EU Competition Policy – A Small Country Perspective[1)]

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Decision-making in EU competition policy is based on two cornerstones – defining the market and assessing dominance. The Nordic countries have levelled particular criticism at the definition of the relevant geographic market for favouring bigger countries and possibly leading to discrimination towards small Member States. This article presents some concerns regarding the EU's merger policy and presents the main guidelines used in the Commission's decisions on Finnish merger proposals in recent years.

How Is Competition Policy Defined in the EU?

Premised on the Treaty of Rome, EU competition policy mainly seeks to maintain or enhance competition in the European integrated markets. The European Commission's economic approach to competition policy places *market definition* at the centre of the process of application of the competition rules. Even though the Treaty defines the relevant market as a precondition to *assess dominance* and for evaluating the possibility that an intended merger would eliminate competition, in practice the main source of antitrust decisions is the Merger Control Regulation.[2)]

In recent years, there has been increasing debate about whether the Commission's market definition is biased. Specifically, discussion in the Nordic countries has claimed that merger policy favours larger Member States over smaller ones. New worries arose when two Swedish merger proposals – Volvo-Scania and SEB-FSB – were recently abandoned, following an interpretation that these mergers would have impeded competition.

How to Define the Relevant Market and Assess Dominance?

The main approach used to assess mergers is to evaluate whether they do not create 'insufficient' market power. To assess market power, one often needs to define the so-called 'relevant markets'. Basically, as can be found in the Commission's merger procedure, the relevant market is measured as *the narrowest market where merging companies can reach some degree of market power.* However, merger regulations differ when compared between the US Department of Justice (DOJ) and the European Commission (see the table on the following page).

The US procedure rests on exact guidelines and defines two dimensions: the product mar-

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2) Monti (2001).

Market Definition and Assessing Dominance in EU and US Competition Policy

	EU	US
Market definition	Not exact methods for relevant markets Mainly demand substitution	Exact definitions for product market and geographic market Both demand and supply substitution
Assessing dominance		
- Measures of concentration	The market share of merging parties	HHI index as the measure of concentration
- Barriers to entry and competition	'strong evidence of a high probability of strong and quick market entry' – basically the same criteria asn in the US procedure	Barriers are low if entry would be i) timely (implying committed entry within two years of a price increase); ii) likely (implying a sufficiently high expected profitability from entry); iii) sufficient (to return prices to pre-merger levels)

ket and the geographic market. These guidelines observe product and geographic market concurrently, and define the power of the merged firm in terms of its ability to raise price above some benchmark price for a significant non-transitory period of time. The European Commission procedure is rather different in that its definition of the relevant market is not so straightforward, even though they use SSNIP (Small but Significant Non-transitory Increase in Price) tests as in the US. Furthermore, it defines geographic and product market sequentially.

Moreover, the US procedure first rests on demand substitution and then on supply-side substitution when there is a need to calculate market shares in post-merger circumstances (Neven et al. 1994). In contrast, the EU market definition is determined by focusing mainly on demand substitution. Supply substitution is used when it is 'instaneous' but mainly as a qualitative adjustment to measure market shares alone.

The US and European authorities also use rather different methods to assess dominance. The US procedure uses the Herfindahl-Hirschman Index (HHI) to measure concentration after the merger, while the EU procedure is based on the post-merger market share only. In the US, entry analysis examines whether entry is timely, likely and sufficient to deter exercise of market power. The EU procedure in this case is more broadly defined as 'strong evidence of a high probability of strong and quick market entry,' even if in practice the analysis is similar to its US counterpart.

The EU Merger Control Regulation was published in 1990 and is the main tool used in the Commission's decision-making. According to Neven et al. (1994), there are several critical aspects regarding these procedures. First, 'The use of market definition is inconsistent; especially supply substitution is sometimes taken account of at the market definition stage and sometimes it is used to assess dominance, and there is no comment on the difference in treatment'. Second, and which is important, *'Both the market definition and the assessment of dominance rely unnecessarily on the qualitative assertions and hunches even if more quantitative evidence could have been available'*. Third, 'The Commission uses a sequential rather than a simultaneous procedure for product and geographic market definition. This will lead to further bias in favour of narrow markets'. Finally, 'The assessment of dominance has displayed an unnecessarily unsystematic and arbitrary char-

acter, especially in estimating the strength of remaining competitors, potential entrants, and countervailing buyer power.' [3)]

When the relevant market is defined as *the narrowest market where the merging companies can use their market power*, concerns are raised regarding how the market definition should be interpreted.

The first concern relates to the basic principle used to assess the market through demand and supply substitution. In doing so, the Commission first looks at the elasticity of demand, that is the extent to which consumers can switch to other products. It then considers supply substitution, or the extent to which producers can switch production to the products in question following a price increase. Now, the open question to the Commission is, How should supply substitution be taken into account and how should product and geographic market definitions be tested more precisely?

The second concern is that the European Commission defines the relevant markets by examining interchangeable or substitutable consumer products. The concern here is how to make decisions when there occurs a *'lack of sufficient substitutability'* or an '*existence of different conditions of competition*'. Neven et al. (1994) claim that the Commission does not specify exactly what the conditions of competition are; they mainly arise from demand substitution, but they have found that in several cases, for example in the decision of Varta/Bosch, the Commission refers to some consideration of supply substitution. Therefore, the Commission defines the market by looking first, and above all, at demand substitution, but sometimes it also uses supply substitution. This is confusing.

Other concerns are as follows. When the market definition is measured as the narrowest market where merging companies can reach some degree of market power then it means that consumers can also choose goods from outside the relevant market. However, it is apparent in several of the Commission's decisions that the focus has been on demand substitution, leaving unnoticed the different conditions of competition. Therefore, some products are left out from the relevant market but are included when assessing dominance. This procedure is valid only if demand substitution is the only method to make a 'relevant market' decision, but inconsistent if both demand and supply substitution are considered, because this indicates that products which are outside of the relevant market are irrelevant to the assessment of dominance. In such a case, the assessment of dominance for merging companies is measured only from the relevant markets and not from outside markets.

The next concern is that the main method used in the Commission's 'substitutability decision making' is an observation of product characteristics. The main problem in this case is to decide whether the product's characteristics are such that there is some degree of substitutability between the products or not? Furthermore, in some merger cases, the Commission has decided that even if goods have different characteristics there can be some substitutability between them. According to Neven et al. (1994), this indicates that there will always be a certain degree of substitutability between the products. The difficulty, however, is how to define clear guidelines for market definition that lay out the degree of substitutability that is enough to restrain market power.

The definition of geographic markets in the EU is measured as the area in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighbouring areas.

Neven et al. (1994) have also criticised the geographic market definition. They point out that the Commission has defined the market using supply substitution in some cases and ignored it in others, as has been the case in the product market definition. Moreover the distinction between the concepts of geographic and product markets should be sharpened. There are no clear guidelines as to when the concept comes from the product market definition or geographic market definition. Instead, these definitions are used sequentially and not simultaneously.

The criticism in the Nordic countries arises from the question of how the Commission measures the relevant geographic market. The main concern is that, since national markets in

3) The report by Neven et al. (1994) is used as main framework in discussion about the market definition and assessing dominance in this article.

the Nordic countries are very small, mergers would quickly lead to market dominance. As such, mergers would likely be blocked, and Nordic companies would therefore be prevented from growing to a size perceived as sufficient to compete on a global or even regional scale. This would not occur in larger countries because their larger market size would preclude merging companies from reaching a dominant position.

According to Monti (2001), the Commission has adopted new guidelines to define more accurately the relevant market. He argues that these changes have increased the transparency of Commission policy and decreased the costs for industry.

Moreover, the Commission has used more specific measurements such as the hypothetical monopolist test (SSNIP test), as in the US horizontal merger guidelines, to measure demand substitution. The main question the test tries to answer is 'whether the parties' customers would switch to readily available substitutes or to suppliers located elsewhere in response to an hypothetical small (in the range 5-10 percent), permanent relative price increase in the products and areas being considered'. If substitution is enough to make the price increase unprofitable, then these substitutes and areas are included in the relevant market. After this analysis supply substitution is analysed and taken into account only if its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy.

Monti (2001) also discusses the Commission's practice. The market definition is provided first by the parties involved. The Commission asks both firms to define their relevant product and geographic markets. Then the Commission uses its experience to analyse the sector and this phase also takes into account the views of customers and competitors. A complete analysis of relevant markets is done only if it is strictly necessary. In merger cases, if either the combined market share is below 15 percent or if no party has a market share exceeding 25 percent in a vertically related or conglomerate market, it is decided that there are no competition concerns (assessing dominance).

However, there are also some concerns about how the Commission has splitted the definition of dominance into (Neven et al. (1994)):

i) The market position of the merged firm. A level lower than 25 percent of market share leads to approval. However, the Commission has also considered several other factors if the post-merger market share has been higher than 25 percent, and approved these merger applications if there is no relevant or strengthening dominance. This procedure of market definition causes the bias especially on narrow markets because product and geographic markets are determined sequentially and market definition is sometimes focused only on demand substitution.

ii) The strength of remaining competition. The reason why a high post-merger market share has often not blocked a merger application is that actual competition is strong. This indicates that the Commission is not satisfied with market share as the only measure of market power and it would use some other useful methods, such as the distribution of competitor's market shares.

iii) Entry and potential competition is taken into account and weight is given to entry lags and barriers. Nevertheless, there are only few cases where the entry lag is assessed and the years of entry lag are different depending on the case. Entry barriers include transport costs, brand awareness and regulatory barriers. In sum, the entry analysis should be more systematic to determine the timeliness, likelihood and sufficiency in the merger cases proposed.

In the case of the relevant market definition, Monti (2001) responded to the Nordic countries by stating that 'the Commission's goal is to identify the competitive constraints that the companies concerned will face.' When there is no serious competition constraint abroad, the national company's market can only be measured in the national markets, as was the case in the decision of Volvo-Scania. Monti also raised the question of how to measure market power in some traditional national sectors such as retail banking or daily consumer goods. The case of Kesko-Tuko was prohibited because it would have created a dominant position in the Finnish market for retail of daily consumer goods. Finally, Monti suggests that small Member States' companies can find other ways to grow. That is, these companies can: i) grow internally, e.g., by offering lower prices, better products

and services than their competitors; ii) expand to other countries (namely, they can find partners outside of their own national market; and iii) merge in the national market if this does not lead to too high market shares. When market share is high after a merger the parties should give adequate remedies to ensure that markets will work efficiently, such as in the Neste-IVO and Enso/Stora cases.

Finnish Merger Proposals in Recent Years

The table on page 74 summarises some of Commission's decisions concerning the merger proposals of Finnish companies. The proposed mergers are only within certain sectors, such as the metal and forest industry, energy, and insurance and banking.

The merger proposals in the metal industry have been approved without any significant problems. During the last two years there have been three significant cases – two with Outokumpu and one with Ahlström. In the merger between Outokumpu and Avesta Sheffield, the Commission did not find any problems with competition in the relevant product markets. The relevant geographic markets were found to be Western Europe or world-wide, and therefore no competition problems were found.

The case of Outokumpu/Norzink was approved because i) there are no competitive concerns in the relevant product markets because various zinc grades compete in the same market; ii) the relevant geographic markets is world-wide and there are no significant trade barriers at the world-wide level; and iii) the Commission did not conclude dominance as regards both single or collective dominance. In the Ahlström/Andritz case, the decision was more complicated because of the broader range of products. The Commission defined the relevant product market just by products or product areas. The relevant geographic markets were measured to be world-wide, without competition concerns. Therefore, 'the Commission does not consider that the notified operation gives rises to serious doubts in any of the product areas where the parties' activities overlap.'

In the forest industry, there has been more variability in the Commission's decisions, with some merger proposals being blocked and others being approved with modifications.

The Commission approved the UPM-Kymmene/Haindl merger with some modifications. The Commission noted that 'relating in particular to the degree of concentration of market shares attained, the size and competitiveness of the medium-size players and the problems identified above in relation to possible co-ordination of capacity' there is no collective dominant position in the market. However, the regulatory approval insisted that UPM-Kymmene should sell two of the Haindl mills to Norske Skog. Also the case of Metsä-Serla/Modo was approved with modifications. In Sweden, there was a competitive concern in relation to the market for paper merchanting as well as serious doubts raised by concentration.

The cases of Finnforest/Moelven Industrier, Stora Enso/Assidomän and Metsä-Serla/Zanders were approved. The Commission found that in each of these three cases the relevant geographic market has at least the EEA dimension with strong competition. Also the case of Stora Enso/Stora Enso Timber was approved because 'the proposed concentration does not impede competition'.

There have been two cases that the Commission has blocked. The first case was Metsäliitto/Vapo, where it referred part of the transaction between these parties to the Finnish Competition Authority, who required modifications to the concentration. The reason was that the proposed concentration threatened to create or strengthen a dominant position in the market for wood-based fuels, the peat market or the combined market for wood-based fuels and peat in Finland. The other blocked case was Metsä Tissue/SCA, where the Commission argued that the merger would lead to a dominant market position in a total of 26 hygienic tissue products in the Nordic countries. According to the Commission, there were several reasons for this such as i) high market shares near 90 percent in some markets for toilet paper and kitchen towels; ii) some brands would leave little space for other suppliers; iii) supermarkets' buyer power would be insufficient to restrain the merged company's market power; iv) duopolistic dominant position for the merged company and Fort James in tissue products in some Nordic countries.

Merger Decisions Involving Finnish Companies

Case (number)	Date	Decision	Why merger approved/blocked
Fortum/Birka Energi (2659)	10/01/2002	6.1b	Approved/effective competition still remains in the Nordic electricity market/no increase in market share
Sampo/Varma-Sampo/Skandia/ Storebrand	21/12/2001	6.1b	Joint venture does not lead to competition concerns
UPM-Kymmene/ Haind (2498)	21/11/2001	8(2)	Regulatory approval/after resale of two mills the merger will not impede effective competition in Europe
3I/Oko Bank/Uniglass Engineering (2593)	11/10/2001	6.1b	Approved/the proposed concentration does not impede competition
3I/Eqvitec/Pohjola/Suomi/ Ion Blast (2592)	11/10/2001	6.1b	Approved/the proposed concentration does not impede competition
Stora Enso/Stora Enso Timber (2595)	4/10/2001	6.1b	Approved/the proposed concentration does not impede competition
Fortum/OM (2508)	10/08/2001	6.1b	Approved/the proposed concentration does not impede competition
Sampo/Storebrand (2491)	27/07/2001	6.1b	Approved/concerns about relevant product markets but does not give rise to competition problems in the relevant geographic market or assessing dominance
Finnforest/Moelven Industrier (2473)	18/07/2001	6.1b	Approved/does not raise serious doubts as to its compatibility with the common market and with the EEA Agreement
Outokumpu/Norzink (2348)	27/03/2001	6.1b	Approved/does not raise serious doubts as to its compatibility with the common market and with the EEA Agreement
SFK99-Rahasto/Fortum/Naps Systems (2290)	22/02/2001	6.1b	Approved/the proposed concentration does not impede competition
Metsäliitto/Vapo	08/02/2001	6.1b	Blocked/creates or strenghtens a dominant position within a Member State
SCA/Metsä Tissue (2097)	31/01/2001	8(3)	Blocked/creates or strenghtens a dominant market position in hygienic tissue products in Sweden, Norway, Denmark and Finland
Stora Enso/Assidomän (2243)	22/12/2000	6.1b	Approved/does not raise serious doubts as to its compatibility with the common market and with the EEA Agreement
Metsä Serla/Zanders (2245)	15/12/2000	6.1b	Approved/does not raise serious doubts as to its compatibility with the common market and with the functioning of the EEA Agreement
Outokumpu/Avesta Sheffield (2180)	4/12/2000	6.1b	Approved/does not raise serious doubts as to its compatibility with the common market and with the EEA Agreement
Metsä Serla/Modo (2020)	04/08/2000	6.1b	Approved with modifications
Ahlström/Andritz (1930)	30/05/2000	6.1b	Approved/doesnot raise competition concerns

In the energy market, the Commission has approved all three of the sector's merger proposals, namely Fortum/Birka Energi, Fortum/OM and SFK99-Rahasto/ Fortum/Naps Systems. In these cases there were no concerns that the proposed concentration would impede competition. The decision in Fortum/Birka Energi was more specific, and the Commission noted that effective competition still remains in the Nordic electricity market. In assessing dominance, the Commission also noted that the proposed merger does not increase market share that much that it would impede customers from choosing some other electricity supplier in Sweden.

The commission has approved all merger proposals in the banking and insurance sector that have occurred in recent years. The Commission cleared the non-life insurance venture between Sampo and Varma-Sampo, both Finnish, and If Skadeförsäkring Holding AB, controlled by Skandia of Sweden and Storebrand of Norway. The only concern related to the non-life insurance market, but the new merged company was expected to face strong competition both at the national and international level. Also, according to the Commission, the merger did not create or strengthen any dominant positions or markets. Before this case the Commission approved the transaction between Sampo and Storebrand, justifying it by noting that even though there are some concerns about the relevant product market it do not give rise to competition problems in the relevant geographic market or when assessing dominance. Sampo, however, later aborted this merger. Two other cases in this sector – 3I/Oko Bank/ Uniglass Engineering and 3I/Eqvitec/Pohjola/ Suomi/Ion Blast – were both approved by noting that the proposed concentration does not impede competition in the banking or insurance market.

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