

FIW Symposium 2008
February 7, 2008, Innsbruck

The role of Economics in European Competition Enforcement and Policy

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*The views expressed are those of the author and do not necessarily reflect those of DG COMP or the European Commission

Introduction



- n Still 15 years ago, explicit economic analysis in enforcement decisions was quite rudimentary
- n Since then, there has been a significant shift towards economic analysis
- n By now, the annual turnover of economic consultancies makes up 15% of the fees earned in antitrust cases
- n Objective of enforcement has become more focused
- n What are the effects on consumers ?

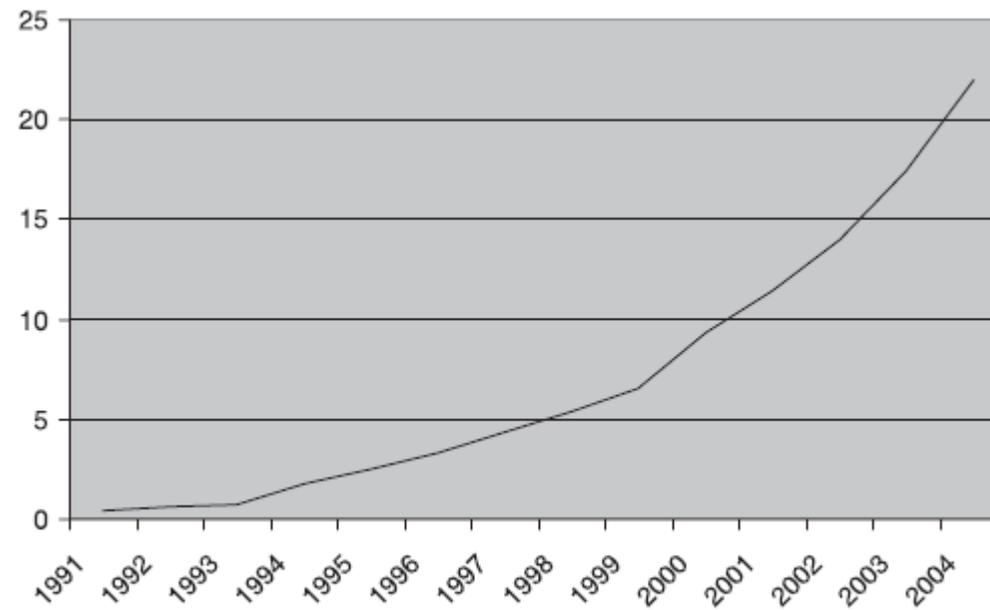


Figure 1. Turnover of economic consultancy firms (current £ million)

Outline



1. The direction and magnitude of effects cannot be captured by simple rules
2. Economics helps in evaluating effects and designing structured rules
3. Some insights on the use of economic theory and evidence
4. EU Courts are receptive and sophisticated
5. Conclusion

Alternative approaches



- n Per se rules or form-based approach:
 - Practices are per-se abusive or presumed abusive (e.g. tying, loyalty rebates, below cost-pricing)
 - A high market share is indicative of market power
 - Foreclosure = Abuse (to be abusive) "it is sufficient to show that (the conduct) tends to restrict competition (or) is capable of having that effect" (Michelin II, p. 239)
- n Full rule of reason (unconstrained effects based approach)
 - Consider whether the practice has led or is likely to lead to consumer harm

Alternative approaches (ii)



- n Structured rule of reason (and simple rules)
 - Particular findings trigger a different approach
 - California dentist association : agreement on prices are per se unlawful unless a justification can be found; its presence triggers a full rule of reason
 - Illustration : presumption that tying is not anticompetitive unless products are complements. If they are, a full rule of reason applies
 - The dominance screen is the expression of a structured rule of reason (practices are not anti-competitive in the absence of dominance – finding of dominance triggers an analysis of effects)

The problem with simple rules



- n There are very few instances in which in which effects can be clearly associated with simple criteria
- n Simple rules involves significant type I and type II errors
- n And impose significant costs on companies
- n Rebates :
 - Rebates schemes of dominant firms ought to be identical for all customers (Michelin II).
 - Retroactive rebates are not allowed (BA/Michelin)
 - Regional rebates are not allowed (Irish sugar)

Rebates



- n But companies that are obliged to provide price list with volume discounts only are deprived from...
- n Designing incentives for retailers to work harder in the interest of the consumer
- n Rebalancing competition between large and small retailers (to the benefit of the latter)
- n Lowering price selectively to increase sales
- n Granting discounts to customers that negotiate hard
- n Respond to entry...

Horizontal mergers



- n Mergers increase the market power of firms by eliminating a competitive constraint
- n At the same time they may bring about efficiencies (cost reductions, complementarities, access to new markets and technologies)
- n Market shares give only a very rudimentary picture of the first effect and no indication of the second



- n Market definition is a discrete approximation to a continuous phenomenon : the degree of substitution between product.
- n Market definition and the computation of market shares involve a short cut
- n Economic methods like the estimation of elasticities to assess substitutability improve precision
- n Advocates of simple rules are like Mr Jourdain (Le Bourgeois Gentilhomme) : they do (bad) prose (economics), without knowing it

Economics and effects



- n Capture by some unaccountable bunch of pseudo scientists ?
- n Business experience and empirical evidence identify empirical regularities which support presumptions and help designing structured rules of reasons
- n For instance, systematic evidence on resale price maintenance support the Supreme Court's reversal of per se illegality
- n How to make best use of economics in actual cases ?



"The theory of economics does not furnish a body of settled conclusions immediately applicable to policy. It is a method, rather than a doctrine. An apparatus of the mind, a technique of thinking, which helps its possessors to draw correct conclusions."
Sir John (not Vickers - Keynes)

Investigating effects



1. Spell out a logically consistent theory of consumer harm
2. Validate that theory empirically
 - Check the realism of the underlying assumptions (ex-ante validation)
 - Check whether observed market outcomes are consistent with the predictions of the theory (ex-post validation)
3. Identify alternative pro-competitive motivations for the practice (validate ex-ante and ex-post)

Investigating effects (ii)



- n Use of established theory, extensions, ad hoc developments
- n Develop testable hypothesis
- n Evidence should be (i) scientifically valid, (ii) open to scrutiny (iii) directly relevant (tied to the facts)
- n Daubert test of scientific evidence : can the theory be tested, peer review, rate of error, wide acceptance
- n No perfect test – reference to simplifying assumptions and data limitations should not be sufficient to dismiss evidence

Investigating effects (iii)



- n What if several pieces of evidence meet all criteria and provide conflicting conclusions ?
 - Not appropriate to ignore results as cancelling each other
 - Evidence is consistent with several hypothesis
 - Valuable insights despite apparent contradictions
- n Above all, need for a convincing explanation
- n Effects based analysis does not have to be overly dense in technical economic reasoning
- n Consistent set of facts and different pieces of evidence

Unreliable tests



- n Consider a simple test in isolation : is $P > ATC$
- n Assume
 - In 90 % of a cases, if a firm predate, $P < ATC$ (error because of non price predation)
 - In 90 % of a cases, if there is no predation, $P > ATC$ (error because of promotion pricing)
- n Assume that the probability of predation is low (1%), consider a sample of 1000 dominant firms.
- n 10 will predate. The test is positive for 9
- n 990 do not predate. The test is positive for 99 !

Unreliable tests (ii)

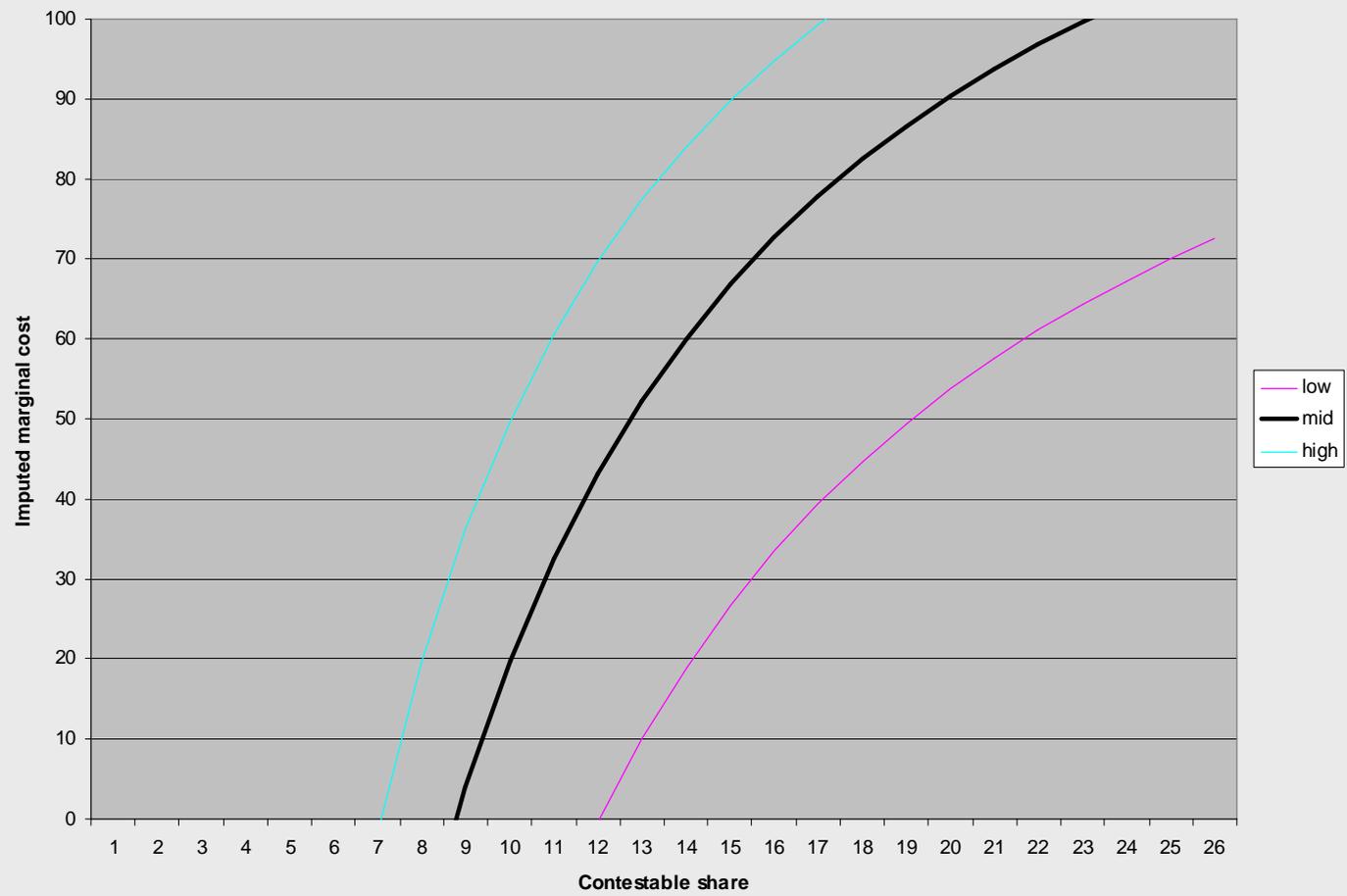


- n So, 108 positive tests, but only 9 are associated with predation – the precision of the test is 8 %
- n This is why medical doctors do not use HIV test with symmetric errors (they simultaneously use tests with different distributions of errors) and in any event do it twice (a privilege that economists do not have)
- n And why enforcers should not rely on a single test of predation but insist on a consistent set of facts (exclusion and recoupment in addition to sacrifice)

Illustration : Rebates



- n A safe harbor : the effective price for a range of output such that exclusion could take place should exceed average avoidable cost
- n If not, consider whether consumers are likely to be harmed. Scale economies, network effect, economies of learning (tipping)
- n Consider hypothetical example :
 - Retroactive rebate of 30 M (contingent on target)
 - Average selling price : 150
 - Volume : 2.5 M
- n Look at effective price as a function of the share which is contested (say 10 %)
 - Effective price = $150 - (30 \text{ M} / 250 \text{ 000}) = 30$



Rebates



- n Assessing the contestable share precisely is more important than assessing marginal cost
- n Sources for the contestable share : business plans (projected penetration under different scenarios), experience in similar markets
- n Sources for the marginal cost. Profit and loss accounts.
- n Sensitivity analysis
- n Consumer harm

Illustration : Input foreclosure



- n Upstream market configuration duopoly with 87 % and 13 % MS
- n Downstream : 5 competitors, integrated firm with 20 %, others with 29, 28, 16, 10;
- n Purchase of input is 3.5 % of downstream output price
- n Vertical foreclosure (refusal to supply):
 - (Reduced sales of input to rivals)x(upstream margin)
 - (Reduced sales to rivals)x(diversion ratio)x(overall margin)

Input foreclosure



- n Using upstream (row) and downstream (col.) margins, compute critical diversion ratios
- n Consider how input prices are affected
- n In merger : to see whether refusal to supply would affect output prices
- n In 82, to find out what prices would be without...

	20	30	40
10	6.5	9.5	12.3
15	4.5	6.5	8.5
20	3.4	5.0	6.5

The attitude of the Courts



- n The larger emphasis on economic analysis that recent years have seen is partly in response to demands made by the Court
- n In its *Airtours*, *Tetra Laval*, *GE/Honeywell*, the Court found that the Commission's economic analysis was not solidly founded [??]
- n In these merger cases, the Court underlined that it will review whether the Commission commits manifest errors of appreciation
- n The Court has made clear that it will not interfere with the complex economic analysis that is necessary to take correct decisions



n In the words of Advocate General Tizzano in *Tetra Laval*,

"The rules on the division of powers between the Commission and the Community judicature, which are fundamental to the Community institutional system, do not ... allow the judicature to go further, and ... enter into the merits of the Commission's complex economic assessments or to substitute its own point of view for that of the institution."

n And Microsoft..



"Although as a general rule the Community Courts undertake a comprehensive review of the question as to whether or not the conditions for the application of the competition rules are met, their review of complex economic appraisals made by the Commission is necessarily limited to checking whether the relevant rules on procedure and on stating reasons have been complied with, whether the facts have been accurately stated and whether there has been any manifest error of assessment or a misuse of powers."

"In so far as the Commission's decision is the result of complex technical appraisals, those appraisals are in principle subject to only limited review by the Court, which means that the Community Courts cannot substitute their own assessment of matters of fact for the Commission's."



- n The Court understands that an assessment requires a story and a consistent set of facts (Impala judgment)
- n "It follows that, in the context of the assessment of the existence of a collective dominant position, although the three conditions defined by the Court of First Instance in *Airtours v Commission*, paragraph 45 above, which were inferred from a theoretical analysis of the concept of a collective dominant position, are indeed also necessary, they may, however, in the appropriate circumstances, be established indirectly on the basis of what may be a very mixed series of indicia and items of evidence relating to the signs, manifestations and phenomena inherent in the presence of a collective dominant position".
(251)

Conclusion



- n Analysis of effects and burden of proof
 - Separate debates
 - Effects based analysis allow for simple cases
- n The EU is in a better position to take advantage of economic analysis than the US
- n And abuse of it...
- n Institutional response
 - Role of the CET
 - Interaction with economic consultants
- n More R&D – identify regularities

Conclusion (ii)



- n Guidelines have an important role to play
 - Express the objective of enforcement without ambiguity (consumer harm ?)
 - Explain how we understand the pro competitive aspects and the mechanisms of exclusion, in conformity with economic theory and reliable evidence – and provide indication about the theories of competitive harm that we are likely to focus attention on
 - Explain the factors that we will take into account
 - Provide safe harbors and presumptions
 - Guidelines acts mostly as an intellectual discipline – and have a commitment value

Conclusion (iii)



- n Thinking that simple imprecise rules offer more legal security than sound principles would be an offence to the legal profession
- n Practicing lawyers do adjust and make the best out of the complementarity