



Competition Policy and the Economic Approach

FOUNDATIONS AND LIMITATIONS

EDITED BY

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Edward Elgar

Cheltenham, UK • Northampton, MA, USA



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Published by
Edward Elgar Publishing Limited
The Lypiatts
15 Lansdown Road
Cheltenham
Glos GL50 2JA
UK

Edward Elgar Publishing, Inc.
William Pratt House
9 Dewey Court
Northampton
Massachusetts 01060
USA

A catalogue record for this book
is available from the British Library

Library of Congress Control Number: 2010932049



ISBN 978 1 84844 884 1 (cased)

Typeset by Servis Filmsetting Ltd, Stockport, Cheshire
Printed and bound by MPG Books Group, UK

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Abbreviations

ABA	American Bar Association
<i>Acad. Manage. Rev.</i>	<i>Academy of Management Review</i>
<i>Adelaide L. Rev.</i>	<i>Adelaide Law Review</i>
<i>Admin. L. Rev.</i>	<i>Administrative Law Review</i>
<i>Adv. Econ. Anal. Pol.</i>	<i>Advances in Economic Analysis and Policy</i>
<i>Am. Econ. Rev.</i>	<i>American Economic Review</i>
<i>Am. J. Sociol.</i>	<i>American Journal of Sociology</i>
<i>Am. Law Econ. Rev.</i>	<i>American Law and Economics Review</i>
<i>Ann. Econ. Statist.</i>	<i>Annales d'Économie et de Statistique</i>
<i>Antitrust Bull.</i>	<i>Antitrust Bulletin</i>
<i>Antitrust L.J.</i>	<i>Antitrust Law Journal</i>
<i>Appl. Econ.</i>	<i>Applied Economics</i>
<i>B.C.L. Rev.</i>	<i>Boston College Law Review</i>
<i>Bell J. Econ.</i>	<i>Bell Journal of Economics</i>
BGH	Bundesgerichtshof (German Federal Supreme Court)
<i>Brookings Pap. Econ. Act.</i>	<i>Brookings Papers on Economic Activity</i>
<i>Cambridge J. Econ.</i>	<i>Cambridge Journal of Economics</i>
cf.	confer
CFI	Court of First Instance
ch.	chapter
<i>Colum. Bus. L. Rev.</i>	<i>Columbia Business Law Review</i>
<i>CPI</i>	<i>Competition Policy International</i>
D.C. Cir.	US Court of Appeals for the District of Columbia
DGCCRF	Direction générale de la concurrence, de la consommation et de la répression des fraudes (France)
DoJ	US Department of Justice
ECJ	European Court of Justice
<i>ECLR</i>	<i>European Competition Law Review</i>
<i>Ecolog. Econ.</i>	<i>Ecological Economics</i>
<i>Econ. Bull.</i>	<i>Economics Bulletin</i>

<i>Econ. Inquiry</i>	<i>Economic Inquiry</i>
<i>Econ. J.</i>	<i>The Economic Journal</i>
<i>Econ. Letters</i>	<i>Economics Letters</i>
<i>Econ. Pol.</i>	<i>Economic Policy</i>
ECR	European Court Reports
ed(s)	editor(s)
edn	edition
e.g.	exempli gratia
<i>Environ. Monit. Assess.</i>	<i>Environmental Monitoring and Assessment</i>
EU	European Union
<i>Eur. Comp. J.</i>	<i>European Competition Journal</i>
<i>Europ. Econ. Rev.</i>	<i>European Economic Review</i>
<i>Exper. Econ.</i>	<i>Experimental Economics</i>
F.	Federal Reporter (US)
FTC	US Federal Trade Commission
<i>Geo. L. J.</i>	<i>Georgetown Law Journal</i>
<i>George Mason U. L. Rev.</i>	<i>George Mason University Law Review</i>
<i>Giorn. Econ.</i>	<i>Giornale degli Economisti</i>
GRUR	<i>Gewerblicher Rechtsschutz und Urheberrecht</i>
<i>Harv. J. L. & Pub. Pol'y</i>	<i>Harvard Journal of Law and Public Policy</i>
ie	id est
IJIO	<i>International Journal of Industrial Organization</i>
<i>Ind. Corp. Change</i>	<i>Industrial and Corporate Change</i>
<i>Info. Econ. Pol.</i>	<i>Information Economics and Policy</i>
<i>Int. J. Econ. Bus.</i>	<i>International Journal of the Economics of Business</i>
<i>Int'l Rev. Intel. Prop. & Comp. L.</i>	<i>International Review of Intellectual Property and Competition Law</i>
<i>Iowa Law Rev.</i>	<i>Iowa Law Review</i>
IP	Intellectual Property
JASSS	<i>Journal of Artificial Societies and Social Simulation</i>
<i>J. Comp. L. & Econ.</i>	<i>Journal of Competition Law and Economics</i>
<i>J. Corp. L.</i>	<i>Journal of Corporation Law</i>
<i>J. Econometrics</i>	<i>Journal of Econometrics</i>
<i>J. Econ. Behav. Organ.</i>	<i>Journal of Economic Behavior and Organization</i>

<i>J. Econ. Issues</i>	<i>Journal of Economic Issues</i>
<i>J. Econ. Lit.</i>	<i>Journal of Economic Literature</i>
<i>J. Econ. Manage. Strategy</i>	<i>Journal of Economics and Management Strategy</i>
<i>J. Econ. Persp.</i>	<i>Journal of Economic Perspectives</i>
<i>J. Econ. Theory</i>	<i>Journal of Economic Theory</i>
<i>J. Environ. Econ. Manage.</i>	<i>Journal of Environmental Economics and Management</i>
<i>J. Evolutionary Econ.</i>	<i>Journal of Evolutionary Economics</i>
<i>J. Ind. Compet. Trade</i>	<i>Journal of Industry, Competition and Trade</i>
<i>J. Ind. Econ.</i>	<i>Journal of Industrial Economics</i>
<i>JITE</i>	<i>Journal of Institutional and Theoretical Economics</i>
<i>JOIE</i>	<i>Journal of Institutional Economics</i>
<i>J. L. & Econ.</i>	<i>Journal of Law and Economics</i>
<i>J. Law Econ. Organ.</i>	<i>Journal of Law, Economics, and Organization</i>
<i>J. Legal Stud.</i>	<i>Journal of Legal Studies</i>
<i>J. Manage.</i>	<i>Journal of Management</i>
<i>J. Pers. Soc. Psychol.</i>	<i>Journal of Personality and Social Psychology</i>
<i>J. Polit. Econ.</i>	<i>Journal of Political Economy</i>
<i>J. Publ. Pol. Market.</i>	<i>Journal of Public Policy and Marketing</i>
<i>J. Regul. Econ.</i>	<i>Journal of Regulatory Economics</i>
<i>J. Telecomm. & High Tech. L.</i>	<i>Journal of Telecommunications and High Technology Law</i>
<i>JZ</i>	<i>Juristen-Zeitung</i>
<i>Law & Contemp Probs.</i>	<i>Law and Contemporary Problems</i>
<i>Leg. Iss. Econ. Integr.</i>	<i>Legal Issues of Economic Integration</i>
<i>Manage. Sci.</i>	<i>Management Science</i>
<i>Marketing Sci.</i>	<i>Marketing Science</i>
<i>Michigan L. Rev.</i>	<i>Michigan Law Review</i>
<i>No.</i>	<i>number(s)</i>
<i>N.Y.U. L. Rev.</i>	<i>New York University Law Review</i>
<i>OECD</i>	<i>Organization for Economic Co-operation and Development</i>
<i>OECD J. Comp. L. & Pol'y</i>	<i>OECD Journal of Competition Law and Policy</i>
<i>OJ</i>	<i>Official Journal (EU)</i>

ORDO*Organ. Sci.*

pp.

para(s)

Q. J. Econ.

R&D

*R&D Manage.**RAND J. Econ.**Ration. Soc.**Res. Pol.**Rev. Econ. Statist.**Rev. Econ. Stud.**Rev. Ind. Org.**S. Cal. L. Rev.**SEDCJ**Small Bus. Econ.**SMJ*

S.Ct.

ss.

SSNIP

*Tech. Rev.**Technol. Forecast. Soc. Change**Tex. L. Rev.**Theory Dec.**Tulsa L. J.**U. Chi. L. Rev.**U. Pa. L. Rev.*

US

v.

World Comp

WTO

*WuW**Yale L. J.**ZfW**ZWeR**ORDO – Jahrbuch für die Ordnung
von Wirtschaft und Gesellschaft**Organization Science*

pages

paragraph(s)

Quarterly Journal of Economics

Research and Development

*R&D Management**RAND Journal of Economics**Rationality and Society**Research Policy**Review of Economics and Statistics**Review of Economic Studies**Review of Industrial Organization**Southern California Law Review**Sedona Conference Journal**Small Business Economics**Strategic Management Journal*

Supreme Court Reporter

subsection(s)

Small but Significant Non-transitory
Increase in Price*Technology Review**Technological Forecasting and Social
Change**Texas Law Review**Theory and Decision**University of Tulsa Law Journal**University of Chicago Law Review**University of Pennsylvania Law
Review*United States Supreme Court
Reporter

versus

World Competition

World Trade Organization

*Wirtschaft und Wettbewerb**Yale Law Journal**Zeitschrift für Wirtschaftspolitik**Zeitschrift für Wettbewerbsrecht*

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Introduction

In the past ten years, competition policy has undergone tremendous change. On the surface, the rules remained the same: cartels are prohibited, companies shall not abuse their dominant positions and big mergers are reviewed by competition authorities. Yet, the wording of laws does not tell the whole story. Enforcement did change, and so did the general framework that underlies the rules on antitrust. The change in competition policy has been labelled ‘more economic approach’ in the European Union: it stands for the integration of the findings of modern industrial economics into rule- and decision-making on anti-competitive behaviour. Today, this economic approach is well enough established to review it in fundamental ways. What are the foundations and limitations of this approach? What are the open and contentious questions that it raises? What additional impulses may competition policy get from economics in the future? And, finally, what are the institutional aspects and the political economy of the paradigm shift towards ‘more economics’? This book aims to answer these questions.

Mario Monti, former European Commissioner for Competition, said: ‘To develop an economic interpretation of EU competition rules was, indeed, one of my main objectives when I took office’. This he has achieved. In 1999, the Directorate General for Competition published a White Paper on Modernization of Competition Law Rules with some first ideas on such an interpretation. The process gained momentum when, in 2002, the Court of First Instance quashed three merger decisions of the Directorate criticizing the lack of economic reasoning on the part of the Commission. Monti reorganized the Directorate, a Chief Economist was appointed to improve decisions, the modelling of quantitative effects became a standard feature of case counselling and any piece of paper as well as new rules published by the Commission had some economic flavour. The peak of this development was reached in 2005, when the Commission published a Discussion Paper on the application of Article 82 EC (now Article 102 TFEU) to exclusionary practices, and when the European Court of First Instance issued the decision in the *GlaxoSmithKline* case (2006), requiring the Commission to show consumer harm when attacking the prohibition of parallel trading of pharmaceuticals. Modern industrial economists gained more influence on competition law enforcement and on the

drafting of rules and guidelines. They have, of course, been around ever since Hans von der Groeben, who was a trained lawyer and economist and the first European Commissioner for Competition. Still, in European practice, lawyers dominated the field including their rule-oriented mindset on how to deal with business. In the US, the Sherman Act was enforced by courts and the Department of Justice – from an institutional perspective not the natural habitat of economists. Yet US antitrust enforcement was shaped by economists from the Chicago School from the 1980s onwards. The rise of this school of thought in antitrust was fostered by policy-makers – Ronald Reagan personifies the important role which politics in fact play in the enforcement of antitrust rules. This book takes into account the triangle of law, economics and politics although its focus is on the vertex of economic thought; and the contributions reflect the current debate among economists over fundamental questions of cutting-edge competition policy. Yet the book also aims at taking this debate to the arenas of lawyers and policy-makers who add their ideas on the economic approach in antitrust matters.

What line of thinking is it that has been promoted as an economic approach? The economics behind it are often attributed to a so-called ‘Post-Chicago School’. With Chicago, this school shares its focus on efficiency, defined as consumer surplus. However, it avoids making too bold general statements and rather looks into individual cases in order to make a thorough analysis, particularly in merger and dominance cases. Two features may be seen as being at the core of this approach: firstly, it is an effects-based approach. The cases are analysed for the effects that they actually produce for both the markets and the economy. Michele Polo, who was part of a group of outstanding economists advising the European Commission on competition policy, stresses in this book the need to identify, through careful inspection of every single case, the harmful effects of any behaviour which is under review. It is not just cases, but also the drafting of new rules that is nowadays heavily relying upon the weighing of quantitative effects before guidance is provided. This case-by-case analysis causes a shift from *per se* rules and standardized decisions to an individual assessment of each specific situation. The yardstick for this assessment – and this is the second key feature – is efficiency. Consumer surplus, a concept investigated thoroughly by Gregory Werden in this volume, is often seen as a proxy for efficiency considerations. Welfare standards (be it consumer surplus or total welfare) have become reference points for competition law. Goals, other than efficiency itself, that have been pursued by enforcing competition law for years, economic freedom or equal opportunities for example, are no longer in focus. As a result of the process to rethink the ratio of antitrust rules, Chicago is on the retreat in

the US, and in Europe interventionism has lost momentum. It is a notable feature of today's competition policy that modern economics bridges the transatlantic gap.

But the story has only just begun. The economic approach promoted significant changes in competition policy and it has sparked the most fruitful debates for decades in the competition community. Today, though, the approach that scrutinized every single belief of competition law is under scrutiny itself: The European Court of Justice overruled the lower Court's decision in *GlaxoSmithKline*, shifting the focus back to protecting competition instead of protecting consumers. The final version of the Commission's paper on exclusionary behaviour is a watered down version that lacks the boldness of the discussion paper. The US Supreme Court's *Leegin* decision, overturning the longstanding prohibition of resale price maintenance, prompted harsh reactions. At this point in time, it is necessary to turn to the assumptions, the limitations, and the future developments of the economic approach. This endeavour is timely, since post-Chicago economics are now well embedded in competition law. The challenge, therefore, is not to answer a simple, binary question – do we want more economics or not? The challenge is to identify the assumptions of modern economics, to grasp new impulses for better economics and to understand the interplay with law and politics.

This book assembles seventeen original essays on the foundations and limitations of the economic approach to competition law, written by economists and lawyers who are leaders in their fields. The essays are based on papers presented at a conference held at the Munich Max Planck Institute for Intellectual Property, Competition and Tax Law. The concept of both the conference and the book is unusual and peculiar. Whereas numerous conferences and books on the 'economic approach' to competition law deal with specific forms of conduct and how they should ideally be analysed from an economic perspective, this book tries to enhance a better understanding of the capacities of the economic approach and its limitations by extending the perspective beyond industrial organizations economics to evolutionary concepts of competition and behavioural economics. Simultaneously, the impact of the institutional framework in which competition policy is to be implemented is taken into account just like the political dimension of competition policy.

Accordingly the group of authors is diverse: some of the authors are prominent representatives of 'mainstream' industrial economics; others focus their research on boundary areas of economics. Lawyers comment on the ideas presented in this book by economists in an effort to draw interdisciplinary lines.

Part I on the 'The Goals of Competition Policy' is dedicated to the

key standard used in the debate about economics in competition law: consumer welfare. The three authors immediately propel us into the sphere of normative foundations of competition policy. Gregory Werden explains that the concept of consumer welfare is more ambiguous than is acknowledged in the debate. He analyses this concept, reveals some common misunderstandings and discusses its specific value for assessing mergers, concerted practices and exclusionary behaviour. Werden takes a rather cautious approach towards the tools of economics and the guiding power of consumer welfare, particularly in cases of concerted practices and unilateral conduct. Viktor Vanberg looks at the consumer welfare standard from the perspective of a constitutional economist. He distinguishes strictly between the goals and the tools of competition law. While he places freedom to compete (and not efficiency) in the centre of competition policy, he willingly accepts the tools of modern economics in order to apply competition law. A specific feature of his constitutional perspective is the discussion of problems in giving advice to policy-makers. Daniel Zimmer, professor of law, comments on both Werden and Vanberg, concluding that – at the end of the day – we have to accept that competition law has a moral quality – and necessarily more than one goal.

Part II on the ‘Merits and Challenges of Modern Industrial Economics’ revisits mainstream economic thinking and shows its strengths and limitations. Daniel Rubinfeld opens the field defending the capabilities of industrial economics and empirical methods in competition policy. Yet, he identifies three unsettled issues for further research: the necessity of market definition, the measuring of market power, and the value of merger simulation models. Michele Polo, being an advocate of the ‘more economic approach’ himself, explains how he uses econometrics to identify whether unilateral behaviour constitutes anti-competitive foreclosure or not. Polo argues that such ‘identification problems’ can be solved through empirical studies and he elaborates on an Italian concrete case involving predatory pricing. Oliver Budzinski provides a comprehensive analysis of challenges and limitations in the use of modern economics, drawing from over ten years of experience with its use in cases in both the US and the EU. He reviews the charges put forward against post-Chicago economics and reaches sophisticated conclusions on several matters. He actually advocates separating the question of more economics in competition policy from the question of case-by-case analysis: modern economics contributes a lot to inform competition policy; however, according to Budzinski, the case-by-case application of modern economic tools raises serious concerns. Laurence Idot, commenting on the three essays in Part II from a lawyer’s perspective, highlights these concerns and raises

institutional aspects that lead her to have reservations with regard to the economic tools which are available in the decision-making process.

Having discussed standards of competition policy and some of the strengths and shortcomings of current competition policy, the book turns to the latest strands of economic thinking. Fresh blood may be drawn from those areas of economic research that are relatively new as sources of inspiration for competition policy. In Part III on 'Competition Policy and Evolutionary and Innovation Economics' the question of new impulses is addressed to economists with evolutionary and innovation perspectives. Uwe Cantner and Wolfgang Kerber, in their respective contributions, argue that modern industrial economics needs to take better account of innovation, dynamic efficiencies and diversity issues in competition policy. They start from Hayekian and Schumpeterian concepts and emphasize the search and learning processes of competition. Uwe Cantner frames these issues with an introduction to innovation economics, its behavioural foundations and the mechanisms driving markets. Competition policy, in his view, needs to integrate knowledge about the dynamics of business that has been acquired through research on industry life cycles for instance. Wolfgang Kerber points out that competition policy needs to maintain diversity and multiplicity as a precondition of innovation. The wording of rules in the EU and the US is open to such an approach and in some cases, competition authorities have already shifted their focus from short-term price effects towards an analysis of the innovation environment. Reviewing theoretical and empirical findings on the topic, Kerber concludes that more research is needed in the field. Andreas Heinemann, commenting on the two essays, takes a closer look at translating evolutionary economics into competition law practice. He identifies merger control in technology-driven sectors and the application of competition law to intellectual property rights as key issues. Despite all the remaining difficulties in assessing long-term effects, Cantner, Kerber and Heinemann make one point clear: evolutionary perspectives and research on the promotion of innovation may add substantially to competition policy, particularly in sectors that have been under severe scrutiny over the past years.

In Part IV on 'Competition Policy and Behavioural and Experimental Economics', scholars specializing in behavioural and experimental studies present some of their stimulating research that has been undertaken in the laboratory. Experimental techniques have shaken established beliefs in how companies and markets function, and they now have also reached competition policy. Justus Haucap explains the concept of bounded rationality that forms the basis for this kind of research. Interestingly, he applies the concept of bounded rationality to two actors: consumers – where Haucap illustrates the point with an example from mobile

telecommunication – and competition officials. The decision-makers in the authorities themselves are subject to bounded rationality, and this, so Haucap claims, needs to be taken into account when designing institutions and procedures. Bart Wilson provides an account of how experimental economics actually work. To do so, he takes the reader to the laboratories where he and his students develop experimental studies and carry them out. Wilson, too, emphasizes how crucial it is to examine, in detail, which institutional rules and patterns are at work in order to understand competition. As Wilson points out with an example concerning zone pricing, experimental studies have advantages over traditional econometric studies. Christoph Engel draws on behavioural, experimental and also econometric work to explain what he calls ‘competition as a socially desirable dilemma’. With data sets from oligopoly experiments, Engel takes a look at the incentives for undertakings to collude. To explain their behaviour, Engel suggests having recourse to public goods theories and a concept of conditional cooperation. His examples make it plain how helpful experiments can be in analysing competition. Yet, he also points at the reservations we still have to make when drawing conclusions from lab work for the real world. This is one of the key aspects for the comments of Andreas Fuchs as a professor of law on the three essays. Fuchs recognizes the sometimes stunning contributions from experimental and behavioural economics and, in particular, he acknowledges the institutional consequences. The modern approaches, presented in Part IV, are ‘valuable complementary tools’, as Fuchs puts it: not more than that, and certainly not less.

Part V of this book on ‘The Political Economy of Competition Policy’ returns the ball to lawyers and practitioners who implement the economic approach into their legal and institutional arrangements. Part V also serves as a reminder that competition law needs democratic legitimacy. Dirk Schroeder analyses institutional and procedural limitations of the current regime. In his view, integrating modern economic research into competition law practice drives current forms of judicial control to the limits. He illustrates the need to rethink the institutional setting with his experience from German and European court cases over the past years. The picture that emerges is a mixed one: some court decisions triggered awareness of economic findings in the work of the competition authorities; other rulings circumvent tough issues of economics and some get it completely wrong. For many cases in Europe and the US, the starting point is the investigation by a competition authority. Bill Kovacic, drawing on his vast experience as Commissioner in the US Federal Trade Commission, takes the readers into the chambers of such authorities. His concern is the independence of competition agencies, a defining strut of the triangle of