

The “More Economic Approach” after 10 Years: Remarks by an Economist

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Outline of my Talk

- Some Very Basic Philosophy: Very First Principles
- The Traditional Approach to Competition Policy in Europe
- Overview of the “More Economic Approach” plus Comments
- Concluding Remarks

Basic Principles of a Liberal Economist

- Markets usually lead to efficient results in the sense that there is no other mechanism to allocate resources in a more efficient way, both from a static and from a dynamic perspective.
- Hence, any form of Government intervention should be justified either by some sort of market failure (that is cured by Government intervention) or by other objectives that the Government wishes to achieve (e.g., income distribution, equity objectives).
- However, for markets to work efficiently secure property rights and the freedom to contract are important.
- Any limitation of property rights (or the freedom to contract) should be justified (with the need for justification resting with the Government).
- This is also true, in principle, for competition policy.

The Traditional Competition Policy Approach

- Traditionally, competition policy in Europe has been heavily influenced by ideas of the Freiburg School: Competition law serves to protect the (a) “freedom to compete” and (b) “market structures that enable competition” (Bundeskartellamt),
- Initially, there was very little debate about the relationship between “the freedom to compete” and “economic efficiency” or total welfare (see debate in German Bundestag around introduction of GWB),
- Traditionally: More reliance on per-se rules: No need to demonstrate market failure or harm to prohibit certain contractual arrangements (cartels, mergers, vertical restraints) – general presumption that (a) high market shares are “bad” and (b) Government intervention beneficial if firms are dominant.

The Traditional Approach (2)

- General presumption that “non-standard contracts” by dominant firms are anti-competitive,
- Main argument against any need to demonstrate harm is that competition as an open process leads to results/has effects that cannot be predicted” (especially in Germany, Hayek as key witness),
- But: If we cannot predict market outcomes, on what basis can we prohibit certain behavior?
- Either: General “pattern prediction” that certain behavior by dominant firms is “usually” welfare reducing, at least in the long run,
- Or: (Implicit) judgment that consumers’ freedom to choose and/or competitors’ freedom to compete is valued higher than a dominant firm’s freedom to contract.

The Traditional Approach (3)

- But: Where is the limit? Example: network industries,
- And: Why is there any merger control at all?
- At least implicitly there is some balancing of one party's freedom versus another party's freedom, and at least implicitly this may not have been too different from the use of an efficiency or consumer welfare standard.
- Now: What if some previous “pattern prediction” turns out to be flawed or even incorrect? At what point should we change the approach to competition policy? Never? Immediately?
- A re-balancing may be justified in the light of new insights – it is not the same as a fundamental change of objectives.

Brief History of the More Economic Approach

- End of 1990s: New Block Exemptions for Vertical Restraints,
- 2002: CFI Decisions in Schneider/Legrange, Airtours/First Choice, Tetra-Laval/Sidel,
- 2003: Establishment of Chief Economist and Team in DG Comp,
- 2004: New Horizontal Merger Guidelines: SIEC Test, efficiency defense,
- 12/2005: Discussion Paper on then Article 82 (consumer standard), Guidance in 12/2008,
- 2005: State Aid Action Plan, guidelines on various forms of state aid since then,
- 2007: Non-horizontal Merger Guidelines.

What is the „More Economic Approach“?

- There is no single, unified “More Economic Approach” – it differs widely between different policy areas (e.g., horizontal merger control vs. state aid control),
- Even within the area of state aid control the approach is quite different between various policy areas (e.g., public broadcasting vs. R&D subsidies)
- In general, the “More Economic Approach” is argued to comprise three elements:
 - The use of modern economic theories and techniques (e.g., for the purpose of market definition),
 - a (gradual) shift from per-se rules to a rule of reason approach, and
 - a shift of objectives from the protection of competition (or market structures) towards the protection of consumers.

Some Remarks on the Change of Objectives

- In (horizontal) merger control, the application of a consumer standard makes it actually **more** difficult to successfully claim relevant efficiency gains – the necessary efficiency gains are **more** difficult to demonstrate under a consumer standard than under a total welfare standard. Hence, applying a consumer standard rather increases the level of protection of the competition process.
- In state aid control the European Commission explicitly acknowledges that a consumer standard is not appropriate to use, but social welfare.
- The shift appears to mainly occur in abuse cases (now article 102) – however, in practice it is not entirely clear how much has changed so far. Also note: A similar shift has occurred in the US (Leegin vs. PSKS).
- Also: A rebalancing may be beneficial given the insights gained in both economic theory **and** empirical analyses (including experiments).

The Efficiency Defense

- Another unifying theme of the “More Economic Approach” is the (theoretical) possibility to claim efficiency gains as an antitrust defense.
- In horizontal merger control, the standard of proof is extremely high (merger specific, timely, verifiable) – no successful case so far.
- Why aren’t efficiencies claimed more often? Signaling?
- In state aid control, the efficiency defense takes a different form: It has to be demonstrated (as step 1 of the so-called balancing test) that there is a market failure to be cured by state aid (or some other policy objective such as social cohesion).
- In abuse cases, again it is not yet entirely clear how much has really changed, given the British Airways case.
- Practical significance may have been over-rated (apart from state aid).

Increased Uncertainty?

- Question about the relevant counterfactual – following the CFI’s 2002 decisions continuing as hitherto was not an option.
- And: Legal certainty must not be over-rated.
- Also: Convergence with US antitrust policy reduces legal uncertainty at least to some degree.
- Simple indicators such as market shares still have a prominent role (e.g., safe harbours).
- There are no compelling signs (yet?) that legal uncertainty has dramatically increased as a result of the “More Economic Approach”.
- Side remark: Convergence between sector-specific regulation and competition law.

Some Final Remarks

- Traditional View of the Freiburg School: Competition does not only discipline firms' market power, but also their political power (institutional environment not exogenous for big business) – this aspect has been (sometimes) lost in the current debate.
- “Too big to fail”-problem demonstrates relevance of political power.
- However, market shares are probably not a very good indicator for political influence, but rather pure size (or number of employees).

Final Final Remarks

- Have the objectives of the “More Economic Approach” been achieved? Not trivial to assess.
- More economic expertise is used today, i.e. more information, maybe sometimes too much (Ryanair/Aer Lingus?).
- Good idea to establish minimum quality standards (best practice) for acceptable economic expertise.
- How to assess the European Commission’s enforcement activities in general?
- Currently: Self-assessment through ex-post evaluation studies.
- Another Idea: Independent assessment through some “Council of Independent Competition Advisers” (“Institutions matter”).

Thank you for your attention!

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