (DG Comp)¹²⁹ has a distinctive role within the abovementioned group of authorities for several reasons: Hungary is a Member State of the European Union; the GVH is a member of ECN; and Hungary's national competition law is closely harmonised with the European Union's competition law. In addition, DG Comp is one of the world's leading competition authorities, and one of the most important entities shaping European competition law.

2.100. The Principles discuss how experience should be utilised and to what extent; the background to which is as follows.¹³⁰ Evidently, the experience of others may be useful to the GVH. This experience may be diverse; it may relate to analytical tools, the above-discussed rules of thumb which are routinely applied by competition authorities, or it may be the results of individual analysis. Therefore, in certain cases the GVH may simply adopt the conclusions of similar analysis previously performed by another authority, instead of undertaking its own. This may be reasonable in cases

¹²⁷ I. Principles paragraph 1.42

¹²⁸ Organisation for Economic Co-operation and Development

¹²⁹ EC Commission, Directorate General Competition (DG Comp)

¹³⁰ I. Principles paragraph 1.43

where circumstances are sufficiently similar, particularly if other competition authorities earlier reached similar conclusions.

2.101. However, the conditions under which the GVH conducts its own analysis will not always be similar to those which held true at the time of investigation by another authority. Therefore the GVH is cautious about the simple 'copying' of already available results, and when this is not reasonable, it prefers to adapt the results to the Hungarian situation. A similar but smaller problem may also occur in connection with methodological issues; well-trying analytical methods cannot always be copied in whole between cases, and often require adjustments according to the particular problem being investigated by the GVH.

2.3. Transparency and openness

2.102. The Principles devote a separate section to the importance attributed by the GVH to ensuring its operations are open and transparent. This is important for a number of reasons. Providing the public with information and ensuring transparency in its activities is a fundamental requirement and principle when developing and implementing public policies. It is consistent with public interest oriented law enforcement, and with the correct operation of public administration. Providing the public with information concerning its activities is also often of help to the GVH in carrying out its work.

2.103. Ideally, competition law formulates general rules which are left to the enforcing agency to be applied in specific situations with sufficient flexibility and ample discretion. As a result, it is very important to have in-depth knowledge of the case law in order to effectively navigate competition law.¹³¹ This particular feature of enforcing competition law therefore gives additional justification for the GVH to publish the outcome of its competition law enforcement activities as widely as possible and to ensure procedural transparency. Consequently, those who have an interest in competition law – for instance, firms and their legal representatives seeking compliance – may learn about the GVH's: competition policy considerations; analytical methods; rules of thumb used in proceedings; how the GVH interprets the various competition law provisions; and how it generally exercises its discretion. This not only increases the predictability of the GVH's proceedings and legal certainty, but also facilitates voluntary compliance and compliance coerced by market players or by the enforcement activity of the GVH..¹³²

2.104. As far as the GVH is concerned, the promotion of openness and transparency is not only a requirement, but is also a highly beneficial practice. As the GVH is an independent authority, openness plays an important role in exercising social control over its work.¹³³ In addition, openness and transparency ensure that its independence is preserved and remains credible to observers.

2.105. Providing information and transparency can also make the GVH's competition advocacy activities easier, given that (as already mentioned) competition advocacy tools include the publication of the GVH's competition advocacy position. The providing of information and transparent operation also serves to promote competition.¹³⁴

2.106. Naturally, the mere publication of competition law enforcement decisions and the positions represented in competition advocacy are not the sole means for providing information and ensuring transparency. Other important informative tools include publications that present the GVH's

¹³¹ More on this: III. Background note paragraph 3.191

¹³² A more predictable environment also facilitates the effective operation of instruments used by competition authorities such as the leniency policy aimed at detecting cartels.

¹³³ More on this: III. Background note paragraph 3.169

¹³⁴ More on this: III. Background note paragraph 3.173

considerations concerning general or specific case-related issues. In addition, those who have an interest in competition policy – e.g, firms and their legal representatives seeking compliance, or officials preparing state interventions – may directly learn about issues such as GVH competition policy considerations, analytical framework and rules of thumb. The alternative way to extract information of this kind is to examine individual decisions and competition advocacy positions – all in all, a far more burdensome exercise.

2.107. The substance of these documents will depend on the situation; they may summarise past GVH practice, or may indicate future practice; they may relate to the shorter or longer term; they may deal with one sector or a particular competition policy issue; they may be general or more specific; they may set out considerations relating to principles, or outline strategies, and will take business considerations into account as well. Given that these documents may greatly promote legal certainty, as well as the effectiveness and efficiency its work, the GVH considers the publication of such documents to be important.^{135 136}

2.108. The GVH must keep any business secrets obtained confidential,¹³⁷ so no matter how strong its commitment to ensuring transparency and informing the public, no business secrets may leak-out or be disclosed by the GVH. Indeed, excessive transparency and openness may even hinder the work the GVH in certain circumstances. For instance, it may encourage cartel members to destroy evidence of their infringement where an investigation by the GVH has been opened. Also if firms have extensive knowledge of certain internal GVH documents this will help them formulate their strategies and arguments in GVH proceedings or during judicial review of a GVH's decision, hindering enforcement efforts. Therefore, even though transparency is of obvious importance in a number of respects, it is not without reasonable limits. As illustrated by the examples above, and mentioned in the Principles, such considerations include: the protection of business secrets; interests related to the effective execution of the GVH's planned or ongoing proceedings; and the successful representation before the court in connection with decisions subject to judicial review.¹³⁸ On the other hand, these constraints do not reduce substantially the benefits that arise (or may be expected to arise) out of the transparency of the GVH's activities.

2.4. International co-operation

2.109. There are various forms of international co-operation which assist competition authorities in performing their tasks. The GVH considers these as important to the operation of competition authorities in a number of respects.¹³⁹ Consequently, as declared in the Principles, the GVH is open to international co-operation.¹⁴⁰ This includes the three main areas of international co-operation, namely: the exchange of experience; co-operation in competition law enforcement (and possibly in competition advocacy as well as in promoting competitive culture); and participation in technical assistance

¹³⁵ The principles explained in this document permeate all of the GVH's activities. Therefore, it is trivial that the same approach and principles appear in all three sections of this document. However, in other occurrences the same principles might be presented in further detail and in a manner required by the particular context. Certainly, none of the sections will contain considerations that would be contrary to the principles described herein.

¹³⁶ I. Principles paragraph 1.45

¹³⁷ The disclosure of business secrets, even to other authorities for the purpose of law enforcement, is strictly regulated and highly limited. Even in relation to other Hungarian authorities, the GVH may only disclose business secrets where authorisation is granted by law, or with the consent of the party concerned. Business secrets are shared with other competition authorities within the ECN also on the basis of high-level legislation and subject to stringent conditions.

¹³⁸ I. Principles paragraph 1.46

¹³⁹ More on the international co-operation between competition authorities: III. Background note paragraphs 3.205-3.206

¹⁴⁰ I. Principles paragraph 1.47

provided to other authorities. As previously stated, the GVH only undertakes co-operation (even if it is international) on the condition that it does not go against its fundamental goals.

2.110. International co-operation in the course of competition law enforcement proceedings is in fact part of the GVH's everyday activities. By law, the GVH is a member of the ECN, and so is engaged in close and extensive co-operation with the other ECN member authorities in respect of competition law enforcement relating to practices that affect community trade. The ECN consists of DG Comp and the national competition authorities of the other Member States. Due to legislative constraints, there is only limited scope for non-ECN co-operation, but the GVH is nevertheless open to this type of co-operation, within the constraints of the law.

2.111. The GVH recognises that providing technical assistance to other authorities can be mutually beneficial to achieving their goals, but their reasons for participating in such programmes go beyond this. Participation in technical assistance enhances the professional standing of the GVH and of Hungary. Requests to participate in technical assistance programmes are a reflection of their reputation. Furthermore, the outcome of technical assistance contributes to making the business and investment climate more favourable in the recipient country. This helps to realise goals that go beyond the scope of competition policy; improving economies and markets that are of interest to Hungarian firms. Moreover, in the initial phase of its operation, the GVH received considerable technical assistance, mostly from the federal competition authorities of the United States, DG Comp and the OECD, and this greatly contributed to its professional development. Therefore the GVH has a first hand understanding of the value of technical assistance, and considers it a moral obligation to participate in programmes providing technical assistance to less experienced competition authorities, to the extent permitted by its resources and according to the demand.

2.5. Training

2.112. The Principles state that the GVH attributes great importance to providing its staff continuous training on competition policy issues.¹⁴¹ The rationale for this is that competition policy constantly evolves, both in terms of substance and procedure.¹⁴² In order to adapt accordingly, the GVH puts proper emphasis on teaching GVH staff about state of the art analytical and procedural methods and informing them regularly of general developments in competition policy.

¹⁴¹ I. Principles paragraph 1.48

¹⁴² More on this: III. Background note paragraph 3.207

III. BACKGROUND NOTE TO THE PRINCIPLES AND THEIR EXPLANATION

3.1. This Background Note is part III of the document entitled "*Fundamental Principles of Competition Policy as Applied by the Hungarian Competition Authority (GVH)*". The purpose of part III is to aid readers with little or no understanding of competition policy by explaining the concepts and terms referred to in the first two sections of this document (Principles and Explanations). *function and...*

3.2. The Background note gives an overview of how markets function, and a detailed explanation of competition policy; first in general terms, then in relation to several competition policy issues and areas. However, it is not intended as a competition policy encyclopaedia or a competition law glossary. Neither is it a competition policy or industrial organisation textbook; it does not address all areas and certainly not all details.¹⁴³ Instead, it contains information on the functioning of markets and on competition policy that is indispensable for understanding and correctly interpreting the Principles and related literature in the first two parts of this document.

3.3. The Background note is structured as follows: following the introduction, the document is divided into two main parts. The first part deals with markets and competition. It outlines their functioning and characteristics, as well as defining related terms such as *market power*, *market structure* and *efficiency*. It also presents the benefits offered by competition to society. The second part discusses the objectives and substance of competition policy, the possibilities for competition policy intervention, and its analytical and institutional framework. *... structure*

3.4. While the document entitled "*Fundamental Principles of Competition Policy as Applied by the Hungarian Competition Authority (GVH)*" is prepared primarily for the professional community, the inclusion of this Background note makes the document easy to understand for readers who are interested in competition policy and in the work of the GVH, but who only have limited prior knowledge of competition policy issues.

3.5. To achieve this, the document disregards technical explanations and uses almost exclusively simple verbal tools and figures. It also avoids using mathematical apparatus typically employed in economics to explain the functioning of markets.¹⁴⁴ The order of the issues discussed does not necessarily reflect deductive considerations; thus in certain cases, a general statement may be preceded by a specific example. Also given the didactic nature of the text, certain issues arise several times in different contexts. An effort has been made to be precise. However, certain points have been simplified to ensure the text is comprehensible, easy to follow and pleasant to read, without compromising their meaning. For similar reasons and to avoid lengthiness, other points are referred to as findings of economics or competition policy, without detailed explanation. The non-scientific nature of the discussion is also reflected by the fact that references are not made to the relevant academic literature

¹⁴³ The Background note does not address some important competition policy issues, such as the concept and definition of relevant market, the interpretation and possible applications of the joint dominance concept, or issues arising in connection with captured customers and after-markets.

¹⁴⁴ Nevertheless, some of the figures included, use geometry to illustrate certain critical economic thoughts related to the subject.

1. Markets and competition

1.1. Basic functioning of markets and the role of competition

3.6. In an economy, various goods are produced out of the resources available, most of which are scarce. If all economic agents were self-sufficient, they would all need to focus their production primarily on satisfying their most basic needs. They would only differ in that some of them would have more while others would have less opportunity to produce surplus products (i.e. a larger quantity or different types of products than satisfies their needs).

trade

3.7. The alternative to self-sufficiency is division of labour and trade. With the division of labour, individual economic agents produce only one or a few products instead of all. The division of labour offers significant benefits compared to self-sufficiency because, while in the latter everybody produces everything themselves (regardless of how bad they are at producing it), in the former everybody does what they are best at.¹⁴⁵ Furthermore, by virtue of the specialisation that accompanies the division of labour, specialised producers become more and more experienced in the activity they do. This way, the society as a whole is able to produce more goods and of better quality from the same amount of resources than would be the case in self-sufficiency. However, as a consequence of the division of labour, individual economic agents do not have all the products necessary to satisfy their basic needs, so they exchange things they have a surplus of for things that they need.¹⁴⁶ This is called *trade*, and the place where trade is realised is called the *market*. Trade and the market are essential to realising the advantages of the division of labour.¹⁴⁷

market

3.8. Thus the market is the place of trade. In practice, we do not mean one single market that includes exchanges of products between all economic agents. Rather, there are different product markets (or service markets) which nevertheless function according to similar rules. Market agents who need a given product are the potential buyers or *consumers*. The aggregate sum of their needs determines how much of the given product is needed, i.e. what the maximum demand is. However, in order for the product to be acquired it must be exchanged for some counter value, the size of which may deter the consumer from completing the purchase. In other words, the more expensive the given product is, the smaller the quantity demanded by consumers will typically be. This is because at this price they prefer to purchase another product or

demand

¹⁴⁵ To put it more precisely, the phrase "what they are best at" is to be understood in terms of comparative advantages.

¹⁴⁶ Although in reality products are typically exchanged for money rather than for other products in the market (in this case, money represents all the other goods for which the product in question could be exchanged).

¹⁴⁷ In theory, co-ordination mechanisms other than market co-ordination are also possible, and these actually used to play a role in the flow of goods. Such an alternative co-ordination mechanism is aggressive co-ordination (when one party takes the necessary goods away from the other), bureaucratic co-ordination (when goods flow according to bureaucratic decisions) or ethical co-ordination. Examples of aggressive co-ordination include some past wars and marauding; bureaucratic co-ordination is observable in certain ancient examples, as well as in socialist systems of direct planning and instruction. However, these alternative co-ordination mechanisms include instruments that are incompatible with the values of modern societies, and/or it has been proven that – at least at the level of the economy as a whole – they perform their tasks far less efficiently than market co-ordination. (Bureaucratic co-ordination continues to play a significant role in internal transactions of firms, while ethical co-ordination may play this role in family businesses.)

decide not to buy anything at all. Accordingly, in most cases, an increase in price will cause a fall in demand; the higher the price, the lower the demand.¹⁴⁸

3.9. Market players who possess surplus products are sellers (who, for the purposes of this discussion, are producers of the product). The situation of producers is the reverse to that of the consumers. There may be a narrow group of sellers with such a large amount of surplus product that they are willing to sell the product for nothing, or nearly nothing. These producers provide the minimum supply. If the price of the product is higher, more producers will be willing to exchange it (or produce it) in return for other products they value more. The result of this is that supply of a given product will typically increase when the price increases; the higher the price, the greater the supply.

supply

3.10. The market is in equilibrium where the quantity demanded is equal to the quantity supplied. In this case, there is no unsatisfied demand (shortage) and no unsold output. In other words, in equilibrium, all exchanges and all transactions take place where the consumer is willing to pay at least the minimum price the seller(s) ask for. This point of equilibrium, determines the market clearing price; the price that will govern all transactions because consumers will not be willing to pay a higher price for the product and producers will not offer it for a lower price, in order to clear (or exchange) the quantity produced. At equilibrium, all consumers who value the product at least at the market price will purchase the product, and likewise, all sellers who are willing to offer the product at market price or less will sell their products. Although the market is not always in equilibrium, market forces, mechanisms always drive the market towards it. If supply exceeds demand, i.e. if the market price is higher than the equilibrium price, the market price will decrease and *vice versa*. That is, the price will naturally move towards the equilibrium price and the quantity of supply and demand change accordingly, towards the equilibrium level.

equilibrium

self-correction

3.11. If market equilibrium is achieved through competition, it also maximizes social welfare.¹⁴⁹ This is so because the equilibrium price, output and consumption are at the optimum level at perfect competition; consumers consume only as much of each good as they are willing to pay for. In addition, because competition will force prices to be equal to (or approximate) the costs of production¹⁵⁰, all possible benefits arising out of trade will be exhausted.¹⁵¹ It will not be possible to make anyone better off without making someone else worse off. This competitive price which equals costs is a result of the competitive process.¹⁵²

competition

3.12. The fundamental condition for the correct functioning of market forces, market mechanisms and even of competition is that market players are rational and strive to maximise their gains from trade (i.e. the difference between what they pay and what

profit maximisation

¹⁴⁸ There are exceptions to this general rule, such as luxury items in certain cases, for which a decrease in prices sometimes results in a reduction of demand.

¹⁴⁹ This is true in general but does not hold in the case of market failure. Market failures will be discussed later.

¹⁵⁰ Economists phrase this more accurately because there are several types of costs. According to the more accurate phrasing, the perfectly competitive price equals the marginal cost or the avoidable cost.

¹⁵¹ In contrast – as will be presented later – in the absence of competition, e.g. in the case of a perfect monopoly, society will not be able to exploit all the benefits arising out of trade because some transactions that are desirable from the perspective of the entire society will not be realised.

¹⁵² More accurately, the competitive price equals marginal cost or avoidable cost.

they are willing to pay), and make decisions in transactions accordingly. This is not an unrealistic expectation, so economic theory assumes that firms acting in the market are also rational and aim to maximise their profit (i.e. to ensure that the difference between their income and their costs is as great as possible).¹⁵³ If there is perfect competition, profit is determined by the equilibrium of demand and so that only *normal profit* is earned; an income that covers costs and/or ensures an adequate return on investment, and accounting for any risk taken. Any profit in excess of this level is *economic profit*. Thus, economic profit is a concept of economic theory and is not the same as the notion of profit used in everyday life (accounting profit).

3.13. Therefore, profit maximisation motivates the decisions taken by firms acting in the market. Coupled with market mechanisms, it induces competition for the acquisition and use of scarce resources as well as for favourable sale and purchase opportunities. As a result, the players on each side of the market (be they sellers or buyers) become competitors. On the other hand, competition ensures that self-correcting market mechanisms produce results that are optimal for the society as a whole. The Structure-Conduct-Performance model is a useful tool for a better understanding of this.

1.2. Overview of the SCP model

3.14. The Structure-Conduct-Performance model provides a good framework for understanding the functioning of markets and competition, and even of competition policy. This paradigm describes the basic relationships between the market structure, the conduct of market players and the performance of the market.

3.15. The structure of the market refers to the number and relative size of market players, the possibilities for market entry and exit, any barriers as well as various other structural factors. Conduct includes the decisions and business practices of market players, of which pricing, marketing, product development, investment and strategic decisions are the most relevant for the purposes of competition policy. Performance describes the functioning of the economy; it shows the efficiency of the economy, the level of technological development, and how the market's operation affects welfare.

perfect competition
vs.
perfect monopoly

3.16. According to the SCP model, market performance (the welfare resulting from competition) is determined by the conduct of market players (the quality of competition), which in turn is influenced by the market structure (the conditions of competition). For example, the market structure of the theoretical model of perfect competition is different to that of monopoly. In the case of perfect competition, there are numerous sellers, each of whom provides only a negligible part of total supply; while in the case of a monopoly, there is only one firm on the supply side (which provides the entire output of the product concerned). According to economic theory, this fundamental structural difference has far-reaching consequences for the pricing decisions of market players; in the case of perfect competition, price will equal costs,¹⁵⁴

¹⁵³ In reality, other objectives also influence the operation of firms and the decisions of firm managers or owners. Such goals might include: to reach as large a corporate size as possible; to achieve a greater market share; or to maximise the firm's market value. Neither should it be ignored that in certain markets, there may be non-profit organisations, which may even be dominant in that market. However, in economics, profit maximisation may be deemed to be the most widely accepted goal, and the achievement of the alternative goals mentioned also serve profit maximisation in many cases, even if indirectly.

¹⁵⁴ Or, more accurately, price will equal marginal cost or avoidable cost

while in the case of a monopoly, it will be higher than costs (monopoly price). This is because, whereas no producer in perfect competition can unilaterally raise its price without losing all its customers, the monopolist is a price setter. The different prices will then lead to different levels of output and different welfare outcomes. Perfect competition is a more favourable outcome because more of a given product will be produced for a lower price. By contrast, a monopolist will produce less at a higher price (to increase its profits) with a resulting welfare loss.¹⁵⁵ In this specific scenario, the message of the SCP model is that the different welfare outcomes and the different output levels may be attributed to different pricing, and different pricing may be explained by different market structures.

3.17. Naturally, this simple relationship is not purely deterministic. There are important reverse effects as well. Such effects are caused by the strategic conduct of firms, the objective of which is to influence the structure (e.g. a firm that is more efficient than its competitors can successfully increase its market share, force less efficient competitors out of the market, and may even become a monopolist). The following section gives a more detailed presentation of individual components and links between them within the SCP model.^{156 157}

1.3. The market structure

1.3.1. Market structure in the narrow sense

3.18. Market structure (or the conditions of competition) itself is a complex concept, which consists of several elements.¹⁵⁸ In a narrow sense, it encompasses the number of players in the market and their relative size compared to the entire market and to each other. This does not refer to the physical size of each firm, but rather the proportion of demand it satisfies. Therefore, both market shares and the concentration of firms are important when describing the structure of a market. Different methods have been developed for measuring concentration in a market; the accuracy of which can depend on the characteristics of the market in question.¹⁵⁹

3.19. The picture formed about the narrowly defined market structure reveals a lot about the scope and intensity of actual competition between firms already present in the market. This is particularly so if market structure is not understood to be a static concept. First, for the analyst the market structure is not necessarily characterised accurately by observations of one given moment in time; changes and fluctuations in the market shares over time may also need to be taken into account. Second,

¹⁵⁵ The differences between perfect competition and perfect monopoly are illustrated by Figure 12.

¹⁵⁶ The Structure-Conduct-Performance Model (SCP) is illustrated by Figure 2.

¹⁵⁷ Originally, although in a much simpler and structuralised form, the SCP model was a product of American industrial organisation theories of the 1950's. This version of the model was subject to substantial criticism, which led to its improvement and which made it more sophisticated. The modern, extended version of the SCP model discussed is adequate for representing the operation of markets and of competition policy.

¹⁵⁸ The components of market structure are illustrated by Figure 7.

¹⁵⁹ Such measures include the number of market players, the concentration rate (the aggregate market share of the first three, first four, etc. largest firms) or the Hirschman-Herfindahl index (sum of the square of market shares of each market operator). These measures take into account absolute and relative concentration in different ways and to different extents. Of the indicators mentioned, the Hirschman-Herfindahl index suits the needs of competition policy best.

barriers to expansion

individual market players in the market may be presented with attractive opportunities to increase their market shares, but their doing so may be prevented by various barriers to mobility or to expansion. For instance, a high market price may tempt some market players to increase their output, but their capacity constraints may not allow expansion in the short term. Therefore, in the narrowly defined market structure, barriers to expansion or mobility are important in determining the extent of competitive pressure potentially exerted by firms in a market.

1.3.2. Entry into the market

3.20. The other fundamental factor of market structure lies in the conditions of market entry or exit. This is important because competitive pressure on individual market players is not only exerted by the other incumbents (the actual competitors), but also by potential competition.¹⁶⁰ In other words, the potential for new competitors to enter the market, attracted by profits, influences the decisions made by incumbent firms and therefore must not be neglected.

barriers to entry...

3.21. The barriers to entry (and exit) are closely related to this. Barriers to entry are factors that prevent, impede or delay new entrants. In the economic sense, barriers to entry mean the cost disadvantages of the new entrant, as compared to the incumbents, assuming that the new entrant is as efficient in technological terms as the incumbent firms.

3.22. Barriers to entry may consist of several factors ranging from various administrative barriers (exclusive rights, statutory procedures) to factors such as sunk costs. Sunk costs are costs that are incurred at the time of entry but cannot be recovered after a failed entry and the subsequent exit. Expenses on introductory marketing campaigns at the time of entry are an example of sunk costs (a new entrant will typically incur much higher marketing costs than an incumbent firm as it will need to draw attention to itself and to its product). The cost of purchasing equipment and assets pursuant to the activity undertaken in the market, may also be deemed to be a sunk cost, assuming that these cannot be resold easily, or without substantial depreciation being incurred.¹⁶¹

3.23. Barriers to entry do not only consist of specific monetary costs, but also factors that delay entry (because, in economic terms, they also increase costs). For instance, if a firm wishes to enter a given market, it has to recruit adequate personnel. Often, this is not a serious problem, but it may take a long time if the activity requires labour with special skills. The firm will need to arrange for its employees to be adequately trained, which costs money, takes time, and delays entry into the market.

... and exit

3.24. Barriers to exit refer to the costs, time-constraints or other difficulties involved in leaving a market. It may be that certain activities have to be performed before exit can take place; for example, pursuant to bureaucratic hurdles or contractual obligations. In most competition policy analysis, barriers to exit can be considered as

¹⁶⁰ Threat of entry is illustrated by Figure 9.

¹⁶¹ To put it more accurately, if resale is possible, it is just these financial losses that embody sunk costs (i.e. the sunk cost is not the entire investment but the part of the amount invested that is lost upon exit).

relevant barriers to entry, because both the cost of entering and exiting will influence a firm's decision to enter a market or not.¹⁶²

3.25. However, it should be pointed out that the real analytical task is to determine the *threat* of entry; the competitive pressure put on incumbent firms by potential competition. It is not enough to list the expected barriers to entry in a market; regard must also be had to the probability of entry, its likely magnitude and timescale.

the point:

the threat of entry

1.3.3. Other factors

3.26. In addition to the two major components discussed above – narrowly defined market structure and entry possibilities – there are many other factors that influence the functioning of a market, and therefore can be said to form part of its structure. They include: the number and frequency of deals, the size of individual transactions compared to the entire market, the usual method for concluding deals, and the related level of transaction costs. For instance, the market for large passenger jets is shared between a few suppliers and entry into the market is difficult. In addition to that, the market's operation is strongly influenced by the fact that manufacturers compete to secure a relatively low number of large purchases; this takes place via bidding on an international scale. These market characteristics will lead to particular business practices and strategies emerging, and will influence how potential competition will be analysed.

*transaction
characteristics*

3.27. Other factors relevant to structure include: how transparent market conditions are; how well-informed each market player is; and whether the various market players have the same level of information about the market and about each other. Markets with otherwise identical characteristics will function very differently as a result of differences in each of these factors. In some markets, high levels of transparency may favour competition, whereas in others, it may give rise to restrictions on competition, such as parallel pricing in an oligopoly.

*information,
transparency*

3.28. The nature of the product or service can also make a difference. Competition may turn out differently in cases where the product has special characteristics. For instance when the consumer is only able to evaluate the quality of the product or service after it has been consumed (experience goods), or if he/she is not able to measure it even after consumption (credence goods).

*product
characteristics*

3.29. The extent to which a given market is characterised by innovation is also important. This refers to the speed of technological change or the innovative and changing nature of products.

innovation, changes

3.30. Other structural factors include the characteristics of market players; such as their levels of technology, their costs, their financial situation. Differences in these characteristics between market players can also influence the functioning of the market.

firm characteristics

*

¹⁶²

Even so, in certain cases, the impact of barriers to exit may be distinguished from the barriers to entry. Such is the case when the investigation is directed on the competition in the market, rather than focusing on entry. If it is difficult to exit a market, market players may be willing to make substantial sacrifices to stay in the market, e.g. they may be willing to operate at a loss for a longer period of time, because leaving the market is expected to cause even greater losses.

3.31. Naturally, market structure is not independent of other factors; it evolves mostly as a consequence of natural and technological characteristics (e.g. economies of scale) but – as will be presented in more detail later – regulatory intervention may also play a substantial role. Moreover, the conduct of firms and the performance realised in the market will also have an effect on the structure.

1.3.4. Market models

3.32. Economists dealing with industrial organisation often mention market forms such as perfect competition or monopoly. Naturally, no two markets are identical, and any kind of pigeonholing can never do justice to their diversity. Yet, it is worthwhile giving an overview of the market models that are most important for competition policy purposes because they are useful analytical tools that help us understand the functioning of individual markets. This concludes the discussion related to market structure, and leads to the next element of the SCP model, which is the issue of firms' conduct on the market.

perfect competition

3.33. One market model is perfect competition; characterised by a large number of sellers and buyers present in the market, free entry, homogeneous products, and perfect information, meaning that all market agents have a clear understanding of all relevant business information, especially with regard to prices. Firms in a perfectly competitive market are price takers, i.e. individual market agents are not able to influence prices as they are determined according to the competitive equilibrium of demand and supply in the market. Although in practice there is almost no such thing as a perfectly competitive market, this market form is very important for analytical purposes as it serves as the benchmark when investigating the extent of competition prevailing in real markets. On the other hand, there are markets which have a structure that is relatively close to the benchmark of perfect competition, even if it is not completely identical.¹⁶³

perfect monopoly

3.34. In contrast to the large number of competitors in perfect competition, there are markets where the supply side is controlled by one single firm. This market model is called a monopoly; the single firm known as a monopolist. A true monopolistic market exists only if entry by another firm is impossible; hereinafter referred to as perfect monopoly. Unlike the numerous market actors in perfect competition, a perfect monopolist is not a price taker; due to its market position it determines market prices in accordance with its own profit maximisation objective. The monopolist is thus a price-setter. According to economic theory, (as already referred to) this monopoly price is higher than the price that would result in perfect competition.¹⁶⁴ Examples of perfect monopoly can be found in the real world, although they are rare.¹⁶⁵

natural monopoly

3.35. Monopoly may be created through the intentional elimination of competition (e.g. by exercising some exclusive right) in a given industry, but in some cases it

¹⁶³ Small agricultural producers, e.g. apple or wheat producers provide a widespread example for this in most countries, but in general stock markets also show similar features.

¹⁶⁴ Naturally, the monopoly price is not just any high price because it is not reasonable even for the monopolist to raise prices for ever; by increasing the price beyond a certain point it would reduce its profit instead of increasing it, because the loss due to the decrease in demand would be more than the profit from price increasing.

¹⁶⁵ Such monopolies include gambling monopolies that can be seen in many countries, where games of chance – or certain games of chance – can be organised only by one designated firm.

develops by necessity, as a natural consequence of the particular features of the industry in question. The latter case is called 'natural monopoly'. A natural monopoly arises where a single firm is able to produce the product more efficiently and, therefore, cheaper than two or more firms, i.e. if the total cost of production is less in the case of a monopoly than the sum of production costs of several firms in the same market. Natural monopolies often arise because of economies of scale. If the proportion of fixed costs (which arise irrespective of the volume of production) is very high in an industry, the less they produce, the higher the average cost of each individual unit will be. The level of production at which economies of scale are realised is known as the minimum efficient scale of production (where long-run average cost is at its lowest). This level must be achieved for there to be sufficient return on the investment to make it worthwhile. In extreme cases, the minimum efficient scale of production may be a high proportion of market demand. Only one firm is able to fully exploit the economies of scale in the market. In these cases, the most efficient solution is to have one single firm, a (natural) monopolist in the market.¹⁶⁶

3.36. A market form that is close to monopoly but which occurs more frequently in practice is the case of a dominant firm with a competitive fringe. In this form, the market leader is a dominant firm that is able to influence market prices with its decisions, and can develop a strategy similar to that of a monopolist in several respects. By contrast, the firms operating alongside the dominant firm, in the competitive fringe, accept prices and their market conduct depends mostly on the business decisions of the dominant firm.¹⁶⁷

dominant firm and competitive fringe

3.37. Oligopoly is a market form in which there is a relatively low number (e.g. 3-5) of market agents on the supply side. Although the phrase *oligopoly* means "few sellers", the decisive characteristic is not the exact number of sellers, but the mutual interdependence that exists between them, and the conduct that results from firms understanding of this relationship. This behaviour may be described as oligopolistic; in order for it to occur a number of factors must prevail, such as market transparency. Oligopolistic behaviour is characterised by the fact that market players – as in some tactical board game – shape their market decisions and business strategies autonomously, but with regard to each other's expected steps and the possible responses. In the course of this prisoner's dilemma type situation, strategies leading to tacit collusion (lacking any explicit coordination) or conscious parallelism may prove to be a rational and sustainable outcome. The results may seem indistinguishable to those of a hard core cartel; lower output and higher prices. The prices that result from oligopolistic behaviour will generally be somewhere between the prices of a perfectly competitive market and a perfect monopoly¹⁶⁸, although it is in the oligopolist's interest to raise them as close to the latter as possible so as to maximise profits.

oligopoly

¹⁶⁶ This is well demonstrated by the example of a pipeline. Once a pipeline has been laid with great effort and investment, the quantity of material flowing through the pipeline may be increased with almost no additional cost until the pipeline's ultimate throughput capacity is reached. Up to this limit, it is not reasonable to lay a new pipeline in parallel with the previous one because the total cost of the new investment would be incurred even for the smallest quantity transmitted through the pipeline, in contrast with the old pipeline for which this additional cost is much lower.

¹⁶⁷ In the past, the production of personal computers presented such a market, where IBM was the dominant firm and the other firms in the industry made up the competitive fringe.

¹⁶⁸ An example of a global oligopoly is the market of large passenger jet planes where the two dominant market players are Boeing and Airbus.

**monopolistic
competition**

3.38. Another specific market model is monopolistic competition, where a relatively large number of market agents compete, producing differentiated products. Due to the strong product differentiation, individual sellers can be clearly distinguished and each of them has an established customer base due to consumer loyalty. So they are not purely price-takers, nor are they able to influence market prices to an extent comparable to a monopolist or a dominant firm.¹⁶⁹

3.39. This brief overview of the most relevant market forms also illustrates how competition policy analysis generally focuses on the structure of the supply side, and on competition between sellers.

1.4. The conduct of firms in the market

3.40. As has been discussed, conduct refers to the market decisions and actions of firms. In theory, conduct includes all sorts of business practices, but for the purposes of analysis, the most relevant are generally those related to pricing and sales. Longer term decisions on product development and investment, as well as strategic decisions, are also relevant.

1.4.1. Market power

3.41. When managing their behaviour and decision-making, the fundamental goal of firms is to maximise profits. The extent to which they are able to realise this goal, as well as the rational strategy they will pursue, is basically determined by the market structure. In perfect competition, firms are price-takers and the profit acquired by them is normal profit, which just about ensures a rate of return on investment commensurate with the risks taken. No economic profit is earned in this situation; normal profits are the maximum these firms are able to achieve and these are determined by the market price. In contrast, the perfect monopolist is able to set its price level and will choose to raise it so as to maximise its profits. A monopolist's profit exceeds that earned by sellers in a perfectly competitive market, and includes economic profit in addition to normal profit. In this context, the ability to raise price above competitive levels is of key importance; it is known as *market power*.

**ability to increase
prices significantly**

3.42. Market power is a firm's ability not to reject the market price, and instead set its prices above the competitive benchmark. To be more precise, a firm with market power is able to maintain a price that is substantially higher than the competitive price, on a long-term basis, without making losses.^{170 171}

¹⁶⁹ An example of monopolistic competition is the industry of bakeries producing bread and pastries, where there are typically many market players on the supply side who are geographically scattered and whose products show several smaller or greater differences. Also, monopolistic competition can be seen in areas such as services provided by restaurants in a large city, because restaurants provide approximately the same but not completely identical services, and geographic location may also be a distinctive factor.

¹⁷⁰ Naturally, all firms are free to determine their prices at any level (unless their prices are regulated); however, the question is whether the market accepts this, i.e. whether the firm is able to determine a price that is higher than competitive in a way that makes it profitable. It may also be that a firm is able to raise its prices over the competitive level for a short while, although not due to its market power, but due to luck or the fact that the market is either not in equilibrium for the moment, or it reacts slowly, or perhaps the buyers are not adequately informed. The same way, a firm may increase its prices over the competitive level but only slightly that is practically negligible or imperceptible for its buyers.

3.43. In the model of perfect competition, market power is assumed to be absent, but in real life nearly all market players have some market power, at least in the theoretical sense of the phrase. If economists had a meter for measuring market power, it would not be a device with a little red light to indicate when there is market power and a little green light to indicate when there is no market power. Instead, this meter should be pictured as having a sliding gauge, which in the case of almost any market, will settle at some level above zero on a wide scale. In other words, market power is not definitive but varying, so the question is not whether there is market power; the question is how great market power is. For the purposes of competition policy and the operation of markets, only significant or real market power is relevant. This does not change the sliding nature of market power but indicates that only the higher range of the scale on our imaginary meter is painted red.¹⁷²

3.44. There is a negative relationship between the intensity of competition and the extent of market power. The stronger competition is, i.e. the greater the competitive pressure on a firm, the less market power it has.¹⁷³ The greatest market power may exist in the case of perfect monopoly, where there is no competition in the market at all and a monopoly price prevails. As competition appears and gains strength, market power gradually decreases. In parallel with the strengthening of competition, the pointer on the imaginary meter will sooner or later sink to the lower range of the scale, where there is no significant market power. Competition policy calls competition of this intensity effective competition because the market's operation does not substantially differ from how the model of perfect competition functions and should not provide results substantially different from perfect competition in respect of output, price levels and the magnitude of the generated profit.¹⁷⁴

**market power and
competition**

3.45. If a firm has market power, it is able to price above the competitive level and realise economic profit. The stronger the market power, the greater the difference will be between the actual price and the competitive price, and thus the higher profit will be. The super-competitive price and economic profit are consequences of exercised market power. This means consumers are exploited, because economic profit is generated from income extracted from them. This exercise of market power (as will be presented later) usually causes efficiency and welfare losses to society, and the greater the market power is, the greater these losses will be.

exploitation

3.46. In addition, a firm may use its market power to restrict competition in order to maintain or further increase its market power, or possibly to leverage it to a related market where it has not yet had market power.

**restriction on
competition**

¹⁷¹ This is equivalent to the somewhat more technical statement that the firm faces an individual demand curve that is "sufficiently" decreasing.

¹⁷² This is similar to how experts think of radiation. Physicists know that the human body is continuously exposed to natural background radiation. For practical purposes (e.g. for disaster prevention services) it is radiation levels exceeding this natural background radiation that generally may be relevant or cause concern (e.g. it may indicate a nuclear accident).

¹⁷³ This does not mean that the extent of market power depends only on competition intensity, because it is also influenced by e.g. the elasticity of demand.

¹⁷⁴ The relationship between market power and competition is illustrated by Figure 8.

1.4.2. Maintaining and increasing market power

3.47. On the one hand, firms with market power are able to realise higher profits, and on the other hand, the fundamental goal of firms is to maximise their profit. Thus, it is not surprising that firms are eager to gain as much market power as possible. Market power is based on the firm's market position, market share, strength, possibly the limited possibilities of consumers or competitors, their conduct, and ultimately, the market structure. Thus, for instance, some degree of market power may exist if consumers are loyal to a firm and do not switch to competitors even if they have to pay super-competitive prices. Another source of market power may be if, for some reason, competitors respond by increasing their own prices too.

natural growth through genuine competition, or...

3.48. Market position, market share or the favourable behaviour of consumers or competitors can be achieved in a number of ways. On the one hand, a firm may gain market power through growth and the improvement of its performance. If it is able to produce the product cheaper or of better quality than its competitors, or it is able to better satisfy the needs of its customers, this in itself may be advantageous because it can increase its profit directly by increasing efficiency. In addition, better performance increases the firm's market share and strengthens its position, consequently increasing its market power. In such cases, the strengthening of market position is a result of competitive pressures inducing positive effects (better performance, increased efficiency), and is realised through the process of competition. In this respect, market power can be a reward of competition for the firm.

... strategy to restrict competition...

3.49. The other way of increasing market power and strengthening market position is to restrict competition. There are many ways competition can be restricted by firms: They may enter into a collusive agreement with their competitors not to compete; they may employ predatory practices and acquisitions to eliminate or suppress some or all competitors in the market, as well as keeping potential competitors (potential new entrants) away from the market by various practices or also by acquisitions. Depending on the circumstances, many instruments may be suitable for driving out competitors and keeping potential new entrants away from the market. Such instruments may include: tying refusal or termination of access to an essential facility; price discrimination; cross-subsidies between various activities; increasing the costs of competitors; predatory pricing; and foreclosing access to the resources or sales channels required for the activity, through exclusive agreements. In addition to market actions, a firm may also successfully lobby for more favourable regulations in order to increase its market power. For example it may get an exclusive right, secure administrative barriers to entry, or may receive state subsidies.¹⁷⁵

3.50. The prerequisite for the success of several practices mentioned above is that the firm should have significant market power in the market where it intends to restrict competition, or in a market that is somehow related to the target market to which the firm intends to leverage its market power. However, the extent of market power required for success will vary across business practices and circumstances; no general thresholds can be determined on the scale of the imaginary meter which delineates between certain failure and certain success in the case of any one practice. The problem is even more complex because the use of the above practices frequently

¹⁷⁵ This conduct is often referred to as rent seeking, which will be discussed later.

does not simply require sufficient market power but also a market structure that enables that specific practice to take place.¹⁷⁶

3.51. Therefore, market power and position can be strengthened, either through the realisation of competition (as a consequence of the related benefits of competition), or through the restriction of competition, characterised by the degradation of the benefits of competition. Unfortunately, it is not always possible to distinguish between the two in practice because they often appear similar to the observer. Thus, for instance, it is very difficult (if not impossible) to distinguish between fierce price competition and ongoing predatory pricing, although in theory the two types of conduct should be discernible. Certain practices such as tying, price discrimination or even strong product differentiation, may be the means for increasing competition and efficiency, but may equally serve to restrict competition. Furthermore, the use of these means as a tool to compete may also have restrictive effects on competition, and *vice versa*: their use in order to restrict competition may possibly strengthen competition. Therefore, it is usually not the intention but the effect that is relevant.

*... but often
similar appearance*

3.52. When firms do not use their market power directly to increase prices or profits, but to maintain, strengthen or leverage their market power, this is called 'strategic behaviour'. Here, the direct intention of firms is actually to change the market structure in a way that is favourable to them.¹⁷⁷

1.5. Market performance

3.53. For business executives, the performance realised in the market is generally measured by sales volume, the realised turnover, the market share, the profit achieved, or possibly an increase in firm value. In the SCP model, performance means something slightly different; because the focus is on social welfare, the analysis focuses on efficiency and economic welfare.

1.5.1. Efficiency

3.54. In economic theory, efficiency generally means producing the most goods (output) possible out of a given quantity of resources, or producing a given quantity of goods (output) using the smallest possible quantity of resources. One firm, industry or society is more efficient than another if it is able to produce a given quantity of output by using fewer resources, or is able to produce greater output using the same quantity of resources. Similarly, efficiency will increase if the quantity of output is constant while the quantity of resources used decreases, or if the quantity of resources used is constant while output increases. To put it simply: efficiency is the opposite of waste.

¹⁷⁶ Such a factor could be information asymmetry and its extent, which could play an important role for example in the case of predatory pricing. In a normal situation predatory pricing would require a very high degree of market power because the predator company would need to maintain below-cost pricing for a longer period than its competitors (or potential market entrants), and would have to be able to recoup its loss. This would necessitate much larger resources than that of its competitors. In the case of information asymmetry between the predator company and its (potential) competitors, and the latter is unaware of the fact that the predator company's price is in fact below-cost. To these competitors the behaviour of the predator company suggests that it is simply more efficient and therefore it is not worth competing with them (even if the predator company has not got sufficiently larger resources).

¹⁷⁷ More on strategic behaviour: III. Background note paragraph 3.70

productive efficiency

3.55. Three types of efficiency are distinguished: productive efficiency, allocative efficiency and dynamic efficiency.¹⁷⁸ Productive or X-efficiency measures efficiency at the operational or corporate level, and means producing products at the lowest cost, i.e. the firm uses the resources available optimally and organises its own operation efficiently.¹⁷⁹ For instance, if the ratio of waste products, losses due to downtime, or energy consumption is lower during production, or the same product is produced using fewer materials because the quantity of waste is lower in a firm, this firm has higher productive efficiency. Putting it another way, productive efficiency means higher productivity at the corporate level.¹⁸⁰ Theoretically, given their profit-maximisation motivation, companies should operate X-efficiently, not allowing for wastefulness. In practice, however, due to a number of reasons, it is not at all obvious that firms will always organise their production at the highest possible productive efficiency level.

allocative efficiency

3.56. Allocative efficiency is not a corporate level efficiency concept; it has relevance at the level of society as a whole, and means that society is using the available resources in the optimum combination, or in other words, that the society – considering the available technologies and other conditions to be given – optimally distributes its resources between the various ways of using them. In contrast with productive efficiency, allocative efficiency is an abstract category that is difficult to measure in practice, so it is not easy to demonstrate and understand either. According to economic theory, if the conditions of perfect competition are fulfilled in all markets, and therefore equilibrium prices are equal to the cost of the given product in all markets, allocative efficiency is achieved.¹⁸¹ In this case, the society produces just as much of all products as is needed by consumers who are willing to pay the cost of producing the given product. However, if the price is higher (or lower) than the cost, society will produce and consume too little (or too much) of the given product (compared to the optimum), meaning that society will use the available resources in a wasteful manner. This is also so in the case of a perfect monopoly, where demand is lower than the competitive threshold due to the fact that pricing is above costs, and therefore the society will not produce and consume products at levels where welfare is maximised.

dynamic efficiency

3.57. Whereas productive and allocative efficiency are often considered static concepts (measuring efficiency in a given point in time) dynamic efficiency allows for changes in efficiency over time. It is associated with innovation, technological development, and with the ability of firms to adjust to changes in the market. Innovation and the technological development stemming from this improves productive efficiency over time, or may open new horizons for static efficiency by the appearance of new products or better quality. Actually, the flexibility and adaptability of a firm ensures creativity innovation, through which they are able to adapt to the constantly changing market environment and to consumer needs, finding market niches, and applying new and innovative business models. The key point of dynamic efficiency is always that it will be transformed into productive or allocative efficiency or will open new welfare-horizons by introducing products that did not previously exist.

¹⁷⁸ The taxonomy of efficiencies is illustrated by Figure 10.

¹⁷⁹ In other words, its cost curve is the lowest possible.

¹⁸⁰ Productive efficiency can also be interpreted at the social level; then it is about the aggregate productivity of society, or that the aggregate cost curve is the lowest possible.

¹⁸¹ Or more accurately, to its marginal cost or avoidable cost.

1.5.2. Welfare

3.58. In the everyday sense, people usually understand welfare to mean that they have no problems and are contented. Many might think that welfare equals the cumulated material riches or the standard of living. For those, better acquainted with economic issues, this may equal per capita GDP. The economic concept of welfare is slightly different from this common understanding, although it is far from true that economic welfare has nothing to do with the satisfaction of people or their standard of living. Economic welfare is an abstract microeconomic concept closely related to the functioning of the market. In a general sense, welfare is something that makes it worthwhile for the economy to function; it is the surplus created by an economy, and is distributed between economic agents.

3.59. It was discussed earlier how, in commercial exchanges, sellers and buyers make rational decisions; sellers will not sell their products for less than the production cost, and buyers will not buy products that are more expensive than they are willing to pay. However, the inverse case – where sellers will sell products for more than the lowest price acceptable for them, and buyers will buy cheaper than the highest price acceptable for them – can exist. This gives rise to economic surplus or welfare, which is divided into two categories: consumer surplus and producer surplus.

3.60. Consumer welfare or consumer surplus is the aggregate difference between the actual price paid by consumers, and the maximum price they are willing to pay for a given good. Therefore, consumer surplus is an amount of money (a saving); how much less consumers spent altogether on the given product compared to the price they would have been willing to pay; this is their gains from trade.

consumer surplus

3.61. In contrast, producer surplus is the aggregate difference between the actual price of goods sold by producers and the cost¹⁸² of producing those goods. Producer surplus is also an amount of money (a profit) – this is how much more producers received altogether for the given goods compared to what the goods cost them; it is their gains from trade.

producer surplus

3.62. The sum of consumer surplus and producer surplus is social surplus (or total surplus) that is, social welfare. This expresses how cheaply society produced the given products, as compared to how much they valued them overall; this is society's gains from trade.¹⁸³

social surplus

*

3.63. It is true in general that the greater the efficiency, the greater the welfare. Thus, for instance, if productive efficiency increases – meaning that firms produce at lower costs – on the whole, society gets the given goods even cheaper and there will be an even greater difference between the cost of producing the given goods and how highly society values them. It is another matter how much of the generated social welfare will become consumer surplus and how much will be producer surplus, i.e. how the surplus is divided between producers and consumers.

more efficiency:

more welfare

3.64. As may already have been guessed, the different categories of welfare can sometimes only be increased to the other's detriment. It seems most obvious in

¹⁸² More specifically, the marginal cost.

¹⁸³ The various welfare categories are illustrated by Figure 11.

respect of producer and consumer surplus - the trade-offs between different types of welfare will be discussed later. There are also situations where the different efficiencies can be increased only at each other's detriment, which will also be discussed later.

3.65. In the SCP model, performance means the efficiency and welfare actually achieved, and the relationship between this, and the efficiency and welfare that could theoretically be achieved. Performance will improve as efficiency and welfare increase. In other words, performance depends on the extent of the different efficiency and welfare losses; the smaller these losses, the better performance will be.

1.6. Relationships within the SCP model and additions to the above

1.6.1. The basic relationship of the SCP model

3.66. As discussed earlier, the most basic relationship between structure, conduct and performance in the SCP model is that structure determines conduct, and conduct determines performance. In other words it is the conditions of competition that primarily determine the quality of competition, which affects the welfare result of competition.¹⁸⁴ This means that structural characteristics will determine the conduct that is available to firms, and which conduct is effective and has a fundamental impact on the intensity and nature of competition in the market. Firms generally have some market power based on the market's structure. If this market power is not significant, relatively intense and effective competition is expected to take place in the market, and the market outcome is likely to be similar to that predicted by the model of perfect competition. If the market power held by a firm is significant, it may use that power directly to acquire economic profit, and/or may use it to restrict competition, maintain, strengthen or leverage its market power in order to maximise profits in the long term. The effect of structure on market conduct should not be pictured as a deterministic relationship. Market conduct may be diverse; what happens is that out of the broad range of possible behaviours, the given market structure narrows down the range of business practices remaining available for firms, though this range is still often relatively wide.

**more competition:
better performance**

3.67. According to the SCP model, firms' conduct and the intensity of competition determine market performance. It is true in general that stronger competition is accompanied by better performance, while the restriction or lack of competition reduces performance. A decrease in competitive pressure reduces the productive efficiency of firms and leads to so-called *X-inefficiency*: firms less exposed to competition tend to become "lazy" and, although the fact that their profit remains below the possibly achievable profit indicates a loss of efficiency, this signal is much less perceptible for them than in the case of vigorous competition. This results in a shift of the cost function and a price increase, which reduces both producer and consumer surplus. Although a decrease in the strength of competition or a super-competitive price (resulting from the existence of market power) increases producer surplus (that is why the firm determines the price at the given level), it reduces consumer welfare to a greater extent, resulting in a decrease in social welfare. This means that a welfare loss will be incurred by society, because of the loss in allocative

¹⁸⁴ The Structure-Conduct-Performance Model (SCP) is illustrated by Figure 2.

efficiency that arises due to the higher price. The relationship between competition and dynamic efficiency is less clear, but it can also be said that in a number of cases the absence of competition impedes innovation and firm adaptability; or at least reduces the motivation of firms to innovate etc, which has a negative impact on dynamic efficiency.¹⁸⁵

3.68. This basic relationship is also demonstrated by the theory of contestable markets. A market is a contestable market if: entry into it does not entail sunk costs; market entry and a possible subsequent exit can be executed swiftly and easily; and if the incumbent firms have no cost advantage compared to the new entrants. It can be shown that even a monopolist is unable to price above the competitive level in a market with such structural conditions, otherwise entry attracted by prices that are higher than the competitive level would deprive it of all profit. Consequently, welfare consequences arising out of contestable markets will be the same as those in perfect competition. In practice, there is no perfectly contestable market, just as there is no perfect competition. The model provides a useful benchmark similar to that of perfect competition because it draws attention to the importance of *potential* competition.^{186 187}

contestable markets

1.6.2. Other relationships in the SCP model

3.69. It was discussed earlier in this paper, that in addition to the most basic relationships, the SCP model describes reverse links as well.¹⁸⁸ An example of such a link is the impact of market performance on the market structure. In fact, this has also been covered in the discussion of conduct, because better performance and increasing productive efficiency were mentioned as a method for increasing market power and profit. When a firm, that considerably and permanently increases its productive efficiency compared to its competitors, (e.g. by one or more innovations) succeeds in the market and considerably and permanently increases its market share, the impact of performance on the structure is demonstrated. Performance may also have other influences on structure. If the efficiency of market players deteriorates significantly because all or some of the firms have grown too "lazy" in the absence of competition, these firms may lose ground in the market either to the benefit of other efficiently operating incumbent firms or because the market becomes more attractive than before for potential entrants. Another case of performance having an impact on structure is when new technologies or business models become accessible as a consequence of technological and business innovation, changing the technological characteristics of production, e.g. eliminating economies of scale or reducing certain

**the effect of
performance on
structure**

¹⁸⁵ Rent seeking is also frequently mentioned in connection to welfare or efficiency losses resulting from market power. The profit increase from greater market power might encourage companies to dedicate a vast amount of resources to influencing administrative procedures in order to ensure that policy making will be beneficial to attaining or increasing market power. These resources do not increase welfare or efficiency, and could be used for welfare enhancing purposes should rent seeking not happen.

¹⁸⁶ In a contestable market, the narrowly defined market structure makes no difference, as the structural conditions related to entry in themselves ensure competitive behaviour and the related welfare consequences.

¹⁸⁷ The relationship between contestable markets and competition is illustrated by Figure 9.

¹⁸⁸ The Structure-Conduct-Performance Model is illustrated by Figure 2.

barriers to entry,¹⁸⁹ or perhaps even the opposite: creating economies of scale or barriers to entry that have not previously prevailed.

strategic behaviour

3.70. The other important reverse effect is produced by strategic behaviour. One could talk about strategic behaviour in the context of the SCP model if the firm's behaviour is not aimed directly at maximising profit, but at changing the market structure; generally with the purpose of maintaining, strengthening or leveraging market power.¹⁹⁰

predatory pricing

3.71. For instance, predatory pricing by a firm is an example of strategic behaviour. Here, a firm sets its own prices at a lower level (typically below cost¹⁹¹) than the rational optimum based on long-term considerations. Its competitors have two choices: either to follow the below-cost pricing and accept the losses entailed by this, or to concede a reduction in their market shares and possibly be driven out of the market. Predatory pricing is ultimately successful if the competitors leave the market – either because their buyers deserted them or because they were ruined by losses – after which the firm may increase its prices to recoup the losses suffered during the predatory period. Predatory pricing is a strategy that is viable only rarely or under special conditions, because the predator also has to suffer significant losses, which can only be recovered by a significant and permanent subsequent price increase. This may prove to be impossible if new firms enter the market or former competitors re-enter after the "seven lean years". However, if market conditions are such that predatory pricing proves to be successful, it demonstrates the essence of strategic behaviour: the firm acting strategically appears to put aside profit maximisation in the short-term, but in fact works for long-term profit and treats temporary losses as investments. The firm in question removes its competitors from the market, thereby changing the market structure, and allowing it to behave differently than before, i.e. to set its prices at a higher level that compensates for the short-term losses and ensures higher profits in the long-term

entry deterrence

3.72. Another example of strategic behaviour is the deterrence of entry by potential competitors. Such behaviour may include extremely strong product differentiation or continuously covering all market niches by brand proliferation. Perhaps supplying individual market niches is not worthwhile in itself for a firm, and its profit at the given moment would be higher by leaving some not too significant consumer groups dissatisfied. However, this may prompt entry, and the new market player's possible further expansion, which may threaten the market positions and market power secured earlier by the incumbent firm (i.e. the source of profit). Depending on the circumstances, the incumbent firm may think it would make the higher profits in the long run by agreeing to incur the losses entailed in filling those market niches. There are several other ways firms may prevent or deter entry; for instance if incumbent

¹⁸⁹ This can be seen in telecommunications since the 1990's. A significant part of the wired telecommunication network, which had been considered a natural monopoly earlier, has lost its natural monopoly character in most parts simultaneously as technological development brought about the emergence of parallel long-distance networks. Currently, experts consider only the local wired network to be a natural monopoly, but further technological development may change even this, e.g. as the cable television and possibly other networks (such as the electricity network) become suitable for providing telecommunication services.

¹⁹⁰ In a broader sense (not in the context of the SCP model of competition policy) all business practices that serve to achieve indirect, usually long-term, goals, and are aimed beyond their immediate impact constitute strategic behaviour. Economics and business sciences, for instance, talk about marketing strategy, R&D strategy, etc.

¹⁹¹ More accurately, below marginal cost or avoidable cost

firms convince potential entrants that they are prepared to make things so difficult for them that their entry will not be worthwhile. Such credible threats or commitments might include the creation of high production capacities (ready to flood the market to drive out a new entrant), and announcing the introduction of new products. Such commitments entail costs, and are rational only in light of reducing the probability of entry, based on long-term indirect considerations.¹⁹²

3.73. Therefore, the point of strategic behaviour is that the firm's actions are aimed at conserving or changing the market structure in that firm's favour. This costs money, but ultimately does not go against the objective of profit maximisation; rather, it may be considered as an investment in market power, through which higher profits can be earned.

3.74. As will be detailed later, it is not only the structure that is able to affect firms' conduct. State regulation and other interventions may also directly influence, determine explicitly, or confine the behaviour of firms or the tools and strategies used in competition.¹⁹³

1.6.3. Efficiency and welfare trade-offs

3.75. It has already been mentioned in the discussion of market performance that trade-offs exist between the various types of efficiencies, as well as between the different types of welfare. This means that in certain cases it is not possible to maximise all types of efficiency or welfare at the same time.

3.76. The trade-off between allocative and productive efficiency is demonstrated by the case of a natural monopolist. As discussed earlier, natural monopolists can serve the total demand in a market at a lower cost than, say ten competing firms, because of economies of scale. On the other hand, a natural monopolist is still a monopolist, and will charge monopoly prices for its products if it wants to maximise its profit. Monopoly pricing will lead to a loss of allocative efficiency, but if someone tried to remedy this with a more competitive market structure, although it would improve allocative efficiency, it would reduce productive efficiency. Therefore, in this case, allocative and productive efficiency may be increased only to the detriment of each other. A similar phenomenon can be seen in other cases too; for instance, there are mergers or activities collectively performed by individual firms, which would considerably reduce costs and therefore improve productive efficiency, but would also considerably increase market power, thereby reducing allocative efficiency.

allocative efficiency
vs.
productive efficiency

3.77. It may be necessary to reduce static efficiency to achieve dynamic efficiency, and *vice versa*. If a large-scale R&D project or product development requires several market players to join forces, it may reduce allocative efficiency through reducing the

static efficiency
vs.
dynamic efficiency

¹⁹² Entry deterrence may overlap with predatory pricing or other predatory behaviour, given that predatory pricing might be aimed against potential market entrants.

¹⁹³ An example for this is price regulation by the state, which restricts market players' freedom to set prices. Market rules may provide a similar example as when the state or some self-regulation sets out certain conditions for concluding deals (e.g. the time or frequency), sets their form, or defines the products (or, in general, certain "rules of the game" that are more fundamental than those addressed by economic regulation). Examples of market regulation (typically, self-regulation) include the trading rules of stock exchanges and commodity exchanges, and the auction rules of some other organised markets. The descending auction of Dutch flower markets also provides an example. Such auctions start with a very high price, which is then lowered until one of the bidders cries out, who then obtains the item at the final price.

competition between them, while this collaboration may easily be a condition for achieving dynamic efficiency. A classic example of the trade-off between dynamic and static efficiency is the system of patent protection for inventions, through which market operators are encouraged to innovate by granting them legal monopolies for a certain period of time.

consumer surplus
vs.
producer surplus

3.78. In certain situations, consumer welfare/surplus and producer surplus may be increased only to each other's detriment. For instance, if a monopolist sets monopoly prices, it results in a reduction in consumer surplus and an increase in producer surplus compared to the competitive situation. Decreasing the monopoly price would increase consumer surplus and reduce producer surplus. In this case, the social surplus would also increase up to the point where price reaches the competitive level.¹⁹⁴ However, there are cases where consumer welfare and social welfare do not move together but in opposite directions, meaning that a particular change may be favourable to one but adverse to the other.¹⁹⁵

3.79. As the different types of efficiencies and welfare categories cannot always be maximised at the same time, it may be difficult to evaluate the performance realised in the market and determine good performance; or rather, it requires the analyst to identify more specifically what is considered to be good performance (e.g. maximising consumer welfare or social welfare).

1.7. The nature of the market and competition

market adaptation

3.80. One of the most important features of markets is their remarkable capacity for self-correction. Although markets are not always in equilibrium – in fact they are almost never in perfect equilibrium due to the constant change in circumstances – market mechanisms continuously drive them towards equilibrium. This is the *invisible hand* often mentioned by economists in connection with the functioning of markets. Naturally, it takes time to adapt, and this time may vary from a few seconds to several years depending on the characteristics of the product and technology, as well as on how well the market is organised.¹⁹⁶ Of course, the equilibrium point will also change over time (possibly before the market reaches equilibrium), for instance because of

¹⁹⁴ The differences between perfect competition and perfect monopoly are illustrated by Figure 12.

¹⁹⁵ A classic example of this is the comparison between a perfectly price-discriminating monopoly and the traditional (perfect) monopoly. Perfect price discrimination means that the firm sets a separate price for each of its products, at the highest level that the particular consumer is willing to pay for the given product. It can be shown that in this case the social surplus will be higher while consumer surplus will be lower than in the case of a traditional monopoly. (To be precise, social surplus will be the same as that generated in perfect competition, while there will be no consumer surplus at all – the total surplus will be gained by the monopoly.) Therefore, if a perfectly price discriminating monopolist is prohibited from price discrimination, consumer welfare will increase but social welfare will decrease.

Although the ability to perfectly price discriminate may appear to be pure fiction at first sight, auction markets may, according to the circumstances, produce results that are very close to perfect price discrimination.

¹⁹⁶ Examples of very fast adaptation can be found in the various stock exchanges, particularly electronic stock exchanges, and especially in respect of prices: the new equilibrium is reached within minutes, or possibly in seconds. A good example of lengthy adaptation is the that of crude oil production: even if the higher prices that result from increased demand justify increasing supply, if reserve capacities are insufficient, it may take years to explore and exploit new locations or build refinery capacities, because this requires not only considerable technical and financial expenditure but e.g. tests and licences from authorities, for environmental purposes, etc. It may also be said that price is usually able to adapt faster than the quantity of demand or supply following shocks in the market.

changes in consumer needs or the level of technology, but market mechanisms will drive the market towards this new equilibrium point. Therefore, the market continuously adapts to new circumstances, and transmits the need for adaptation between the various market players.¹⁹⁷ From this perspective, the market is similar to a weeble.

3.81. The price system plays an important role here because market signals work through price changes; market players learn about changes occurring in demand and supply through price signals. They do not necessarily need to know the details of specific changes; it is often enough to simply adapt to the price signals, which often provide a really sensitive reflection of market adjustments. Competition and the price system, as the basic operating mechanism of the market, ensures welfare maximisation by making sure that the goods with the highest demand are produced and are purchased by the people who are willing to pay the most. These also ensure the goods are produced using as few resources as possible. As regards the operation and importance of the price system, it should also be mentioned that prices typically adapt to changes substantially faster than demand or supply, and because of the above, distortions in price signals or in the pricing system will lead to distortions in demand and supply and to consequent welfare losses.

price signals,

price system

3.82. However, there are exceptional circumstances in which the market and competition do not yield the best result in terms of welfare. These situations are called market failure. A classic example of market failure is public goods such as defence or public lighting. Public goods are goods whose use or consumption cannot be physically¹⁹⁸ limited to those who make an economic contribution to their creation or maintenance. Therefore, although everybody is interested in the production/provision of public goods, nobody is motivated to make an economic contribution because they can use them anyway, i.e. free ride on the efforts of others. Therefore, on a commercial basis, public goods may not be produced at all, or may be underprovided. In the case of market failures, the functioning of the market and/or competition needs to be suspended or at least restricted to a certain extent in order to reach the optimal result. For instance, production and/or financing of public goods needs to be ensured (at least partly) in a non-market based manner; thus defence or public lighting may be financed out of taxes, and potential consumers may have to be bound to pay those taxes. The so-called externalities or free riding possibilities in general, as well as information asymmetry, can also lead to market failures. The elimination of market failures, by restricting the operation of the market and/or competition, can often be implemented by state regulation or other state intervention, and frequently through the conduct or co-operation of market players who restrict competition.

market failures

3.83. According to the picture outlined above, competition is the inherent driving force of the functioning of the market and is reflected in market mechanisms. Wherever there is a market, competition is present to some extent and in some form.

competition:

***inherent drive
and***

market competition

¹⁹⁷ Although in general, a well-organised market is the best in information processing and transmission, this does not mean that the market will unconditionally and always offer protection from all phenomena such as the short-term emergence of economically unfounded "bubbles" or "hysteresis". That is why examples can be found for regulations such as the temporary suspension of stock exchange trade in the case of extreme price movements. In certain cases, market adaptation may mean a shock-type correction with the bursting of these "bubbles". Ultimately, it is again the proper functioning of market mechanisms that leads towards equilibrium in these situations.

¹⁹⁸ Or more precisely, by a physical solution that is acceptable in economic or other terms.

The only question is the exact form and strength of competition, which in turn basically depends on the market structure. On the other hand, market competition, in the form we are familiar with, results from a pro-competitive market structure, and its intensity may vary. When no market player has significant market power there is effective competition, and the attributes of competition can be observed in the functioning and performance of the market.

**competition in the
market
vs.
competition for the
market**

3.84. Up until this point, market competition has been discussed as competition taking place in the market, which is in fact the most common form of market competition. However, under certain circumstances, market competition may take the form of competition *for* the market, instead of competition *in* the market. Competition for the market has somewhat different attributes but is equally a form of competition, and in certain cases may produce results that are identical to those of competition in the market.¹⁹⁹

**dimensions of
competition**

3.85. Firms may compete with each other for consumers in many ways: they may offer lower prices than their competitors (price competition); or may improve the quality of their products (quality competition); or they may introduce new technologies or products to the market. In markets where the product is complex, price competition or quality competition may also be complex. For instance, price competition between telecommunications operators is a competition between fee packages; quality competition between car manufacturers may relate to the safety, spaciousness, reliability or design of the car, etc. Therefore, competition is a multi-dimensional phenomenon, with many different aspects.

3.86. Although pure price competition or pure quality competition can be observed in certain markets, typically the different aspects of competition are combined with each other. In spite of this, certain markets may also be characterised by the dominance of one or the other aspect of competition. In the case of homogeneous products, for instance, price competition usually plays a much greater role than in a market described by strong product differentiation. In addition, innovation and product development competition may dominate industries that produce high-tech consumption articles. The dimension of competition prevailing in a given market depends on the decisions and the strategies applied by the firms. Finally, the regulatory or other intervention of the state may also influence the dominant aspect of competition in a given market, e.g. by eliminating the role of certain dimensions of competition with various prohibitions, say, by imposing uniform quality or prices on the market. Similarly, the efforts of market players to restrict competition may also relate to certain dimensions of competition or combinations of such dimensions, or even to all aspects simultaneously.

partial restriction

3.87. It follows from this that competition may be restricted only in relation to certain competitive aspects, without competition being eliminated altogether.²⁰⁰ However, depending on the circumstances, a partial restriction of competition may be sufficient to eliminate effective competition. In this context, it is relevant to ask how important the individual aspects of competition are to overall competition and to the functioning of the market, from the perspective of the general nature of market conduct and the

¹⁹⁹ To a certain extent, the functioning of auction markets mentioned earlier might show characteristics of the competition for the market, e.g. through the effect of "the winner takes all".

²⁰⁰ Naturally, this is not necessarily the total elimination of competition according to the given dimension.

performance realised in the market. Although this is largely dependent on the market structure and other factors, it is mostly true that the restriction of price competition constitutes a very serious restriction on competition and has far-reaching consequences for welfare.

3.88. In the case of market failure, the restriction of competition may have beneficial effects on welfare. However, the type and scope of restriction required for the specific market to function properly depends on the specific characteristics of the market failure. Total elimination of competition is usually not necessary to eliminate market failures; it is sufficient to have a partial restriction on competition, which may mean restricting or eliminating a certain dimension of competition. As this improves the functioning of the market, restricting or eliminating an aspect of competition may lead to increasing the overall strength of competition in the given market.²⁰¹ This is different from the norm where restricting an aspect of competition generally damages overall competition, depending on the role of the given aspect.

reasonable restriction

3.89. The intensity of competition may vary greatly across time, location and markets. As has already been discussed, one extreme case is perfect competition, where the level of market power is zero, prices are at the competitive level and market performance is the best possible. As this model does not exist in reality, competition policy uses the concept of effective competition for markets where competition is strong enough not to allow the emergence of significant market power, and the consequent substantial losses in welfare or efficiency.^{202 203}

effective competition

3.90. Competition, as a basic engine of market operation, probably cannot be eliminated entirely from any market, because it forms an integral part of the operation of markets. If there is no explicit market competition for some reason, the different firms can still compete with each other for resources or prestige. However, market competition can be completely excluded by setting up a perfect monopoly, as a consequence of which different welfare and/or efficiency losses would arise. Although these losses are smaller, they are still significant if competition is not completely eliminated but is reduced to a level where effective competition is not present any more, i.e. where there is significant market power present.

3.91. Given its nature, competition is a dynamic process that involves conflicts. This not only means the market is not always in equilibrium, but also that competition is not about friendship; competitors often act against each other's interests. There are winners and losers in competition, and success is not guaranteed for anyone.

competition: conflicts

3.92. Firms that are not able to produce with the efficiency and adaptability required in the given market, will face decreasing market share and profit in the long run, and may even have to exit the market. There may be a situation where some of the market players are driven into the background (or even out of the market), but are replaced by others, and as a result, the overall structure of the market does not change

success and failure

²⁰¹ A typical example of this is distribution systems where vertical externalities exist, the instruments used to eliminate market failures often weaken intra-brand competition (competition between products of the same producer within the given distribution system), while inter-brand competition (competition between distribution chains exclusively linked to a given manufacturer) will be strengthened as the distribution system becomes more efficient. The latter effect is usually more important than the former for the overall level of competition.

²⁰² Cf. III. Background note paragraph 3.44

²⁰³ The relationship between effective competition and market power is illustrated by Figure 8.

significantly. Here the failure of individual market players will not influence the nature and intensity of the competition taking place in the market, and the expected positive welfare effects will not be jeopardised. In this case, it may even be favourable that the assets and resources originally used by failing market players are employed in a different, more efficient form.

3.93. If the unsuccessful market players are not replaced by others, the market structure may become less favourable for competition, and competition may weaken as a result. However, if this process is based on efficiency, the success of certain market players is a natural consequence of their growth and superior performance. The exit of less efficient firms will be more beneficial than artificially maintaining their presence for the sake of a more 'competitive' structure. Greater efficiency may result in lower prices, even though there are now fewer firms. The extra profit enjoyed by the more efficient firms is their reward for increasing efficiency and succeeding in the competitive process.²⁰⁴

business disputes

3.94. The fact that competition entails conflicts is also reflected in disputes that often exist between competitors and between business partners. These disputes are inherent in competition, but a significant proportion are merely contractual disputes (which can be resolved by civil law means), or disagreements concerning the allocation of income between them. They are not related to how the performance of the market develops, and do not change the level of consumer or social welfare or the nature of competition.²⁰⁵

***competition
and
competitiveness***

3.95. From time to time, it is suggested that competition is harmful to the competitiveness of firms; for instance, because fierce competition prevents the accumulation of large incomes through monopolistic profits, which would strengthen the firm in competition. Those who forward this argument would often welcome "getting together" or the creation of a so-called "national champion", artificially protected from competition in the hope that it would secure the market success that can be achieved by competitiveness. The relationship between competition and competitiveness is indeed an important issue, because it is well-known that general economic policy goals such as economic growth, employment or increasing the standard of living can be realised on the basis of competitiveness.

3.96. In fact, competition is not an obstacle, but rather a stimulator of competitiveness. Real competitiveness emanates from having greater efficiency than competitors, instead of artificial protection such as state subsidies, import restrictions or restricting competition in other forms. The latter may fail to result in competitiveness or may result only in virtual "competitiveness" that can be maintained only at a high cost to society. Efficiency, whether it be the productive efficiency of firms, the

²⁰⁴ The third option is firms that are driven out, or kept out of the market and are not replaced by new ones, due to an exclusionary practice, rather than better performance and efficiency of remaining firms. In such cases, the excluded firms are victims not of competition but of an unreasonable restriction of competition. The market structure is changed in a way so that competition intensity decreases which leads to welfare losses, but society is not compensated for these losses. The problem is that – as has been already mentioned – this case is difficult to distinguish in practice from the case described in the previous paragraph.

²⁰⁵ Such disputes may arise e.g. between firms in a vertical relationship (seller-buyer). If in the short term, a downstream firm depends on its upstream supplier, the supplier may set higher prices to profit from this situation. However, if the customers of the downstream firm do not accept this higher price, then the price increase will ultimately have no effect on consumers, the volume of output and welfare, and will only influence how the two firms distribute income, which is typically not an issue for competition policy.

allocative efficiency of society, or dynamic efficiency manifested in technological development or dynamic business, are all enhanced through competition, as is the dynamic economic environment that supports competitiveness. Competition continuously puts pressure on market players to adapt to the circumstances and to perform better. Firms, industry and the national economy are best placed to improve competitiveness and contribute to the fulfilment of general economic policy goals, when they are exposed to competition instead of being protected from it.²⁰⁶

3.97. The benefits of competition for society are clear, based on the abovementioned picture of the functioning of the market and competition. Sellers fight for the disposable income of buyers, and through this, competition results in lower prices, better quality, a broader product range and faster technological development. In other words, competition makes a significant contribution to efficiency and economic welfare. The only exception to this is market failure where the partial or total restriction of competition can bring positive effects. Competition plays a significant role in enhancing the competitiveness of firms and of the national economy by promoting the different forms of efficiency. By doing so, it furthers general economic policy goals such as economic growth or employment, i.e. the creation of the foundations for increasing the standard of living.²⁰⁷

***the benefits of
competition***

²⁰⁶ Also in the football (soccer) World Cup, the teams most likely to play in the final are not those who practice with 12 players or with a smaller than standard-size goal, rather it is the teams that play football well because their players are trained in the tournaments of high-standard leagues.

²⁰⁷ This is true even though there are examples that appear to contradict this, such as the fact that non-competitive firms may go bankrupt, slash jobs or that the increase in efficiency allows for using less labour force from time to time. These phenomena are natural in a competitive and dynamic economy, but do not generally prevail – particularly in the longer run – because changes not only terminate jobs but create new ones, and the resources of the firms exiting the market are not removed from the economy; they are only re-allocated to market players who are able to use them more efficiently.

2. Competition policy

3.98. As we discussed in the previous chapters, market competition is of key importance to achieving and maintaining good economic performance. However, market players may be interested in unreasonably restricting competition, or in engaging in practices which have the effect of such restrictions. Society needs to protect competition from these various efforts which are aimed at, or have the effect of, restricting it. The public policy that serves to protect competition is competition policy. Therefore, in this context, competition gets protection not as a goal *per se* but as a tool for realising efficiency and welfare.

2.1. The objectives of competition policy

ultimate goal:

welfare and efficiency

3.99. Although the goals of competition policy are not identical in all countries, a widely accepted approach has evolved concerning a significant part of the major issues. According to this, the ultimate goal of competition policy is to maximise efficiency and social welfare, i.e. to ensure that a broad range of good-quality products is available to consumers at cheap prices. Through this, competition policy helps to increase competitiveness. By doing so, it makes an indirect contribution to achieving such widely accepted economic policy goals as economic growth or employment, which are considered important to increasing the standard of living.^{208 209}

competition is not a goal per se

3.100. Although competition policy is primarily aimed at the protection of competition, in the exceptional cases of a clearly identified market failure, a proportional restriction of competition may be acceptable. Protection of competition is often understood to mean protection of effective competition. This means that if a restriction impedes competition in such a way that effective competition no longer prevails, that restriction is unreasonable, unless exceptional circumstances exist.²¹⁰

alternative goals

3.101. Historically, competition policy has been expanded to include other policy objectives. These include: regulating large firms; protecting the "weak" from the "strong"; and ensuring "fair" competition.²¹¹ Today, these wider goals have either been abandoned, or are interpreted so narrowly that they coincide with the ultimate goals of efficiency and welfare to such an extent, that it would be practically unnecessary and misleading to refer to them.²¹²

²⁰⁸ The contribution made by competition policy to these remote goals is not direct or short-term because the criteria for economic growth, employment and increasing the standard of living do not appear in the competition policy analysis and decision-making. In this context, competition policy makes an indirect contribution, i.e. it contributes by protecting competition and through that, efficiency, as well as long-term consumer welfare.

²⁰⁹ The objectives of competition policy are illustrated by Figure 1.

²¹⁰ The reverse of this statement is not true: it is not only the elimination of effective competition that represents an unacceptable restriction, but also a restriction on competition that does not reach this extent but is unreasonable.

²¹¹ The use of such terminology is not helpful because it may imply that competition policy looks at market processes from a moral perspective, which is certainly not the case in respect of modern competition policy.

²¹² The Hungarian Competition Act also mentions fair competition but not in a competition policy context (for which the Act uses the phrase "freedom of competition"), rather it does so in connection with the unfair manipulation of consumer choice, and in respect of certain unfair competitive practices such as imitation or violation of business secrets.

3.102. Like welfare, efficiency is a complex concept: there are different categories of efficiency and welfare, and in certain cases these different efficiency and welfare categories can only be maximised to each other's detriment. If our ultimate goals are efficiency and welfare, it is not clear: whether allocative efficiency should be maximised even to the detriment of productive efficiency; whether prejudicing static efficiency in the interest of dynamic efficiency should be permitted; or whether consumer or social welfare should be preferred when they are in conflict. Therefore, it is necessary to clarify the welfare goal more precisely.

different types of efficiency and welfare

3.103. A more accurately defined welfare goal may be consumer surplus or social (total) welfare (which includes producer surplus). Both options have their advantages as well as their disadvantages. However, the time scale of competition policy by no means covers only the momentary condition; its perspective is long-term, so in fact long-term consumer welfare or long-term social welfare may appear as the objective. If the selected objective is to maximise long-term consumer welfare, it applies not only to a given moment in time but means the aggregate or average welfare for a given period of time. This allows for granting temporary preference to producer surplus over consumer welfare, where it is determined that this will later be converted into consumer surplus in the longer run (e.g. by realising investments or dynamic efficiency). Therefore, protecting consumer welfare in long-term may involve sacrificing consumer welfare for periods in the short-term. In practice, conflicts between this goal and long-term social welfare seem to be relatively rare.

for instance, long-term consumer welfare...

3.104. After the welfare goal is defined more accurately, the situation related to different efficiencies is also easier in conceptual terms. At this point, the question is not whether, productive or allocative efficiency, or static or dynamic efficiency, is more important. Instead, the question is whether in the given situation, it is possible to achieve a level of productive efficiency that allows long-term consumer welfare to increase, even taking into account the deterioration of allocative efficiency that accompanies it. Similarly, where there is a conflict between dynamic and static efficiency, the question is whether the future growth of static efficiencies can be expected to outweigh their current losses, thereby increasing long-term consumer welfare in a given situation. To put it more generally, one type of efficiency should not be strictly preferred over another. Rather, preference should always be given to the combination of different efficiencies which best serves the realisation of long-term consumer welfare (or the selected welfare objective).

... and the appropriate efficiency mix

2.2. General overview of competition policy intervention

3.105. Competition policy aims to achieve and maintain the high performance of markets. However it does not embark on this task by, for example, requiring firms to meet some standardised efficiency indicators. Such an approach would not be feasible, nor would it be logical as we know that performance generally depends on a firm's conduct, and that conduct is derived from the market structure and conditions. Thus, bearing in mind the causal relationships in the SCP model, competition policy ensures high performance by intervening in the market structure and in firm conduct, instead of direct intervention into performance.²¹³

²¹³

The scheme of competition policy intervention within the SCP-model is illustrated by Figure 3.

3.106. On the one hand, competition policy intervention is designed against the emergence of and/or increase in market power that does not arise out of natural growth, and against the use of existing market power exercised so as to exploit consumers. All this relates to the restricting of competition; competition policy tries to prevent unreasonable restrictions on competition and/or the negative impacts arising out of the restrictions.

structural control
vs.
behavioural control

3.107. When competition policy intervenes in the market structure, it is called structural control. In controlling structure, competition policy takes measures such as: breaking up firms; divesting a part of their operations; or by prohibiting planned mergers. When competition policy intervenes directly in the behaviour of firms, it is called behavioural control. In controlling conduct, competition policy prohibits or may even require specific conduct; for example, prohibiting tying and price fixing by a firm. Structural control and behavioural control can overlap, but this does not raise practical problems.²¹⁴

3.108. Structural control is usually better than behavioural control. Through structural control, a structure more favourable for competition is created in the market. Consequently, the functioning of the market approaches the optimum through self-correcting market mechanisms; this is because the change in structure affects conduct and performance. By contrast, the typical case of behavioural control, in a sense, constitutes 'violating' the market because it is about getting firms to behave in a way that would otherwise not follow from the structure. One could say that structural control affects the motives and possibilities of firms, while behavioural control tries to influence corporate behaviour in spite of the motives and possibilities that prevail in the market. Furthermore, structural control typically requires a one-shot intervention, while the characteristics of behavioural control demand regular or long-term intervention, as well as the monitoring of conduct and the identification of correct behaviour. Therefore, competition policy usually prefers structural control.

3.109. However, there are market situations where structural control is not able to effectively remedy a competition related problem. In situations such as natural monopoly, the market structure that is favourable for efficiency in a market, may not be favourable to competition. In this case, structural intervention, such as dividing up a firm, may cause efficiency losses to society that outweigh any benefit from increased competition. There is also behaviour which, although does not arise independently from structure, may not relate directly to some specific non-competing structure, so its elimination cannot be ensured solely by the instruments of structural control. For instance, the structure may make it easier or more difficult for competitors to successfully agree on their prices, but ultimately this conduct does not depend only on structure and cannot necessarily be completely eliminated by its adequate transformation. In these situations, it may be necessary to focus on behavioural control, which may be the only effective remedy. On the other hand, many difficulties may arise in behavioural control, which competition policy is not necessarily able to handle properly.

²¹⁴

For instance, merger control is usually referred to as an example of structural control, but one could argue that mergers are also business practices and form parts of market strategies. The automatic classification of strategic behaviours also causes problems, because they are business practices aimed at changing the structure, and hence one could find arguments in favour of classifying them either as structural control or conduct control.

3.110. A similar duality can be observed in the case of the two major types of competition policy intervention, one of which tries to prevent market power from increasing (or surviving) as an effect of unreasonable restriction of competition, while the other tries to prevent the holder of market power from using this power to exploit consumers. Consumer exploitation is a consequence of the restriction of competition, so exploitation disappears when the obstacles to competition are eliminated. In addition, it is typically very difficult or downright impossible to identify and remedy exploitation in practice, due to methodological or other reasons. Therefore, competition authorities can combat exploitation in a manner that is consistent with the concept of competition policy, but considerations of rationality and practical implementation are not consistent with it for the reasons outlined above. Hence, out of the two major tasks, preventing unreasonable restrictions of competition should be given priority because it may help to prevent a significant part of situations fit for exploitation.²¹⁵

***action against
restriction
vs.
action against
exploitation***

3.111. The term competition policy is often used in both a strict and a broad sense. Competition policy in the strict sense basically means competition law²¹⁶ and its enforcement, usually by a competition authority. Activities customarily performed by competition authorities, in particular competition advocacy, are usually also regarded as part of competition policy in the strict sense.²¹⁷ In a broader sense, competition policy comprises all structural and behavioural interventions that are aimed at protecting (and promoting) competition. In addition to competition law, competition policy in the broader sense includes the regulation of network industries and other sectors often treated as natural monopolies, the market opening programmes and deregulation launched in these sectors. Ultimately, depending on the specific situation, competition policy in the broader sense may include public policies such as privatisation policy or trade policy as long as they are intended to serve the protection or promotion of competition. Hereinafter we will elaborate on competition policy in the strict sense.²¹⁸

***competition policy in a
narrower and broader
sense***

2.3. The competition authority and its activities

3.112. The competition authority is the principal enforcer of competition policy in the strict sense and the guardian of competition. Accordingly, the competition authority's task is to enforce competition law i.e. to conduct competition law enforcement proceedings.²¹⁹ In addition, the competition authority's usual activities include

²¹⁵ Albeit consumer exploitation may still occur, as market power does not emerge only through an unreasonable restriction on competition; it is equally difficult to control exploitation in these cases.

²¹⁶ The term *competition law* as used here – and throughout the document – does not include provisions relating to unfair competition and misleading customers. Although the Hungarian Competition Act deals with these issues, they are not considered to fall within the ambit of competition law according to the internationally accepted terminology of competition policy.

²¹⁷ Competition advocacy means influencing state interventions affecting competition – including regulation – in the interest of competition. Competition advocacy will be discussed in detail later.

²¹⁸ This approach is also related to the fact that the GVH's activities are basically associated with a narrowly defined competition policy.

²¹⁹ In addition to the public enforcement of competition law through GVH competition law enforcement procedures, there is the possibility of private enforcement of competition law in the framework of civil law procedures (i.e. before courts) in several jurisdictions including Hungary. This means that competition law can not only be enforced by the competition authority but can also be launched in an action by a private party before a court. The possibility of private enforcement of competition law does not change the fact that the competition authority plays an outstanding and often leading role in the field of competition policy because its activities have

competition advocacy, influencing other state interventions affecting competition (including regulation) in the interest of competition, and the promotion of competition culture.

2.3.1. Competition law enforcement

3.113. There are different types of competition law enforcement proceedings that can be identified according to their subject matter, and may be classified into case types such as mergers or cartels. The following section gives a brief overview of the different case types.

2.3.1.1. Mergers

3.114. A merger²²⁰ situation exists when two (or more) firms, which have been independent from each other, cease to be distinct in terms market presence through asset transactions; ownership or other control relationships. This can be realised where one firm or its owner acquires a majority stake in another firm, but there are many other ways in which one firm can gain control over another. Mergers can change the market structure; altering the concentration of the market or the difficulties faced by potential new entrants, or both.

3.115. Due to the different possible effects on competition, we distinguish between horizontal, vertical and conglomerate mergers. Horizontal mergers take place between competitors or potential competitors, while vertical mergers take place between firms that have an actual or potential relationship of seller and buyer. Participants in conglomerate mergers have neither vertical nor horizontal relationships with each other.²²¹

competition policy concerns...

3.116. It is primarily horizontal mergers that are of concern to competition authorities because these entail a concentration of the market. Competition policy experts identify two major groups of merger related concerns: unilateral (or non-coordinated) and co-ordinated effects. On the one hand, the firm created as a result of the merger may have considerably greater market power than previously existed, and may therefore be able to restrict competition or exploit consumers through its conduct, independently of other market players. These are the unilateral (or non-coordinated) effects, where there is an increased likelihood of abuse by a dominant position. On the other hand, the market structure arising as a result of the merger may be much more conducive to collusion, or an oligopolistic structure may be created where coordinated oligopolistic behaviour (or tacit collusion) by firms may lead to similar results without an explicit agreement being undertaken. These are the co-ordinated effects, where following the

a considerable impact on private law enforcement. This influence – although formally the competition authority's activities are not binding on courts – is realised through leading cases handled by the competition authority, the publication of public documents and participation in private law enforcement as *amicus curiae*.

²²⁰ In addition to the term *merger*, the legal texts of the European Union and its member countries (including the Hungarian Competition Act) use the word *concentration*, because this is the term applied by the Community's merger regulation as well. Practitioners however in general use *concentration* rarely.

²²¹ In practice, these types may also be mixed, so that a merger may have horizontal and vertical components at the same time, e.g. if a vertically integrated firm merges with a vertically non-integrated competitor of whom the vertically integrated firm is a supplier.

merger, there is an increased likelihood of a cartel forming, or of oligopolistic behaviour (tacit collusion or conscious parallelism).

3.117. In the case of vertical and conglomerate type mergers there is much less concern about the reduction of competition, a usual condition of which is that one of the merging firms should have significant market power at the start.²²² This is the case if one of the merging firms controls an essential facility.²²³ In this case, it may happen that the firm created by the merger will allow no more access to the given asset, thereby driving competitors out of the market or making entry difficult. This conduct is called vertical foreclosure.

3.118. Mergers often result in various efficiency benefits. Efficiency benefits may differ depending on the type of the merger; for instance, economies of scale are typically associated with horizontal mergers, whereas reduced transaction costs are typically associated with vertical mergers. In fact, market players typically merge in pursuit of efficiency benefits and not pursuant to restrictions on competition.²²⁴

*... and efficiency
benefits*

3.119. The efficiencies created by mergers may induce competition and therefore increase the intensity of competition in the market. In other cases, however, mergers can have effects that restrict competition without having substantial efficiency benefits. Finally, there are also cases where mergers are accompanied by both efficiency benefits and anticompetitive effects.²²⁵

3.120. Merger control means structural control aimed at preventing the emergence of, or an increase in significant market power, unless it is made acceptable by the degree of efficiency gains resulting from the merger. In this context, merger control is a preventive instrument; it may take place in the framework of various procedures, but is usually coupled with a preliminary notification system, i.e. firms have to notify the competition authority about their planned mergers and must apply for an authorisation to conduct the transaction.

*an instrument for
prevention*

3.121. In merger control, the competition authority investigates the merger and identifies its likely effects on competition and efficiency. If the negative effects on competition are not compensated by the expected increase in efficiency, the competition authority will prohibit the merger. If the opposite is true, the competition authority will authorise the merger. This might be because no considerable reduction in competition is likely, whether because the merger will not modify the structure to such a great extent, or because the increase in efficiency will result in increased competition. It may also be that the intensity of competition decreases but the efficiency benefits arising pursuant to the merger are so sizeable that it is worth

assessment

²²² In contrast to horizontal mergers, where it makes no difference whether one of the parties already had significant market power before the merger, because the relevant issues are whether the firm created by the merger will have such power, or whether the merger will result in a significant increase in market power.

²²³ An essential facility is an asset which, or the access to which, is absolutely necessary for market players to remain in the market, and which cannot be duplicated realistically due to its physical or economic characteristics. Essential facilities will be mentioned in the presentation of abuse of dominant position as well. (III. Background note paragraph 3.124)

²²⁴ The taxonomy of mergers and typical competition concerns and efficiency gains related to them are illustrated by Figure 15.

²²⁵ Simultaneous benefits and losses are illustrated by Figure 13.

accepting a reduction in competition from the perspective of long-term consumer welfare.²²⁶

merger remedies

3.122. If the result of this assessment is that the planned merger cannot be authorised in its original form, it will not necessarily be prohibited outright. The parties and the competition authority may agree a package, which supplements/modifies the merger in a way that remedies the competition authority's concerns relating to the lessening of competition. In such cases, the competition authority will conditionally authorise the merger, i.e. impose/accept merger remedies. Such remedies may include the divestiture of certain assets of the merging parties, or the prescription of some kind of conduct by the parties.²²⁷ Merger remedies allow the realisation of merger-related benefits, and the other benefits the parties expect from the merger, without harming competition (or harming it too much). However, this is only possible in cases where the two types of effects can be at least partially separated or do not stem from the same source, pursuant to the complex nature of the transaction.²²⁸

2.3.1.2. Abuse of a dominant position

3.123. Abuse of a dominant position is when a firm behaves in a way that unilaterally (without agreement or collaboration with other firms) restricts competition or exploits its consumers. Accordingly, two categories of this case type can be distinguished: exclusionary abuse and exploitative abuse. These two types are the same in the sense that they may exist or can have a perceptible negative impact only in the case of strong market power (dominant position).²²⁹

exclusionary abuse

3.124. Out of the market conducts aimed at increasing or conserving market power discussed earlier, exclusionary abuse covers those that are not based on efficiency, not manifested through some co-operation between firms, and can be grasped and managed by the instruments of competition law in theory. They include, for instance,

²²⁶ This can be seen in Figure 18 which illustrates the direct and indirect effect on welfare and the GVH's competitive assessment.

²²⁷ Typically, divestiture may be an option, for example in mergers of retailer chains, if the competition concern is that all food stores (bank branches or other commercial units) would be owned by the same firm in certain areas, thereby creating significant market power after the merger. In such cases, instead of prohibiting the entire merger it may be reasonable to require the divestment of certain businesses to independent market players, which may remedy the concerns related to the merger.

Behavioural remedies are well illustrated by the Ciba-Geigy and Sandoz merger that created Novartis. Novartis would have acquired significant market power in the field of research in genetic therapy, while divesting the part of the research division dealing with this topic would have prevented the realisation of a significant part of the efficiency benefits arising out of the merger. Therefore, the European Commission ultimately set the condition that Novartis should ensure access to certain research results for other firms as well.

²²⁸ Naturally, it is not absolutely necessary to preserve benefits and eliminate detriments in full. It is enough to eliminate a sufficient volume of detriments so that the benefits overbalance the remaining detriments and thus the merger could be seen favourably.

However, there are cases where this is not possible because benefits and detriments are so closely related or stem from the same source so that it is not possible to determine a remedy that is acceptable for both the competition authority and the parties. An example of this was the planned merger of Volvo and Scania in 1999, where competition policy concerns focused on the heavy goods vehicle production of the parties. The European Commission would have only been able to authorise this merger with the condition that the parties may not merge their heavy goods vehicle production; however, the essence and main motive underlying the planned merger was to unite these two activities. Thus, the merger failed.

²²⁹ The dichotomy of abuse of dominance cases is illustrated by Figure 14.

the above-described predatory pricing, or in some cases²³⁰ refusal to deal and tying or price discrimination. In other words, all the strategic behaviours that result in a change in market structure that is unfavourable to competition. Exclusionary abuse may entail the removal of competitors from the market, may hinder entry or possibly both at the same time.

3.125. Some practices may have an effect similar to those described above, but due to their nature, cannot be prevented by competition law, and so are not usually deemed to be abuses of a dominant position. In certain cases, extremely strong product differentiation serves to hinder entry and prevents consumer needs from being fully satisfied. Save for exceptional cases, however, it is difficult to imagine that modern competition law will find a viable method for eliminating such product differentiation. Similarly, certain practices that deter entry cannot always be dealt with by modern competition law. Entry deterrence may be achieved through means such as true or untrue announcements on the development of certain new products, early market introduction of incomplete products, acceleration or deceleration of developments, or setting up significant reserve capacities in a widely publicised manner.

3.126. Exploitative abuse is not about restricting competition; it concerns exercising market power in relation to consumers in order to increase profits. The most frequently mentioned exploitative abuse is excessive pricing, where a dominant firm determines its prices at a level that is considerably higher than the competitive level on a non-transitory basis. Other types of exploitative abuse, such as exploitative tying, may be deemed excessive, and in most cases may be understood to be another form of excessive pricing.

exploitative abuse

3.127. Whether exclusionary or exploitative, significant market power is required for an abuse to occur. However, as already discussed in the section on market and competition, the "success" of the various practices requires different degrees of market power (often very strong) or the existence of certain conditions.

3.128. As regards abuses of a dominant position, competition authorities are responsible for detecting such practices, for conducting a welfare analysis of their effects, and for intervening where an abuse is found to exist. This intervention may be to declare a violation of law, to impose a *cease and desist* obligation, and may be coupled with a sanction (usually a fine). In certain cases it may be necessary to oblige the abusive firm to undertake a certain conduct.

3.129. When evaluating these practices, the considerations described under merger control also play a role in connection with exclusionary abuses; meaning that the task is to identify and consider the effect of the practice in question on competition and efficiency. The objective is to prevent unreasonable restrictions of competition and to allow practices that increase efficiency or competition. Therefore, contrary to widespread beliefs, an exclusionary abuse does not mean an abuse against an actual or potential competitor or direct contractual partner, even if any of them suffered an injury because of the abuse. Instead, it is deemed to be an abuse from the perspective of end consumers and/or their general interests.²³¹

assessment

²³⁰ Mainly in connection with access to essential facilities.

²³¹ It is no wonder that in the U.S. the term *monopolization* is used instead of *abuse of dominant position*, which does not give rise to such a misconception.

***fundamental
difficulties with
restrictions...***

3.130. As discussed earlier, it is often difficult for the observer to distinguish between restriction of competition and strong competition, particularly in practice. This difficulty is probably most conspicuous in the case of exclusionary abuses, which require the competition authority to exercise caution in both assessment and intervention (particularly sanctioning). As none of the competition authorities operate under ideal circumstances, there is a possibility of wrongful findings i.e. the risk exists that the competition authority may find an actually competitive practice (or one only restricting competition reasonably) to be anticompetitive or may find a practice that is actually anticompetitive to be competitive. Competition authorities try to identify practices as accurately as possible, striving to avoid both type I and type II errors. However, the source of these errors include factors external to the competition authority, therefore there is a point beyond which it is impossible to reduce the risk of being wrong; it is only the proportion of the two types of errors that remains at question.²³²

***... and with
exploitation***

3.131. In the case of exploitative abuse, there is no need to evaluate or compare the effects on competition against any efficiency benefits because neither is typically relevant due to the nature of the practice.²³³ By contrast, one of the greatest challenges in enforcing competition law arises in respect of identifying an abuse and imposing an effective remedy. Exploitative abuse (e.g. excessive pricing) takes place when competition is restricted; where the firm has significant market power. However, the behaviour investigated (in the example, the price charged) should be compared against the behaviour that could be normally experienced in the course of effective competition (in the example, the competitive pricing), which may not exist in the given case, and the firm should be forced to behave accordingly. In order to do so, the competition authority must be able to determine the market's outcome if there were effective competition and force the firm to charge a competitive price. However, the processes of the market and of competition are held in such high esteem precisely because their outcomes cannot be created artificially.²³⁴

3.132. When a competition authority investigates an abuse of a dominant position, it performs behavioural control. This is obvious in the case of exploitative abuse, but is perhaps less obvious in the case of exclusionary abuse given that the latter is usually linked to strategic behaviours, which are relevant for the competition authority precisely because of their impact on market structure.

²³² More on this: III. Background note paragraphs 3.196-3.197

²³³ Although efficiency considerations can be raised in connection with certain allegedly exploitative practices.

²³⁴ An authority can do no more than approximate the competitive outcome, but even an acceptable approximation can only be expected from regulation, which is part of broadly defined competition policy. Regulation to simulate or approximate the competitive outcome has a different character from that of competition law enforcement; for instance, it requires far greater information and apparatus.

Even a regulation that may be able to approximate the competitive outcome relatively well in theory (if favourable circumstances are given) will not necessarily lead to a result that is satisfactory for society, because the costs of sufficiently good regulation may exceed the benefits that arise out of it. (If the costs of regulation exceed its benefits, regulatory failure exists). In such cases, the best solution for society is to continue living with the exploitative practice (and, naturally, try to prevent it whenever it has a chance to), rather than try to combat it directly.

Though, given the nature of the issue, – the problem of determining the competitive outcome in the absence of competition – is linked primarily to exploitative abuses, it may still arise in connection with exclusionary abuses: e.g. in cases related to access to essential facilities, if the matter is not access refusal but access pricing.

2.3.1.3. Agreements

3.133. Several types of agreements can exist between firms. Horizontal agreements that restrict competition through practices such as price fixing or market allocation are called hardcore cartels.²³⁵

3.134. When competitors allocate the market between them, they set up one or more smaller monopolies, which have significant market power in their respective market segments. Each segment represents a certain customer or a certain group of customers divided according to geographical location or other criteria. Through this market sharing, firms are able to exploit consumers regardless of what the original market structure was like. Price fixing creates significant market power for each participant by ensuring the absence of price competition. Certain cartels engage in the creation (or increase) of market power and exploitation simultaneously. This is well demonstrated by price fixing, which enhances market power by restricting or eliminating price competition, but also exploits consumers by raising prices well in excess of the competitive level. In contrast to exploitative abuses of a dominant position, the exploitative nature of price fixing is self-evident and will cease as soon as the price fixing is stopped.

cartels...

3.135. Besides the potential exploitation of consumers, the only other purpose and effect of cartels is the restriction of competition. What is more, cartels are usually able to restrict competition to a large extent, and can cause significant welfare damage. In contrast to mergers and many other practices, cartels typically do not have positive effects on welfare or on efficiency. Therefore, in the case of cartels there are no issues to be analysed and considered such as whether the overall impact on competition is positive or negative, whether there are efficiency benefits related to the practice, and whether they compensate for any restriction on competition. The advantage of this is that cartel enforcement circumvents this challenging and often complex analytical exercise.²³⁶ Accordingly, all developed competition laws strictly prohibit cartels and competition authorities combat them fiercely. Another reason underlying the strong anti-cartel action is that cartels mostly operate in secret, and therefore are by their very nature, hard to detect. As the expected rate of discovery is also low, it holds for all jurisdictions that the proportion of cartels detected is likely to only represent the tip of the iceberg. Therefore, sufficient deterrence can only be ensured through severe

... the worst behaviour

²³⁵ Naturally, it is not only the agreement between competitors on the exact price, i.e. the total elimination of price competition that may constitute price fixing. Price fixing may also be an agreement that leaves more or less room for price competition but limits it, for instance by determining a minimum price or agreeing on one element of a multi element tariff.

The situation is similar with market allocation as well; it is not only the perfect separation of markets by the competitors that constitutes a cartel, and not only the allocation of the entire market that constitutes market allocation, but also if e.g. competitors agree on which one of them will service a given single customer.

One cartel activity is bid rigging, which is actually a form of market allocation. The point of bid rigging is that the participating firms organise a pattern among themselves to distribute orders of either one or more bidding schemes by arranging winners to these auctions. Then, instead of submitting effectively competing bids, they submit bids that are guaranteed to be worse than the bid of the arranged winner.

A cartel agreement itself can also take many forms, besides written explicit agreements, which do not alter the fact that such a conduct constitutes a cartel. Without a separate agreement spontaneous tacit collusion and conscious parallelism alone do not constitute a cartel despite the fact that the manifested effect of such a conduct is similar to cartels. Even if these conducts (alone) are considered as cartels it would be extremely difficult to enforce their prohibition.

²³⁶ The difficulty that arises in connection with cartels primarily relates to their detection and evidence of their existence, as cartels typically operate in secret.

punishment. Otherwise, given the low probability of detection, it might still be worthwhile for cartels to form, even with the threat of relatively (but not sufficiently) serious sanctions.²³⁷

soft horizontal agreements

3.136. The main rationale for other horizontal agreements is to jointly achieve a certain result, other rather than to restrict competition. This result might include the development of a product, or the performance of an activity that is beneficial for all participants. Typically, these collaborations, known as strategic alliances, joint ventures, and so called 'soft agreements', are aimed at efficiency benefits. However they may restrict competition to some extent, even though this is not their primary goal. The substantive problems arising in connection with these agreements and, the substantive approach of competition authorities, are basically the same as explained for mergers (although there may be important differences in procedure).

vertical restraints

3.137. Similarly, vertical agreements or vertical restraints, which are often distribution agreements, usually eliminate some vertical externality,²³⁸ thereby yielding efficiency benefits to the firms involved. In spite of this, these agreements can also restrict competition in certain circumstances, as with vertical mergers and certain abuses of dominant position. Therefore, the issues that arise in the case of vertical restrictions are those that were detailed in connection with (vertical) mergers and the abuse of a dominant position.²³⁹

mixed agreements

3.138. Although the particular features of hardcore cartels makes them easily distinguishable from other agreements, there are agreements whose characteristics blur this distinction. First, making efforts to hide the collusive nature of a cartel agreement does not change its substance, and so the competition authority still considers these agreements to be hardcore cartels that require strong action.²⁴⁰

3.139. Second, certain 'soft agreements' may occasionally include purely competition-restrictive elements (clauses), such as price fixing which usually "happen

²³⁷ Perhaps leniency policies that offer concessions to cartel members who self report in more and more countries may seem to be an exception to this for the casual observer. In fact, a leniency policy also serves to increase the effectiveness of the fight against cartels because using the information provided by the co-operating cartel member, the competition authority may exert the full penalty on the other cartel members in cases when it would not have learned about the cartel infringement in the absence of co-operation.

This is illustrated by the fact that in the United States – the legal system with the longest tradition of combating cartels – more than half of the cartel detections were due to their leniency policy, and over 90% of all the fines imposed on cartels between 1997 and 2005, were imposed in procedures launched as a result of the leniency policy.

Moreover, a leniency policy is likely to kill several cartels by its very existence (even without specific competition authority action) by destabilising cartels through undermining mutual trust between cartel members.

²³⁸ For example the problem of double marginalisation or the principle-agent problem, which hinders the performance of the whole vertical chain.

²³⁹ The taxonomy of agreements and the typical competition concerns and efficiency gains related to them are illustrated by Figure 16.

²⁴⁰ This happened in the case of the Lysine cartel, one of the largest uncovered international cartels of the 1990's. The cartel members set up an international trade association with the sole function of creating a forum for them to meet regularly. The trade association apparently performed representations of industry interest, and dealt with issues such as environmental protection. However, in fact, the association had no activity – although documents were prepared about the agendas of meetings, it was done only for conspiracy reasons, to mislead authorities – but the meetings – in contrast with the printed agenda – were used to discuss the prices to be applied by the cartel and the allocation of markets, which was confirmed by video and audio recordings taken secretly by the authorities. After cartel members were exposed, they were sanctioned with record levels of fines.

to be there" by coincidence. This circumstance does not necessarily turn the entire agreement into a hardcore cartel; at least not in the sense that the most severe action is required from the competition authority by all means. Naturally, in the course of evaluating the agreement, it will be revealed that the purely restrictive provisions of the agreement constitute unreasonable restrictions on competition and consequently may not be legally enforceable.

3.140. Finally, the intermediate case is where a soft agreement exists and works in parallel to a real cartel. This can often be seen in the case of certain self-regulations such as the codes of conduct set by trade associations. These cannot be said to be real cartels, and cannot be said to be real soft agreements, because the attributes of both agreement types can be found in them.²⁴¹ In these cases, one document actually contains more than one agreement "living under the same roof", alongside or possibly reinforcing each other, of which one is a typical soft agreement and the other is a typical cartel.²⁴²

3.141. The competition law actions related to these various agreements are usually deemed to belong in the scope of behavioural control, in spite of the fact that (similarly to mergers or exclusionary abuses), vertical restrictions, soft agreements and even certain cartels might have an effect on market structure, or can be instruments of strategic behaviour, which can also be relevant for the purposes of enforcing competition law.

*

3.142. Those dealing with competition law refer to the case types described above, together with the rules and law enforcement applicable to them, as *antitrust*.²⁴³ In properly conducted competition law enforcement proceedings, the competition authority protects competition by keeping in mind the ultimate goal of competition policy. In order to do so, it first has to find relevant cases and identify the problems that must be investigated. In certain cases, such as mergers, this relatively easy but

antitrust

²⁴¹ In the codes of conduct mentioned above, provisions to protect the interests of consumers – e.g. those that are supposed to guarantee appropriate service or information to consumers or product safety – and provisions restricting competition – such as various (perhaps complete) prohibition of advertisements or price setting using various techniques – are often mixed.

²⁴² The so called 'facilitating practices', if they form an agreement, can also fall on the borderline between cartels and soft agreements, if they form an agreement. These facilitate the operation of a cartel, for example by facilitating the identification of deviating cartel members or their punishment. An example to this would be an information-sharing agreement between cartel members – usually referred as information cartels. This can assist in monitoring the individual cartel members to make sure they do not deviate from the cartel. This form of secondary conduct (the information agreement) constitutes a fundamental part of the cartel mechanism.

These practices can result in the formation or maintenance of concerted practices or conscious parallelism. In these cases the said conduct can restrict competition and if they take the form of an agreement – for example as an information agreement – will be considered as anti-competitive agreements and will be treated according to that. (This is true even though concerted practice or conscious parallelism itself is not considered as cartel). On the other hand there are practices that albeit facilitating the creating of cartels, concerted practice or conscious parallelism can be pro-competitive and can increase consumer welfare (the motivation behind these practices is not anti-competitive).

For this reason it is always a function of the circumstances and the context whether a so called 'facilitating practice' is treated as cartel or soft agreement, or falls under some other competition policy consideration. Obviously the type and result of such a competition law intervention also depends on all the circumstances of the case.

²⁴³ Certain sources dealing with EU competition law use the term *antitrust* in a narrower sense and understand it to include only abuses of dominant position and case types related to agreements but not merger control.

may also be very difficult, as in the case of cartels. In the latter case, the competition authority must exercise great caution in deciding how to best use its limited resources, and avoid waste on irrelevant issues.

the competition policy analysis

3.143. After this, the competition authority performs a substantive analysis, the point of which is to distinguish unreasonable restrictions of competition from competitive behaviour or reasonable restrictions of competition. Although this is unnecessary in the case of cartels (a cartel is certainly an unreasonable restriction of competition), the other case types often require sophisticated assessments of the behaviour and the market, as well as the circumstances of competition and the extent and nature of competitive pressure on firms. In the analysis (as described in the section on the functioning of the market) identification of possible market failures and efficiencies, and the careful assessment of direct and indirect effects on competition, play a special role. For the purposes of analysis, the effects that can potentially occur are as relevant, as those already existing.²⁴⁴

3.144. If competition policy follows the above goals, it may only consider a substantial restriction on competition to be reasonable (and acceptable) if it is necessary for handling some market failure, and the efficiency benefits arising out of it make up for the losses caused by the restriction on competition. In other words, restriction on competition is acceptable if as a result of the restriction, long-term consumer welfare is likely to increase.²⁴⁵ Competition policy considers such welfare increasing restrictions of competition to be proportionate restrictions (provided that they only restrict competition to the extent necessary to the welfare increase).²⁴⁶ Restrictions of competition at a degree that would lead to the elimination of effective competition is generally unacceptable because this degree of effective competition is usually also a condition for long-term consumer welfare to be increased through the efficiencies created.²⁴⁷

increasing competition vs. protecting competition

3.145. In conducting competition law enforcement proceedings, competition authorities aim to maintain the level of competition that already exists (or potentially exists), instead of further increasing it. This allows them to take action against restrictions on competition in the form of behavioural or structural controls, but usually does not allow the competition authority to aspire to make a market more competitive through artificial means. Naturally, the effort to maintain the competitive *status quo* does not constitute a nonsense constraint because respecting existing conditions

²⁴⁴ An example of this could be an unsuccessfully operated price fixing agreement, where participants have agreed on a price but from time to time or even frequently offer prices that are lower. In this case, the operation of the cartel ultimately did not affect actual market prices or affected them only modestly, but this does not change the fact of law infringement; at most, it can mitigate the extent of this violation.

²⁴⁵ This can also happen if – as a result of a (partial) restriction of competition – the overall level of competition and hence welfare increases. Another possible scenario would be when the overall level of competition decreases (hence resulting in a welfare decrease), but the efficiencies produced by the restriction of competition are of such extent that they eventually result in welfare gains. Therefore the effect on welfare can be direct (through efficiency gains if there are any) or indirect (through competition). Competition and efficiency gains affect each other as well – for example competition can be a guaranty for the realisation of efficiency gains following a merger, and efficiency can induce more competition.

²⁴⁶ This can be seen in Figure 18 which illustrates the direct and indirect effect on welfare and the GVH's competitive assessment.

²⁴⁷ In certain highly exceptional cases, it may be justified to eliminate effective competition. An example for this is a natural monopoly, where efficiency benefits may be so sizeable that enough of them may be realised even if competition is completely excluded.

does not entail the acceptance of unlawful practices. For instance, price fixing that has been operating for years may not be considered to form a part of the competitive *status quo* in the sense it is used here, so any action against it will obviously be possible.

3.146. A fundamental consideration exists in relation to the functioning of markets, which underlies the competition authority's safeguarding of the competitive *status quo* in respect of competition law enforcement. As it explained earlier, the operation of markets and the strength of competition not only evolve as a consequence of business practices that restrict competition intentionally or non-intentionally, but also as a consequence of natural market processes and the natural development of market players, such as changes in consumer habits and technologies. Although some firms have significant market power in some markets, this power in many cases may be based on performance that is not to be challenged in terms of competition policy. If the competition authority regularly intervenes in the competitive process, rearranging the functioning of the market in an attempt to eliminate market power, this would interfere with the self-correcting market mechanisms which calibrate the evolution of markets. This industrial planning, in place of action aimed at preventing possible negative changes, may interfere with the returns expected by firms on their investments.

3.147. However, this train of thought does not apply, or applies only partially, to sectors where market opening programmes are taking place, have recently taken place or are being prepared. In these sectors (at least in Europe) the competitive *status quo*, or rather, the absence of competition, evolved typically under state protection (e.g. state ownership, state investments or the provision of exclusive rights) rather than by natural market processes. Accordingly, the incumbent(s) have not gained their current, often rather strong, position through their performance and the functioning of the market, but instead have simply inherited it. This way, the competitive *status quo* of these sectors is irrelevant for competition policy purposes because changing it will not interfere with the functioning of the market, and in many cases, changing it is necessary for the normal operation of markets.

***market opening
context:***

***formerly state
protected firms***

3.148. In these sectors, introducing competition and transforming previous methods of operation are on the agenda. These focus on eliminating the explicit legal barriers to competition, while it is just as important to ensure that effective competition can evolve in a practical sense, after market opening has occurred. Therefore, ideally, competition authorities do not resort rigidly to preserve the existing condition in their competition law enforcement proceedings. They should be mindful of the intention to create effective competition in the context of opening markets, and focus their interventions on structure and conduct in line with this objective.

3.149. Naturally, all this does not change the fact that competition law enforcement proceedings and interventions by the competition authority may only take place if triggered by some "event" in the market, e.g. a merger or where the competition authority becomes aware of an allegedly restrictive conduct.

2.3.2. Competition advocacy

3.150. In addition to the pro-competitive interventions of the competition authority, other public policies also influence market structure and the conduct of the market players. Such interventions appear, for instance in exclusive rights, various administrative barriers to entry, price or other conduct rules (obligations or

prohibitions) or certain state subsidies. Using these instruments, the state is able to substantially restrict or promote competition, whether intentionally or not. Therefore, if the competition authority really wishes to influence the market structure or conduct in the interest of competition, in addition to competition law enforcement, it must influence these state interventions; this is competition advocacy. Competition advocacy includes the competition authority's activities through which it intends to influence the design and implementation of the various public policies, including various state regulations and other state decisions, in the interest of competition.^{248 249}

²⁵⁰

3.151. Various public policy interventions may be influenced by competition advocacy. The normative theory of regulation deals with where and how regulation *should* operate. It suggests that state intervention in the economy takes place in order to eliminate market failure. The positive or descriptive theory of regulation deals with where and how regulation *actually* operates. It suggests that regulation is actually much more wide spread, and often serves the interests of those who are regulated. According to this, regulation usually functions differently from its originally declared objectives, or actually covers areas that require no regulation. The reason for this, among others, may be lobbying by interest groups, or in some cases, so-called regulatory capture.²⁵¹

pro-competitive,...

3.152. The objectives of these public policies may be, in part, pro-competitive, and may even become a part of competition policy in the broader sense. For instance, there may be a trade policy that liberalises trade and thereby improves the conditions of competition. Another such policy may be the regulation of prices charged by a natural monopoly, as an effort to substitute missing or restricted competition. Pro-competitive public policies may supplement, substitute or assist narrowly defined competition policy.²⁵²

²⁴⁸ Examples of such non-regulatory state decisions are privatisation decisions.

²⁴⁹ A somewhat broader understanding of competition advocacy also prevails, according to which competition advocacy comprises all non law enforcement activities of a competition authority, i.e. in addition to the ones mentioned here, it also includes activities such as expanding the knowledge related to competition and competition policy or increasing the acceptance of competition. On the other hand, with regard to the different nature of the two types of activities, the GVH distinguishes between competition advocacy and the promotion of competition culture.

²⁵⁰ The scheme of competition advocacy within the SCP-model is illustrated by Figure 5.

²⁵¹ One reason for the regulatory capture is information asymmetry: formal regulation – e.g. some price control or to identify what measures can be taken by regulated entities and what time is needed for this under what circumstances – requires a huge amount of information that is held by the entities subject to regulation and not by the regulator. Thus, in developing and enforcing regulation, authorities are forced to rely on the regulated firms. Another reason is – perhaps due to specialisation – that future carrier opportunities for experts dealing with regulation of a particular sector open practically only within the sector they are regulating. The above leads to a third reason; namely that regulators tend to see the world through the eyes of the regulated entities.

²⁵² Examples of substitution include price regulation (which handles the problem of excessive pricing) or access regulation (to provide open access). In both cases, regulation resolves issues that should otherwise be handled by competition policy in the narrow sense and/or the competition authority.

An example of such assistance may be regulation that requires various separations – accounting, management or ownership separation –, which usually do not totally eliminate the need for applying competition policy in the narrow sense but usually make it easier. In the case mentioned, it is much simpler for the competition authority to determine e.g. whether there is cross-financing between the activities of the firm than if the different activities were not separated. Thus, in the course of competition law enforcement, it is easier for the competition authority to identify and prove any anticompetitive conduct than in the absence of regulation.

3.153. Within this group, it is worth mentioning regulations relating to opening markets (mainly in Europe) that are linked to the enforcement of competition law by special ties. In many cases, they borrow competition law concepts or create their own concepts in compatibility with the principles that have evolved in competition law, and require the participation of competition authorities to manage problems such as a former monopoly or ensuring access to networks.²⁵³

3.154. Public policies unrelated to competition policy are not pro-competitive, and may even serve to realise explicitly anticompetitive goals. Efforts to ensure environmental protection and public health, or to promote national security may sometimes restrict competition, for example by raising administrative barriers to entry. An example of a public policy that follows explicit anticompetitive objectives may be an industrial policy that aims to create national champions, or a protectionist trade policy that contributes to concentration in a market by excluding or hindering import competition.

... neutral, and anticompetitive public policies

3.155. In competition advocacy, the same criteria and substance apply as in competition law enforcement. Accordingly, if the goal is to achieve long-term consumer welfare, substantial restrictions on competition may be reasonable only in the case of market failure, provided that long-term consumer welfare will be maximised as a result of the restriction.²⁵⁴

the same criteria...

3.156. Despite this, competition advocacy is not as constrained as competition law enforcement in maintaining competition, and is directed more at enhancing competition. It is not exceptional for competition authorities to propose e.g. market opening programmes or pro-competitive regulatory changes or deregulation in the framework of their competition advocacy activities. The general competition policy approach is the same here as the one described for competition law enforcement, but because competition advocacy deals with state interventions rather than natural market processes, the idea of respecting the competitive *status quo* is less relevant and less applicable, similarly to its underlying considerations. Therefore, in this respect, the competition authority's scope is typically wider in conducting competition advocacy than in competition law enforcement proceedings. Regarding issues related to neutrality and competition, the scope of the competition authority will also be wider in their competition advocacy activities than in competition enforcement (whereas competition enforcement typically does not cover the problem of neutrality, it forms part of competition advocacy activities).²⁵⁵

... but a wider horizon

3.157. Another important difference is that competition advocacy is not purely a response to a market occurrence, because such an event is not a condition for

²⁵³ An example of such regulation is the new regulatory framework of electronic communications that came into force in the European Union in 2003. Its central element is the concept of significant market power, and requiring firms with significant market power to perform certain obligations to prevent some abuses of dominant position. This regulatory framework concept of significant market power is based on, related to, and essentially has the same meaning as the competition policy concepts of dominant position and significant market power.

²⁵⁴ In other words, this also means that the restriction has to be indispensable for achieving the welfare level in question.

²⁵⁵ For example, it is not considered as anti-competitive, and it does not even belong to the reign of competition policy if a company unreasonably discriminates between its suppliers or purchasers and is disinterested in the competition between those companies, even if it eventually affects competition. However, a regulation, a licensing system, etc. that unreasonably discriminates between companies and thus impedes market entry would be a competition policy issue and hence target of competition advocacy activities.

evaluating and influencing state interventions. In this sense, competition advocacy may be less reactive and more proactive than competition law enforcement.

**targets:
policy goals
and implementation**

3.158. In practice, competition advocacy may be aimed at the objectives of other public policies, i.e. at encouraging their goals to be consistent with those of competition policy. Thus, for instance, the competition authority may argue for a pro-competitive trade policy and against a protectionist trade policy. On the other hand, competition advocacy may focus on the implementation of these public policies, by ensuring that their goals are achieved with the least possible damage to competition, based on the options available.

possibilities...

3.159. In principle, the competition authority performs a comprehensive analysis in competition law enforcement, taking into account all the factors relevant to decision-making. In doing this, it investigates, not only the effects on competition, but the total effect on welfare, and makes a decision as to whether a particular restriction on competition is reasonable. When other public policies also serve economic welfare related objectives, the competition authority can, in principle, perform such a comprehensive analysis in competition advocacy as well.²⁵⁶ This is why, competition advocacy may scrutinise both the specific method of achieving these objectives, and the objectives themselves, with a view to furthering competition policy. In this case, therefore, the adequacy of the restriction on competition depends on the total effect on welfare.

... and limitations

3.160. However, if the goals of the other public policy in question are not related to economic welfare, for instance to prevent an epidemic, the competition authority is not in a position to perform a complete analysis, even in principle. In such cases, the competition authority's advocacy role is limited to examining whether the restriction on competition is indispensable for realising the given goal, without questioning the goals themselves. Therefore, whether a restriction on competition is justifiable, in the context of competition advocacy, depends on whether it is really necessary for achieving the goal in question.

3.161. The competition authority is not the master of other public policies; usually it has no powers in relation to their design and implementation, and in certain cases lacks the expertise. Unlike competition law enforcement, the competition authority has no powers and is not in a decision-making position in the area of competition advocacy. This means that it is not able to prohibit or veto interventions it considers to be unjustifiably anticompetitive; they can only forward arguments and opinions through letters and comments addressed to the competent public body, and by involving the public. Where powers in relation to competition advocacy do exist, they are usually limited to accessing necessary information, to making comments and to obliging addressees to respond.

**part of the political
process**

3.162. In the course of competition advocacy, the competition authority has varying degrees of involvement in shaping various public policies and the debates. Therefore, to a certain degree, competition advocacy is part of the specially functioning political process in the broader sense, and in some cases it inevitably becomes even part of Politics with a capital "P".

²⁵⁶

This does not imply that the competition authority is able to perform the complete analysis in practice too, because this may be prevented by factors such as lack of information, resources, special skills or time.

3.163. Based on the above, the most that a competition authority can achieve in competition advocacy is to prevent unreasonable restrictions on competition; the least it can achieve is to simply draw attention to the anticompetitive effects of a given policy. In the former case, the competition authority is able to identify both competitive effects and other effects, to compare these, and is even able to convince decision-makers of its position. In the second case, the competition authority (for practical or theoretical reasons) is unable to identify other effects or balance the various effects, but is able to identify and present competition effects, enabling decision-makers to attach appropriate weight to competition policy aspects.

*maximum and
minimum programme*

2.3.3. Promoting competition culture

3.164. The promotion of competition culture is the third main pillar of the competition authority's activities. This includes general awareness of competition policy and law, general attitudes towards competition, as well as the academic community that deals with competition policy issues.

3.165. Competition culture and its functions are so closely related to the other two pillars of a competition authority's activities, that a description of this relationship is needed. Therefore, the following description gives an integrated presentation of competition culture and its promotion as well as how competition culture can facilitate competition law enforcement and competition advocacy.²⁵⁷

3.166. General awareness of competition, competition policy and competition law is a complex area. First of all, it includes knowledge of the basic ideas related to competition and the recognition of its positive effects; that competition usually results in lower prices, better quality and broader ranges of goods, instead of higher prices, worse quality and less choice. Secondly, a basic understanding of the functions of competition regulation and of the competition authority should form part of common knowledge. It should generally be known, for example that the purpose of a competition authority is to protect competition, and not to protect domestic businesses from "excessive competition" by foreign firms, or to perform doping tests at sports events. Thirdly, common knowledge should include an adequate understanding of basic competition rules; for example, that cartels are prohibited, that larger mergers must be authorised by the competition authority, or that competition law protects competition instead of competitors.

general awareness

3.167. General attitudes reflect how much society and its individual groups accept competition as the fundamental institution of the market economy, and to what extent they have positive associations with or expectations from competition. The degree of this acceptance of competition, is largely derived from knowledge about the basic relationships in competition. If this knowledge is widespread and accurate, it will strengthen the acceptance of competition. However, if it is erroneous, a distorted picture of competition may evolve and people may perceive it as being "destructive", leading to "chaos", to job losses and a decline of competitiveness, as benefiting the dishonest, and so on. These misconceptions may culminate in the popular rejection of competition.

attitude to competition

²⁵⁷ The other synergies between the major activities of competition authorities are covered in a separate section to come. (III. Background note section 2.3.4 (Synergies))

target groups

3.168. With regard to awareness and attitudes to competition and competition policy, it is individual groups as well as society as a whole that are relevant; in particular, firms subject to competition law, public administration officials, politicians, the population, and the media. As regards firms and/or entities subject to competition law, awareness is relevant in a number of respects, including voluntary compliance and competition law enforcement as these entities may be perpetrators as well as victims of competition law violations.²⁵⁸ The level of vigilance demonstrated by those working in public administration is particularly relevant with respect to competition advocacy. Here the emphasis is not so much on knowing competition rules but on the general attitude towards competition and recognising the positive impacts of competition.²⁵⁹ The awareness of politicians, the public and the media is relevant primarily for the building of political and public support for the competition authority. This may indirectly improve the effectiveness of the competition authority's work by facilitating the provision of material resources, legal and other tools and powers required for the competition authority's activities, and also direct moral support.²⁶⁰

"culture of competing"

3.169. The understanding of competition culture as the "culture of competing" goes beyond this issue. Taking an analogy from sports, this is usually understood to mean something like *fair play*; however, it is necessary to make a fine but highly significant distinction. If competition policy focuses on long-term consumer welfare, even the "culture of competing" cannot mean an inclination for "friendly", less intense competition. Otherwise, this understanding of "fair" competition actually implies an absence of competition culture, and may directly lead to restrictions on competition (e.g. in the case of certain professional associations that tend to enforce "ethical" rules preventing competition under the auspices of "fairness" and "fair play"). Therefore, the the culture of competing only accords with competition culture if it does not include "friendly" competition (where "competitors are not harmed"). Rather it means hard, possibly even aggressive competition which still respects the rules of the game, and includes a reluctance to collude with competitors.

²⁵⁸ Better awareness helps compliance or at least reduces the probability of committing unintended violations of law. It helps firms to more readily recognise when they become victims of competition law violations, but also guides them to avoid such situations wherever possible or, if the violation has already taken place, they are able to give adequate information to the competition authority. Better knowledge helps firms to address complaints to the competition authority in the right cases, i.e. to turn to the competition authority in these cases but not to overburden it with other cases. All this facilitates the submission of adequate complaints to the competition authority so that it can make use of them, while unfounded problems or those that are in fact not relevant to competition do not reach the competition authority. Better awareness also supports the competition authority's smooth proceedings because parties have a better understanding of their procedural opportunities and obligations.

²⁵⁹ Better awareness of public administration employees and their positive attitude to competition may help the competition authority's competition advocacy activities in a number of ways. Perhaps the most important is that more knowledge makes it easier to understand the competition authority's competition advocacy positions. In addition, a higher degree of awareness contributes to ensuring that the competition authority is indeed contacted with respect to relevant matters and at the proper stage of the case for consultation, but is not overburdened unnecessarily, since officials are more capable in identifying interventions that are relevant for competition policy purposes. In addition, a higher level of awareness may also reduce the need for competition advocacy by ensuring that the public policies are designed by themselves to be pro-competitive, recognise and build on the positive effects of competition.

²⁶⁰ An idea mentioned in connection with firms and legal subjects should be mentioned in connection with politicians and the public. This is that better awareness facilitates raising adequate complaints while avoiding inadequate ones, and also facilitates the shaping of demand expressed by politics and the public *vis-à-vis* the competition authority and competition policy in line with the competition authority's mission and competition policy contexts.

3.170. The academic community that deals with competition policy includes: researchers and tutors, university chairs, departments, courses, research programmes, research organisations, magazine articles, books, professional events etc. These all work on competition policy issues, either within the fields of law and economics or in an interdisciplinary manner. The academic community dealing with competition policy issues helps the competition authority's work in a number of ways. By addressing competition policy issues, this infrastructure contributes to keeping competition issues on the agenda, to having a creative approach to the various problems and suggesting possible solutions, and to improving general awareness of competition policy issues. The academic community also provides competition authorities (and other authorities) with staff and managers familiar with competition policy issues, and who have a good understanding of how individual markets operate, the competition strategies that are applied, and so on.

***the academic
community***

3.171. However, the academic community does more than merely increase general understanding of competition, or give direct or indirect help to the competition authority on theoretical and practical issues. Competition law enforcement is frequently the task of an authority that is independent from government in the narrow sense. In this respect, a form of “soft control” is exercised over the competition authority through the vivid discussions and research that is produced by the academic community. Driven in part by reputational considerations, this “soft control” extends to the relevant judicial review and private enforcement proceedings in the courts. Therefore, for the performance of the competition authority to remain high, it should not be left to become a professional monopoly. Professionals help to prevent this by continuously addressing the competition authority's activities by raising ideas, analyses, professional evaluations and criticism.²⁶¹

3.172. Based on the above, it can be seen that competition culture helps competition, the enforcement of competition policy and competition law, as well as the competition authority's work. Therefore, promoting competition culture is not only a task for the competition authority, it also benefits its other activities. However, in contrast with competition law enforcement and competition advocacy, where the competition authority has a leading or exclusive role, competition culture is an area where the competition authority is at best a participant and is by no means the sole contributor.

***the competition
authority's role***

3.173. Nevertheless, the competition authority may promote competition culture by employing a number of instruments and in a number of ways. Such instruments include the competition authority's educative or PR activity,²⁶² its openness to communication and the transparency of its activities,²⁶³ its relationship with the

²⁶¹ The elements of competition culture and target groups for education are illustrated by Figure 6.

²⁶² Part of the competition authority's education and PR activities consist of providing information on the benefits of competition, and on the nature and provisions of competition law as well as presenting the competition authority's general activities and tasks or specific decisions and achievements using information brochures, leaflets, press releases and press conferences, and the other usual methods. The competition authority's professional publications and information – which may be produced for business or other target groups – in addition to the usual PR activity also serve to strengthen competition culture.

²⁶³ This includes the participation of the competition authority's staff at various professional events and lectures delivered by them concerning the authority's position, or the organisation of similar professional programmes or public consultations by the competition authority about competition policy issues. The publication of decisions and competition advocacy documents by the competition authority; its efforts to organise and express experience or approaches that can be generalised and disclose them in the form of notices or guidelines, and the efforts to try to present

academic community and the work it commissions from them,²⁶⁴ and the provision of moral support to firms launching compliance programmes²⁶⁵, and in reasonable cases of infringements, taking into consideration that such programmes have been adopted.

limits

3.174. Certain totally unrelated activities undertaken by the competition authority may inadvertently serve to promote competition culture. An example for this is consultations held as part of lobbying by firms. In the course of constructive lobbying, firms inform the authority of their positions concerning the given issue and *vice versa*. This may be useful to both parties and may even help to promote competition culture, but is not deemed to be a typical activity of promoting competition culture. The competition authority's participation in holding or certifying training courses on competition law, including participation in corporate compliance programmes, could improve competition culture but would also raise serious problems of conflict of interest, and would expose the competition authority to criticism concerning its independence and impartiality. In numerous cases firms hold informal consultations with the competition authority prior to proceedings or before taking certain business decisions. Such consultations may also have a positive impact on competition culture, but their focus is not on promoting competition culture.

2.3.4. Synergies

**competition advocacy:
preventing problems...**

3.175. The three main activities of the competition authority supplement each other in a number of ways. If the structure of a market can be made more favourable for competition by advocacy, this may prevent certain practices that would trigger competition law enforcement proceedings later on. Thus, for instance, if by way of competition advocacy, the competition authority manages to secure the privatisation of a formerly state owned national monopolist, that is then broken into smaller competing firms, this may reduce the probability of later abuses of a dominant position.

**... and facilitating
proceedings**

3.176. In other cases, competition advocacy may facilitate competition law enforcement proceedings. An example for this is when the abuse of a dominant position relates to cross-subsidies between the various activities of the firm. If, as a result of competition advocacy, a regulation ensures the proper division of costs, it will facilitate the competition authority's work in investigating the alleged abuse. Otherwise, the competition authority might not be able to allocate costs without which, however, the competition policy analysis cannot be performed, either.

**...sometimes even
better tool than law
enforcement**

3.177. In some cases, problems that would otherwise be the subject of competition law enforcement could be better solved by using competition advocacy to better inform regulatory tools. A typical case of this is excessive pricing by natural

these as well as other documents in an easily comprehensible form if possible, are also parts of the same.

²⁶⁴ This may mean the competition authority involves the academic community in its work, which may give it inspiration and generate demand. The competition authority may also commission studies and analysis with more general objectives, and the publication of the study findings may provide additional stimulation over and above their direct use. Naturally, it cannot be excluded that the competition authority – provided its financial resources allow it – may give direct financial support to the publication of periodicals or books dealing with competition policy.

²⁶⁵ Corporate compliance programmes are packages of measures with the purpose of ensuring that the firm does not violate the law – in this case, competition law – in its activities, and usually the training of staff and perhaps certain quality assurance elements are integral parts of these packages.

monopolies and exploitative abuses in general. As was described earlier, the handling of these in competition law enforcement proceedings only proves to be successful in exceptional circumstances, and usually only offer a temporary solution. In these cases, the introduction of regulation (e.g. price regulation) is not always successful but is certainly more appropriate.

3.178. Competent law enforcement that is consistent with the principles referred to in competition advocacy can greatly support the competition authority's competition advocacy activities by making them credible. In this case, the competition authority cannot be accused of "talking the talk but not walking the walk". That is why it is important that the approach forwarded by the competition authority in competition advocacy should not differ substantially from that used in competition law enforcement.²⁶⁶

***firm and consistent
law enforcement:
more credible
competition advocacy***

3.179. The synergy between competition law enforcement proceedings and competition advocacy is also manifested when the competition authority combines the two instruments together.²⁶⁷

combined instruments

3.180. The promotion of a strong competition culture assists both competition law enforcement proceedings and competition advocacy in a number of ways, and can even provide indirect assistance through securing the moral support of the public and political decision-makers.

3.181. On the other hand, competition law enforcement and competition advocacy can make a significant contribution to the promotion of competition culture. Certain high profile cases or competition advocacy actions direct the attention of both the public and professionals to the competition authority and to competition. They may also prove to be the most effective tool for informing and educating about the benefits of competition and competition policy. Easy-to-understand information on enforcement and competition advocacy may help to represent the position and arguments of the competition authority as well as competition policy contexts. The academic community dealing with competition policy, if it is involved in the competition authority's work, will gain a better understanding of the functioning of the market, competition and competition policy and will draw inspiration and ideas from this collaboration. However, the most important impact on competition culture may be if society experiences the benefits of competition as a result of successful competition authority

***positive impact on
competition culture***

²⁶⁶ On the other hand, the positions represented in competition advocacy and in competition law enforcement procedures do not necessarily coincide even in ideal cases, and there may be smaller differences in approach. The reason for this is the different nature of the two activities. In competition law enforcement and competition advocacy, the level of information available to the competition authority, its opportunities for obtaining information, the time available for analysis or the depth of analysis may differ. In addition, the competition authority may often be more offensive in competition advocacy than in competition law enforcement, because – as has already been discussed – in the latter case, the protection of competition can typically be identified with maintaining the *status quo* of competition, while in the former case it comprises the protection of emergence of competition too.

²⁶⁷ For instance, the proper handling of self-regulations containing certain restrictive elements on competition may require competition law enforcement procedures to be combined with competition advocacy, especially in the case of code of conducts related to certain liberal professions. A part of the provisions included in such self-regulations that restrict competition may be treated – as agreements restricting competition – in the framework of competition law enforcement, while another part may be based on explicit authorisations granted by law, meaning that the competition authority has only competition advocacy available to it. Therefore, it is quite possible that the competition authority should use both instruments if it intends to remedy all the problems related to the self-regulation in question.

intervention. These may include falls in price following the elimination of a cartel, or after successful market opening.

2.3.5. Other possible activities

3.182. In addition to the typical antitrust activities presented, competition authorities occasionally perform additional tasks. Some of these occur more frequently while others arise relatively rarely or as exceptions in the activity portfolio of competition authorities. Some occur pursuant to assumed or real synergies relating to the main activities of the authority, some in situations that have evolved historically and others for practical institutional reasons. It is seen relatively frequently that the competition authority performs certain consumer protection tasks, supervises public procurements, and the regulation of network industries. The fact that the competition authority also deals with the control of state aid, is unique to the EU, or more accurately to its Community level competition authority operating in Brussels.

2.4. Some characteristics of competition law and its enforcement

3.183. Competition law and its enforcement have a number of traits that determine the strict operation of competition policy. Naturally, this has a fundamental impact on how a competition authority addresses competition law enforcement issues. It also influences competition advocacy and is reflected in the competition authority's efforts to promote competition culture.

legal tools and economic content

3.184. Naturally, competition law and its enforcement require legal instruments both in specific interventions and in developing a general framework (e.g. during legislation). However, competition policy deals with the functioning of markets; its objectives, concepts and ideas are based on economics, so the enforcement of competition law is supposed to make sense in economic terms. This means that the theories behind the competition authority's activity both in terms of principles and the specific interventions must be sensible from an economic perspective, and should be consistent with the picture formed about the market concerned. In other words, in terms of substance, competition policy analysis is an economic analysis done in the context of economics.

a proxi approach

3.185. Competition policy deals with competition: with the competitive pressure on firms and exercised by firms; with (significant) market power; with its emergence, increase and consequences; and with other welfare effects. If it were possible in practice to easily measure the strength of competition, the market power of firms and all effects on welfare (or if they could be observed directly) competition policy analysis would be relatively simple. Given, however, that no such simple and direct method currently exists for most cases, competition policy usually applies a kind of indirect approach, and draws conclusions on market power, competition, and ultimately welfare, from the description of the structural elements that can be observed, starting from the SCP model. In other words, the basic framework for competition policy analysis is based on an indirect method of investigation.

empirical methods

3.186. The focus on empirical methods in competition law enforcement is a relatively new development, particularly in Europe. Naturally, all enforcement of competition law is empirical in the broad sense that it investigates real market events and collects real data and information, usually provided by the firms, as the starting point of analysis.

These provide the basis of competition policy analysis of the market and the investigation of business practices undertaken by the competition authority. Normally certain simple calculations are also performed, for instance in calculate market shares, but the analytical steps mostly consist of a series of considerations that rely on logic and rationality, and on the evaluation of the contents of written documents, reports and contracts, which all play an important role.

3.187. The increased use of empirical methods involves more than this. It may include the use of various market research tools and low-tech or more sophisticated quantitative analysis. In such cases, the competition authority draws conclusions on the substitutability²⁶⁸ of various products. For example: based on a consumer survey; by employing quantitative analysis based on bidding studies (using figures from tender proceedings) to estimate the competitive pressure exerted on one firm by another; or possibly attempted merger simulation to predict a planned merger's impact on prices. Basically, empirical methods supplement rather than substitute the traditional tools of analysis. They assist in testing hypotheses developed using traditional methods, but, depending on the circumstances, may also play a decisive role in analysis.

3.188. Empirical methods often fit into the indirect analytical framework mentioned above, and within that, play a role in forming a picture of the market structure (e.g. through helping to identify the relevant market). However, in certain cases, there is a possibility for the competition authority to draw conclusions that are directly related to the development of competition by applying certain empirical methods, without engaging into a structural analysis.²⁶⁹

3.189. Although in principle the expected development of productive efficiency can be quantified relatively well using the information held by firms, comparing the different welfare effects is not a simple arithmetical task in practice. A part of the reason for this is that certain welfare effects (such as allocative efficiency or dynamic efficiency) usually cannot be quantified and can only be grasped by the indirect method referred to above, or that the different effects may strengthen or weaken each other, through the effects on competition. Therefore, if effective competition disappears it is unlikely that the increase in productive efficiency (which is, realistically expected to come about in a competitive environment) will actually be realised and that the benefits arising out of it will ultimately reach consumers, i.e. that it will make a substantial contribution to consumer welfare. This, in most cases would only be guaranteed by competition. Efficiency benefits might still occur in the absence of competition in exceptional situations, such as those natural monopolies where the expected increase in productive efficiency is so large that even its relatively minor realisation or its contribution to consumer welfare would still be seen as sufficiently significant.

***non-mechanical
analysis***

3.190. Although competition policy considerations have scientific foundations, with various empirical methods playing an increasing role in competition analysis, competition law practitioners in many respects prefer to apply more as an art than as a science, where the analyst's subjective consideration plays an important role, within certain reasonable bounds.

subjective element

²⁶⁸ Substitution is a key factor in determining the relevant market and/or in identifying competitors, and therefore, to draw up a picture about competitive pressure.

²⁶⁹ For instance, by predicting whether a merger would lead to price increase or identifying the degree of competitive pressure.

general rules, diverse application:

3.191. While the objectives and principles of competition policy may be clear, legislation covering all details is impossible and makes no sense due to the variety and changes in business practices of firms and markets. Therefore, competition law consists of relatively general rules, which can only be applied by interpreting and applying them on a case-by-case basis, often requiring balancing the different factors. This leaves relatively broad room for manoeuvre for the enforcement agencies, and even requires an active attitude from them in interpretation. This way, in addition to the wording of the legislation, the case law and approaches reflected in various decisions are also important components of competition law.

... and rules of thumb

3.192. Competition authorities follow numerous doctrines and rules of thumb. These emanate from the relevant theoretical considerations and the large volume of case-by-case assessments and balancing, which provide a sound and certain result in situations that are deemed typical.²⁷⁰ These rules, and their publication in guidelines, help to increase legal certainty and so play an important role in competition law enforcement.

3.193. However, these rules of thumb also contain simplifications, so they may provide results which differ from that of an individual analysis in certain non-typical cases. The extent and frequency of such differences may be smaller or larger depending on how sound and reliable the rule of thumb in question is. If these differences are relatively significant and frequent, it may be reasonable to waive the rigid application of the rule of thumb in question and to deliver a decision that is best in terms of substance. However, if these differences are relatively small and rare, it may be reasonable to agree to apply the rule of thumb in question with relative inflexibility (in order to ensure legal certainty and administerability).

legal certainty

3.194. This illustrates the point that in competition law enforcement it is not always possible to ensure an effective decision (in terms of the substance) and perfect legal certainty at the same time. Nevertheless, it is to a reasonable degree possible to reconcile the nature of competition law, which is characterised by case-by-case assessment based on economics, with the need for legal certainty. In other words, it is possible to develop a balance between these two aspects to a satisfactory level; allowing for delivery of sufficiently good decisions, while ensuring sufficiently strong legal certainty.

prediction and estimation

3.195. One of the most important characteristics of enforcing competition law is that it involves predictions and estimations. This is particularly evident in the case of merger control, given that a merger's effects must be predicted. The methodology employed in other types of cases also involves degrees of prediction, although this is less self-evident. For instance, the effects of a past business practice have already occurred, but in many cases, distinguishing these effects from each will to a large extent will be a predictive exercise.²⁷¹ Furthermore, the enforcement of competition law may be

²⁷⁰ One such rule of thumb is that, when setting remedies concerning horizontal mergers, it is reasonable to prefer structural remedies to behavioural ones. Another, though more general, rule in decision-making is that if intra-brand and inter-brand competition can be protected only to the detriment of each other, most competition authorities usually prefer inter-brand competition (because in general, this is more important for overall market competition). A third example may be a simple decision-making rule followed by the federal competition authorities of the United States according to which if, the post merger level of the Hirschman-Herfindahl index is less than 1 000, it is usually not assumed that the merger will raise concerns, and the transaction is not investigated any further.

²⁷¹ The reason for this is that the relationships examined in competition policy analysis are usually not deterministic but stochastic. Accordingly, the instruments of competition policy analysis often

aimed at practices that are still ongoing, the effects of which will continue into the future. Therefore, in practice, any given effect can be rarely said to be absolutely certain in competition policy analysis in practice; the real question is whether there is good reason based on sound analysis to consider a given effect to be likely. Naturally, this does not mean that the analysis performed is pure speculation.²⁷²

3.196. In an ideal world, the competition authority is able to accurately identify various market and efficiency effects and unreasonable restrictions of competition each and every time, and based on this, it always makes the best possible decision. However, in reality, there is scope for the competition authority to make mistakes. For instance, by considering a practice to be competitive that unreasonably restricts competition, or deeming a practice unreasonably anticompetitive, which in fact is a competitive practice (or restricts competition reasonably). The consequence of such mistakes is that the competition authority does not intervene in the right cases or in the right way.²⁷³ It may happen that the competition authority does not do its job with due care; for instance, if it fails to perform an analysis, or performs it improperly with erroneous results. However, errors may not only result from the competition authority's negligent work but from other circumstances as well. These may include limited resources or time available for the competition authority; the limited information that is available; various methodological limits or characteristics; and certain inflexible legal provisions which are independent of the competition authority.²⁷⁴

the risk of being wrong

produce results in a statistical sense, not only for the future but also for the present or the past. For instance, it is possible to estimate in statistical terms but impossible to identify in a deterministic sense to separate the effects of a behaviour that has already occurred in the past from the other effects on the market at the same time, or the substitutability of two products from the perspective of consumers.

Similarly, there is for instance also a stochastic relationship also between the emergence of diseases and their risk factors (such as smoking). Although in a specific case, the relationship between a disease that has already developed and the risk factor cannot be clearly identified in the deterministic sense, these factors can be demonstrated to increase the frequency of becoming ill – or the probability of becoming ill, in respect of one individual – so it is reasonable to take them into account and minimise them by health care intervention even in the absence of a deterministic relationship. In other words, interventions may be justified by a stochastic relationship and not only by deterministic relationships.

²⁷² This is actually true not only for market effects but for some other issues as well. For instance, determining the cost level of a firm that produces more than one product may be such an issue if the overhead costs – which attributed not to just one individual product but to the entire firm – are considerable. In such cases, overhead costs cannot be clearly allocated between the various products because there are several allocation conventions, which may have different results.

²⁷³ Out of these two types of errors, the one where the competition authority intervenes without it actually being necessary is usually called type I error or a positive false decision; the one where it does not intervene although it should is called type II error or a negative false decision.

²⁷⁴ The competition authority could reach a different (and better) result if it could perform its analysis with unlimited resources for an unlimited time. In reality, however, the competition authority's resources are finite, just as the time available (e.g. due to procedural deadlines or simply because a decision concerning the practice investigated would have no practical relevance after a certain time). These circumstances may exclude or make unreasonable certain analysis methods in theory or practice, so the competition authority may reach only a kind of second best under the given circumstances instead of the perfect optimum of an ideal world without limitations. Any errors occurring due to such reasons are not the competition authority's fault.

Even if unlimited time and resources are available, there is a limit up to which it is reasonable to refine analysis, because the costs of analysis may exceed the potential damage caused by the problem to be eliminated beyond a certain point.

If the competition authority is unable to apply the analysis method that is best in theory because the appropriate market information is not available, cannot be obtained or produced, it has a similar effect. In this respect, the competition authority's powers to obtain information may mean substantial help, but there may be cases where the "best" data is not available in the desired form even to market players. Here again, the time and resource factor may play a role because the desired information may be available or possible to produce in theory but not within a reasonable

3.197. Accordingly, there is a certain risk for even the most perfectly operating competition authority that some of its decisions will not be appropriate. As long as the competition authority is able to improve its work, the general risk of errors may be reduced, and naturally this is what competition authorities want. However, there is a point beyond which errors are caused only by factors that are independent of the competition authority, and at this point, the risk of different possible errors can be reduced only to each other's detriment: if the competition authority wishes to reduce the risk of not intervening (in good faith) in cases where it actually should, then it also has to accept the increased risk of unreasonable intervention. Naturally, these errors do not necessarily occur (and do not occur most of the time), nor do they necessarily become perceptible even if they arise.²⁷⁵ In spite of this, the risk of error exists and this will damage competition if it occurs. In some cases, the competition authority will not take action against a practice that is actually unreasonably anticompetitive, and in other cases, it will be the competition authority's intervention that restricts competition (when it proceeds against a practice that is actually competitive or only reasonably restrictive). Naturally, it does not follow from this that these risks should paralyse the competition authority's activities (if the competition authority remains idle, one type of errors is completely eliminated but the other is maximised). However, it is true that the competition authority needs to manage the risk of the abovementioned errors; it must make a choice during law enforcement in general, or in specific cases, about whether it will deem one error to be the lesser evil, or whether it should keep an equal distance from both types of errors.^{276 277}

time or at reasonable cost. Any errors occurring due to these reasons are also not the competition authority's fault.

It is also important that the relationships investigated by competition authorities are typically stochastic rather than deterministic, and partly in consequence, a part of the analysis tools used by competition authorities provides statistical rather than deterministic results. (More on this: III. Background note paragraph 3.195) Therefore, due to methodological reasons, there is necessarily a certain (slight) probability that the decision that flows logically from the analysis will be wrong even if the competition authority made no professional errors in selecting the method and performing the analysis, and is therefore not at fault for the error.

Wrong decisions that are independent from the competition authority may also stem from a rigid legal provision which, perhaps does not lead to the ideal result in certain rare cases, while the competition authority as an enforcement agency has no power for overruling it.

²⁷⁵ The point of the errors discussed here is exactly that decision-makers do not know whether they are wrong in the given case; to be more precise, they always believe they are making the right decision (even if they are aware of the existence of the general risks). At the time of the decision these errors are not necessarily even perceptible for the outsider, given their nature and their reasons.

²⁷⁶ Naturally, the competition authority may make these choices only within the room available for it to move. In certain cases, legislation does not leave this discretion to the enforcement agency and explicitly requires a specific method for managing risks.

²⁷⁷ The problem of committing type I and type II errors also appears in other fields of law enforcement, as well as in many areas of everyday life. The problem shows many similarities to the risks associated with medical treatments. A surgeon may commit malpractice, thereby causing damage that could have been avoided.

However, there are smaller or greater risks associated with the various health care interventions even if the surgeons and health care staff are best prepared, perform their work with the greatest degree of attention and conscientiously, and fully comply with the relevant protocols. For instance, a patient may have an unexpected reaction to certain medication, a sophisticated equipment may fail suddenly or not be available, unexpected complications may arise, or it may be revealed that certain symptoms remained hidden from the doctors in the light of which different decisions would have been made about the interventions required, further medical examinations were needed for a more precise diagnose but these might cause the patient's condition to worsen or may be harmful for him/her, etc.

3.198. As stated earlier, the protection of competition is the direct purpose of competition policy enforcement; although rather than being a goal per se, it is an instrument for achieving welfare and efficiency. It has also been stated that welfare and efficiency are complex concepts, and as the ultimate objectives of competition policy, require further clarification. Some additional characteristics of competition law and its enforcement are related to these objectives. First, pursuant to these objectives, consumer welfare or social welfare means the welfare of the community or country whose competition policy is in question. For instance, in the case of the USA's competition policy, the objective is the welfare of U.S. consumers; in the case of Italian competition policy, the objective is the welfare of Italian consumers, and so on. Therefore, national competition policy usually does not consider restrictive practices, such as export cartels, to be unreasonable restrictions on competition (or considers them as such only on a reciprocal basis) because they exert their negative impact outside of the given country.

domestic consumer principle

3.199. Another relevant factor to the ultimate goals of competition policy, is that competition law and its enforcement is meant to protect competition, not competitors. This is apparent from the already presented welfare oriented competition policy approach with regard to competitors who have to exit from the market, and potential entrants for whom entry is made more difficult. Such events may raise competition policy concerns, but if the market structure itself does not change – i.e. the competitors driven out are replaced by others – then competition is not restricted and there is no reason for competition policy intervention. Even if the structure changes because the exiting firms are not replaced by new entrants, intervention may still be unnecessary. If this change is driven by efficiency rather than by the restriction of competition.²⁷⁸ In such cases, intervention to protect competitors would discourage firms from competing, and would thus stop the competitive process, and ultimately contravene the welfare goal.

protecting competition vs. protecting competitors

3.200. All this reveals one of the most important features of competition law and its enforcement; namely that it has a public law nature, protecting competition in the public interest instead of individual interests. As shown by earlier examples, various private interests may coincide with this public interest from time to time. On the one hand, the competition authority may rely on these private interests in its activity, and on the other hand, the private interests may benefit from the competition policy intervention. However, the earlier examples also show that the private interests referred to (particularly those of competitors) do not necessarily coincide with the public interest, and this should also be taken into account by the competition authority in its activities.^{279 280}

the public interest related to competition

As it is impossible to fully eliminate risks of this nature, health care institutions adapt to the situation by acknowledging similar risks and try to manage the risks that arise in the best possible manner in the patient's interest, by evaluating and balancing them.

²⁷⁸ This is not necessarily the situation in sectors where market opening is in progress, has taken place recently or is expected to take place shortly, and the subject matter of analysis is the business practice by a firm that had earlier been protected by government measures. In such cases, efficiency advantages of the incumbent may be apparent or may prove to be temporary, and the effect of this efficiency on structure is not necessarily realised in the presence of effective competition. Therefore, it may happen to be more favourable for long-term consumer welfare if the firm is not able to use this apparent or temporary efficiency advantage to securing its market position by changing the structure durably, or to slow down market opening by delaying the emergence of effective competition.

²⁷⁹ Cf. the points related to dominant position saying that the term *abuse* in the name of this case type does not refer to an abuse *vis-à-vis* an actual or potential competitor or direct contractual

another public interest:
the efficient operation of the competition authority

3.201. The competition authority uses the resources it has been entrusted by society. These resources are finite and the competition authority must operate within a defined budget and head count. The consequence of this is that they are not able to handle all competition problems that arise. Therefore, the efficient use of the competition authority's resources is also in the public interest. The competition authority uses the resources entrusted to it efficiently if it is likely to realise the greatest possible increase in welfare, or prevents the greatest possible welfare losses. This is feasible if the competition authority puts the highest emphasis on those competition law enforcement proceedings and competition advocacy issues that promise the greatest welfare gain or avoid the greatest welfare losses. Therefore, case selection and an uneven allocation of resources between individual cases are conditions for the competition authority's efficient operation and are therefore in the public interest.²⁸¹ As all public policies, competition policy assumes the identification of priorities, which also calls for the competition authority enforcing this public policy to deal more with certain issues and less or not at all with others, which obviously necessitates the selection of cases and resource allocation, and affects final decisions.²⁸²

independence

3.202. The competition authorities responsible for enforcing competition law are often independent of government, although they form part of public administration. The reasons for the competition authority's independence are similar to those of the independence of central banks. The competition authority's task – to protect competition – is a long-term economic policy objective, which may necessarily and regularly conflict with short-term economic policy objectives. If the competition authority were directly controlled by government, there would be a great risk that competition policy goals are sidelined in the pursuit of short-term day-to-day economic policy considerations. This would have a detrimental impact on competition and welfare, and would negatively influence legal certainty and the related investment security and investor confidence. Independence is one solution for avoiding this; by isolating the competition authority from external interference.²⁸³ The right degree of

partner but a conduct (abuse) that has negative consequences for consumers. (III. Background note paragraph 3.129)

²⁸⁰ This is also true for private enforcement of competition law, even though obviously, the parties involved initiate the proceeding and take part in it driven by their own (private) interests. Private enforcement of competition law still means the enforcement of competition law provisions, and therefore, its objective is not to protect private interests but the public interest related to competition, consequently, intervention criteria are the same as used in the competition authority's procedures.

²⁸¹ Naturally, this public interest is not the one that is related to competition but the one related to the efficient use of society resources. The former (the public interest related to competition) pervade competition policy in its entirety and forms a part of substantive competition law: behaviours that harm public interest related to competition – instead of those that harm the interests of individual firms competing – are the ones that violate competition law. In contrast, the latter (i.e. the public interest related to the efficient operation of the competition authority) is an aspect that arises specifically in law enforcement: it is not reasonable for the competition authority to deal with all (potential) violations of law.

²⁸² This does not apply to the private enforcement of competition law because that is based to a significant extent on the use of resources of the parties that act on their own interests, which first, brings about a more modest involvement of community resources, and second, acts against wasting the resources and therefore reduces the risk of wasting community resources as well.

²⁸³ This is illustrated by one story from the Odyssey, which is about the island of sirens. Ulysses' journey took him along an island that was famous for the marvellous songs of sirens, which, however, enchanted all sailors and irresistibly attracted them to the rocks on the beach, where the sirens cruelly devoured them. Ulysses wanted to hear the unique song but also wanted to stay alive. He knew that however strongly he and his crew resolved to do differently, all of them would feel an irresistible urge to land if they heard the wonderful voices.

independence is usually ensured by combining various institutional solutions, which include elements such as decision-making autonomy, restricting the possibilities for appointing and replacing senior executives, or possibly a certain degree of financial autonomy.²⁸⁴

3.203. Naturally, the independence of competition authorities does not mean general isolation from the outside world or the economic policy environment. When analysing markets and practices, and in their decision-making, competition authorities should take into account the economic policy environment, as well as government intentions. For instance, if the likely effects of a merger in a regulated sector may significantly depend on the future changes of regulation, it is practical for the competition authority to take into account the relevant government plans in its analysis. Similarly, after opening a market, the efforts of the competition authority and the sector-specific regulatory authority can be efficient and, in some cases even effective, if they co-operate and harmonise their decisions and interventions, and use their respective instruments jointly.

3.204. It is similarly important, that the competition authority is obliged to operate independently of market players, which is completely natural in the case of administrative bodies. Otherwise, the lack of interferences or the impartiality of the competition authority may be questioned. Naturally, independence from firms does not mean isolation from the markets, because learning about and analysing market processes forms an indispensable part of the competition authority's work. Thus, independence does not exclude the competition authority from holding consultations with market players about issues such as the operation of markets or the impact of certain practices on competition.

3.205. In parallel with the expansion of international trade, capital flows and the globalisation of the world economy, more and more firms operate in foreign markets. The geographic extent of more and more markets exceeds the territory of individual countries, and more and more cross-border business practices and international restrictions of competition can be observed. The effective and efficient handling of these phenomena in terms of competition policy requires it to take on an international dimension as well; possibly with co-operation between the competition authorities of different countries. The various forms of co-operation between competition authorities involve three main areas: the exchange of experience; co-operation in competition law

*international
co-operation*

The solution is well-known: Still outside the range of the song, Ulysses specified the route, and plugged the ears of sailors with wax, then had himself tied to the mast, instructing his men to untie him only when the island was out of sight again. The plan worked: the crew remained deaf to the song of sirens, just as to the commands and pleas of Ulysses, who fell under the spell of the song, to turn to the shore. Although Ulysses went wild in the vicinity of the island, he blessed his foresight when he was untied from the mast after they had left the island behind.

In other words, after having set the objective, Ulysses gave his men independence in performing their task, having recognised that otherwise it would be himself who would prevent the realisation of his own long-term (literally vital) goals for the sake of short-term considerations.

²⁸⁴

Total independence for a competition authority is impossible to give, either, because that would mean a loophole for getting out of the society's democratic control. Naturally, an independent competition authority is still accountable for its activities, and certain forms of accountability come more into focus in the case of an independent organisation. For instance, generally competition authorities' decisions can be challenged before a court, their financial relations are checked by the competent authorities, and their activities are to be disclosed to the public.

Independence does not mean immunity against criticism either, and openness serves just this purpose to a certain extent. Criticism – at least in the longer run – may be able to influence the competition authority's activities. In this context, the academic community dealing with competition policy has outstanding importance, as explained before.

enforcement proceedings (and possibly in competition advocacy); and participation in technical assistance.

3.206. During exchanges of experience, competition authorities learn about theoretical, practical, analytical and sanctioning tools and methods (as well as the observed benefits and drawbacks of these tools and methods in different situations) used by their counterpart authorities in dealing with similar issues and encountering similar problems. This, along with the debates held in the course of this exercise, can greatly contribute to the emergence and dissemination of widely accepted methods, and so are useful beyond addressing international restrictions of competition. The purpose of the co-operation is to assist each other's procedures by such means as providing information and/or evidence, performing certain procedural acts for another authority, and co-ordinating procedures in terms of schedules, the delivering of decisions or the imposition of sanctions.²⁸⁵ The purpose of technical assistance is to increase the capacities of a less experienced competition authority or to develop the competition authority's activities by transferring knowledge, experience and competition policy know-how.²⁸⁶ This makes it clear that international co-operation between competition authorities has a function in helping authorities to perform their core activity directly or indirectly.

training

3.207. The competition policy analytical toolkit constantly evolves; particularly due to the development of both economic theory and empirical analytical methods. This involves changes in certain rules of thumb used by competition authorities, and may entail modifications in the legal framework for proceedings, in procedural routines and sometimes even in approaches. In a number of fields technology, products and markets are also exposed to constant and dynamic change. This is particularly so in innovative sectors and makes it necessary for competition authorities to provide continuous training for their staff, because up-to-date knowledge is essential for making decisions based on modern analysis and which take into account changes occurring in the marketplace.

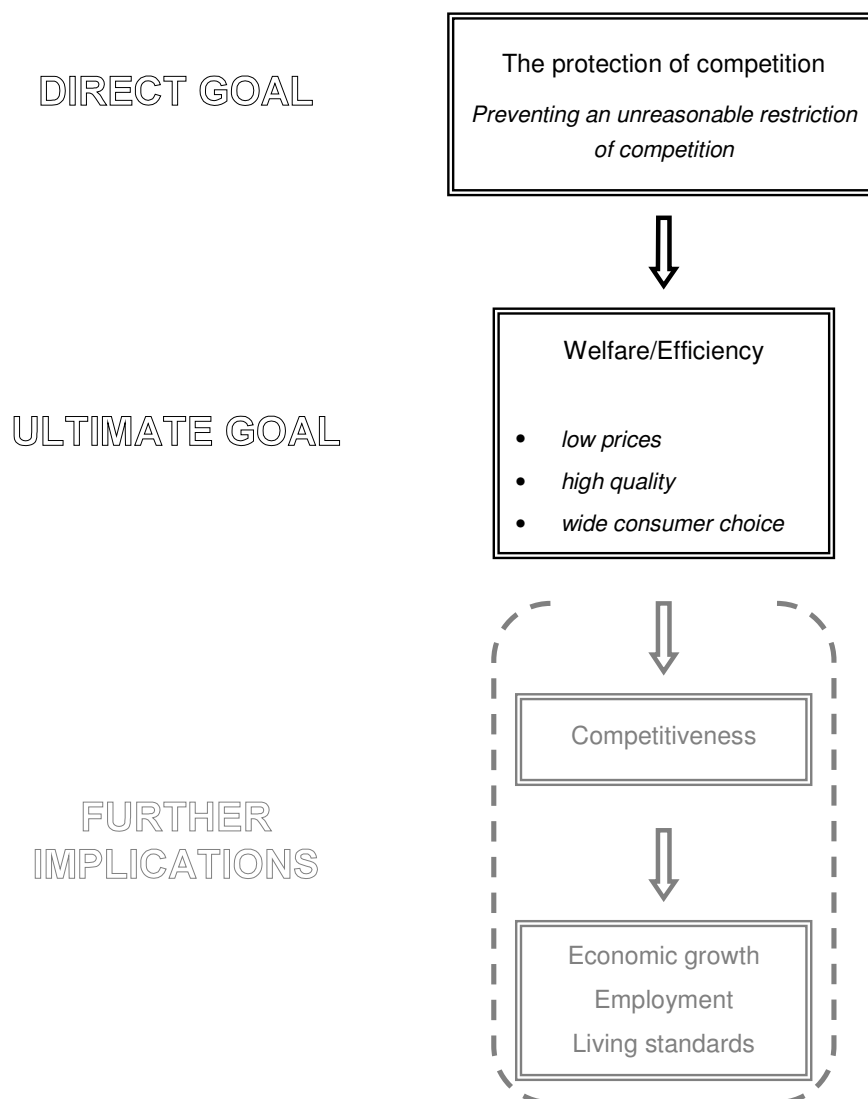
²⁸⁵ Such a co-operation may help competition authorities to conduct competition law enforcement procedures, – ranging from fact finding, through better learning and understanding particular markets, up until taking effective measures –, as for example the competition authority performing the procedure may rely on information and evidence that is available only in another country, obtained and transferred by the competition authority of that country.

On the other hand, international co-operation which, for instance, entails the provision of non-public information about domestic firms to foreign authorities or serves to enforce the interests (laws) of another country may raise a number of concerns. It is no coincidence that certain forms of this type of co-operation require explicit authorisation by law, are usually based on reciprocity, and depend on the fulfilment of certain conditions (e.g. limitation on the use of the information provided).

Naturally, similar co-operation to give specific support to an activity of a competition authority can also be envisaged in the field of competition advocacy or the promotion of competition culture. These cases are typically subject to less concerns and rules that restrict the competition authorities' room to move.

²⁸⁶ Typically, technical assistance is realised by using the financial resources of donor organisations interested in the economic development of the target country, instead of using the competition authorities' financial resources. When a competition authority participates in technical assistance, it does so on the basis of collegiality and helpfulness. Nevertheless, this activity is indirectly related to the performing of the authority's core tasks. Technical assistance facilitates co-operation between the authorities concerned later on, which may help to conduct certain competition law enforcement procedures. Experience shows that participation in technical assistance also gives professional inspiration for the competition authority providing the assistance, and leads to more in-depth understanding and new realisations regarding competition policy ideas and methods, which also support conducting competition law enforcement procedures as well as competition advocacy and efforts to promote competition culture domestically.

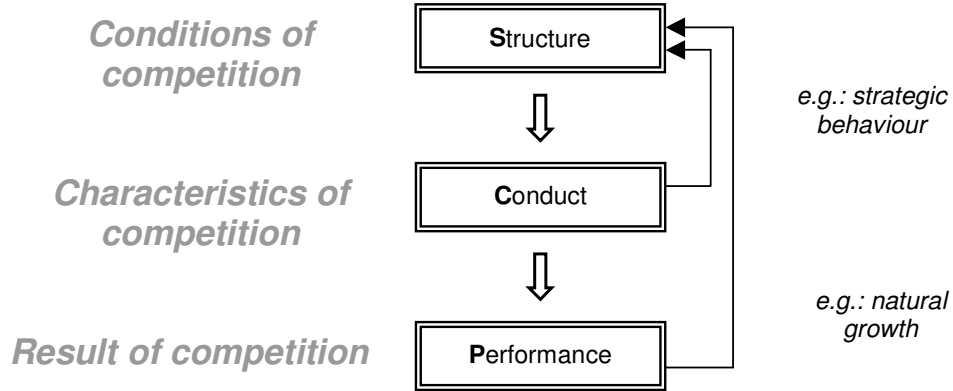
IV. FIGURES



The general objectives presented above guide the work of the GVH. Pursuant to the activities of the GVH, the welfare objective should represent the long-term welfare of Hungarian/European consumers and the related efficiency-mix.

Cf. III Background Notes, paragraphs 3.99-3.100, also II Explanations, paragraphs 2.14, 2.18, and I Principles, paragraphs 1.5-1.8

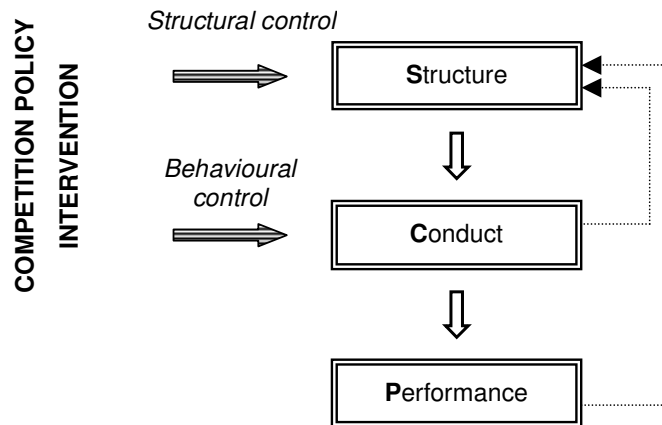
Figure 1: The Objectives of Competition Policy



According to the SCP model, market performance is essentially influenced by the conduct of market participants, which in turn is determined by the structure of the market. This way the welfare result of competition depends on the characteristics of competition, which is derived from the conditions of competition. Reverse links also exist both from conduct and from performance to structure.

Cf. III Background Notes, paragraphs 3.14-3.17, and sections 1.6.1 and 1.6.2

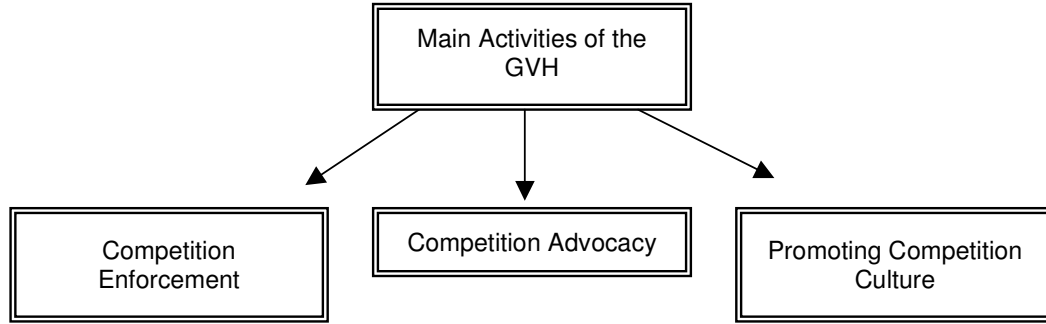
Figure 2: The Structure-Conduct-Performance Model (SCP)



Although the ultimate goal of competition policy is achieving good performance (welfare/efficiency), competition policy intervention is directed towards market structure and the behaviour of firms.

Cf. III Background Notes, paragraphs 3.105-3.107

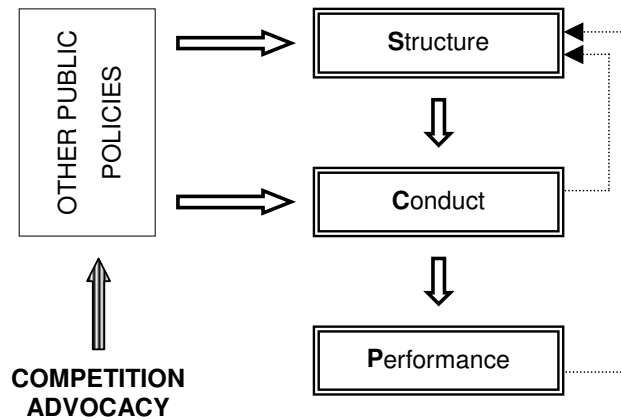
Figure 3: Competition Policy Intervention in the SCP-model



The GVH attributes equal importance to all the three pillars of its activities and seeks to synchronise them. It also aims to realise and exploit synergies that exist between them.

Cf. II Explanations, paragraphs 2.76-2.78, I Principles, paragraphs 1.2 and 1.35

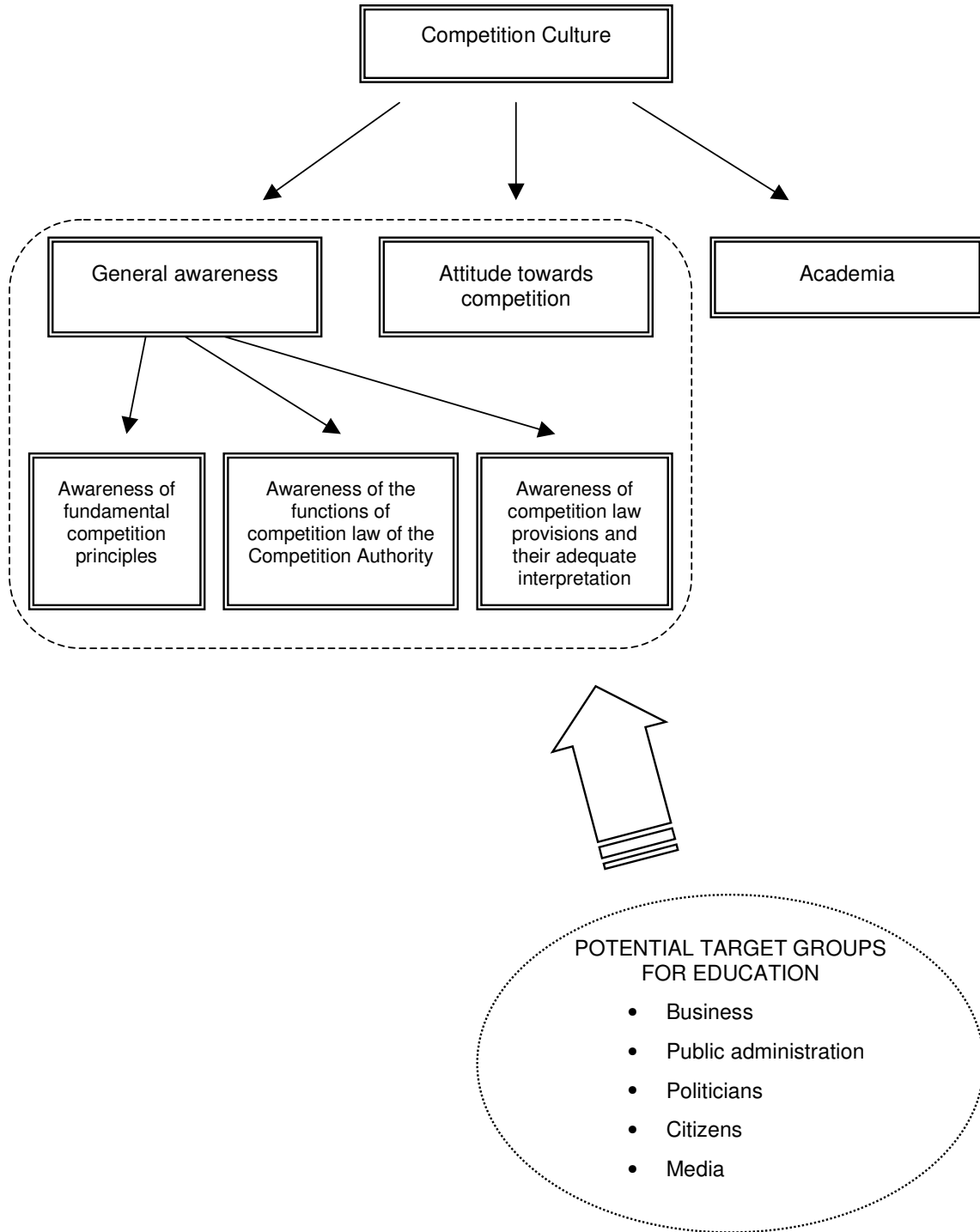
Figure 4: The Main Activities of the GVH Pursuant to the Freedom of Competition (Activity Pillars)



Public policies other than competition policy may also affect the conditions of competition and thus market structure and conduct. Competition advocacy purports to influence these public policies in favour of competition.

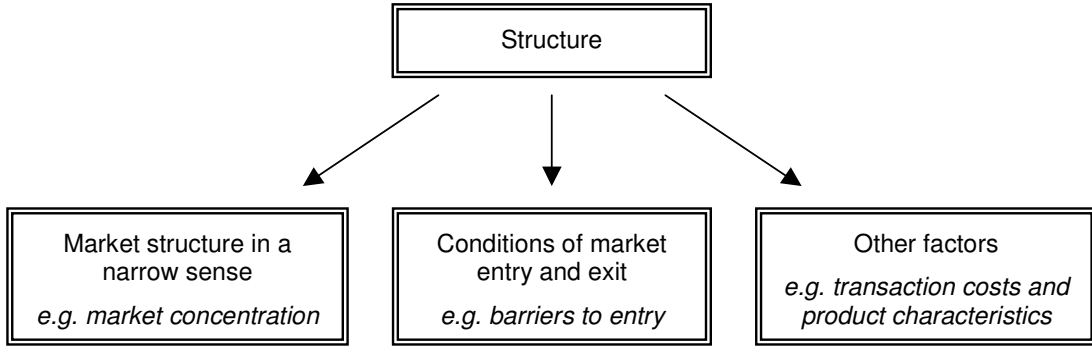
Cf. III Background Notes, paragraph 3.150

Figure 5: Competition Advocacy in the SCP-model



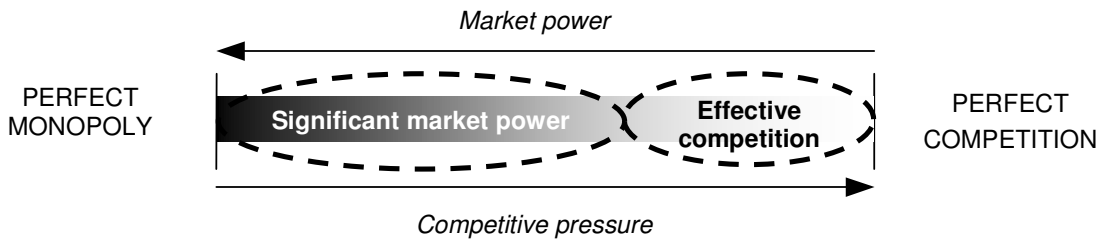
Cf. III Background Notes, paragraphs 3.166-3.171

Figure 6: The Elements of Competition Culture



Cf. III Background Notes, section 1.3

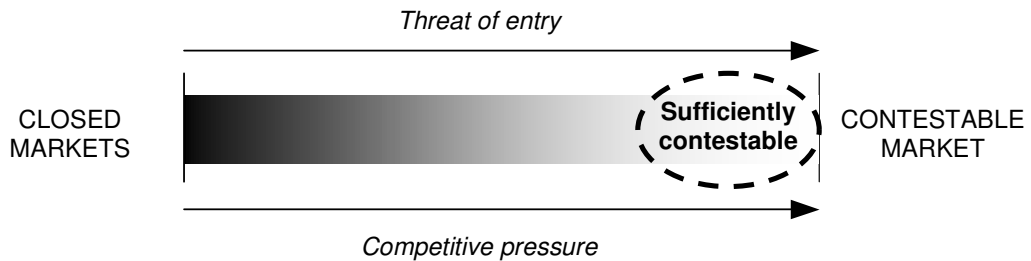
Figure 7: Components of market structure



Market power shows a continuous changing transition without leaps. There is a reciprocally proportional relationship between the strength of competition and market power: the more intense competition gets, the weaker market power is.

Cf. III, Background Notes, paragraphs 3.43-3.44, and paragraph 3.89

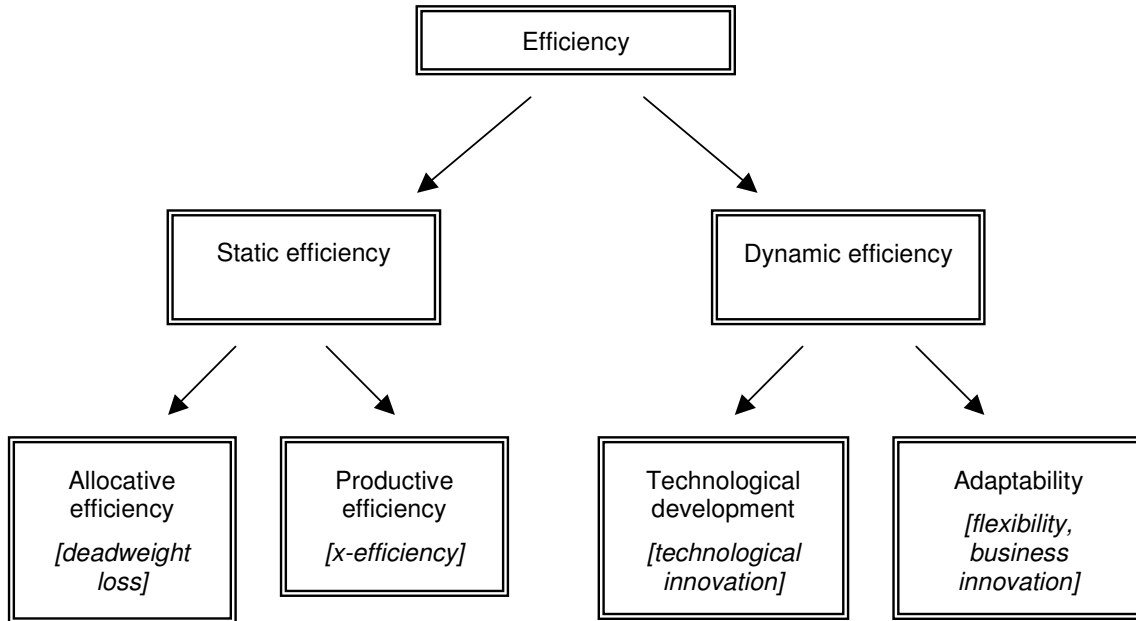
Figure 8: Market Power



Although like perfect competition, contestable markets hardly exist, if ever, in the reality, they provide a useful benchmark with which to demonstrate the importance of potential competition. In reality, for achieving effective competition, it may be sufficient for markets to be sufficiently contestable.

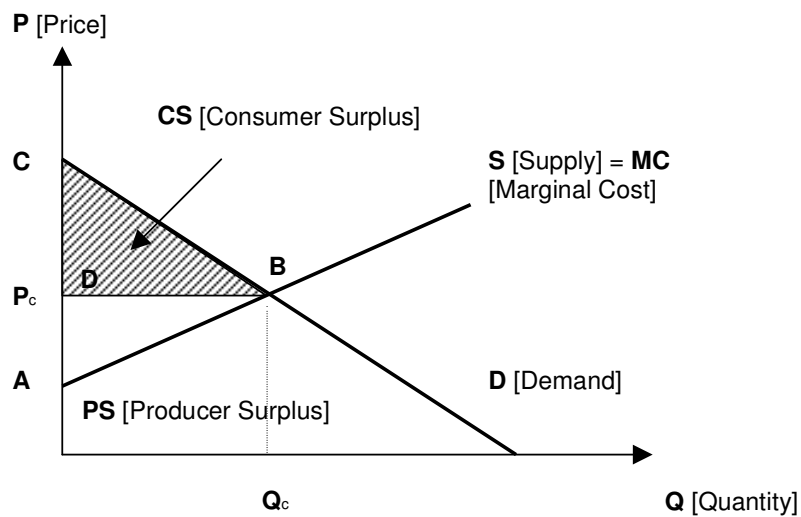
Cf. III, Background Notes, Section 1.3.2 and paragraph 3.68

Figure 9: Threat of Entry



Cf. III Background Notes, Section 1.5.1

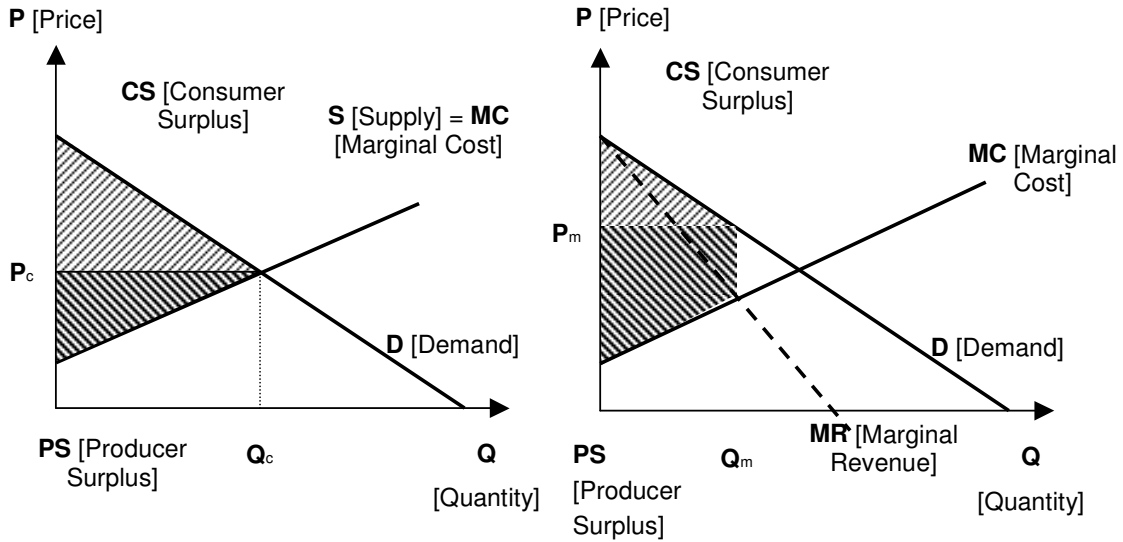
Figure 10: Taxonomy of Efficiencies



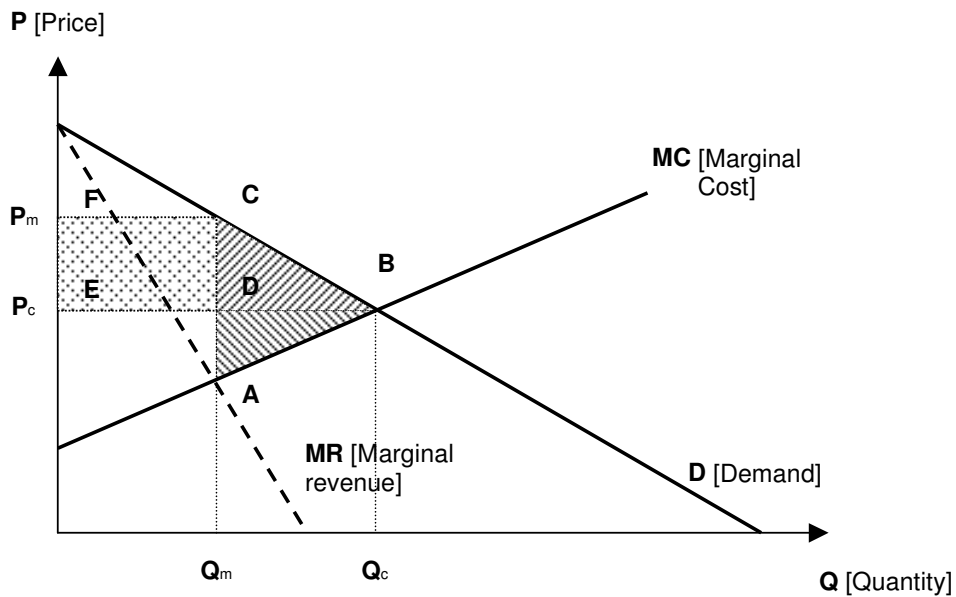
Consumer surplus is the area between the price and the demand curve (DBC triangle). Producer surplus is the area between the price and the cost curve (DAB triangle). The sum of consumer and producer surplus is the social (total) surplus (ABC triangle).

Cf. III Background Notes, Section 1.5.2

Figure 11: The Different Types of Welfare



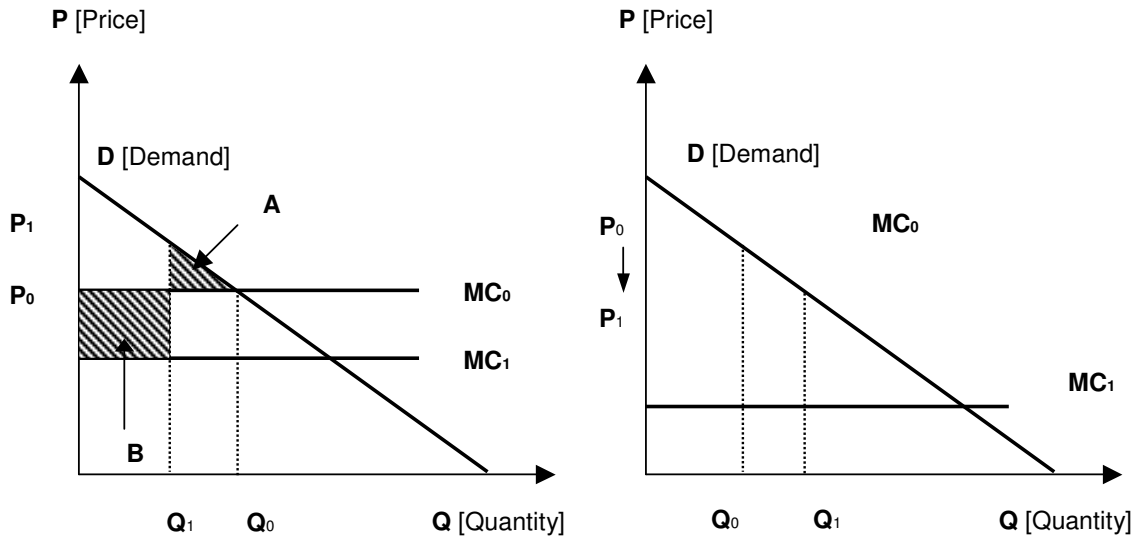
In case of perfect competition, price will be equal to marginal cost, whereas in a monopoly, quantity will equal be set where the marginal cost curve intersects the marginal revenue curve, and this will determine the monopoly price.



The first figure demonstrates the difference between perfect competition and a monopoly. The monopoly price will be above the competitive price and the production level of a monopoly will be under the competitive one. Therefore consumer surplus will be lower in a monopoly (the difference is the sum of the areas determined by EFDC and CDB) and total surplus will be reduced as well (by the deadweight loss – the area determined by ABC).

Cf. III Background Notes, paragraph 3.16

Figure 12: Perfect Competition v. Perfect Monopoly

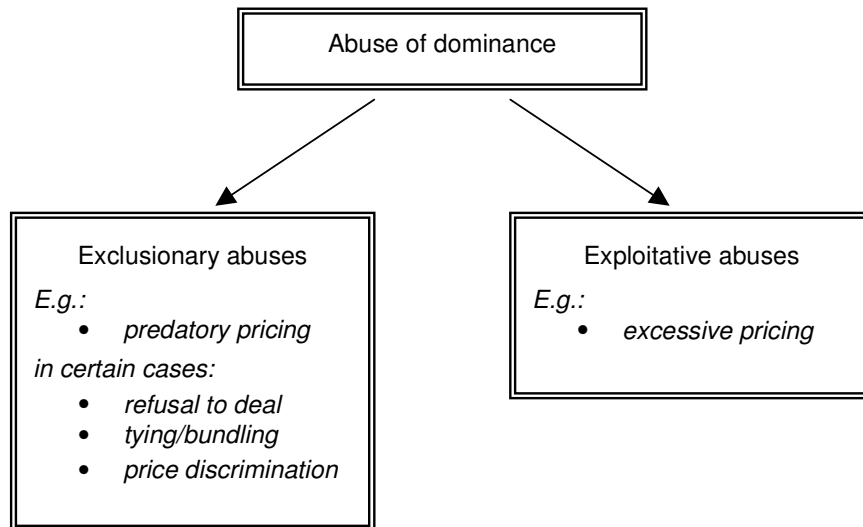


The figure on the left demonstrates the situation where increased market power (for example as a result of a merger) leads to a price increase (from P₀ to P₁) but as a consequence of the efficiency gains, costs decrease at the same time (from MC₀ to MC₁). Triangle **A** demonstrates the loss, rectangle **B** the benefits of the above change.

The figure on the right shows a case where the cost reduction is so significant that the new price (P₁ – above the level of the new cost curve MC₁), which is not a competitive price, will be lower than the previous competitive price (P₀ – that was equal to the old cost curve MC₀).

Cf. III Background Notes, paragraphs 3.118-3.119

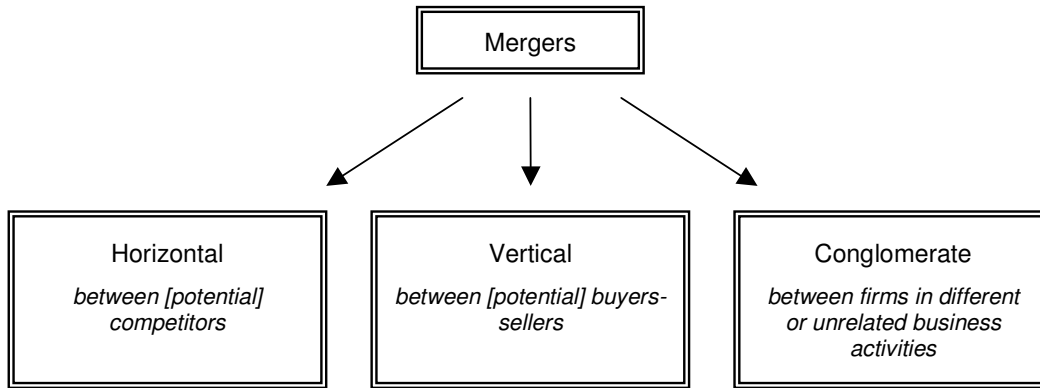
Figure 13: Simultaneous Benefits and Losses



Exclusionary abuses are aimed at increasing or protecting market power; exploitative abuses are characterised by the exploitation of consumers.

Cf. III Background Notes, paragraphs 3.123-3.127

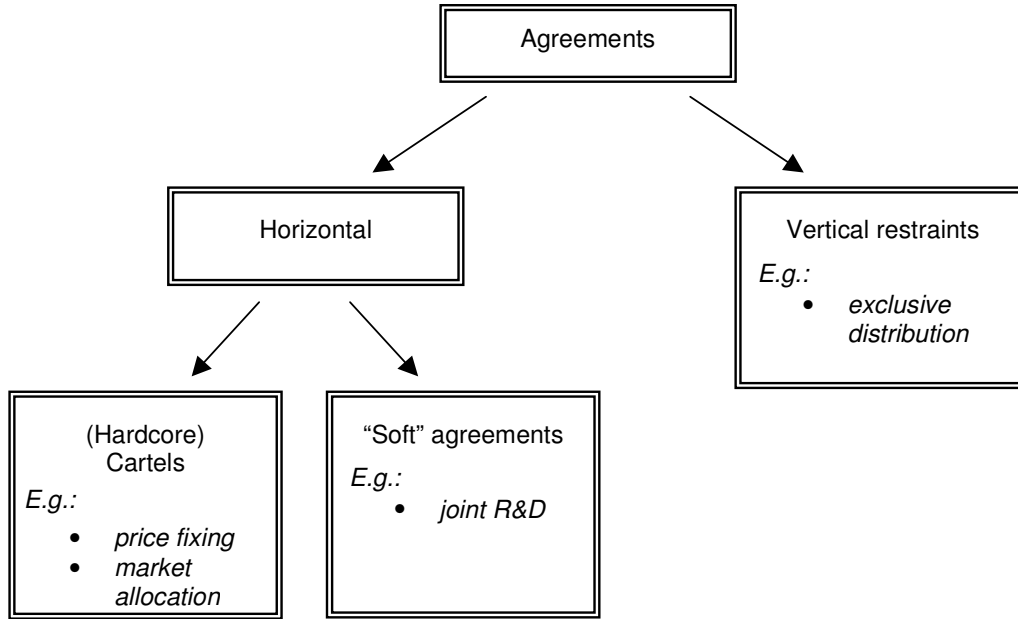
Figure 14: The Dichotomy in Abuse of Dominance Cases



Typical competition policy concerns		
<ul style="list-style-type: none"> • creation or strengthening of significant market power • emergence of oligopolistic conduct, creation of market conditions facilitating collusion 	<ul style="list-style-type: none"> • market foreclosure (e.g. access problems) 	<ul style="list-style-type: none"> • typically none
↓ HORIZONTAL ↑	↓ VERTICAL ↑	↓ CONGLOMERATE ↑
<ul style="list-style-type: none"> • economies of scope • synergies 	<ul style="list-style-type: none"> • reduced transaction costs • eliminating vertical externalities 	<ul style="list-style-type: none"> • financial and other synergies
Typical efficiency gains		

Cf. III, paragraphs 3.115-3.119

Figure 15: Taxonomy of Mergers and the Typical Competition Concerns and Efficiency Gains Relevant to Them



Typical competition policy concerns		
<ul style="list-style-type: none"> • direct restriction of competition • exploitation of consumers • establishing or strengthening of market power (in certain cases) 	<ul style="list-style-type: none"> • establishing or strengthening market power 	<ul style="list-style-type: none"> • market foreclosure (e.g. raising entry barriers)
↓	↓	↓
(HARDCORE) CARTELS	„SOFT” AGREEMENTS	VERTICAL RESTRICTIONS
↑	↑	↑
<ul style="list-style-type: none"> • none 	<ul style="list-style-type: none"> • economies of scale • dynamic efficiency • addressing informational asymmetry 	<ul style="list-style-type: none"> • elimination of vertical externalities (e.g. free riding possibilities)
Typical efficiency gains		

Although the attributes determining cartels and other types of agreements are substantially different, a mixture of these characteristics might be peculiar to certain agreements.

Cf. III Background Notes, paragraphs 3.133-3.141

Figure 16: Taxonomy of Agreements and the Typical Competition Concerns and Efficiency Gains Relevant to them

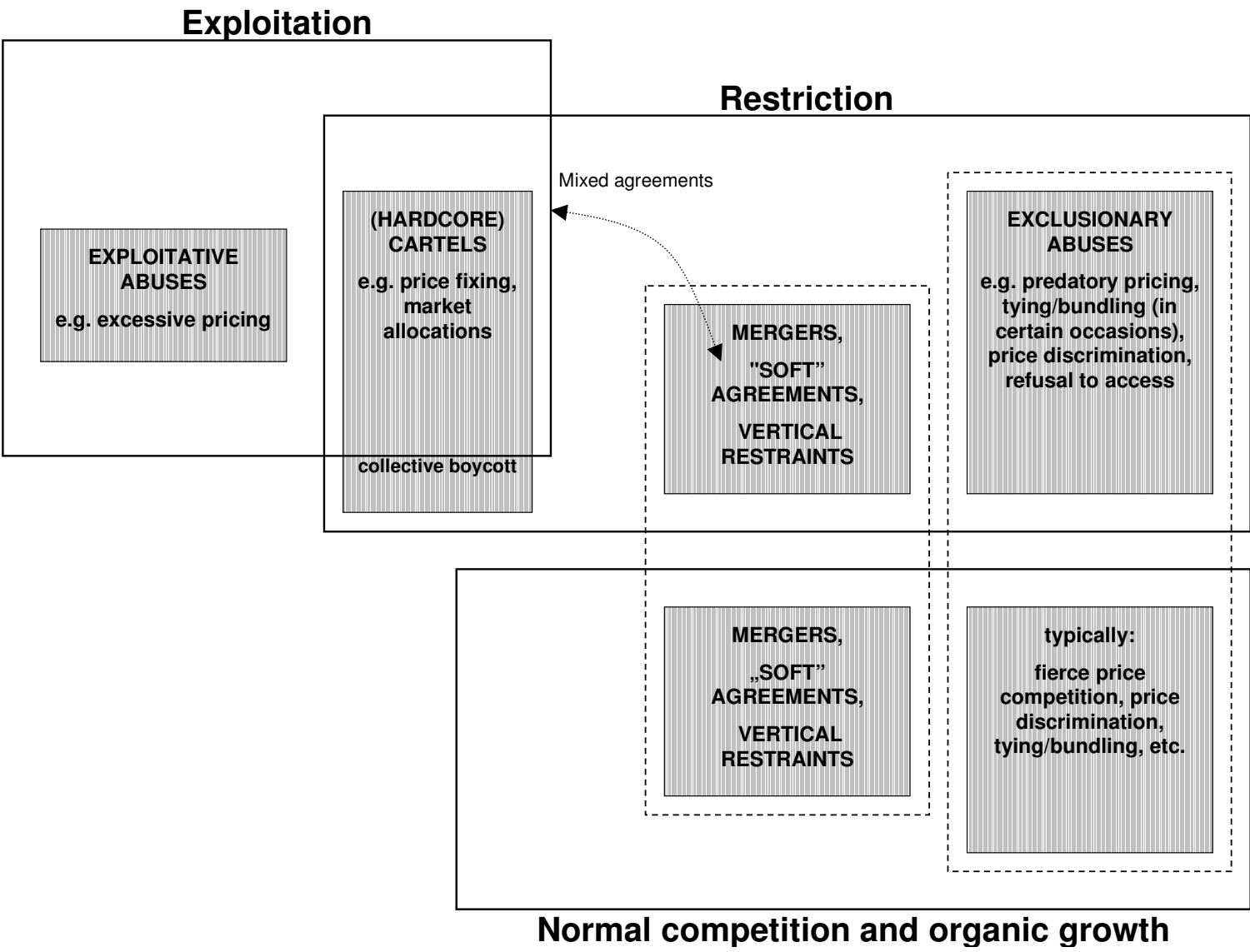
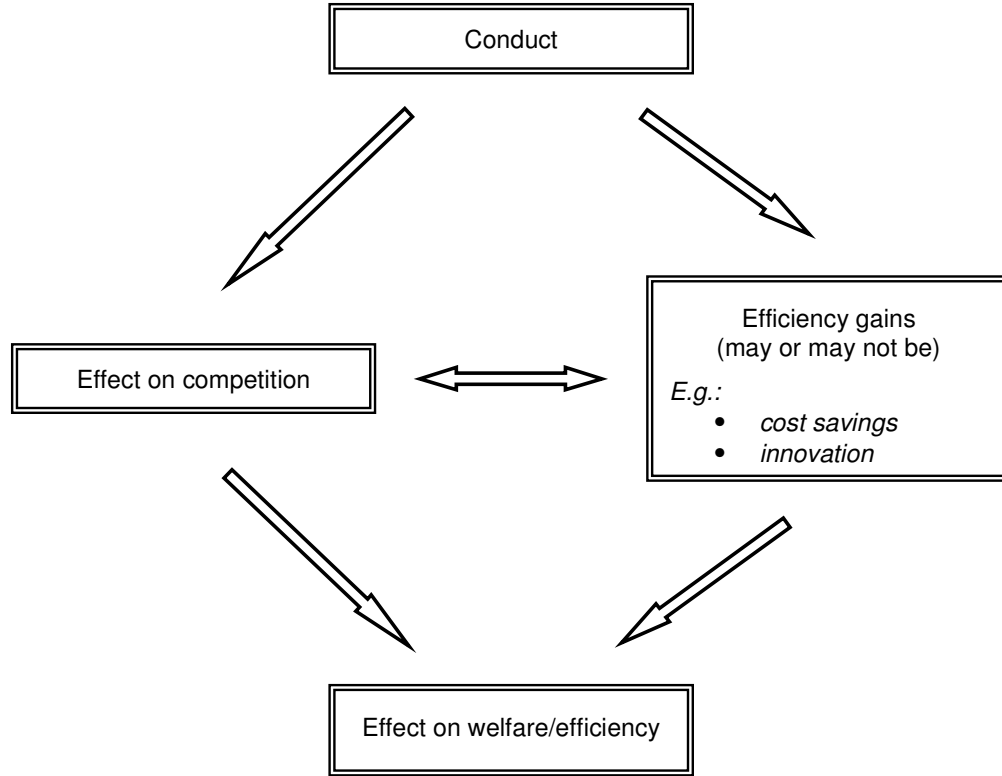


Figure 17: The Relationship between Anticompetitive conduct, Exclusion, Normal competition, and Other Types of Conduct



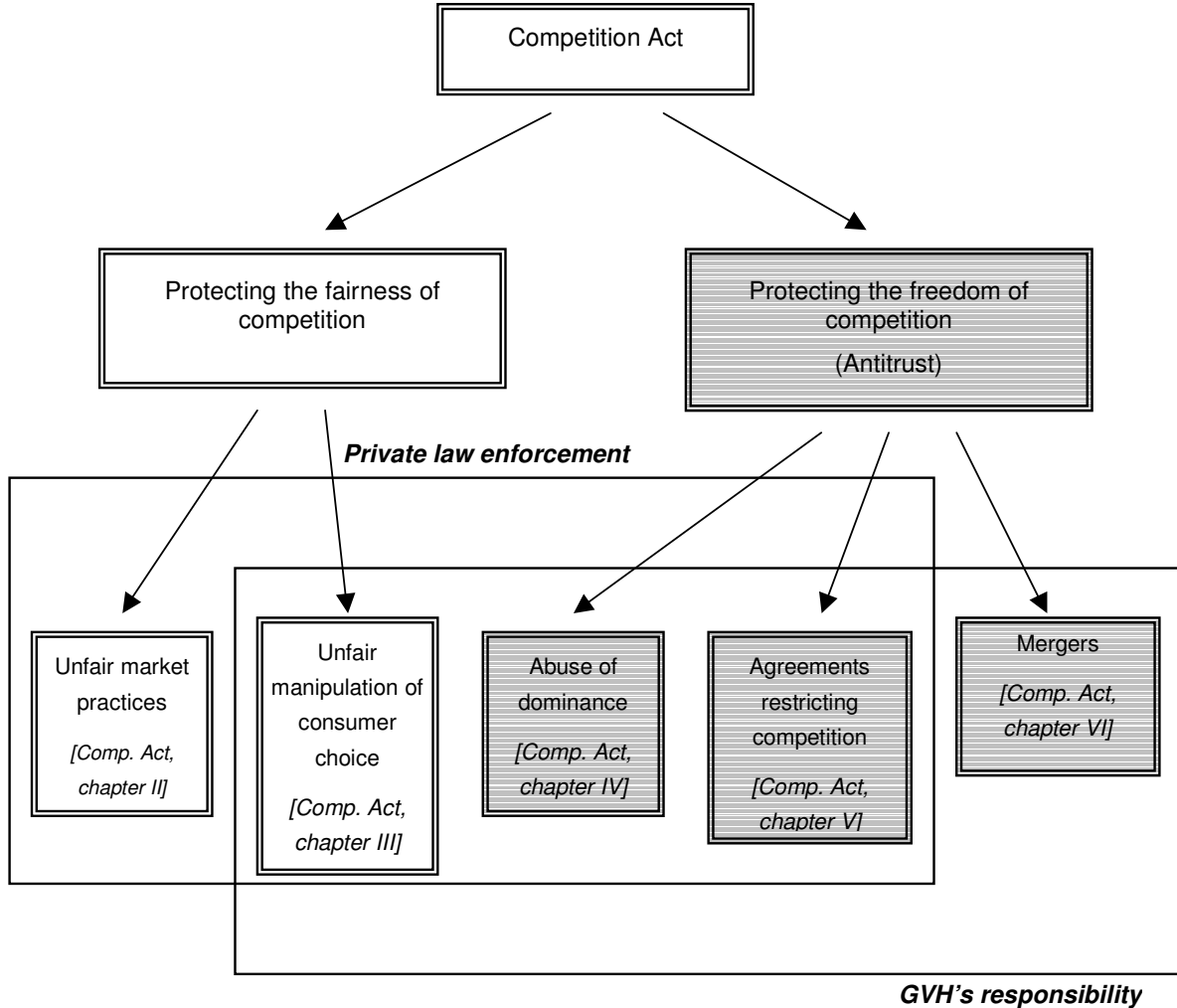
Business practices affect efficiency and welfare directly through efficiency gains and indirectly through their effect on competition. The direct effect on efficiency and the effect on competition also have an impact on each other: effective competition might be strengthened as a result of efficiency gains; in the absence of effective competition, potential efficiency gains ought to be dismissed.

Strengthening competition			✓
Restricting competition	<	Directly increasing efficiency	✓
Restricting competition	>	Directly increasing efficiency	✗

The relationship between the direct effect on efficiency and the effect on competition (i.e. in sum, the total net effect on welfare and efficiency) will influence the competitive assessment of a particular conduct.

Cf. II Background Notes, paragraphs 2.25-2.26 and 2.28-2.29, and also I Principles, paragraphs 1.9-1.14

Figure 18: The Direct and Indirect Effect on Welfare and the GVH's Competitive Assessment



This document is about issues relating to the freedom of competition. The GVH principles relating to the freedom of consumer choice are explained in a separate work.

This figure summarises the different categories of competition enforcement only; competition advocacy and the promotion of competition culture also belong to the area of the freedom of competition.

Cf. II Explanations, paragraphs 2.1-2.2 and 2.7-2.8

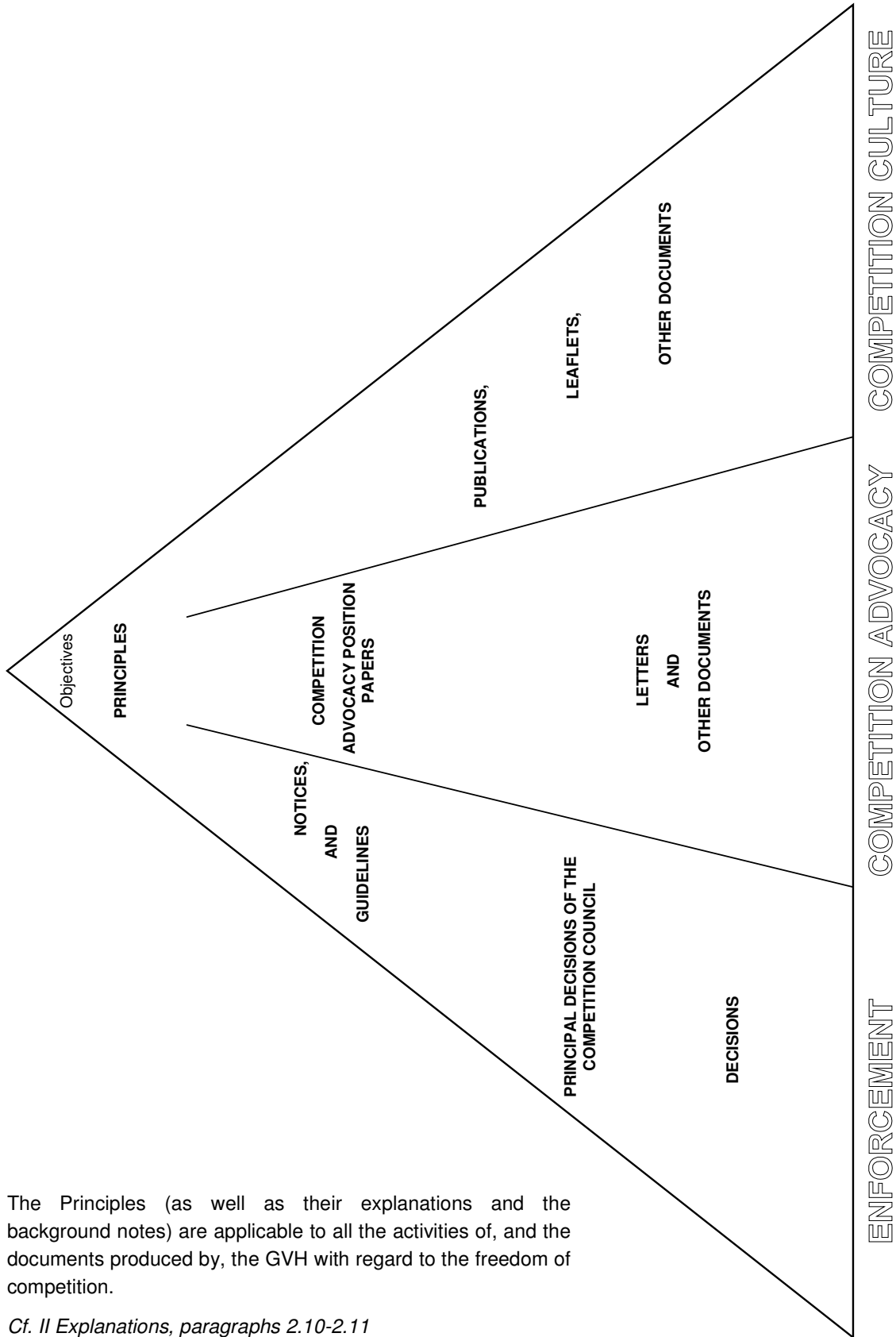
Figure 19: The Protection of the Freedom of Competition in the System of the Hungarian Competition Act

Staying in the market under any circumstances and unconditional market entry	≠	FREEDOM OF COMPETITION
Market players' individual freedom of action	≠	
Lack of unreasonable restrictions of competition	=	

An action against the freedom of competition is the same as an action unreasonably restricting competition.

Cf. II Explanations, paragraphs 2.19-2.20 and also I Principles, paragraph 1.6

Figure 20: The Meaning of the Freedom of Competition in the Hungarian Competition Act



The Principles (as well as their explanations and the background notes) are applicable to all the activities of, and the documents produced by, the GVH with regard to the freedom of competition.

Cf. II Explanations, paragraphs 2.10-2.11

Figure 21: How the Principles relate to Other GVH Documents