Antitrust enforcement and industrial policy considerations: the Italian (and now EU?) case against Amazon. VERY FIRST DRAFT

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Introduction

All antitrust laws of the world address two types of conduct. Exploitative conduct where firms either individually or collectively use their market power to exploit or expropriate their trading partners, exclusionary conduct, where firms either individually or collectively exclude competitors from the market so as to defend or prolong their market power. The debate both in academia and across jurisdictions has been on the definition of what exactly should be prohibited and, perhaps more importantly, on the separation line between what is allowed and what is prohibited. On this antitrust has gone through various cycles.

In the US, under the influence of the common law approach, the law was meant to prohibit unfair trading practices. But enforcers lacked a clear definition of what was unfair and many practices were prohibited without a real economic justification. Then in the 1970s the Chicago revolution, with its emphasis on economic analysis, gave a rigorous definition of what is unfair, *viz* practices leading to a reduction of consumer welfare. Consumer welfare thus became the standard with which to analyze any possible restriction of competition and, as a result, only those practices negatively affecting consumers were prohibited.

Similar developments occurred in the EU, but the end result was not as clear cut. Instead of a standard based on unfairness, the EU started with an approach where the creation of the internal European market was a primary objective of enforcement. This placed great emphasis on practices, such as absolute territorial protection clauses, that tended to isolate the markets of member States, irrespective of whether consumers benefitted or not.

Starting in the mid-1990s this approach was heavily criticised, especially by academia, and in comparison to enforcement developments in the US. As a consequence the EU drastically changed it. But the EU never formally adopted the consumer welfare standard. Rather it adopted an effects-based approach, where economic analysis played an important role in identifying the effects of the practices under investigation. Contrary to the US, the objectives of the law remained somewhat fuzzy. Indeed, the EU adopted a protect-competition approach, partly mitigated by the use of rigorous economic analysis for identifying the anticompetitive effects of investigated practices.

As a result of these developments and of the extensive use of economic analysis in defining anticompetitive harm, in recent years a soft convergence between the two jurisdictions has been achieved, even though the legal standards of what constitutes an antitrust violation are not exactly the same. The instances of disagreement in enforcement between the US and the EU, that had been quite numerous until the mid-1990s, diminished substantially in recent decades and in fact were only a few. The controversies originating from these cases – the GE-Honeywell merger of 2001, the Microsoft case of 2004, and a few others – were more centred around the economic evidence on which the EU prohibitions were based, and on the size of the fines imposed, rather than on the legal standards involved. Since disagreements

[1] This article draws on previous work by Darryl Biggar and myself. I thank Darryl Biggar for his contribution to this, and previous, papers.

were increasingly rare, the EU and the US seemed to be moving in a common direction. Antitrust looked more and more like a settled field of public policy.

In all these years, however, the debate around the goals of competition law did not disappear entirely. Especially in the US, economists repeatedly expressed concerns that an exclusive focus on consumer welfare was not consistent with conventional economic concepts of welfare, which typically give weight to the welfare of both sides of the market (buyers and sellers). More fundamentally, some commentators pointed out that a strict focus on the welfare of downstream consumers implies that competition law is blind to the exercise of market power towards upstream suppliers. This is inconsistent both with conventional economic principles and with the observed enforcement actions of US competition enforcers and judges (which are now quite active, for example, in addressing restrictions of competition providing their effects in labour markets).

In the EU where the consumer welfare standard was never formally endorsed, the debate was more centred around what it actually meant to protect the competitive process and no unifying approach was ever developed. For example, the as-efficient-competitor-test discussed by John Vickers in his article on the abuse of economic power, that would have provided some constraints on when a practice of a dominant company would have been considered exclusionary, was never endorsed fully. And the 2009 EU guidance paper on what is an abuse suggests that there are instances, in particular when the market would develop into a monopoly, when also keeping a less efficient competitor in the market would be welfare enhancing. But when in practice such an exception to efficiency should be considered was never discussed nor identified with precision. As a result, contrary to the US, in the EU the effect-based approach would still leave some discretion and uncertainty on what for example dominant firms could or could not do.

The importance of defining a clear standard of what is anticompetitive, is not simply associated with theoretical considerations or with achieving coherence in enforcement. The existence of a clear economic objective leads enforcers (and the judicial) to concentrate on that objective and define the harm in terms of the that objective. In the US, the insistence on consumer welfare led enforcers and judges to first look for consumer harm when analysing a case. When none was found the case was dismissed. On the other hand, in the EU where a clear standard had not been identified, effects were being considered, but lacking a clear standard of appreciation some discretion in the evaluation of the competitive nature of a given practice was always possible. In part because consumer welfare was subject to some serious criticism, the EU did not feel the urge to follow the US. As Giuseppe Tesauro said at the first ICN conference in Naples in 2002, “the Atlantic Ocean is not a one-way street”.

The success of the consumer welfare standard in the US and in many other jurisdictions (besides the EU) is also associated with the fact that it provides an easy screen when deciding whether a case is worth pursuing or not. This is very effective because it leads to an efficient use of public resources, both on the part of the enforcers and on the part of the judicial. A standard having such characteristics, i.e. you don’t have to wait the end of the proceedings to understand that a given practice is prohibited, is extremely helpful and provides valuable guidance to antitrust authorities pursuing a State initiated case and private parties looking for damages. I believe that standards in antitrust have to be easy to understand and to be able to direct enforcement to the most damaging practices, minimising both the errors and the use of public resources.

However a standard needs to be up to its task. In recent years the problems associated with consumer welfare in the US have returned to the forefront of antitrust thinking and debate. The driver is concerns about the rise of powerful digital platforms such as Google, Apple, Amazon, or Facebook. These platforms form the hub or focus of ecosystems of related firms, which rely on the platform to reach consumers and to provide their services. Increasingly concerns have been raised that these powerful digital platforms have been able to exercise considerable market power over firms in their ecosystem, raising barriers to entry and reducing the incentives for investment. Many commentators and competition enforcers feel that these practices could be and should be prosecuted under competition law. But where is the harm to consumers? Many of the products and services provided by these platforms are offered to consumers free of charge. Consumers receive substantial benefit and utility from these platforms and their services. If we look only at the consumer side of the market it is hard to find any evidence of a problem at all.

According to the critics, a narrow focus on the consumer welfare standard has blinded competition enforcers to the harm caused by these platforms – harms that could be and should be controlled under antitrust law. This debate over the handling of digital platforms is raising fundamental questions about the purpose of antitrust and competition law. The foundations of competition law are being called into question to a greater extent than at any time in the past generation. The 'traditionalists' argue that the consumer welfare standard (perhaps with suitable tweaks) is up to the task, and the 'revolutionaries' argue for a reconsideration of the foundation of antitrust law and a return to the prohibitions of unfair trading practices of the origin. Critics argue that abandoning the consumer welfare standard risks opening the door to imprecise or non-economic thinking such as the concept that when it comes to firm size, bigness is inherently bad. This is seen by many as a return to the 'bad old days', when firms were prevented from competing (or not allowed to merge) simply because of their size.

The problem of a lack of a standard was particularly severe in the EU where for example a dominant firm was considered to be prohibited from competing, as the General Court has affirmed in the Intel judgement (later corrected by the ECJ). The lack of a standard leaves enforcement without an anchor and may lead to highly discretionary decisions.

The antitrust laws are drafted in a very general way. This is to be welcomed as it makes it possible that legal prohibitions introduced over 130 years ago in the US and almost 70 years ago in the EU are still valid today. Those historic laws remain able to discipline an economy very different from the times the rules were drafted. However, while such generality is to be welcomed for the flexibility that it allows, enforcers cannot be left alone applying the legal rules, without adopting a clear economic standard. As Robert Bork famously observed:

> Antitrust policy cannot be made rational until we are able to give a firm answer to one question: What is the point of the law – what are its goals? Everything else follows from the answer we give …… Only when the issue of goals has been settled is it possible to frame a coherent body of substantive rules.

The coherence Bork mentions is clearly associated with legal certainty. Antitrust rules are enforced ex-post but the outcomes of that enforcement need to be understood and clearly predictable ex-ante for them to be respected. They lose much of their significance and deterrence ability if the goals pursued are not clearly defined.

A standard of appreciation is therefore necessary and in this respect only economics brings a clear discipline and clear indications of what is prohibited.

Industrial policy, State aid and the internal market rules

Industrial policy is about picking winners and abandoning losers, adopting on a case-by-case basis the necessary tools to achieve these goals - subsidies, State ownership, restrictive regulations, and so on. In contrast, antitrust is about enforcing a specific set of rules to create a level playing field for competition. As we know in the EU there are no exceptions to antitrust enforcement and the rules are meant to be applied in all sectors of the economy and to all players in a common and homogenous way.

I thought that the debate on industrial policy was over when in the 1970s Assar Lindbeck, a well-known Swedish economist, wrote that industrial policy is an ad-hoc inefficient policy because it cannot identify winners and losers ex-ante. The examples he made were about Sweden and Japan. He said that that there were no objective reasons on why Sweden became specialised in the ball bearing industry and why Japan became the number one producer of motorcycles in the world. So since we cannot anticipate where efficient suppliers would concentrate their efforts and achieve a successful outcome, how can we identify the winners? Markets evolve, not following our wills and our desires. While still working with the Authority I led in 2005-08 the so called Sepa task force aimed at creating rules so that a unified financial market would emerge in Europe. One of the political aims of the group was to make it easier for a European player to enter the credit card market and become an effective competitor to Visa and MasterCard. The rules were changed and existing barriers that impeded the integration of financial markets Europe-wide were removed, but no new player entered. And the reason was that existing players were efficient enough to accommodate to the new environment.

As for subsidies, the rules in place ensure that there are benefits to the economy that go beyond the subsidy itself. But these rules, while effective in disciplining individual State Aid measures, especially the insistence of the EU that the private investor test be respected, are much less efficient when applied to schemes of State aid. The objectives pursued by such schemes are only identified according to some preconceived categories and are block exempted (Research and development, small and medium sized companies, protection of the environment, transport, etc.). The end result is not necessarily as positive as anticipated, since the benefit of the scheme is simply presumed. Industrial policy may be pursued by such schemes. This is why the Commission is obliging member States to undertake ex-post assessments and evaluations of State aid schemes.

The combination of all of these controls makes industrial policy difficult to pursue in the EU through State aid or anticompetitive regulations.

Antitrust enforcement as a modern industrial policy tool

The interpretation of antitrust rules is somehow more flexible than State aid provisions. As Bork had suggested, identifying a clear objective for enforcing the law reduces such flexibility and constraints the possibilities of enforcement. There are a few existing alternatives to consumer welfare: the protection of the competitive process, total surplus,

fairness. In my view all have serious shortcomings in the sense that the standard is either not in line with the legal provisions (the total surplus standard) or cannot be rigorously defined, resulting in some fuzziness on the separation between what is prohibited and what is allowed.

I already discussed the shortcomings of the consumer welfare standard both with respect of input markets and the digital platforms. Recognising them, in recent years many US commentators have suggested that the primary goal of competition is the 'protection of the competitive process'. This approach rejects the need to articulate the impact of a particular action on economic welfare – instead, an action is assessed according to its effect on 'competition' and the 'competitive process'.

While this approach adds a lot of flexibility to the possible interpretation of the rules, the protection-of-the-competitive-process standard has insurmountable problems because for example protecting competition may be interpreted either as implying that only efficient competitors are protected from anticompetitive exclusions or that even inefficient players are protected. This lack of clarity (which the EU has not solved yet) results in substantial discretion on the part of antitrust enforcers, leading to unpredictability and inconsistency in decision-making. A related drawback is that this approach fails to articulate the link between protecting competition and promoting economic welfare. It therefore lacks tools to resolve important trade-offs between competing objectives, such as conflict between short and long-term considerations. For example, the protection of competition standard cannot easily distinguish pro-competitive and anti-competitive price discrimination, between excess returns and the proper incentives for innovation, between the quality of service and anticompetitive exclusion.

A few other possible economic foundations for competition law have been proposed. For example, the textbook approach to total welfare, characterised by fixed supply and demand curves, would not only allow a perfectly discriminating monopolist to exist, but would also promote its creation. Instead, most antitrust laws prohibit price discrimination. Furthermore, under a total welfare standard a merger leading to monopoly would be evaluated under the condition that total output is not reduced, by the way a much simpler test than that performed under a consumer welfare standard (where what matters are that prices paid by consumers are not increased), but a result that all competition authorities would find unacceptable when the merger would lead to much higher prices even though output is not affected (which happens when the demand curve is quasi-vertical).

Finally in recent years several commentators have argued for a broader set of goals for competition law, including the reduction of inequality, prevention of concentration of political power, promotion of economic development, or promotion of media diversity. But, the precise implications for antitrust enforcement remain unclear. I suggest that concerns such as fairness must be able to be articulated within a foundation in economic welfare concepts, like it was done with the adoption of the consumer welfare standard. Otherwise, the risk of discretionary decisions where defence is impossible is enhanced.

A new objective for antitrust

Recently, in a number of papers, Biggar and Heimler[2] suggest that an antitrust standard has to be based on a clear and measurable characteristics and should facilitate conventional economic welfare analysis, otherwise trade-offs could not be coherently addressed. They propose, as an alternative to existing standards, that protecting irreversible and relationship-specific sunk-investment both resonates with the practices of competition authorities around the world (a positive standard) and provides a sound economic foundation for competition law enforcement going forward (a normative standard). This objective is drawn from and based in conventional economic welfare analysis (with its focus on economic welfare as the sum of producers' surplus and consumers' surplus), but it departs from the conventional application of that theory in that it does not assume that the supply and demand curves are fixed. Instead, these authors argue that market participants routinely make material sunk investments in reliance on on-going trade, that market power is the ability to hold-up one's trading partners, and that protecting these investments from hold-up, so as to promote valuable sunk investment is the primary economic objective of competition law. This framework provides a valuable guide to market players on what is prohibited and to authorities on how to enforce the law.

Sunk relationship-specific investments are very common. For example, in coal-exporting countries such as Australia, coal miners may make a substantial sunk-investment in mines, which have little value without access at reasonable conditions to a coal export port. An airline may invest in developing flights from and to a given airport while relying on reasonable tariffs for take-offs and landing. Similarly an electricity generator investment relies upon access to an electricity grid at fair and reasonable prices. A seller of goods on Amazon's marketplace might be required to make a material sunk-investment in product research and development before offering the product for sale through Amazon's channels. Almost all significant, on-going transactions require some form of sunk-investment by one or more of the parties to a transaction.

The main problem with sunk-relationship-specific investments is that they are subject to the threat of "hold-up" – the risk that, once the investment is sunk, the counterpart in the transaction will change the terms and conditions of trade to expropriate the value of that sunk investment from the legitimate owner. In a competitive market, those investments are not specific to any one trading partner and cannot be expropriated because, if an attempt is made, an alternative buyer or an alternative seller could easily be found. However, if there are no alternatives, sunk investments may be expropriated by changing the terms and conditions of trade by one party of the transaction.

Faced with the threat of hold-up, entrepreneurs will be reluctant to make essential sunk-investments or will make less valuable investments that are less prone to hold-up. Economic value will be foregone. This potential for economic harm gives rise to a solid economic justification for antitrust interventions, a guide to distinguishing pro-competitive from anti-competitive behaviour, and a framework for deciding the remedies to be adopted.

The competition concerns that have been raised against dominant digital platforms can be seen as part of a longstanding concern within competition law about certain actions by

[2] See Biggar, D. and Heimler, A. (2020), "Is Protecting Sunk Investments a Primary Economic Rationale for Antitrust Law?", *Journal of antitrust enforcement* and Biggar, D., Fels, A. and Heimler, A. (2019), "The Goals of Competition Law Debate and Competition Policy for Labour Market", *CPI Chronicle*,) Biggar, D. and Heimler, A,. *(2021),* "Antitrust Policy Towards Digital Platforms and the Economic Foundation of Competition Law", *Industrial and Corporate Change*

dominant firms which expropriate the value of investments by trading partners. The sunk-investment approach to antitrust provides an economic foundation for addressing such concerns within the existing legal framework and it also provides a standard for assessing a violation of the law.

Besides the possibility of identifying anticompetitive practices that the consumer welfare standard would not recognise, one of the advantages of the sunk-investment approach to antitrust is that it shares with the consumer welfare standard the ability to function as a screen when deciding to open a case or not. Is there a sunk-investment by a trading partner that risk of being expropriated by a given practice? If the answer is yes the case is worthwhile pursuing. I think this is a very important characteristic of this antitrust standard that is not shared by others like fairness or the protection of competition standard.

The Italian Amazon case and the sunk investment approach to antitrust

On 16 April 2019, the Italian authority opened an antitrust proceeding against Amazon for allegedly excluding from the market competing providers of logistic and transport services through its Prime label. Subsequently, on 10 November 2020, the European Commission opened proceedings against Amazon on the same grounds. The final decision by the Italian Authority of 30 November 2021 was shared with the European Commission and informally approved by it. The Italian case thus becomes of EU relevance.

Proceedings started because Amazon provided logistic and transport services for Prime sellers, i.e. sellers whose products are delivered to final consumers free of charge and faster than otherwise, not allowing these sellers to maintain the Prime label, should they purchase logistic and transport services on their own. The abuse was the fact that competing logistic and transport service providers were excluded from the market.

Payment for the services Amazon provided were very efficient: Consumers covered the fixed cost of the service, paying Amazon 36 EUR a year to become Prime customers, while the marginal cost of the service was paid by sellers for every shipment Amazon made. In the course of the proceeding with the Italian Authority, Amazon proposed as a remedy to allow sellers to maintain the Prime label even if they decide to manage their own logistic and transport services. However, in order to be guaranteed that shipments arrive on time to final consumers as promised, Amazon forced Prime sellers to transfer to Amazon their contract with the transport service provider. So in all situations, both when providing its own transport services and when allowing transport services to be chosen by sellers, Amazon would itself pay the transport services for Prime shipments.

According to the Italian Authority, the fact that Amazon obliges sellers to use Amazon's logistic and transport service is abusive because it excludes more efficient service providers, both in logistic and in transport. And also the remedy that Amazon has introduced in the course of the proceedings (allowing Prime sellers to self-manage logistic and transport) remains anticompetitive because it forces sellers to share sensitive information on the cost of transport service with Amazon.

But why does Amazon wish to control logistic and transport services for Prime shipments? The reason is simply because it wants to make sure that the quality of service is up to the standard it has promised to final consumers. It fears that sellers would receive the Prime label, but then underperform according to Amazon's standards, without Amazon being able to discover it, or do anything about it.

Amazon's practices have a clear pro-competitive rationale (to maintain or improve service quality). But is there an economic harm? The decision by the Italian Authority is not conclusive. In the absence of a clear economic harm, this competition law action risks being discretionary and has overtones of protection of the local industry – an industrial policy intervention.

What would the sunk investment theory, with its focus on hold-up, say about this case? There is a potential theory of harm here: It seems likely that at least some sellers being obliged to use Amazon's services to receive their Prime label (but are these sellers really obliged to receive the Prime label? if not there is no abuse) may be expropriated of their sunk investment in logistics (logistic that these sellers use for the handling of their non-Prime shipments). The standard for assessing the existence of an expropriation would be based on the level of the unit cost Amazon charges to cover its logistic and transport services. If the unit cost Amazon charges is below its marginal cost then it may lead to the shutting up of these alternative logistic services (and as a consequence Amazon would then be able to raise its prices to sellers, exploiting the sunk investment they made in the platform itself). If the unit cost for logistic or for transport services is indeed at or above costs then, considering the remedy that Amazon offered (allowing for some flexibility), there is no abuse. Had the Authority instead adopted a consumer welfare standard for this case, no harm to consumers would have been identified.

Conclusions

The Italian Authority opened its investigation on Amazon on these matter on April 19 2019 and notified to the ECN. The on November 10 2020 the EU opened proceedings on exactly the same issues, carving out the Italian market. In the press communiqué announcing its decision (taken on November 30 2021) the Italian Authority claimed a strong cooperation with the EU Commission with respect of the decision taken. The case is thus a Community case. It is not simply a decision of the Italian Authority but of the EU as well. My discussion of the case is thus of EU relevance.

The main point I make is that without an anchor in a proper welfare standard, competition law enforcement is all at sea. A proper welfare standard for identifying antitrust violations ensures that the law is not enforced in a discretionary manner and prevents industrial policy considerations driving the actions of antitrust authorities. A rigorous welfare-based standard ensures anticompetitive concerns are effectively addressed, reducing, if not eliminating, the possibility that enforcement simply results in protecting domestic producers from viable competition.

A second conclusion is that the coordination within the ECN needs improvement. The Amazon practices under investigation are EU wide (in fact they are world-wide) and the EU is clearly the best placed authority to deal with them. The solution that has been found shows a lack of strategic thinking on the part of the Commission when reviewing cases notified to the ECN and, more in general, the low relevance of the ECN in establishing priorities for the EU. It is a recurrent problem. It already appeared with the booking platforms. Now again. A reform is needed.