

Daniel Zimmer

University of Bonn – Bonn, Germany



***On Fairness and Welfare:
The Objectives of Competition Policy
(Comment)***

European University Institute
Robert Schuman Centre for Advanced Studies
2007 EU Competition Law and Policy Workshop/Proceedings



To be published in the following volume:
Claus-Dieter Ehlermann and Mel Marquis (eds.),
*European Competition Law Annual 2007:
A Reformed Approach to Article 82 EC*,
Hart Publishing, Oxford/Portland, Oregon (in preparation).

Please do not quote or circulate without permission
© Daniel Zimmer. All rights reserved.

12th Annual Competition Law and Policy Workshop
Robert Schuman Centre, 8-9 June 2007
EUI, Florence

Daniel Zimmer*

On Fairness and Welfare: The Objectives of Competition Policy

A comment on papers by:

David J. Gerber; and Christian Ahlborn & A. Jorge Padilla
2 August 2007

Both papers on the objectives of competition law are very clear in their analyses. Both provide a solid basis for discussion. David Gerber makes a clear-cut distinction between two different sets of questions where economics can come into play: first, economics play an important role with respect to the analysis of facts and empirical data; second, economics may serve as a policy input when deciding on the normative question of which goals competition policy should serve. The paper reflects, in a clear manner, the state of the law: European competition law, in particular the core provisions within Articles 81 and 82, in the courts' interpretations, are process-oriented, and not, at an initial stage of analysis, directly consumer-oriented.

Christian Ahlborn and Jorge Padilla very thoroughly analyze the different reform proposals and develop their own suggestions. Deciding in favour of consumer welfare as the single goal of competition policy, they discuss a very sophisticated rule of reason and a qualified *per se* legality approach and evaluate both under cost-of-error aspects.

What remains is the question at the policy level. Should the Community's competition policy, as restated by David Gerber, be changed in a fundamental sense – possibly in the sense of a direct and sole consumer-welfare orientation as advocated by Christian Ahlborn and Jorge Padilla?

Competition means more than just consumer welfare

After the judgment of the Court of Justice of 15 March 2007 in *British Airways*,¹ the overall structure of competition law seems more transparent than ever before. At first examination, European competition law follows an open, structure- and process-oriented approach, meaning that it is unnecessary – even for an application of the prohibition rules – to prove that, in a specific case, the conduct is detrimental to consumers.

* University of Bonn.

¹ Case C- 95/04 P, *British Airways v Commission*, not yet reported.

Competition law is about *competition*. Thus, starting with a semantic analysis, it seems obvious that competition means more than just consumer welfare. In *British Airways*, the ECJ repeated its statement in the 1973 *Continental Can* judgment² that there are *structural prerequisites* to competition. According to the ECJ, the Court of First Instance had not erred in law by foregoing an examination of whether the conduct in question had caused prejudice to consumers and limiting itself, rather, to an analysis of whether British Airways' bonus scheme had a restrictive effect on *competition*.³

However, in light of the ECJ's judgment in *British Airways*, we know that there may be a second stage of analysis at which efficiency and consumer welfare are *directly* introduced. At paragraph 86 of the judgment, the Court indicates that an efficiency justification is also permissible under Article 82 EC.⁴ Hence, today it seems clear that European competition law requires, in all three areas – Article 81, Article 82 and Merger Control – a two-stage analysis. At the first stage it follows a more open approach and does not *directly* concern itself with *consumer benefits*.

Why not? According to the law as it stands in Europe, competition seems to serve more purposes than solely consumer welfare. Of course, consumer benefit is at the core of the concept, but by virtue of its open approach, EC competition law is able to cover more.

It has always been an *effect* of competition law to protect individuals – who are not necessarily final consumers – against an abuse of market power. There are some test cases by which this may be demonstrated. One of these is demand power, or demand cartelization. If, for example, large car manufacturers form a demand cartel in order to purchase parts more cheaply, this is a cartel under Article 81(1) EC. One might argue that this cartel benefits consumers, at least in the case where, corresponding to lower purchase costs, the car manufacturers will *lower car sales prices*. Under the legal system of Article 81, however, this justification is only admissible within the narrow limits of paragraph 3 – which entails an inquiry both as to the indispensability of the restraint for the attainment of the objective and as to the subsistence of residual competition in the market following the transaction.

Under the current system of Article 81, demand cartels are – unless the conditions of paragraph 3 are met – prohibited. As the ECJ has repeatedly stated, competitors must not substitute “practical cooperation” for the “risks of competition”.⁵ The cartel prohibition

² Case 6/72 *Continental Can* [1973] ECR 495, paragraphs 25 *et seq.*

³ *British Airways*, *supra* note 1, para. 107.

⁴ To quote the paragraph in full: “Assessment of the economic justification for a system of discounts or bonuses established by an undertaking in a dominant position is to be made on the basis of the whole of the circumstances of the cases (see, to that effect, *Michelin*, paragraph 73). It has to be determined whether the exclusionary effect arising from such a system, which is disadvantageous for competition, may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer. If the exclusionary effect of that system bears no relation to advantages for the market and consumers, or if it goes beyond what is necessary in order to attain those advantages, that system must be regarded as an abuse.”

⁵ Case C 89/85, *Ahlström Osakeyhtiö and others* [1993] ECR I-1307, para. 63. See also Case 40/73, *Suiker Unie* [1975] ECR 1663, paras. 173 *et seq.*

applies not only downstream, but upstream as well: as long as there is no need to create a counter-weight to a powerful supplier, a purchasing cartel falls within the prohibition of Article 81(1).⁶ Thus, by securing the independence of decision-making among competitors, the law protects certain prerequisites, or “living conditions” of the competitive process. This “behavioural” component is, together with the “structural” conditions discussed above in the context of the *British Airways* judgment, another important element of the ECJ’s concept of the competitive process. An effect of this system is that *suppliers* are protected against demand cartelization. The example of a demand cartel clearly shows that the law does not currently confine itself to the goal of maximizing the welfare of final consumers. A demand cartel is prohibited regardless of whether or not it leads to consumer harm.

The relationship between fairness and welfare

The relationship between fairness and welfare requires, first, some clarification with respect to this terminology. Louis Kaplow and Steven Shavell have advanced the thesis that social policies should be assessed entirely on the basis of their effects on individuals’ well-being.⁷ However, they advocate a wide notion of welfare, opening the concept up to accommodate any advantage which could be considered to further the well-being of individuals. Such a concept of welfare, which is able to integrate the value judgments of a legislator, might help to overcome the existing communication problem between proponents of a “competitive distortion” model and a “welfare” model of competition policy.

The EC Treaty’s decision to protect competition as such is based on a fundamental confidence in the benefits of a market economy. As has been demonstrated above, this concept does not allow for a reduction to just one single aim such as *consumer* welfare.⁸ Competition advances a number of aims which cannot be determined in an exclusive manner. Individual freedom of action, the protection of market participants against the abuse of market power by others, an interest of consumers in a cheap supply of the goods desired, and a collective interest in the promotion of technical and scientific progress have all been regarded as figuring among these aims. The application of competition law is not dependent on positive evidence that just one of these ends is achieved. The law protects competition as such because it is deemed, by way of *presumption*, to have favourable effects of one sort or another. A deviation from the principle of competition is admissible only in exceptional cases. It requires a demonstration that a restriction of competition, such as a cartel agreement, is necessary for the improvement of the production or the distribution of goods or for the promotion of technical or economic progress, whilst allowing consumers a fair share of the resulting benefit. This two-stage analysis (beginning with the principal prohibition of restraints on competition, and only then allowing for exceptional justifications on grounds of efficiency)

⁶ Case C 250/92, *Gøttrup-Klim and others v DLG* [1994] ECR I-5641, paras. 28 *et seq.*

⁷ Louis Kaplow and Steven Shavell, “Fairness versus Welfare: Notes on the Pareto Principle, Preferences, and Distributive Injustice”, 32 *The Journal of Legal Studies* 331 (2003).

⁸ For an economics-based argument in favour of a consumer welfare orientation, see Damien Neven and Lars-Hendrik Röller, “Consumer surplus vs. welfare standard in a political economy model of merger control”, 23 *International Journal of Industrial Organization* 829 (2005).

applies, as noted earlier, in all three areas of competition law: cartel prohibition, abuse of dominance and merger control.

There is no need, nor is there any reason, for a change of the described policy. As shown above, to concentrate on a single aim, namely that of *consumer* welfare, would reduce the scope of competition law significantly. The current law protects not only consumers but also producers. For example, suppliers of goods are, as has been demonstrated, protected against purchasing cartels. Suppliers may also invoke the prohibition provision of Article 82, which prohibits an abuse of demand power by dominant purchasers as well. Why does the law protect producers and not only consumers? Producers have the same rights as anyone else in a market economy. In particular, they enjoy property rights. If we wish, and this seems to be the most important point, to encourage people to commit themselves to an activity on a market, we ought to protect them from expropriation. This includes protection against expropriation by way of cartelization or abuse of dominance. If we took the view that it is acceptable for a purchasing cartel to deny a manufacturer the possibility of earning revenues on a previous investment, we would create a disincentive to market participation.

This reasoning refers to the infrastructural function of law in general and of competition law in particular: in order to create incentives, not disincentives to participate in the market, the legal system must provide a set of rules guaranteeing that the legitimate expectations of the players are realized. This includes not only the possibility to enforce contractual obligations, but also a protection against unjust exploitation. One may call this – if one wishes to do so – a “fairness” consideration. In this sense, competition law serves, *inter alia*, a goal of fairness. It is important to see that this consideration is not a goal in itself, but rather serves an economic function as well: we have good reason to assume that “fair” and “equitable” rules promote the willingness of firms and individuals to engage in market operations, thereby furthering the aggregate well-being of individuals. This argument demonstrates that welfare requires more than the avoidance of deadweight loss and the acceptance of “efficient” restraints on competition.

The use of modern economic techniques when applying competition law cannot be praised highly enough. The contribution of economic theory in the context of the assessment of facts – such as market definition and the prognosis of the effects of particular conduct or of structural changes – is indispensable.⁹ However, as David Gerber points out in his paper, economic theory cannot provide an answer to normative questions. In a democracy with a division of powers, it is for the legislator to decide upon normative issues. The EC Treaty, in Articles 2 to 4, lays down a multitude of objectives, including a common policy in the areas of agriculture, fisheries and transport, the coordination of the Member States’ employment policy, social and environmental policy, the promotion of research and technological progress, the encouragement of the development of trans-European networks and measures to

⁹ For an analysis of the use of modern economic tools in European and German merger control, see Ulrich Schwalbe and Daniel Zimmer D, *Kartellrecht und Ökonomie – Moderne ökonomische Ansätze in der Europäischen und Deutschen Zusammenschlusskontrolle*, Verlag Recht und Wirtschaft, 2006.

achieve a high level of health protection. In the particular context of competition policy, the Treaty follows – as has been demonstrated – an open, process-oriented approach. A reduction to just one single aim – such as consumer welfare – is inconsistent with this normative decision.