The Role of Economic Analysis in the EC Competition Rules

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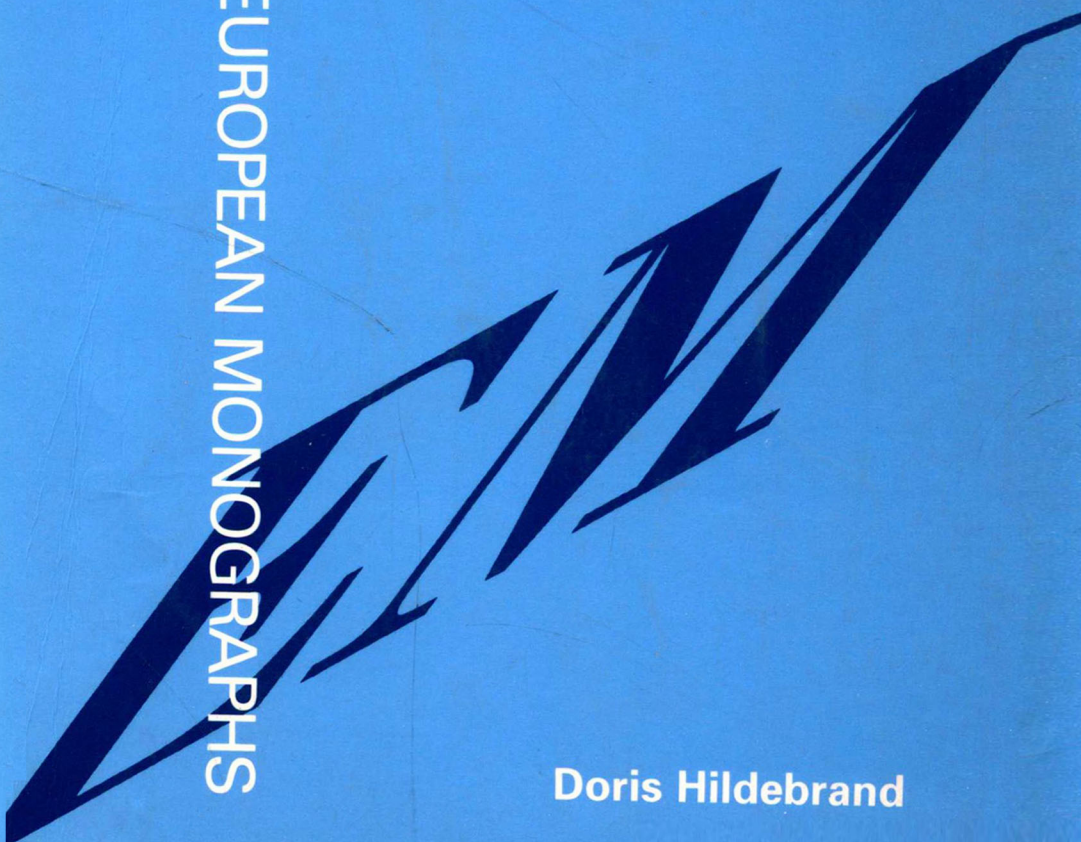

Doris Hildebrand

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Foreword

I do not believe it would be an overstatement to say that we are now at a crossroad in European history.

Much has already been achieved in terms of deepening the internal market and broadening common policies. Much has also been achieved in terms of acceptance of a competition-based economy. There is now a consensus within the European Union that competition, with its power to force companies to operate efficiently and to innovate, is one of the keys to our economic success. We have abandoned the old protectionist policies which led to a belief in National Champions. Instead we have adopted a commitment to open markets and free competition and it is the role of the Commission, as a competition authority, to ensure that these markets remain open and that free competition can flourish unhindered. As a result, today's Europe is almost unrecognisable from the one of only 10 years ago. To a great extent these achievements testify the success of the policies implemented by the European Commission, at the forefront of which Competition Policy.

However, a lot still remains to be accomplished. The great post-war dream of European integration is about to take a momentous step forward. The single currency is about to become a reality. The final steps to completion of the Single Market are being taken. The Community is looking to expand to the East. These are huge changes. In the meantime, we also have to face the changes that are affecting the rest of the world: globalization of trade and the ever increasing pace of technological change.

Market integration, enlargement, and globalization of markets challenge competition policy in both quantitative and qualitative terms. As to quantitative terms, it leads to increasing cross-border activities and to an increasing number of cases to be dealt with. This is underlined by the fact that from 1994 to 1995 the total number of Article 85/86 cases opened by the Commission's services rose by more than 40%. As to qualitative terms, we must take into account the realities of a rapidly changing economic environment; we cannot apply our policies in a vacuum.

All this calls for a modernization of competition policy in Europe, both in legal and economic terms.

But modernizing rules does not mean going soft on restrictions to competition. What is at stake is to find the most appropriate way to quickly deal with harmless cases and to seriously investigate the problematical ones (i.e. price or quota-fixing and market-sharing cartels as well as horizontal and vertical agreements in oligopolistic markets which might weaken competition or create barriers to entry).

What modernizing competition policy really means is enabling the Commission, as a competition authority, to better and more quickly understand the economic rationale underlying the functioning of the markets. It also means that the Commis-

sion must be provided with efficient procedural rules and guidelines in order to be in a position to properly handle the increasing case load more efficiently and more effectively with its limited resources.

This will certainly involve a greater and more consistent use of economics and economic theories by the Commission when defining and applying competition rules. Such an approach was already desirable in the past and I personally regard it now as being indispensable. That is why this book comes at a perfect point in time.

However, it is fair to say that the move towards a more economic-based approach has already started. The Commission has recently published a *notice on market definition*. The notice outlines the basic legal and economic concepts underlying the Commission's approach. It sets out the process followed to reach a conclusion as to market definition in individual cases and provides clear indications as to the evidence on which the Commission relies to define relevant markets. Further notices explaining the corpus of the economic theories on which the Commission bases its assessment will follow. They will deal – *inter alia* – with the concepts of single and oligopolistic dominance. By formulating and rendering public the conceptual framework the Commission uses and the methodology it follows, I hope to increase the consistency as well as the predictability of the Commission's policy and decision making.

In this respect and although one may not share the entirety of the views expressed by Doris Hildebrand, this book is a very well documented and carefully thought attempt to establish, first, which are the streamlines of the competition theory (read theories) used by the Court of Justice and the Commission, and secondly, what could be an appropriate competition theory framework for the future. In this respect, it should be welcomed as a very valuable contribution for both academics and practitioners to a better understanding of what EC competition policy is about, but also as a useful challenging piece of work for all those who think about the modernization to be entailed by EC competition policy.

Karel van Miert

Acknowledgements

I would like to thank my husband Nico J. Hildebrand for his persistent efforts to encourage me in my career and for his commitment to my work. Since I started to work on my book in 1992, he not only contributed to the making of the concept with his expertise in international management but continued to be the true inspiration for this book. I also would like to thank our four children Philip (7), Pascal (5), Bastian (5) and Nicole (4) who despite of their young age supported my work with enthusiasm.

Thank you, ... Nico.

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Chapter I. Introduction

1. Problem Definition

The ultimate aim of the EC competition rules is to maintain or help to establish competitive market structures. According to this viewpoint, competition is an instrument to ensure that entrepreneurial forces are mobilized and the full potential of the efficiency of firms is exploited. Since unemployment is one of the big themes in Europe, competition is of growing importance to serve the economy. Research has shown that future job generation will occur mainly in new established small and medium sized firms. Those firms will be the result of a competitive market structure and of activated entrepreneurial forces.

The competition process leads not only to competitiveness and greater economic efficiency, but also to increased consumer welfare, which plays an important role in EC competition law. Competition, in this sense, is an unlimited sequence of moves and responses in which profits can be seen as a motive for the initiation and imitation of economic efforts. The time competition needs to erode these profits indicates the degree of the competition's effectiveness, i.e. determines whether competition itself performs its function in a sufficient manner and exerts sufficient competitive pressure which cannot be controlled by incumbents. It is obvious that this *European* view of competition is a dynamic one and is regarded as the guiding principle in a forward-looking economic policy designed to achieve growth and employment.[1]

Economics comes into play twice. Firstly, in the design of the EC competition rules and secondly, when competition rules are applied.

The first aspect is a normative one in the sense that modern society demands an ideal (perfect) market situation including the functioning of competition. This goal should be manifested in the law. It is a matter of fact that the main principles of EC competition law are laid down in the EC Treaty. That is why this book will not discuss which economic mainstream concept is best suited to the European market or suggest any Treaty changes. The book views the EC competition rules as they stand, as a comprehensive, holistic vision of competition law, reaching an age of integration and linkages, supposed to adapt to all the dynamic challenges of other EC policy areas. Viewed against the background of the overall EC policy, as outlined in Chapter II, the Court of Justice has repeatedly made reference in its

1. German Council of Experts on Economic Affairs (1986), *cf.* BTDr. 10/6562.

decisions on competition issues to Articles 2 and 3 of the EC Treaty as the basic principles underlying the EC Treaty's rules of competition.[2]

Both pragmatic and historical approaches dictate that economics for EC competition law should be guided by the objectives of the EC Treaty. Repeatedly the Court of Justice stated that rules are designed to maintain effective competition, meaning that in each market there must be sufficient competition to ensure the observance of the basic requirements and the attainment of the objectives of the EC Treaty. The maintenance of effective competition is viewed by the Court of Justice as so essential 'that without it numerous provisions of the Treaty would be pointless.'[3] This means that European competition law is a predominant tool for economic policy or rather, more modestly, non-competition criteria are used in the application of competition law.

In the past twenty years the mission of EC competition law was the creation of a single market achieving conditions similar to those of a domestic market.[4] The need to keep markets open is still an objective. Moreover, EC competition policy intends to see whether there is sufficient competition pressure to force firms to be dynamic, innovative and to adjust and also to compel them to actually pass on their internal welfare gains to the economy as a whole.[5] Undisturbed competition takes its place in the interests of European market integration synergistic with and vital to the four freedoms of movement: goods, services, capital and persons. Undisturbed competition includes freedom from government distortion. Freedom from government distortion includes transparency of subsidies and elimination of unjustified subsidies, as well as elimination of non-tariff barriers among Member States.[6]

In fact the enforcement of the EC competition rules has moved onto the central stage of public and business policy. Almost every day Commission officials are on the front page of European newspapers, either to demand governments to comply with the EC competition rules or to accuse businesses of not doing so. Thus, the importance of the EC competition rules in our daily lives becomes increasingly apparent.

The second aspect which comes into play is the concrete application of economics in the EC competition rules. EC competition law is regulatory and interventionist and the need emerges to develop the background stage for an economic analysis properly in order to achieve the maximum benefit for the consumers out of the rules. The need becomes even more evident in pointing out that

> '... the strict enforcement of the competition rules gives rise to difficulties. These include the degree of regulation which Community competition policy currently involves, the failure to satisfactorily define the ambit of that policy,

2. E.g. Case 6/72, *Europemballage Corporation and Continental Can Co. Inc.* v. *Commission*, 21.2.1973, (1973) ECR 215.
3. Case 6/72, *Continental Can* v. *Commission*, 21.2.1973, (1973) ECR 215.
4. Case 85/76, *Hoffmann-La Roche & Co. AG* v. *Commission (Vitamins)*, 13.2.1979, (1979) ECR 461.
5. This idea is incorporated in Article 85 (3) of the EC Treaty. The example of rationalization agreements makes this particularly clear. Such agreements may be exempted from the general ban, provided that a sufficient amount of competition is left intact and benefits are passed on to consumers.
6. Fox (1993) p. 350.

> procedural delays, and the fact that undertakings are expected to behave as if the Community were a true common market when this is not yet fully so. In the latter context undertakings may find themselves infringing the rules on competition when, at least in their own eyes, their actions were pro-competitive, or were defensive measures designed to counteract distortions caused, by example, by national price controls, national fiscal regimes, volatile exchange rates, or differences in national markets.'[7]

The Commission, as the policy maker, starts to recognize the need to adapt its former approach. The old-fashioned method to analyze markets and traditional competition arguments has been overruled by the speed of technological development and by the rapid convergence of whole sectors. The insufficiency of the old style to analyze markets and apply economics became clear. Mr. Karel van Miert, Member of the European Commission responsible for competition policy, postulates the policy to draw a solid picture of the markets in question and analyze factually what the real situation is. Legal certainty, the need to concentrate scarce resources quickly on the most important issues and the will to shed bureaucracy, are his buzz words.

That is the reason why this book is focused on a new trend: the broader application of economics in EC competition law. Using some major problems like the discussion about a wider or a less wide application of Article 85 (1), the current inconsistencies in vertical restrictions, the assessment of dominance in Article 86, the delineation of the relevant market in Article 86 and the Merger Regulation, it will be illustrated how important economic insights are to serve EC competition law. It will also be discussed whether competition law may benefit from economic theory. A possible answer is that economic analysis needs economics and that competition law needs economic analysis. Nevertheless the benefits of such an interdisciplinary analysis may lay the basis for a closer co-operation between economics and law in Europe.

Traditionally, in the United States, economists and lawyers work together on the same subject-matter, antitrust law. 'Traditionally' has to be taken literally. The United States Sherman Act of 1890 is seen as the earliest and best-known response to a combination of economic, social and political circumstances, influenced by resentment against the increasing domination of big business, political fears of concentrated power and the perceived threat to the traditional right of individuals to determine their own destinies. For decades, legal and economic literature are filled with controversies and uncertainties on how to apply this antitrust law.

The emergence of the field of industrial organization in the late 1950s, has led many economists in the United States to become involved in the analysis of real-life markets. Because the development of this new field occurred in an era of relatively intense enforcement of antitrust law, economic expertise was called upon more frequently in antitrust litigation to determine the size of markets or the potential consequences of mergers. The result of this evolution in the United States is that today 'many economists, especially those with Chicago leanings, think that because

7. Bellamy/Child (1993) p. 36.

antitrust is about markets, as is microeconomics, antitrust law should be economics.'[8]

A great deal of the current controversy in the U.S. between economists and law professors on antitrust law rests on the fact that the latter argue that the goal of antitrust laws is usually not to achieve economic efficiency. Economists on the other hand argue that economic efficiency is always a valuable goal that can be achieved through properly designed and enforced antitrust laws. The controversy is even more complex as some legal specialists occasionally side with economists in assigning the goal of economic efficiency to antitrust laws, and some economists openly question the ability of antitrust laws to achieve economic efficiency. The very positive fact of all those controversies and uncertainties on how to apply antitrust law, is a considerable amount of expertise and literature. Over the decades, highly sophisticated tools were developed to analyze markets or to measure market power, always in the light of the Sherman Act.

Europeans face a complete different situation. Research on the competition rules in the EC Treaty, signed in 1957 in Rome, came alive over the years, introduced primarily by Court of Justice judgments. The Merger Regulation, which entered into force on 21 September 1990, is a very new research area. Simply, a lack of research tradition in economics in EC competition law has to be recognized. A disciplinary divide between law and economics takes place, a division which is completely unnecessary. The reality is that no European school of thought exists which can be compared with the Harvard or the Chicago School. That is why the input of the Member States plays an important role.

In particular, as we will see in Chapter II, the Germans have had a great influence on the drafting of the EC Treaty and on the work of the Commission in its early years. But Germany itself enacted the Law Against Restraints on Competition (*Gesetz gegen Wettbewerbsbeschränkungen* – GWB) in 1957.[9] Only in 1973 were provisions added requiring pre-merger notification and enabling the Federal Cartel Office (FCO) to combat mergers and acquisitions that created or strengthened a market-dominating position. This means that experience with modern competition policy has no sound traditional record in Germany. Moreover, EC law is part of International Public Law (*Internationales Völkerrecht*) at German universities, which means that resources for research are limited. This makes EC competition law a rare discipline, not to speak of the link of research schools in economics with research schools in EC competition law. The German input in research about economics in EC competition law is reduced to a few samples only.

Altogether the European tradition on economics in EC competition law cannot be compared with the long-standing tradition in the United States. This insufficiency makes the topic of this book an interesting one, since the author attempts to build a comprehensive bridge between economic theory and EC competition law with the aim to integrate both disciplines for the benefit of the European Community.

8. Jenny (1994) p. 186.
9. Gesetz gegen Wettbewerbsbeschränkungen (GWB), 1957 Bundesgesetzblatt [BGBl] 1081 (Ger.).