ARTICLE 86 EEC: ECONOMIC ANALYSIS OF THE EXISTENCE OF A DOMINANT POSITION

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Reprinted from
EUROPEAN LAW REVIEW
Vol. 4, No. 6, December 1979
Article 86 EEC: Economic Analysis of the Existence of a Dominant Position

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Introduction

In three recent judgments, namely those of United Brands—Bananas (UBC),1 Hoffmann-La Roche—Vitamins (Roche),2 and Hugin,3 the European Court has ruled that a company has held a dominant position in the EEC for the purposes of Article 86. Economists who have studied monopoly would not agree with all the elements of the Court's reasoning. In this paper I shall examine the methodology used by the Court, explain the methodology that would be used by economists, and point out how the two differ; for at times economists and the Court seem to be in agreement, and at times not. Economists are said to seldom agree amongst themselves, but on the subject of how to recognise monopoly (i.e. dominance), mainstream economists disagree far less than may be commonly supposed.* In contrast, they disagree vigorously as to what public policies, if any, should be followed to eliminate monopoly.

The Court's methodology

Definition of dominance

Dominance means economic power over a customer (or supplier), or a group of customers (or group of suppliers).* This idea seems simple to comprehend. In one respect, however, it is not commonly understood: dominance is economic power over a period of time, and not transient power. Let me explain by example. Consider a London neighbourhood where

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* The author presented some ideas incorporated in this paper to the E.S.C Conference held in London on March 20, 1979. He wishes to thank John McGee, Rosita Etadale and especially Valentine Korah for encouragement and help, and Brian Bransbury for permission to use his English translation of the court's judgment in Roche when working on this paper.


3 Case 22/78, Hugin Kassaegister and Hugin Cash Register Ltd. v. Commission [1978] 3 C.M.L.R. 45 hereafter referred to as Hugin.

4 The economists referred to are those who call themselves neo-classical economists. They model their theories on foundations laid out first by Adam Smith. For a history of the development of their theories of the firm, see: Philip L. Williams, The Emergence of the Theory of the Firm (Macmillan, 1978).

5 Classical economists referred to any holder of scarce resources, such as a landlord, as a monopolist, but such persons cannot expand output, even if they would wish to—and the price they receive can be governed by the market. The neo-classical definition is given later.

423
only one shop opens on Sunday. Next Sunday, if it were to double its prices without warning, it would not lose many customers initially. Is this store dominant? The answer must be "No," since in London there are many entrepreneurs who would open their shops on Sunday if they discovered that the existing firm had raised its prices in this way. The new competition would quickly drive prices down, and the existing shop might suffer badly, especially if its customers were to cease to patronise it even when its prices were lowered to meet the new competition. There is hardly a firm that does not have some transient power to raise prices for some of its customers, but, as many have discovered by experience, the use of such power may bring disaster upon the firm. In contrast, a shop located in an isolated community such as a Scottish island, may have real economic power. Its community may be so small that it cannot support more than one such shop. Of course, its potential monopoly may be very small, as its community may be few and poor. Nor will such a store necessarily charge very high prices because the costs of loss of custom may outweigh the extra margin earned on its sales. Nonetheless, such a store enjoys a position which is almost unassailable, and the prices it charges may be higher than if competition were to prevail.

In UBC the European Court defined dominance for the purpose of Article 86 as follows:

"The dominant position referred to in this article relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers."  

It reiterated the definition in Roche, and went on to say that dominance does not exclude the existence of certain competition, but that a dominant firm can decide or at least influence the conditions under which competition will develop, and that a dominant firm can behave in its market without needing to take account of the competition and without suffering damage as a result. Economists would agree with the Court in so far as a firm does not need to supply all the market to be dominant. (More will be said on this.) Economists, however, would like the Court to make it quite clear that dominance is a concept related to time. They would take issue with the Court’s stress on fear of competition. Many firms have acted not fearing competition, and yet competition has materialised. Dominance is a position of power over time.

The Court, in trying to decide if a firm is dominant, should not place weight on the opinions of managers. For instance, in Roche, internal documents which asserted that the firm had power over prices were cited by the Court in its belief of Roche’s dominance. Economists and business historians have noted that, frequently, managers like to believe they have power over their customers (or suppliers), whereas they rarely have such power. Moreover, lay persons may use the words monopoly and dominance casually, and not with the precise meaning of the Court.

The relevant market

The Court has said that it is necessary to define a market; economists would agree—for to point out dominance, one must say upon what market a firm is dominant. In Roche (para. 28) and UBC (para. 22), the Court defined the extent of a market by reference to the existence of substitutes on the demand side and in Continental Can Company to substitute on the supply side. For example, in Roche the defendants disputed whether Vitamins C and E should each be considered as part of one market. According to the Court (paras. 28 and 29), Vitamins C and E had two uses, one as additives to foodstuffs (called the bio-nutritive use), and the other as anti-oxidants, fermentation agents and additives (called the technological use); in their first use, C and E performed different functions and in this usage neither could be substituted for the other, and there was no other product which could perform as substitutes for either; in their second use, C and E were not only interchangeable with each other, but there was a variety of other products which could also be interchanged with them. The notable aspect of the case was that it was not always possible for Roche to distinguish between customers who wanted Vitamins C and E for the different uses, because some buyers who used C or E in foodstuffs also required anti-oxidants for which C and E could be used interchangeably. An economist would argue that there were three markets defined from the demand side: the two separate bio-nutritive use markets of C and E, and the technological usage market which included C, E and other anti-oxidants. It is obvious that a change in price of (say) Vitamin C would have little effect on the quantity of E sold for its bio-nutritive use. Economists would say that there is a low cross elasticity between C and E, and that these products were substitutes (i.e. they were in different markets). But a change in price of C would have a substantial effect on the quantity of E sold for its technological use, indicating a high cross elasticity, and that these products were substitutes (i.e. in the same market). The Court ruled that Vitamins C and E were separate markets stressing their bio-nutritive uses. Here economists would agree with the Court, but would note that any analysis of these markets must also consider the technological market for reasons which will be explored.

(1) In UBC, the Court failed to note an important distinction in the market, because they ignored the time dimension. This is a different time dimension (i.e seasonal) from that mentioned earlier (viz. long run versus short run).

- Article 86: Economic Analysis of Dominant Position

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7 Para. 38 of the Judgment.  
8 The words "certain competition" may mean oligopoly. It also says that dominance does not exclude lively competition, which may also mean oligopoly.  
9 Roche, para. 39. In UBC (para. 113) similar ideas are expressed.  
In UBC (para. 12), the Court noted that for the banana to be regarded as forming part of a market which is sufficiently differentiated from other fruit markets, it must be possible for it to be singled out by such special features distinguishing it from other fruits that it is only to a limited extent interchangeable with them. Now, the Court noted that during the summer months, but not the winter months, the price of other fruits was competitive with bananas, in the sense that a change in their price influenced the quantities sold (and, hence, the price of bananas). Because bananas cannot be stored, it seems obvious that there were two markets defined by the seasons. In winter, bananas had few substitutes, but in summer, had substitutes. In winter, the relevant market was bananas, in summer, surely it was bananas and other fruit: but the Court did not see this distinction, because it failed to grasp the importance of the time dimension.

In UBC (para. 31), the Court also noted that the banana has certain characteristics which enable it to satisfy the constant needs of the very young, the old and the sick; and that, for this group, bananas may not have any close substitutes. If this is so, then the Court could have defined the relevant market as being only those bananas sold to these groups of people. In this case, other fruits would not be substitutes, even in summer. Any definition of the market should not preclude a market analysis which extends beyond the relevant market.

In Hugin (para. 5), the Court defined the relevant market as Hugin spare parts required by independent undertakings. This definition of the market is conceptually different from that used in Roche and UBC.

First, the Court defined the relevant market with respect to a brand, not a product. This is a minor point. Economists would have noted that spare parts could be made by independent concerns to fit Hugin machines. The Court (para. 9) says that this was not the case, nor could ever be the case.

Second, the Court defined the relevant market without discussing the existence of possible substitutes on the demand side for independent undertakings. This is not a minor point. Consider those independent undertakings in the business of repairing, maintaining or refurbishing (but not renting or leasing) cash registers for independent customers. They often deal in more than one brand of machine. Their engineers could, and did, repair more than one brand. In this respect, substitutes did exist on the demand side from the point of view of independent undertakings. The Court never discussed whether this substitution was easy, that is, whether the cross-elasticity was high or low. Hugin, in refusing to supply Liptons, apparently forced the latter to turn to servicing other machines. Liptons had said this shift was costly. The Commission in its Decision (paras. 117 and 119) did not show a proper analysis of this cost. Moreover, it did not even give figures on sales, costs or profits for Liptons' servicing business for outside customers separated from its other activities such as renting and leasing.

Text of dominance

In Roche (para. 41) the Court said:

"Furthermore although the importance of the market shares may vary from one market to another the view may legitimately be taken that very large shares are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant position."

However, it is quite clear from the Court's pronouncements in Roche and UBC that it believes that the existence of large market shares cannot by itself prove dominance: to prove dominance there must be both large shares of the market and other factors which are called "indicators." In Roche and UBC the following factors have (among others) been considered to be indicators by either the Commission or the Court: large investment requirements; surplus capacity; profitability; production of a range of products; efficiency; and vertical integration.

[1979] 3 C.M.L.R. 211 at p. 257. The Court goes on to say: "An undertaking has a very large market share and holds it for some time, by means of the volume of production and the scale of the supply which it stands for—without those having much smaller market shares being able to meet rapidly the demand from those who would like to break away from the undertaking which has the largest market share—is by virtue of that share in a position of strength which makes it an unavoidable trading partner and which already because of this was secured for it, at the very least during relatively long periods, that freedom of action which is the special feature of a dominant position."
Comment
The major disagreement between economists' methodology and that of
the Court is in their attitude to the question of the relevant market.
Contrary to what many people have suggested, the disagreement is not so
much in the way the relevant market is defined but rather in the way in
which the Court restricts the scope of its analysis to that market. As will
be explained in the next section, dominance presupposes barriers to entry.
Its proof requires an analysis of all the factors influencing the firm—
for factors outside the relevant market can affect competition in that
market. (Moreover, as I shall point out in the case of vertically integrated
firms, abuse of a dominant position can extend to markets beyond the
market where the firm is dominant.)

How economists would identify dominance
There are potentially two methods of identifying dominance. The first is
to examine whether a firm has monopoly power, that is, whether it has
the power to raise prices without competition materializing (in a relatively
short period of time). The second is to examine whether the firm is
receiving the benefits of monopoly, one of which might be the earning of
monopoly profits. Economists focus attention on the former.

Economists define dominance in a number of different ways. Perhaps the
clearest definition is that dominance is the power of the firm to raise prices
to above supply cost without existing rivals or new entrants taking away
its customers in due time. This definition uses a concept of supply cost
which may not be familiar. Supply cost can be conveniently seen as the
minimum cost that an efficient firm would have to incur to produce the
product in question. It includes such costs as raw materials and labour,
but also opportunity costs of using scarce resources such as
management, and a normal rate of return to providers of capital funds.
The importance of time has been mentioned already—for a firm can have
the whole market and have only temporary power which is not dominance
if, upon raising prices (above supply cost), a new firm would appear and
undercut prices. In contrast, if there are "barriers to entry," then a firm
can raise prices without rivals appearing. Economists would describe all
"barriers to entry" as "indicators," for a firm cannot exercise monopoly
unless there are barriers to entry for new competitors.

By far the most obvious barriers to entry are those prescribed by law,
such as patent rights or exclusive government licences. Moreover, from the
earliest studies of economics, all have agreed that if economies of scale are
such that the minimum efficient scale of operation is large in comparison
to the market, then there can be a barrier to entry and, hence,

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14 Supply cost is defined as the industry's marginal cost for an incremental
unit of output.
a barrier to entry as "a cost of producing (at some or every rate of output)
which must be borne by a firm which seeks to enter an industry but is not
borne by firms already in the industry.

Dominance as a consequence of economies of scale
"Economies of scale" is a phrase describing the changes in unit costs
that result from operating a process at differing outputs. The term
does not describe the actual cost differences in operating a given plant
at different outputs, nor the benefits of vertical integration. The process under
consideration can be a production operation, or a distribution system, or
a research laboratory or even a whole firm. It is also assumed that
the process adopted uses the best available techniques. There are two dimen-
sions usually discussed, the minimum efficient scale (MES) and the slope
of the scale curve. MES is defined intuitively as the smallest sized plant
which achieves the lowest unit cost, and the slope of the curve can be
approximated by the amount by which costs rise when a plant of half MES
is used. Recapitulating, dominance means the power to raise price above
minimum costs, which are the costs incurred at MES.

In any market the relationship between price and output is represented
by the demand curve. Demand is said to be elastic if a large contraction in
output would require prices to be raised by only a small amount, and it is
said to be inelastic when the opposite holds true.

In the first example, the competitive case, it is assumed that the MES
is small in comparison to the size of the market. For this reason, in
Figure 1, the scale curve reaches its lowest point at an output which is well
to the left of the demand curve. It is also assumed that the market-demand

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is elastic. For this reason, the demand curve looks flat in Figure 1. The lowest price a firm could charge which would cover its costs (including a normal return on capital) is the unit cost for a firm operating an efficient plant at M.S.E. This price is $P_1$. In the figure, $P_1$ corresponds to the lowest point on the scale curve. In normal market conditions, $P_1$ is the competitive price. Were the existing firms to have 100 per cent of the market, it would not be dominant. Suppose it raised its prices to $P_2$, above $P_1$. To do this, it must contract output significantly, because demand is elastic. But this large contraction allows scope for a new firm to enter the market and capture a small market share. Because the M.S.E is small, it need only capture a small market share to utilise an efficient-sized plant, and not be at a cost disadvantage to the large firm. Moreover, the new firm's additional supplies to the market will not depress the price so much as to make the investment unprofitable.

Figuratively, the new firm perceives a residual demand curve which shows the relationship between the output supplied and the price received by both firms for their products. The scale curve for the new entrant lies below the residual demand curve in the figure, which reflects the fact that the new firm can enter profitably.

This formulation assumes that the new firm does not think that the existing firm will change its output plans if entry takes place. Clearly, this is simplistic. On the one hand, the existing firm may contract output upon entry, keeping prices up and making entry more profitable; on the other hand, it may expand output, driving prices down, trying to dislodge the entrant. Note that in the latter case, for the existing firm to force the new firm to make losses it, too, must bear losses, as it has no cost advantage. More will be said later.

21 Normal market conditions occur when the industry does not suffer from idle capacity or too little capacity.

22 For better discussion, see F. Modigliani or F. M. Scherer, op. cit. note 16.

23 According to the Commission (para. 55), Liptons alleged that it would not be economical to have such parts specially manufactured. However, an independent firm might find it worthwhile to produce spare parts if it could gain orders from many users such as Liptons.
Although the Commission claimed before the Court that the United Kingdom Design Copyright Act (1968) could allow Hugin to forbid the production of spare parts by an independent firm, it is informed that Hugin did not contemplate using this Act to prevent independent firms from producing spare parts for its machines. If the potential market for spares is large in comparison to the MES, perhaps because the brand has large sales, then entry may take place. As leading automobile producers have discovered, independent firms can, and do, set up in the business of producing spares. It is also said by trade experts that N.C.R., the world’s leading producer of cash registers, has had competitors in its spare parts market. But if the potential market for spares is small in comparison to the MES—then the firm will have a monopoly, (except perhaps where the original machines are still being produced—more will be said about this).

The third example is that of the dominant firm with fringe competitors. Here, it is assumed that the MES is large relative to the market and that demand is inelastic. The dominant firm is A; it has an efficient-sized plant and has a large share of the market, but there are fringe competitors, B, C and D. A is dominant because if any firm (which includes B, C or D) were to enter the market to compete on equal terms with A, it would create over-capacity in the industry, forcing price to below cost, and it would render its investment unprofitable.

Figure 3 shows the operating cost curves (not the scale curves) of firms A, B, C and D. The lowest price A can charge which would cover its costs is $P_1$. At this price, B, C and D cannot survive. At $P_2$, a price higher than $P_1$, firms B, C and D still cannot survive, and A is earning some monopoly profits. $P_2$, a still higher price, may be most profitable for A, even though at $P_2$ firms B, C and D can survive and can supply part of the market. (This is because, in economists’ language, the long-run marginal cost curve of A may intersect the industry marginal revenue curve at an output where the price is no less than $P_4$.)

46 See pages 23 and 25 of the transcript of arguments before the Court, in Case 227/79, Hugin.

47 This is explained in greater detail in F. Modigliani, op. cit. note 16.
The necessity for a full market analysis

It is obvious from the preceding analysis that if the MES is small in relation to the market, then it would be impossible for a firm to be dominant unless there were some additional entry barriers. But it might seem that if the MES is large in relation to the "relevant market," then a firm with a large market share would be dominant; this latter presumption should be restated, for there are four cases where MES may be very large and yet a firm is not dominant, even if it supplies all the "relevant market."" The first case is fairly obvious. It is where the slope of the scale curve is very flat. In this case, although the MES is very large relative to the market, the disadvantages of operating at a small scale may be slight.

The second case is where the "relevant market" as defined from the point of view of the Court, is in a sense too small. To take a topical example, if the relevant market were silicon chips in the EEC, and if the MES were 100 per cent of this market, then in the absence of a high tariff or a quota, a firm having 100 per cent of the European market is unlikely to be dominant because silicon chips are easily transported. From the point of view of EEC buyers, suppliers outside the EEC are potentially excellent alternatives to the existing firm. Because the Court is concerned only with the EEC, it is understandable (but possibly misleading) that it does not define the relevant market as broadly as the economic market.

The third case is where the market is correctly defined from the demand side, but the existence of alternative uses for the product causes the significance of MES to be overstated. For example, consider a chemical compound which has two uses, X and Y. The product could be vitamin X, the bio-nutritive use, and Y the technological use, or else X, Y for the old and sick, and Y all other bananas). Suppose that in its X use, the product has no substitutes, but in the Y use it competes with many other products. If the "relevant market" is defined as use X + Y, and if the MES of production is as large as the size of the X market, then a firm may command the whole of the X market and yet not be dominant. To see this, suppose that the firm were to raise prices to its X customers, then a new firm may be able to set up production, devoting most of its output to the X market (where the influence, even of a plant of MES, on price may be very small due to Y being a much larger market), and devote a small part of its output to the X market in competition with the existing firm. If prices fall in the X market, the new firm may still be able to survive by devoting its output to the Y market.

It might be thought from these examples that a better definition of the relevant market, in particular a recognition of substitutes in supply, would allow one to see a clear connection between dominance and MES, size of the market and market share. This is not so, for, as I shall show in the fourth example, it is the existence of common costs that makes this tinkering with definitions such an unsatisfactory alternative to a proper analysis.

For the fourth example, consider the market for wool. Let us suppose (hypothetically) that technology were to advance so that sheep-rearing were able 

...to exhibit economies of scale, and that as a result there were only one farmer in the market rearing sheep. (Let us further assume that tariff barriers were to prevent import competition and that there were no alternative uses for wool beyond its present use. Would this farmer be...
it is not the contribution to profit from each season taken separately that matters, but rather the combined contribution of both seasons.

Another example is the production of parts: spare part production is usually a joint output from the production of parts for original equipment. A rise in the price of spare parts, not accompanied by a fall in the price of parts for original equipment, may encourage a new firm to enter, on the one hand supplying spares, and on the other hand supplying parts for original equipment. Where spare parts are specific to one brand or model, the entering firm may not be able to make its output acceptable to users without obtaining permission from design, copyright or patent holders; in contrast, where spare parts are of a common nature to several brands of equipment, as is the case with tyres and light bulbs for cars, or paper tape and key tops for cash registers, no permission need be obtained.

The corollary to this is also true: the absence of both common costs in supply and substitutes in demand allows seemingly complex situations to be reduced to a series of simple ones. For example, in Roche (para. 47) the question was raised whether the production of a wide range of products could be an indicator of dominance. The Court rejected this argument, but for the wrong reason. It argued that because the products constituted separate markets, the matter could not be relevant and, moreover, Roche was not the only firm producing a wide range of products—many others produce a wide range of albeit different products. It should be clear to the reader that the benefits of producing a wide range of products could accrue to a firm if there were cost advantages in multi-product production. Roche did produce a wide range of products—but each product required different and separate equipment, so there were apparently no common production costs. Moreover, rivals in some markets fared well producing perhaps one or two lines. The reason why Roche’s production of a wide range gave no advantage was, therefore, not only the separability of demand, but also the absence of common costs.

In short, the proof of dominance lies not in the definition of the “relevant market” but, rather, in a full analysis of all the factors which influence the power of a firm.

The relevance of time

In several places I have alluded to the importance of time. Economists have noted that few monopolies other than those prescribed by law have lasted more than a decade or two, as, even without anti-monopoly laws, the process of competition is very powerful. But those applying the EEC Treaty may have (rightly or wrongly) shorter time horizons. Marshall

12 Similar arguments can be used with respect to the Commission’s claims of Roche marketing a wide range of products or of Roche’s overall size. Mainstream economists have for years argued that overall size is not an indicator of dominance.

13 A. Marshall’s treatment of time, e.g. that in Principles of Economics (Macmillan 1930), and his distinction between the short run and the long run, is considered to be pathbreaking by economists—most economic treatises and textbooks acknowledge this debt.

ARTICLE 86: ECONOMIC ANALYSIS OF DOMINANT POSITION

its investment. Accounting losses are compatible with monopoly: for instance, a firm may buy a dominant position (e.g. a patent) at a price which is greater than the value of the future stream of profits. In UBC (para. 120) the Court rightly rejected the Commission's arguments that UBC's high accounting profitability was an indicator.

In Roche (paras. 48, 49, 54 and 55) the Court cited the large amounts of unused capacity held by Roche as an indicator of dominance. Economists draw an important distinction between "idle" capacity and "excess" capacity. "Idle" capacity is capacity whose incremental cost of usage is greater than the ruling market price. "Excess" capacity is the opposite: the existence of excess capacity for a long period of time is clear evidence of monopoly power being exercised. "Idle" capacity, in contrast, is observed in both competitive and uncompetitive industries. "Idle" capacity is usually a symptom of an unforeseen contraction in demand, or the advent of new firms or new technologies to an industry. "Idle" capacity is also observed in industries whose demand is cyclical. Distinguishing between "idle" capacity and "excess" capacity is almost impossible (because accounting data are inappropriate for this purpose) and, for this reason, economists are very wary indeed of drawing any direct connection between the existence of unused capacity and monopoly. The Court should also be wary.

Some economists argue that capacity of either an "idle" or "excess" nature can be a barrier to entry. They would argue that the existence of unused capacity could deter entry, as the entrant fears a price war rendering its investment unprofitable. If we look back to Case one, it can be seen that such a price war would be threatening if the entrant decided to enter with a plant whose size is less than the MES. But would it be threatening if the entrant came in with a plant of MES or larger? Probably not, for the argument tends to overlook the costs to the existing firm of conducting a price war. Because the entrant's costs are as low as those of the existing firm, it may be impossible for the existing firm to drive the entrant out. (If the existing firm uses operationally expensive idle capacity to flood the market with goods, then its costs may be greater than those of the entrant, who does not have to increase supply). For these reasons, most economists believe that only "excess" as opposed to "idle" capacity can act as a deterrent to entry. Some others hold a more extreme view, which is that entrants ignore unused capacity and enter in belief that the existing firm will not start a price war, but rather contract output to accommodate the entrant. Therefore, in deciding whether unused capacity acts as a barrier to entry, the Court should proceed with great caution and, where possible, look at the facts: a priori reasoning is dangerous.

13 Defined as additional costs of usage which include any additional opportunity costs of management time.

17 The test for monopoly is that prices are greater than incremental costs and it is not that prices are greater than average, i.e. unit cost.

18 See, for instance, F. Modigliani and F. M. Scherer (op. cit. note 16).

Vertical integration: an indicator or an abuse?

In UBC (para. 122) the Commission alleged that vertical integration (including vertical contracts) was an indicator of UBC’s dominance. The Court neither agreed nor disagreed with the Commission, but drew attention to the marked degree of ownership or control over the banana plantations, the packing stations, the transportation system (railways and ships), as well as a marketing network which included the advertised brand name "Chiquita." Economists usually argue that vertical integration does not increase existing barriers to entry. For example, if I were to hold a patent for a wooden mousetrap, I could prevent anyone using such a mousetrap. Now, if I were to integrate vertically backwards into timber, could I increase the barriers to entry? The answer is clearly, no, unless there are barriers to entry to the timber trade. Economists usually argue that by integrating vertically, the barriers to entry are only added up and not multiplied.

Vertical integration nearly always accompanies monopoly, not because it raises barriers to entry, but because it gives the monopolist greater power to extract more favourable prices from its customers. A monopolist usually wishes to charge higher prices to those customers for whom its product has fewer substitutes. It cannot do this if its customers inter-trade. Vertical integration takes place to prevent inter-trading. For example, electricity generating companies own their own distribution systems (among other reasons) so that they can practice price discrimination between residential and commercial customers. When, in an early paragraph I stated that abuse can extend beyond the relevant market, I was referring to such a situation. It will not be long before the Court realises that vertical integration is not a method by which monopoly power is created, but rather a method by which monopoly profits can be extracted. But, vertical integration although it accompanies monopoly, is not an indicator of monopoly. Many firms operating in competitive industries are vertically integrated because such actions bring greater control over quality of inputs or outputs, and because of other cost savings.

Conclusions

In applying Article 86 EEC, the European Court has said on several occasions that it is necessary to examine the economic power of the undertaking concerned. For more than two hundred years, economists have been concerned with this difficult question. Their deliberations have revealed several points. First, dominance is only possible when there are barriers to entry into the industry, and that the chief barrier is where the minimum efficient scale of operation is large compared to the market. Secondly, proof of dominance requires an analysis of all factors influencing the firm, and not just of the relevant market—because factors outside the relevant market may be very important. Thirdly, dominance is a concept which is related to time. It is not the power that a firm has in a short period (for most firms, large and small, have power in the short term) but the power that the firm has after a longer period. That power is the power to raise prices above supply costs without competition materialising. The longer time period should be defined as that period in which one would expect competition to materialise if it were not hindered or fettered either by actions of the existing firm, or by the nature and technology of the market.