Market power and market definition

Market definition is only an intermediary objective

Modern econometric tools allow in some cases to assess market power directly: if so, defining the market is not needed; if not, two steps in the analysis:

1. Market definition (product and geographic)
2. Market power assessment
1. Market definition

Product Market: the set of products “substitutes enough” to each other.

a) Demand substitutability and supply substitutability
b) How to find this set?

SSNIP (Small Significant Non-transitory Increase in Prices) test: could a hypothetical monopolist selling products X profitably raise prices by 5-10%?

If yes, X is the product market
If no, apply SSNIP test again with X and Y, etc...
Market definition, II

How to implement this ‘thought experiment’?

Own-price elasticities, cross-price elasticities, price correlation tests

NO: Price differences and product characteristics

A problem with this test: raise prices relative to what?

Merger cases: current prices
Art.82 cases: competitive price? (more difficult to check; also, cellophane fallacy)

Geographic definition: SSNIP test, transport costs
2. Assessment of market power

*The traditional approach*
- Central role of market shares
- Which thresholds for market shares?
- Measurement and relative strengths (reserves, capacities, persistence of shares)
- Ease and likelihood of entry
- Buyers’ power

*Econometric techniques*
- Estimation of residual demand elasticity
- Logit models