

2 June 2004

Ms. Lourdes DaCosta
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Re: Draft MEGs

Dear Lourdes,

Below are my comments on selected sections of the Draft MEGs. If you wish clarification of any matter, please advise.

Yours sincerely,

Peter G.C. Townley

COMMENTS

Paragraph 3.18

It appears that you are trying to describe ‘cluster markets’ without naming them as such. I would identify the term as there exists a fairly large literature on the topic, especially concerning how the concept applies to banking and telecommunications industries (although Ergas [1998] is more general). Ergas (1998) is partly embedded in Shiff *et al.* (1998) if you wish to direct people to sources (below). The *Antitrust Bulletin* has published several articles regarding cluster markets over the past few years, especially with respect to banking — and the precise topic may be important (again) soon in Canada.

Ergas, H. (1998), “Cluster markets: What they are and how to test for them,” online: University of Auckland Centre for Research in Network Economics and Communications Working Paper, <http://www.necg.com.au/PappubAbstracts/0064.html>

Shiff, Deena, Henry Ergas and Mitchell G. Landrigan (1998), “Telecommunications issues in market definition,” 6 *Competition and Consumer Law Journal* 32

Paragraph 8.12

You identify ‘real cost savings’ in this paragraph, but do not provide any link to Section 96(3) until paragraph 8.17. My experience is that firms do not understand the difference between social and private resource savings, so it might be best to be very explicit.

First, you may wish to elaborate on what counts and what does not in order to emphasize ‘real’ *versus* ‘pecuniary’ savings. The first *Superior Propane* decision is good for examples in this regard. See paragraphs 374-376. Nevertheless, the treatment of real *versus* pecuniary in *Superior Propane* should not be given as a general reference because of a number of errors that were not caught by any party to this decision (including the Tribunal). For example, *Superior* deducted severance pay from its claimed efficiencies, yet this is clearly private and not social, thus pecuniary. (Similarly, pension obligations to those laid off — the opportunity costs of which were incurred pre-merger — should not count against a merger.)

Second, some claimed efficiencies are neither purely ‘real’ nor purely ‘pecuniary’. This leaves a role for shadow pricing — when the value of the resource is not adequately captured by its market price. I think the shadow pricing of labour (shadow wage rates) could be important in the analysis of mergers, especially given concerns expressed by some ill-informed parliamentarians — in the context of Bill C-249 — about employment impacts. There is a lack of understanding that these (and other) impacts need not be considered explicitly when resources are priced correctly. I.e., if priced correctly, no explicit consideration of employment effects is warranted. Any cost-benefit analysis textbook (including mine: [Principles of Cost-Benefit Analysis in a Canadian Context](#) [Toronto: Prentice Hall, 1998]) would serve as a reference. Also useful is the Treasury Board’s (1998) [Benefit Cost Analysis Guide](#), available at http://www.tbs-sct.gc.ca/fin/sigs/Revolving_Funds/bcag/BCA2_E.asp.

Paragraphs 8:25-8:27

This section seems to be based on the Tribunal’s redetermination decision in *Superior Propane*, but the mechanics applied there were conditional on the first two steps of the Balancing Weights Approach (see my affidavit in this case) being satisfied and evidence previously adduced regarding the income characteristics of the principal beneficiaries of that merger.

Throughout the point is missed that it is to be a relative assessment. I.e., in general, information is needed concerning the characteristics of both those who would gain from the merger and those who would lose. You may wish to spell out the circumstances in which distributional impacts would not be considered adverse. Also, you might warn the parties of the need for marketing and/or Statistics Canada surveys in addition to what you have suggested.

There is more to the topic. Indeed, a literature on this subject has developed since my affidavit in *Superior Propane*, and you may wish to note the following from the most recent statement on the treatment of efficiencies by the **International Competition Network** (at http://www.internationalcompetitionnetwork.org/amg_chap6_efficiencies):

“Many in the Canadian business and legal community believe that the balancing weights approach advocated in the *Superior Propane* case properly reflects the intention of the Canadian government in its objectives of promoting a more cost-effective and internationally-competitive economy for a small open trading economy like Canada: the fact that gains in efficiencies which are real and specific to a merger may override certain anti-competitive effects is consistent with this broader national objective.”

I appreciate that this is a sensitive, difficult topic. Nevertheless, if the Bureau were to signal a willingness to accept the validity of the ICN’s view and the current jurisprudence as expressed by the Federal Court of Appeal, it is likely that assistance in this area would be offered.

Paragraph 8.29

You may wish to note the circumstances in which x-inefficiency is unlikely to be a problem. (Your treatment seems a bit one-sided and dated.) For example, the form in which managers are remunerated is likely to be important. If it is profit-based, perhaps in the form of bonuses and/or stock options, x-inefficiency is unlikely to be a problem. The composition of ownership may also be a factor if, for example, the shareholders of the firms involved have a history of firing ineffective managers and directors.

I think part of the problem is that when people think of x-inefficiency, they often think in terms of regulated industries or current/former crown corporations. You state that the associated losses “may be much larger than the deadweight loss associated with allocative efficiency,” but you provide neither an empirical justification nor recent theoretical support for this view. If you can cite sources, please do.

Paragraph 8.30

Although you are careful to say that high concentration “may” stifle innovation, your view seems to be that high concentration will not encourage innovation. For a balanced view on this topic you may wish to review the following:

Morck, Randall and Bernard Yeung (2001), “The economic determinants of innovation,”
Industry Canada Research Publications Program, Occasional Paper 25
