Economic analysis and competition policy

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The protection of competition in Cyprus and Europe

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Why competition policy?

- One of the few areas of law that is based on an economic theory (patent law is another example)
- Economic theory suggests that competition maximizes social welfare and leads to a better allocation of resources
- Monopolies (or oligopolies) deviate from that outcome, therefore they need to be contained
- Not entirely uncontroversial, but widely accepted as a guiding principle

A bit of history

Adam Smith

- Competition is good

But beware:

"People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."

Laissez faire, cartels and the birth of regulation

- Smith's warning was more apt that he probably ever imagined
- Free enterprise in the 19th century led to the formation of trusts/cartels that controlled commerce in key economic sectors (railroads, shipping, oil, etc.)
- Policy response in the US was the creation of the first regulatory agencies and the passing of the Sherman Act in 1890

Sherman Act

- Section 1:

  "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.“

- Strong: any agreement that restrains trade is illegal
- But ***rule of reason*** doctrine prevailed over time: requires proof of “unreasonable restraint of trade”
- Some agreements (price fixing, market division) ***per se*** illegal

Sherman Act

- Section 2:

- "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony [. . .]"

- Monopolies or attempts to create one are illegal
- Wide-ranging and unclear, has been through various interpretations and refinements (Clayton Act, 1914; Robinson-Patman Act, 1936)

Implementation

- Some of America's industrial giants were prosecuted on the basis of the Sherman Act: Standard Oil, US Steel, American Tobacco, AT&T, IBM, Microsoft
- Enforcement became particularly activist after the Great Depression and through the 1960s. Companies were prosecuted just for being dominant
- In the 1970s there was a pullback towards less intervention
- Degree of activism determined by current events and political climate , but also mirrored developments in economic theory

Europe

- The spirit of the Sherman Act were transcribed into EU Treaties; articles 81 and 82 in Treaty of Rome (1957), articles 101 and 102 in current EU Treaty
  - Article 101 prohibits agreements which restrict competition
  - Article 102 prohibits firms the abuse of a dominant position
- For a long time implementation at the European level was weak; countries more interested in protecting their turf
- Things started changing in 1990s and now DG Competition is very powerful

Economic theory: the early years

- Early 20th century: economic theory dominated by marginalism and Marshall's neoclassical analysis
- Theories of imperfect competition eventually developed in 1930s by Chamberlin, Robinson and Hotelling
- New theories lent intellectual support to activist antitrust policies
- 1940s-1950s: the Structure-Conduct-Performance paradigm linked high market concentration with inefficiency and gave further justification to anti-monopoly policies

Chicago critique, game theory, empirics

- Chicago critique of 1960s poked holes in SCP arguments and methods
- Part of general dissatisfaction with effectiveness of state intervention (regulation and competition policies, public enterprises) that led to era of less state and more market (liberalization, privatizations, deregulation)
- Development of game theory in 1970s swung the pendulum back (a bit) by lending some credibility to the SCP arguments
- Theory showed anything is possible. Weight shifted to empirical analysis and case-by-case examination

Per se vs rule-of-reason

- Market participants (and courts) like to know what type of conduct is allowed and what is not (*per se* illegality)
- Economists reluctant to write down specific rules; the usual answer is "***it depends***" (consistent with "rule of reason" doctrine)
- Creates need for specialized courts/judges/lawyers
- Large growth in legal activity and consulting services

Role of economics

- Economics is needed in:
  - Market definition, market analysis
  - Establishing harm in rule of reason cases
  - Calculating damages in per se cases (e.g. price-fixing)

- Increasing presence of economists in competition authorities (though still dominated by lawyers)

- Most have in-house economics teams and chief economist

- Last few EU Competition Commissioners have been economists (Monti, Kroes, Almunia, Vestager)

Use of economic tools

- *Sound economic reasoning* is very important in all aspects of competition law: market definition, establishing harm, calculating damages
- Empirical analysis has also become standard, though at a relatively basic level (simple demand models)
- More sophisticated methods used by academic economists take too long to implement and are seen as too complex
- Nonetheless, some progress in gaining acceptance in policy areas, e.g. merger simulation

Challenges

- For economics
  - Devise more *per se* rules to provide guidance
  - Develop empirical tools that are robust and can be implemented quickly
  - Static versus dynamic considerations

- For policy
  - What is the right welfare criterion?
  - Tacit collusion
  - Improving competition culture

Building institutions

- Competition policy is a vital complement to open markets
- Must be implemented by independent competition authority
- Independence means freedom to exercise powers granted to them by the state *without political interference*
- The state's role is to appoint the right people and let them do their job
- Building strong institutions takes time and money; but it's a worthwhile investment

Thank you