An Economists’ Guide Through the Joint Dominance Jungle

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An Economists’ Guide Through the Joint Dominance Jungle

by

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Abstract: In this paper we discuss the application of joint dominance concepts from an economic point of view. We interpret joint dominance in economic terms and argue that recent confusions in the application of joint dominance have arisen because the legal and economic definitions of the concept of collusion are quite distinct. We make the case that a consistent application of joint dominance is only helpful if it is used as an instrument to prevent collusion in the economic sense. However, the recent economic literature then puts significant restrictions on the circumstances under which joint dominance can reasonably be used as an argument to prevent mergers. This requires an analysis of the change in incentives of firms to deviate from collusive agreements in the short run as well as the credibility of threats to “punish” non-compliance to a collusive norm through aggressive product market competition in the future. We illustrate some these arguments using the recent Airtours/First Choice case and show that current practice by the European Commission cannot be economically justified.

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1. Introduction

Since the first appearance of joint dominance arguments in European merger control in the context of the Nestle/Perrier case, the use of the joint dominance concept has proliferated. With Kali-und-Salz and Gencor/Lonrho there is now court confirmation that the European Commission can use the concept successfully to block mergers. Indeed, the latest Commission decision on Airtours seems to indicate that the Commission is intent on pushing the boundaries for the applicability of the joint dominance concept even further. This is already having profound effects on other merger proceedings and merger decisions anticipating the potential impact of the joint dominance argument.

Unfortunately, in all of this process the underlying economic justification for a joint dominance concept has remained fuzzy. This is in contrast to single firm dominance. There it has become clear that the Commission has to demonstrate a significant impact (or significant likelihood of an impact) of the merger on the prices charged by the merging entities. This disciplines the analysis of the Commission by tying it to an economic analysis of the market and opens the arguments to scrutiny. However, when concepts are not very well defined as is currently the case with the concept of joint dominance, there is a real danger that arbitrary intuitive judgments about the competitive effects of mergers can again dominate merger decisions. Recent decisions on joint dominance like the Airtours case raise the real danger that the application of joint dominance in practice can undermine the trend towards a more rigorous economic analysis of mergers.

In this paper we will argue that the application of the joint dominance concept can be put on much more solid grounds and be firmly anchored in generally accepted principles of economic theory. To do so, joint dominance has to be assessed on the basis of the economic concept of collusion. We present some results from recent economic research applying the theory of collusion to merger analysis and show that this framework is very useful for structuring a rigorous analysis of joint dominance in merger cases. In particular, some important rules for policy emerge. However, the conclusions from theory suggest that current application of the concept of joint dominance cannot be justified economically.

To properly understand the economic assessment of the joint dominance issue we first have to have a clear understanding of the economic analysis of single firm dominance (section 2). This will allow us to understand which aspects of competition single firm dominance covers and what is gained by adding joint dominance as a policy instrument. In addition, we have to clarify the use of the economic concept of “collusion” on which the analysis is based (section 3). The economists’ concept of collusion is much wider than the legal definition encompassing behaviour that is often called parallel conduct.

With this conceptual framework in place we can discuss the current state of the economic analysis of joint dominance in section 4 and critique the current use in European Commission practice in section 5. Section 6 concludes.
2. The Economics of Single Firm Dominance in Merger Analysis

Traditionally the analysis of mergers has focused on the question whether a (single firm) dominant position would be created or strengthened by a merger. The legal definition of a dominant position has often remained void of economic content. For example, a popular definition in the legal literature describes dominance as “the ability of firms to act independently of the market”. This is neither a meaningful definition nor one that is operational for practical policy. The definition is not meaningful since no firm can ever act “independently” of the market. Decisions will always take into account the reactions of demand to price changes and the expected supply behavior of other firms in the market. This also makes it impossible to measure whether a firm is dominant so that any judgment on dominance would be entirely subjective.

The Economic Interpretation of Dominance

From the economic perspective dominance is nothing else but a significant degree of market power. More precisely, it is a position of the firm in the market, in which the price can be raised significantly above marginal costs towards the price the firm would set were it a monopolist offering all products in the market. Note that firms in virtually all markets have some degree of market power. Dominance requires that this market power is very substantial and likely to persist. This economic definition fully captures the purpose of competition law but it is at the same time economically meaningful and in principle implementable by measuring market power empirically.

The economic approach, which treats dominance and market power as synonymous, faces two problems for acceptance by practitioners. The first is conceptual. The concept equates dominance with the act of setting high prices, something lawyers are usually unwilling to do. For lawyers the ability to raise prices and the actual action that exploits that ability are two distinct concepts. However, in practice, this legal distinction is semantic: the only way to demonstrate dominance is to show that prices have been raised. If firms are not profit maximizing and set a price below the profit maximizing price it is neither of practical value to establish dominance nor will it be feasible to establish dominance on the basis of economic data.\(^2\) The second problem is one of implementing economic measurement. Typically it is very difficult to measure market power.\(^3\) In practice, it can typically not be established by econometric methods whether a price is close to the monopoly price in a specific market and hence proof of existence of a

\(^2\) This is a logical impossibility. All economic analysis of market power requires the assumption that firms are profit maximizing. Otherwise no inference can be drawn form the data because it cannot be disentangled whether competitors are limiting the exercise of market power or a firm is simply not exploiting the market power it has.

\(^3\) This problem is discussed in the context of competition policy against collusion in Kühn (2000). Enforcement of collusion partially gets around this problem by focusing on the communication between firms.
dominant position is generally not possible. Often policy therefore relies on imperfect indicators of market power like market share, which are somewhat correlated with market power.

Dominance in Mergers: What Changes as a Result of the Merger?

Fortunately, the analysis is considerably easier in merger policy. Mergers are prohibited not when a dominant position exists, but when they create or strengthen a dominant position. All that should matter for the analysis is the likely change in the incentives of a firm to raise prices. The distinction between a dominant position and its abuse therefore dose not arise. In economic terms all we need to establish is that there is a substantial gain in market power arising from the merger. It turns out, that an estimate of the change in incentive to raise prices for the merging firms is much easier to obtain than an estimate of how close the mark-up of a given firm is to the monopoly mark-up. How exactly this can be done has, for example, been demonstrated by Baker and Bresnahan (1987).

Conceptually, the market power of a firm is captured by how elastic its demand is, that is how quickly it looses customers as it raises the price. If the firm faces competitors with close substitutes it will loose a lot of demand as it raises its price. We then say that its (residual) demand is very price elastic. If goods are poor substitutes the firm will not loose as many customers for any percentage increase in price. The change in market power from a merger comes about because the merged firm can simultaneously move the prices of all the products in the merged firm. It will then not loose as many customers to outsiders than before the merger. Hence, the demands the merged firm faces will typically be less elastic then before the merger. If this difference is small the merging firms were imposing little competitive constraint on each other pre-merger and a merger has little competitive impact. If the difference is large the firm would have an incentive to raise prices substantially after the merger. The methodology of Baker and Bresnahan (1987) allows the estimation of the pre- and post-merger elasticities for the merging firms from pre-merger data and hence a direct empirical assessment about the change in market power.

The analysis of unilateral effects of mergers in US merger policy is essentially what we have just described. If the competitive conditions do not change through the merger, the information about unilateral incentives to increase prices by the merging firms (unilateral effects) is indeed all that is needed to qualitatively assess the overall impact of the merger. The reason is that the induced price increases by competitors will always be

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4 In competition policy practice this is reflected in the fact that virtually no price abuse cases are ever brought. It is simply generally not possible in the absence of economically reliable cost data to make inferences about how far firms have increased price above marginal cost. This precludes proper proof in courts.

5 It is easy to construct reasonable examples of markets in which a firm would have arbitrarily small market power but a very large market share. Such a firm would not be dominant according to an economic definition. Whenever possible it is preferable directly to analyze the degree to which competitors impose a constraint on prices on a potentially dominant firm and not rely on market share data. Indeed, market definition exercises are primarily concerned with identifying products that impose competitive constraints on each other. They are not primarily an exercise to generate market share figures.
smaller than those of the merging firms and at most of the same order of magnitude. Hence, if the estimation procedure of Baker and Bresnahan (1987) suggests that price of the merging firms would go up by less than five percent, it would be clear that prices of competitors go up even less.

Admittedly, there are in many cases data problems that prevent a proper estimation of the relevant elasticities. However, merger analysis is greatly disciplined by an attempt to approximate this procedure qualitatively. For example, simple information about customer switching between products can give a lot of information about the likelihood that the merging firms produce mutually close or distance substitutes relative to the mean substitutability relationships with other products in the market. Together with market share data a rough assessment of market power can be made. What the approach shows, is that we have to focus on the competitive constraints that merging firms were imposing on one another and that legitimate merger policy has to based on data that is relevant to that question.

The Limitations of Unilateral Effects Analysis

However, more serious limitations of this basic analysis arise from the fact that the competitive environment will also change through a merger. This concerns three important potential changes that can be induced by a merger: a change in cost structure, a change in entry incentives, and a change in the way companies interact in price setting. We will call the latter the companies’ “competitive behaviour”. The empirical analysis necessarily assumes that cost structures, entry incentives, and “competitive behaviour” are unchanged after the merger. This is clearly not the case, but it is impossible to estimate these changes from pre-merger data. The reason why we could estimate unilateral price effects is that we observe variation of price in the data so that we can estimate the relationship between exogenous movements in price and output of the merging firms. However, behavior under the post-merger cost structure or entry under post-merger market conditions is never observed pre-merger. These are effects that are purely counterfactuals and we have to rely on theoretical reasoning or some clever way of eliciting the knowledge of the merging firms to find an estimate of those effects.

In this paper we focus on how to take account of potential changes in “competitive behaviour” induced by the merger and show that some clean policy recommendation can be drawn from theoretical analysis. What exactly do we mean with “competitive behaviour”? In economic theories of repeated interaction in markets the predicted price outcomes depend on the beliefs of firms about how much a price cut (or increase) by one firm will be followed by a price cut (or price increase) of other firms in the future. The more severely firms believe that competitors will respond to a price reduction, the higher the established price will be. In other words, economists would call this the degree of collusion in the market or “competitive behavior”.

The empirical procedure of Baker and Bresnahan (1987) makes the assumption that the degree of collusion or “competitive behaviour” is unchanged after the merger. This is almost certainly wrong. The change in market structure induced by a merger will lead to
changes in the incentive to collude. What unilateral effects or single firm dominance analysis ignores is therefore that through merger collusion between the merged firm and others might become possible or could be reinforced. If a merger would facilitate collusion in the sense that it would become feasible or be feasible at higher prices, there would be a much larger effect on market performance than the implied change in prices assuming behavior is constant. However, it is also possible that the new asset distribution makes collusion more difficult. Then prices might not go up at all because collusion is undermined. This impact of mergers on the scope of collusion in a market has been called the ‘coordinated effect’ of mergers in the US and is the primary reason why merger policy needs an additional instrument to that of single firm dominance.

Before we can discuss in detail how we can address this issue in merger policy we need to explain in detail what the term “collusion” exactly means when used by economists and how this economic term relates to the legal concept of joint dominance.

3. The Economic Concept of Collusion and its Relation to Legal Doctrine

The economic and legal concepts underlying the term “collusion” are very different and this difference tends to lead to substantial confusion on the issue of joint dominance. For this reason we first clarify the economic concept of collusion and contrast it with the corresponding legal concepts.

*The Concept of Collusion in Economics*

In economics the essential difference between imperfectly competitive behavior and collusion is to what extent firms condition their behavior on the past behavior of their rivals. We call situations (imperfectly) competitive when past actions are ignored if they do not have a direct impact on current profits. Under such circumstances prices close to the monopoly prices cannot be sustained. To see this suppose firms tried to sustain monopoly prices. If rivals to a firm do not condition their future behavior on the price decision of the firm today, future profits are independent of current price decisions. Hence, there is an incentive for the firm to lower the price from the monopoly level and gain market share from the competitors. In the absence of illegal direct side payments between firms price-cutting to the imperfectly competitive level cannot be prevented. This is precisely the force of competition.

In collusion this competitive incentive is undermined by a combination of some credible threats and promises. Firms promise each other explicitly or implicitly to keep prices high in the future if everyone does so today. However, should any firm undercut prices everyone threatens (explicitly or implicitly) to revert to unusually low prices. Collusion in economic theory is any strategy in which price setting is conditioned on past behaviour of competitors in the market. Only if a firm believes that the future price setting behavior of rivals will depend on its own behavior today, can the short run incentive to undercut prices above the (imperfectly) competitive level be limited. In virtually all of our models
of collusion this works in the following way: There is some “collusive” price norm. If everyone sticks to this price norm everyone expects everyone else to set a price according to this norm in the future. However, if anyone deviates everyone expects everyone else to revert to a “competitive” price norm. In economics we call this switch in behavior that results from someone not acting according to some collusive price norm “punishment”. What the economic theory of collusion analyzes is the impact of the market environment on the incentives to deviate from the price norm in the short run and the scope for punishing such deviations later.

Note, that the theory says nothing about how the price norm is established. This may come through explicit communication between firms as in classic collusion cases in the competition policy literature. However, a price norm can also be established through independent learning of competitors’ behavior over time in which firms settled down to behavior that would lead to drastic price decreases if anyone would undercut the implicitly established norm. However, the incentive structure that is sustaining the price norm is exactly the same independently of how the norm was established in an industry.

The Conflict between Legal and Economic Concepts of Collusion: Parallel Conduct

Much confusion in competition policy arises from the fact that the legal analysis of collusion sharply differentiates between the two ways in which a non-competitive price norm is established. If firms come to an agreement after talking about prices, competition lawyers would call this collusion. If there were no explicit agreement to a norm this would be considered “parallel conduct”. Lawyers make this sharp distinction because they consider collusion through explicit agreement (i.e. with communication) illegal, while “parallel conduct” is considered legal. The argument is that in “parallel conduct” every firm simply does what is best for itself anticipating what others are doing. Hence, there is no intent to violate any competition rules. However, this reasoning in terms of intent and explicit coordination is not very meaningful in the light of economic theory. In any circumstances where collusion in the economic sense exists, be it of the “parallel conduct” type or with explicit communication, a firm always does what is in its individual best interest given what it expects others to do. A firm may even vehemently disagree with collusion on moral grounds; it would still fully participate in collusive conduct because of the anticipated behavior of its competitors. For the economic analysis it is immaterial what the motivation of firms is. All that matters is whether firms are likely to raise the price towards the monopoly outcome. The welfare effects are the same, independent of motivation. For the discussion of joint dominance the legal distinction between “parallel behavior” and (undetected) collusion in the legal sense is therefore immaterial. 7

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6 We know that this is possible from collusion experiments in which experimental subjects learn to abide by some price norm above the competitive outcome without ever communicating.

7 The distinction does prove helpful, even from an economic perspective, in anti-trust enforcement. The reason is that market evidence cannot be used systematically to prove that prices were raised above the (imperfectly) competitive level. Proof of collusion is therefore generally impossible from market data. For this reason it turns out to be better to treat only detected communication about prices as hard evidence for collusion in competition policy enforcement (see Kühn 2000).
**Merger Policy can be a Preventive Instrument against Undetected Collusion and Parallel Behaviour**

If we could detect collusive prices directly and perfectly through a market test there would be no need for considering the effects of mergers on the potential for collusion. We would simply fine companies that raise their prices above imperfectly competitive outcomes. The fact that collusive behavior cannot be perfectly controlled in this way means that we should restrict asset transactions between firms that could considerably increase the potential for collusion. Collusion concerns are therefore legitimate concerns for merger policy. This is the only justification for introducing an additional policy instrument, i.e. joint dominance, into merger analysis.

It should be noted that such policy is preventive against what is called “parallel conduct” as well as explicit collusion that is not detected. Unfortunately the legal competition policy literature has argued that only parallel conduct is the target of merger policy, not explicit collusion because that is covered by the norms against collusion. First, this position enormously overestimates our ability to detect explicit collusion. Secondly, for the definition of the correct merger policy rules in the face of these types of behavior the distinction between “parallel conduct” and “undetected explicit collusion” is immaterial.

There would be no point insisting on these differences if they were only semantic and would not materially affect competition policy analysis. But valid arguments about the likelihood of joint dominance have been rejected in the past because “punishments” were considered irrelevant for the case of “parallel conduct” and only of importance for explicit collusion. This claim is, of course, wrong. A “punishment” in terms of the economic theory is only the difference between the profits in the future if firms stick to some price norm and the profits induced if someone deviates from that norm. Punishments in this sense are implicit in “parallel behavior”.

All that is important for the following is that economic theory has systematic predictions about how the incentives for collusion in the economic sense systematically differ between different environments because of the impact of these environments on the incentives to deviate from a non-competitive norm and the credibility of sustaining large differences in future profits conditional on earlier behaviour in the market. As a matter of terminology we will call the first “incentives to cheat” and the second “credibility of punishment”. Whatever we say about these terms they apply equally to explicitly collusive, but undetected, behaviour and to “parallel conduct”. We thus have the essential terminology in place to show how economic theory can guide in the design of rules for dealing with the issue of joint dominance.
4. The Economic Analysis of Joint Dominance

Consistent with a definition of dominance we have to define joint dominance as the ability of firms to jointly exercise market power. This involves on one hand the ability of the firms to significantly raise the prices if they acted as if they were a single firm. This would clearly never be the case for a group of firms that controls only a small share of the overall market. In addition the more important question has to be answered whether the potentially jointly dominant firms are able to act as if they were a single entity. This is nothing else but asking the question to what extent collusion between a given set of firms in the industry is feasible. This latter question adds an additional dimension to the single firm dominance analysis.

As in single firm dominance, merger policy is again only interested in the change that is induced by the merger. It is not material, whether the pre- or post-merger market structure is likely to produce collusive conduct.\(^8\) We primarily want to know whether a particular transaction has the potential to change behavior of a group of firms in a market towards a significantly more collusive mode. Of course, if the characteristics in a market indicate that collusion is unlikely after the merger anyway, then joint dominance cannot be created or increased. To evaluate this theory has generated a list of market characteristics, that are believed to make collusion unlikely. However, in many cases these criteria will not be conclusive, because their absence does not imply that collusion is likely. It is therefore of much greater importance to focus on the change in the incentives to collude that is induced by a merger and evaluate whether this change can have substantive impact on the incentives to collude.

A Merger Implies more than just the Disappearance of a Firm

The question about the change in the incentives for collusion is often not asked because it is seemingly obvious: Eliminating one firm from the market should always make it easier for the remaining firms to collude. However, this simple intuition ignores the most fundamental aspect about mergers. They generally do not just lead to the elimination of some firm from the market. Instead mergers consolidate the assets owned by the two firms participating in the merger. In a real sense any merger increases the size of the merged entity relative to its competitors in the market. Mergers will combine the productive capacities of firms and will bring their product lines together. In addition, assets like patent holdings or cash flows are combined and can thus change the competitive position of the combined firm. Indeed, much of the potential efficiency gains from mergers will also come from the recombination of assets that a merger makes possible.

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\(^8\) This is fortunate for merger policy. In economic terms it can almost never be established how likely collusion in a given market is. There are only some circumstances like tight capacity constraints or very infrequent interaction of firms where we can exclude collusion on a priori grounds. It is never possible to show that collusion is “very likely”.
If we look at a merger in terms of the asset transfers involved it becomes clear that the major changes induced by a merger are that one firm disappears and at the same time there is a fundamental change to the symmetry or asymmetry in asset structures between the firms involved. Furthermore, any remedy we might want to impose will work through some kind of asset transfers in form of the disposal of capacity, of certain brands, of patents, or the licensing of patents to third parties. This means a remedy will also primarily affect the distribution of asset holdings. Implicit in any remedy is the idea that the anti-competitive impact of the disappearance of a firm and the consolidation of assets by the merging firms can at least in part be compensated by an asset transfer.

The recognition that mergers lead to drastic changes in the asset distribution is particularly important in order to recognize that the competitive conditions in an industry do not necessarily worsen when one firm disappears through the merger. If the merger increases the asymmetry between firms sufficiently it may, indeed, make coordination much more difficult between the remaining firms. We will discuss below that there are many well-defined cases in which the scope for collusion in the industry should be expected to strictly decrease from a merger.

While this may appear counterintuitive to the reader a simple example may illustrate how drastically our intuitions can change when we do not mechanically count the number of firms in the market, but look at the distribution of assets created by a merger. Suppose there was an industry with four firms, each with 25% market share, and assume they are identical in their structure of production and asset holdings. It may be reasonable to expect that collusion among the four could be possible. Suppose, two of the firms were to merge. A na\(ive\) first approach would simply acknowledge that we go from four to three firms in the industry. Does that mean collusion has to be more likely? Taking a second look might make one doubt. Post-merger, we have one firm in the market that is twice the size of its two rivals. Indeed, with 50% market share it is itself a dominant firm. Is it really easy in this market for the big dominant firm to collude with the two much smaller ones? The asymmetry now leads to a considerable divergence of incentives between the firms and consequent conflicts of interest in price setting. Why should we have any confidence in a claim that the symmetric four firm situation is better for competition than the asymmetric three firm configuration created through the merger? It is quite possible that the remaining firms are induced to compete harder with the new large firm so that the single firm market power of the merged entity would not compensate for the destruction of collusion.

But why do we have such a hard time thinking about market structures in these terms? The simple answer is that we do not have any good intuition about the impact of a merger on collusion, because this question has, until recently, never been asked. However, there is a whole literature on collusion that we routinely use in assessing the likelihood of collusion in a market. Building assets like capacities or product lines into this standard framework should therefore give us reliable guidance on how to think about such comparisons.

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9 With more intangible assets like goodwill or customer base it is more questionable that an asset transfer can be carried out at all.
Economic Research on Coordinated Effects of Mergers and joint Dominance

The pioneering study doing precisely this exercise was written by Cadot, Jenny, and Rey (1996). In this paper the authors study a standard model of collusion in a market with homogeneous goods among firms who can face capacity constraints. They then analyze the effects of capacity reallocations between firms on the incentives to collude. Their analysis was inspired by the Nestlé-Perrier case in which the merging firms had planned to sell one of their largest brands to the largest remaining competitor, eliminating the post merger asymmetry between the firms. The results of their analysis indicated that whenever collusion is an issue in the market it is made harder when capacities are asymmetrically distributed. More importantly they demonstrated that under well-defined general conditions a merger could reduce the likelihood of collusion.

Intuitively, the incentives to stay in a collusive equilibrium are very different for large and small firms under price competition with capacity constraints. A large firm will have larger incentives to undercut its rivals because it has more capacity to fill. A small firm that is almost, but not quite capacity constrained at the monopoly price will have some incentive to “cheat” in the short run, but this incentive will be very small, because it can only increase its sales up to the capacity constraint. A large firm, in contrast, has a lot more capacity available and can effectively gain more customers with the same price deviation from the collusive norm. Hence, large firms tend to have a greater incentive to deviate from the collusive price.

On the other hand the asymmetry in capacities will also have an important effect on the effective punishments that can be imposed on the different firms. In particular, the worst “punishment” a firm can impose on its competitors is to produce up to full capacity. This minimizes the ability of other firms to raise the price. However, if a firm is small and almost capacity constrained when everyone charges the monopoly price, it can only punish very little by increasing its output up to the capacity constraint. Hence a firm with large capacity facing a firm with little capacity will have large incentives to deviate from any collusive norm, without this being disciplined by much of a threat of additional production by rivals and, consequently, lower prices in the future. In this sense increases in asymmetries in the capacity holdings of different firms make collusion more difficult.

Now it is easy to see that a merger can reduce the likelihood of collusion. If the largest firm in the market buys up a capacity constrained competitor this has two effects. First, the firm has more capacity and therefore has greater incentives to undercut competitors to fill it. Second, it has taken a competitor off the market. But this competitor was capacity constrained before the merger and therefore could not expand its production when price deviations required punishments. This firm is therefore irrelevant to the potential punishments that can be imposed. The punishment potential is, therefore, unchanged through the merger, while the incentives to deviate form the collusive price norm are increased. Hence, the merger makes collusion less likely.
This result is not some theoretical fluke but follows directly from the standard reasoning we apply to assess the likelihood of collusion in markets. To understand how robust these conclusions are, it is instructive to look at another recent contribution to the literature by Kühn and Motta (2001) that focuses on the products in a product line (brands) as assets. Their paper analyses a general model of product differentiation and competition between multi-product firms owning several differentiated products. Large firms in their model are firms with longer product lines. There are arguably many real world situations that match this stylized setup (sale of home videos, Portfolios of soft drink brands etc.)

Superficially the effects in the models are quite different in the sense that the roles of large and small firms are reversed. In the product line approach it is not the large firms but the small firms that have the largest incentive to deviate from collusive conduct. The reason is that on each brand a small firm gains more from any given price cut, because it shifts demand to itself from a larger number of competing products than its larger rival firm. It is the smallest firms that in this context induce the greatest competitive pressure in the short run. On the other hand it is now more difficult for large competitors to credibly revert to very competitive behavior. For any low (punishment) price charged by other firms a large firm has a greater incentive to raise the price above the punishment norm than a small firm. The reason is that the large firm looses less demand to others from a price rise because it owns more products. The fact that a large firm has more single firm market power than a small firm makes it reluctant to participate in severe punishment schemes that would limit the incentives of small firms to deviate from a collusive price norm.

The second effect may again sound counterintuitive, but a simple example will demonstrate that it is not. Suppose in the home video market we had two firms: A really large one and a tiny independent producer. For customers any one of the products of the large firm can be a substitute for the few products of the small firm. Hence, to really hurt the small competitor, the large firm has to substantially reduce prices on all of its products as a response to undercutting. This is very costly for the large firm, because it can earn close to monopoly profits even when the tiny competitor sets very low prices. It is typical for very large firms in the real world to ignore substantial price cutting of small rivals exactly for this reason.

Robust Conclusions from Economic Research

While the structures of the models analyzed in these two papers appear very different, they do generate robust conclusions about the impact of the heterogeneity of asset ownership in an industry:

**Policy Rule 1:** Generally, increasing the differences in asset ownership among the smallest and largest firm in a potential jointly dominant group will make collusion between the jointly dominant firms more difficult. In particular, a merger of the largest firm, leaving the identity of the smallest firm unchanged, will typically decrease the scope
for collusion in the market. Such a merger cannot be found to create or increase joint dominance among that group of firms.

In models with product differentiation like Kühn and Motta (2001) this effect will also translate into a decrease in the highest sustainable price as the asymmetry in the industry increases. This result is in striking contrast to the analysis of asset transfer in the absence of collusion. The cause for these opposing results originate in Kühn and Motta (2001) from exactly the same cause: the market power of the largest firm. An increase in short run market power makes collusion with the largest firm harder, but it increases unilateral market power of that firm. As we will discuss further below this is typical for issues of joint dominance. Market features that improve performance if collusion is absent typically facilitate collusion when it can be sustained and vice versa. The reason is that features that make the market more competitive in the absence of collusion are exactly those that make harsh punishments more credible. This tension between collusion and single firm market power leads, however, to an extremely useful observation for competition policy practice: Single firm and joint exercise of market power are mutually exclusive phenomena. This leads to another important policy rule concerning joint dominance:

**Policy Rule 2:** The finding of dominance and joint dominance should be mutually exclusive for a given market.

To illustrate why this rule is sensible let us consider the shape of firm profitability as we are increasing the asymmetry between two firms. To keep things simple, we will consider a duopoly situation. Figure 1 plots the stylized relationship between firm profitability (normalized by assets) and the asymmetry between the two firms:

![Figure 1](image-url)
The figure shows on the horizontal axis the share of the largest firm in the assets (say share of brands in the Kühn-Motta model) and on the vertical axis profitability of the largest firm. As heterogeneity is increased profitability is initially decreased since collusion gets more difficult to sustain under heterogeneity. However, as the large firm becomes larger the unilateral impact on its incentives to raise the price starts dominating the moderating influence of a decreased scope of collusion with the smaller firm. At that point profitability starts rising to the monopoly level. Essentially, we can interpret the minimum point on the schedule as the degree of heterogeneity at which we would switch from two-firm dominance to single firm dominance.

Such separation of regimes is also helpful, because the policy prescriptions will be very different whether we consider single firm dominance or joint dominance to be the competition problem of the transaction. Typically, changes in the environment that weaken single firm dominance strengthen joint dominance of firms and vice versa. A remedy that is helpful under single firm dominance may, therefore, be counterproductive under joint dominance. To get an intuition why this might be the case it is convenient to think about the issue of punishment in sustaining collusion. Anything that makes the market more competitive in the absence of collusion will typically increase the credibility of harsh punishments as a response to deviations in collusion. From this the tension in policy descriptions becomes apparent. This gives us another policy rule that competition authorities should heed:

**Policy Rule 3:** *The impact of a change in the market structure is typically the opposite when we consider single firm dominance or joint dominance.*

Consider again an example with two large firms in a market (facing a competitive fringe). Suppose that the smaller firm of the two large firms sells some of its brands to the larger firm. (One can think of this as selling a subsidiary). Should we be worried about this as a competition authority? The answer is: It depends whether we have joint dominance or single firm dominance in the market. If firms are fairly symmetric so that we have joint dominance and the regime remains one of joint dominance after the transaction, no intervention is indicated. Given that no single firm dominance is created prices would fall and the transaction is likely to be motivated by efficiency gains. On the other hand if single firm dominance is created or existed before the transaction, price increases should be expected. Essentially, the evaluation of competitive effects depends on whether we are on the downward sloping part of the graph in figure 1 or on the upward sloping part.
Policy rule three and our example directly suggest that we have to be very careful when we use standard summary test statistics for evaluating the competitive effects of a merger. For example, the popular Herfindahl index is a good first approximation for ranking changes when analyzing single firm dominance. In single firm dominance prices typically go up both with concentration and the asymmetry between firms. However, for a preliminary ranking of market structures in joint dominance situations the Herfindahl is entirely inappropriate because asymmetry in those circumstances will contribute to lower prices in the market.

**Policy Rule 4:** *The Herfindahl Index should not be used to rank market structures when joint dominance is an issue.*

The above discussion immediately raises the question what kind of dominance we should consider in particular cases. Indeed, in competition policy practice the European Commission has not only claimed single firm and two-firm dominance. In the recent Airtours case it broke new ground by claiming a joint dominant position between three competitors. How should we decide what type of dominance there is beyond the distinction between single firm and joint dominance? The apparent answer is a straight application of the insights we have discussed above. We know from our analyses that firms have an easy time colluding when they are fairly symmetric, but have a harder time colluding, as they get more asymmetric, up to a point where collusion is effectively not an issue anymore. Hence, joint dominance should only be an issue between firms that are fairly similar among themselves and quite different in size from other firms in the industry. Hence, we can have a rule of the following type:

**Policy Rule 5:** *To determine which firms are potentially dominant, a group of firms should be selected that has similar market shares within the group and very different market shares to firms outside the group.*

This rule leads to surprisingly different treatments of mergers in concentrated markets, which, however, on reflection make perfect sense in the light of the theory of collusion. For example, there are circumstances in which we want to treat firms as jointly dominant even when at least one of the firms surpasses the standard threshold for single firm dominance. To see this consider a market in which one firm has 42% market share and another 38%. Typically, the competition policy authority would talk both about single firm dominance and joint dominance. We have shown above that this is not appropriate. Indeed, in this case it may be more reasonable to treat the two firms as jointly dominant rather than find single firm dominance.

Such a finding would make a large difference for the assessment of a merger between the larger firm and a small competitor with, say, 5% market share. From a joint dominance perspective, such a merger would reduce the scope for collusion between the two large firms and the merger should be considered unproblematic. Indeed, a divestment restoring previous market shares would be counterproductive.
Contrast this with a market in which we would have a market share distribution of 42%, 19%, and 19% and the same fringe as before. A finding of joint dominance is unreasonable here, because the largest firm has more than twice the size of the medium sized firms. The only reasonable dominance concept would be single firm dominance. We would only look at single firm dominance. The acquisition of a competitor with 5% market share would then probably be prohibited or only passed with significant remedies.

Both resolutions of the two proposed mergers are entirely reasonable once we look at them from the perspective of what changes in the market. However, from a traditional perspective the policy prescriptions appear counterintuitive. We are treating a merger in an arguably more concentrated market more leniently than a merger in a less concentrated market. Indeed, it will probably be true that in the first hypothetical market prices would be higher than in the second and competition less intense. However, that is immaterial to the change that is induced by the proposed merger. The added asymmetry improves the performance of the more concentrated market, while it worsens the performance of the less concentrated one.

This example gives a glimpse of the great dangers inherent in the use of joint dominance arguments in practice. In particular, there is the understandable temptation on the side of competition authorities to go “n-dominance shopping”, settling for the dominance claim with the most restrictive policy prescription. However, this may lead to a very inefficient merger policy, to excessive intervention in markets, and a fairly arbitrary decision making process. The problem is aggravated by the fact that no academic analysis can ever yield the “right” market share or structural benchmarks to follow in a particular case. A consistent policy can only be done by strictly applying the economic theory of collusion and using the facts of the case to derive specific conclusions.

Given these problems the application of joint dominance concepts increases the incentives for gaming between the merging parties and the competition authority in merger proceedings. To give a taste of what that would look like let us return to the example we just discussed. We had argued that in our first scenario joint dominance analysis would suggest that if we find joint dominance the merger in the more concentrated scenario should possibly be permitted. Suppose that in this specific case, the merging firms did not like to be called jointly dominant and have done everything they could to convince the European Commission that collusion is difficult in this market. For example, they have argued that monitoring is very hard. The consequence would be that the merger would be blocked on single dominance grounds. When joint dominance analysis is applied properly it can therefore be in the best interest of firms to argue that “parallel conduct” is unavoidable in the market given the symmetry of the market structure.

Towards Empirical Benchmarks

How will we ever avoid complete arbitrariness in practice given the intricacy of joint dominance arguments? In our opinion the only way out is one of relying even more heavily on empirical analysis in merger cases. Indeed, the analysis of Baker and
Bresnahan (1987) that we discussed for the use in single firm dominance can be used to shed some light on the appropriate policy response to a merger as in our first example. If joint dominance is already a pre-merger problem, then there should not be much additional gains for the two largest firms from jointly raising prices. Hence, we can devise a test by which we reject the joint dominance hypothesis, whenever residual demand elasticities drop significantly when the two potentially jointly dominant firms raise prices jointly. This test would show that the two fairly symmetric firms were exercising a significant constraint on each other and that therefore the presumption of joint dominance was not warranted.

The problem with such procedures is that they heavily rely on data provided by firms not party to the merger. This may not necessarily be a problem for the European Commission given the powers to seize data for these purposes. However, given that this is typically secret, privately held information of competing firms there is a problem with the merging parties access to data that is critical for the assessment of market structure and therefore their case. It appears an open question whether the investigation process could be structured in such a way that the results of the analysis could be properly checked by the parties. However, this is an issue that with the increasing use of more rigorous empirical techniques will have to be dealt with in European merger analysis. Indeed, if we cannot give joint dominance analysis a firm empirical grounding, we might be better off without this instrument.

Now that we have given an overview about how modern theory approaches the issue of joint dominance, the diverging policy recommendations for single firm and joint dominance and ways to use empirical analysis to give findings of dominance a stronger grounding, we are now ready to discuss some of the current practices on joint dominance in European merger policy.

5. Current Policy from an Economist’s Perspective

Current policy at the European Commission level appears to be edging a step forward by recognizing that the theory of collusion is the right framework for assessing joint dominance concerns (see Christensen and Rabassa 2001). This is despite the totally confused discussion of joint dominance in the Airtours decision. On the other hand the repeated insistence by the Commission that “unilateral” effects could be analyzed under joint dominance is again muddying the waters. There is no unilateral effects analysis that would not fall under the analysis of joint dominance, since the increase in prices from a merger absent collusive effects are fully captured by an analysis of the incentives to raise prices of the merging firm. All that is left after a single firm dominance analysis is the question of whether collusion is facilitated by the merger. A proper framework for competition policy is therefore to analyze this and only this under the concept of joint dominance.

The Checklist
In some sense the Commission has, in the past, implicitly acknowledged that joint dominance analysis is the analysis of coordinated effects of mergers. The checklist the Commission applies to joint dominance has been essentially the list compiled in the textbook by Scherer and Ross (1992) of those market characteristics that traditionally have been held to facilitate or hamper collusion. This list has some problems because some claims made about collusion enhancing factors that are adopted in this list are not supported by modern theory. However, the list is useful in one precise sense: if we find important features in the market that make collusion unlikely, joint dominance in the post-merger configuration can never be found. Hence, under such circumstances joint dominance should be rejected out of hand.

A Positive Case for Joint Dominance Requires the Analysis of the Change in Incentives to Collude

The problem with the checklist is that it can never establish a positive case that joint dominance has been created or strengthened through a merger. If we find many features of the industry that aid collusion it does not follow from this finding that a given merger increases the problem, as the literature we cite has amply demonstrated. A positive case to establish the creation or strengthening of a dominant position requires demonstration that the market circumstances change in such a way that collusion is more likely after the merger. The European Commission has never done so in any merger that has been blocked for joint dominance concerns. In a strict sense they have therefore failed to establish grounds under the merger regulation to block these mergers.

The lack of analysis of the change of the scope for collusion is the single most glaring mistake in the use of joint dominance by the European Commission in merger cases. However, the incorrect, mechanical use of the check-list and the application of incorrect market characteristics has had a significant negative effect on merger policy. In the remainder of this section we will point out some of the more important abuses in the application of the joint dominance checklist.

Structural Links

A primary example for such abuse is the use of “structural links” as an indicator of joint dominance. This includes, in particular, cross-share holdings between firms or the existence of joint ventures. Indeed, in the early days of joint dominance application there was the idea floating around that such links were necessary to find joint dominance. Once collusion theory is accepted as the correct benchmark for the assessment it is obvious that such links can never be necessary for establishing joint dominance. Fortunately, the Court of First Instance in the Gencor/Lonrho decision freed merger analysis from such dangerous baggage.

However, the opposite contention, namely that “structural links” are a strong indication for joint dominance, is just as wrong. However, it is routinely still held to be true by the European Commission, which proudly reports to the public to have based its decision in Airtours/First Choice (among other things) on the existence of “structural links”. It is, of course, true that cross-share holdings and, typically, joint ventures increase single firm
dominance in a market. A firm with large market shares and significant cross-shareholdings in competitors will have more market power than a firm with the same market share and no such cross-holdings. However, policy rule 3 applies to this case. Cross-shareholdings may reduce the scope for collusion, because they limit the ability of firms to impose credible punishments (see Malueg 1992). Furthermore, structural links can have more adverse impact on collusion if they are asymmetric. One firm owning a share in a competitor, with no reciprocal share owning will increase the asymmetry between competitors in the market and can even lower prices.

This does not imply that there are never structural links that can enhance collusion. For example, it is conceivable that structural links can improve the observability of a rival’s conduct. But then it has to be carefully argued why this is so and that the increase in transparency is actually relevant to the pricing decisions in question in the specific case. This is never done in practice. There is a blanket assertion that structural links facilitate collusion. Such an assertion is simply wrong. The European Commission cannot save itself the trouble of exactly arguing how a specific structural link impacts on the incentives to collude and demonstrate that the link has a material impact on the pricing decisions in question.

A proper assessment of structural links in merger proceedings is even more difficult. It depends on how structural links interact with the asset transactions implied by the merger. The real question to be answered is: Is the price reaction of a merger greater or smaller with structural links than without.

Multi-market Contact

A second frequently abused concept is that of multi-market contact. Once merging firms are found to have multi-market contact they have little defense under current practice. However, there is no justification for this on the basis of theory or empirical evidence about multi-market conduct. It is true that firms that operate in multiple markets can never have less incentive to collude than if each of those markets would be served by a different set of firms. However, this trivial insight does not imply that multi-market contact seriously affects market behavior in a particular case. The effectiveness of multi-market contact relies on very restrictive market conditions.

Theoretically, multi-market effects arise from the pooling behaviour across markets with very different incentives to collude. In simple terms, suppose that a firm has strong incentives to collude in one market and weak incentives to collude in another. Across the two markets it will then have average incentives to collude. Only if that average incentives is sufficient to induce global collusion, while collusion only in the market with weak incentives was impossible, does multi-market contact matter. If firms are operating in many markets, all of which have approximately the same market structure, multi-market contact has no effect.

Whether multi-market effects are important or not, has so far not been established convincingly. Even with some of the best work on the subject (see Parker and Röller 1997), it can be easily disputed whether their findings really relate to multi-market
contact or other unobserved market characteristics. The evidence for substantive multi-market effects can be considered at best weak at the current stage of the research. There is no support for very restrictive policies based on claims about multi-market contact.

There is one area in which we do have to take multi-market contact into account when analyzing market conditions and where we can be quite certain that we will do the right thing. This is the question at what market level to analyze joint dominance. The European Commission applies joint dominance analysis market by market at least in the geographic dimension. However, this is inappropriate when analyzing the overall incentives of firms to collude. Whether we find joint dominance or not can drastically change when one takes multi-market interaction into consideration.

A simple example helps to illustrate this point. Suppose the two top firms have 40% and 25% market shares in one country. In another country of equal market size they have exactly the opposite market shares of 25% and 40%. If we apply the analysis of dominance market by market we would not find joint dominance in any one of the markets because of the strong asymmetry between the firms. However, viewing both markets together the firms are now perfectly symmetric. Their incentives to deviate from any global agreement are perfectly aligned. Collusion is much easier than the country-by-country analysis would suggest. Indeed, suppose one firm initially had a share of 25% in one market and 40% in the other, while the other shares of 25% and 40% were owned by separate companies. If the latter companies merge, the scope for collusion would go up dramatically. However a country-by-country analysis would suggest no concerns of joint dominance.

Note, that this use of multi-market contact is very different from the standard use. It identifies the degree of asymmetry between firms across the different markets to assess whether multi-market contact is important. There is nothing objectionable to such a use of multi-market contact arguments. What cannot be permitted is a simple counting of the number of contacts between the firms in different markets to assess the importance of the multi-market contact argument.

Vertical Integration

A third market characteristic that has to be treated with much more caution is the presence of vertical integration. The blanket assertion that vertical integration aids collusion or that symmetry in the degree of vertical integration will generally strengthen claims of joint dominance is not justifiable. Effectively, the Commission has opened up the way to block even vertical mergers because they increase or strengthen a horizontal dominant position. In this area the strong reliance on such arguments is preoccupying because so little is known about the interaction of vertical market relations and collusion. We know that vertical integration can help collusion by eliminating the need for the monitoring of input market behavior. But that simply means that vertical disintegration makes it much harder to collude than standard models suggest. The argument that similar degrees of vertical integration imply similar cost structures is superficially plausible but not at all obvious without empirical evidence. The assertions that are being made in the
cases on the impact of vertical relations on joint dominance have so far remained entirely speculative.

5. The Airtours/First Choice Case

Given the complexity of joint dominance analysis it is entirely unsurprising that important cases go badly wrong. The application of simple intuition, plausibility and common sense can lead to very bad decisions. The recent Airtours/First Choice case is good example for a policy practice that relies on such unsubstantiated joint dominance claims. It represents a low point of economic reasoning at the Commission.

First, the Commission freed itself of the rigors of economic analysis claiming that the theory of collusion was not relevant to parallel conduct. In particular, the analysis of the ease of punishment was considered irrelevant for parallel conduct. Such a position as taken in paragraphs 51-54 in the Airtours/First Choice decision are economically indefensible. The Commission used these claims to immunize itself against any rigorous economic argument. With this baggage the decision can be characterized as nothing else but arbitrary.

A closer analysis of the case on the basis of the published decision unsurprisingly raises serious doubts whether the prohibition is economically defensible. We will present some of the major concerns below. We will start with the analysis of what changes through the merger and then consider the evidence of how likely collusion (or parallel conduct) is in this industry.

The Reduction in the Number of Firms

The Commission argued that the scope for parallel behavior was enhanced because the number of large firms was reduced from 4 to 3 and because the elimination of FirstChoice eliminated the last “medium sized” player. As we have shown the mere observation that a firm is eliminated in a market does not in any way imply that the scope for collusion has increased. Nor does the existence of a “medium sized” player have any relevance for the scope for parallel conduct or collusion. Indeed, the theory says that the asymmetry between the largest and the smallest firm in a potentially jointly dominant group is what determines the impact on the scope of collusion.

The Change in Heterogeneity

An analysis of the published market share figures reveals that the pre-merger configuration was hardly conducive to collusion with the largest firm in a group of four with 30% having twice the size of the smallest, FirstChoice, at 15%. However, it is hard to establish strong conclusions from the change in market share through the merger. The

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10 With “economically indefensible” I mean that no reputable academic economist could possibly defend the claims of the Commission in this part of its decision.
largest firm increases its size, but the smallest firm among the remaining three large players also has a higher market share. The change in heterogeneity from four to three is relatively small. It also appears a stretch to find three firm dominance given that the largest firm in the potentially collusive group exceeds the smallest by about 75% in size. According to our policy rule 5 the analysis should probably focus on two firm dominance in this market.

This immediately raises a difficult question. How high does the market share of two merging firms have to be to find joint dominance. Such assessment is inevitably arbitrary. However, we have to work with some such benchmarks even in single firm dominance cases. In single firm dominance cases we typically require that firms have more than 40% market share to find a presumption of dominance absent other pro-competitive market features. The benchmark for joint dominance therefore has to be significantly higher because it is no foregone conclusion that firms can collude. A 50% benchmark appears to be low and probably would be opposed by a larger number of economists familiar with oligopolistic markets. Indeed, since the setting of such benchmarks is quite speculative we would not want to create a presumption of joint dominance anywhere below 60%. This would mean that with a joint market share of 65% by the two top firms after the merger there could be a legitimate concern that two firm dominance was established through the merger.

Were the Market Characteristics Conducive to Collusion?

This is the point where the assessment has to turn to an analysis of the features of the market, which might facilitate or hinder collusion between those firms. The most striking feature of the market is that the theory of collusion excludes the possibility of price collusion for a market with the specified characteristics. Apparently, as the Commission itself points out, firms were tightly capacity constrained. This invalidates any claim of a joint exercise of market power for two reasons. First, any price at which all capacity in the market is sold is a competitive price, so that there is no sense in which the price reflects anticompetitive reductions in output. Second, when we are close to capacity constraints collusion cannot function, because there is no scope for punishing firms that deviate from a collusive price norm.
This means that all meaningful strategic interaction must take place at the capacity setting stage. According to the Commission, capacity decisions are essentially about coordination of many different types of capacities (seating on planes, hotels etc.), which have to be in place 1 to 1.5 years ahead for an entire season. This implies that in capacity setting firms interact very infrequently, at most once a year. However, infrequent interaction seriously undermines the credibility of collusive interaction. In this market firms would have to react to a capacity expansion of one firm in one year, by severely increasing their own capacities in the next. The return streams of that are at least 18 months in the future, making such potential retaliations of low relevance for current profits. If we compare this to markets in which there is significant collusive potential like electricity spot markets in which firms interact daily, this market is one with low likelihood of collusion.

The only potential counter argument of the Commission is that firms are able to add approximately 10% capacity in the short run if they saw their competitors expand capacity excessively. This could indeed, be a valid argument in a homogeneous goods industry. Two competitors each adding 10% capacity can have a very substantial impact on the market in such an industry. But this industry is an industry with strongly differentiated goods. Adding capacity in France is not the same as adding capacity in Spain. A 10% overall capacity addition may only amount to very small capacity additions locally and the potential impact on the scope for harsh competition will entirely depend on the degree of substitutability between the different destinations. Furthermore, this argument also overlooks that it is very difficult to monitor capacity additions at very many locations so that the detection of capacity deviations may be very difficult. No substantiated claim has been put forward by the Commission that short run retaliation could be at all effective in sustaining collusion. No empirical evidence is available to suggest that such market characteristics make collusion likely. Given the other characteristics in the market that strongly point towards a market in which it is difficult to collude it can only be concluded that the Commission has not substantiated its claims.

The Abuse of Arguments on Commercial Links

The Airtours case also illustrates how arguments on commercial links, while superficially plausible, are totally invalid. One of the problems in this industry (as in the airline industry and others) is to efficiently use capacity. This will very often involve capacity sharing among competitors. The Commission took this as a sign that there was joint dominance. A simple economic analysis shows that such claims are entirely invalid.

What would be the consequence of a merger on collusion in an environment with capacity sharing or trading between competitors? Part of the “punishment” for collusion becomes the elimination of cooperation on capacity sharing, reducing everyone’s profits by increasing cost. When two firms merge, the necessity for market trading of capacity is reduced because more random mismatches between capacities and sales can be resolved internally. This leads to less punishment from the breakdown of cooperation. Hence, collusion becomes more difficult with the merger because of the nature of the structural
links. A simple economic argument based on the economic role of capacity sharing thus leads to the opposite conclusion to that drawn by the European Commission.

The Commission relied on a market transparency argument to maintain that the structural links reduced the scope for competition. But even there that conclusion is incorrect. Since the merger would endogenously reduce structural links and cross-firm capacity sharing, the degree of available information about the competitors’ strategies would be diminished through the merger and therefore reduce the scope for collusion.

More Invalid Claims

The litany of economically invalid claims in the Airtours decision could be much extended. The use of the Herfindahl index to assess the change in market structure in the decision is invalid as we have discussed earlier. The assessment of monitoring overlooks the fact that information from past catalogues does not allow the monitoring of capacity deviations in the short run as claimed by the Commission. Only monitoring of short run capacity changes would make the threat of short run capacity adjustments credible. This is, however, essential to build at least a half way coherent case for the Commission.

We should note that all of these issues are difficult ones. They arise because the theory of collusion is much harder to understand than the simpler arguments needed for the analysis of unilateral effects of mergers. The subtleties involved will often confuse even economic experts more familiar with collusion theory than the typical case handler in a merger case. But exactly this fact makes the overconfident approach to joint dominance taken by the Commission in the Airtours case so worrying.

6. Conclusions

Merger policy has arrived at a crossroads. The recent trend towards much more rigorous economic analysis in merger cases, started with the notice on market definition, could be undermined by the current approach to joint dominance. This approach, exemplified by the Airtours decision, constitutes a step back to the use of theoretically and empirically unsubstantiated assertions. For a solid competition policy clear measures for finding dominance and economically valid empirical standards of evidence are crucial. This is even more important in joint dominance cases given the complex nature of the issues.

The joint dominance instrument could be a blessing given our inability to keep collusive conduct in check. But serious doubts are in order. A proper analysis within the time constraints of merger proceedings is hard, because the proper application of collusion theory is something that cannot be standardized and requires considerable expertise. At a minimum this insight should lead to a much more conservative use of the collective dominance instrument by the European Commission. Currently there is a definite trend towards excessive intervention, which raises the question whether we are not better off taking the joint dominance instrument out of the hands of the Commission.
References: