The role of economic analysis within Article 81

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A traditional starting point

- *"People of the same trade seldom meet together even for merriment and diversion, but the conversation ends in a conspiracy against the public or some contrivance to raise prices."* Adam Smith, Wealth of Nations.
- Concern with conspiracies among suppliers that cause harm to the public.
- Today the emphasis might be placed on harm to 'consumers' rather than harm to 'the public', perhaps reflecting greater heterogeneity in spending patterns.
- But continued recognition that a relatively wide notion of harm is relevant. Thus, for example, harm to a competitor may be caused by undercutting his/her prices, but that is not considered a problem on the ground that customers/consumers will benefit from the lower prices.

Compare with Article 81

- Article 81(1) prohibits agreements, decisions of associations of undertakings and concerted practices which have as their object or effect the prevention, restriction or distortion of competition.
- Potentially much wider in scope.
- What agreements are covered? What is meant by “competition”? What is a “distortion” of competition?
- Do not expect clear answers to the latter questions from economists.
- Scope follows purposes, which are linked in this case to the the “construction” of a common market.
- Wider scope puts more emphasis on exemption issues, and hence the economic importance of 81(3).
- And notice the “fair share of the resulting benefit” test in 81(3), which provides a partial link back to older tradition (harm to consumers).

Some basic economics

- Managers from each of two companies, A and B, meet and reach an agreement that, among other things, constrains/fixes the price of A's product.
- What are we to make of this?
- At the most abstract level, it might be argued that the effect is necessarily to prevent, restrict or distort competition: A's commercial/pricing freedom is restricted/constrained by the agreement.
- Some scholastic interpretations of Article 81 have almost gone as far of this, but it leads ultimately to economic absurdity.
- In practice, intentions and effects depend on context.

Context 1: A and B are "in the same trade"

- In this case, A and B supply goods/services that are seen as alternatives (*substitutes*) by their customers. Economists refer to this as a "horizontal" agreement, but this terminology can be misleading (see later slides).
- B will favour A setting high prices, because this will increase the demand for its products: it will be able to sell more at any given prices, including higher prices for its own products.
- A will tend to favour a higher price if B reciprocates, since this will increase demand for its own products.
- There is a joint interest in agreeing higher prices (provided that such prices are not easily undermined by outsiders).
- Hence the view of A. Smith: a tendency to conspire in ways that harm customers. Many economic intuitions are based on an implicit presupposition of substitutability.
- (Clusters of reasonably close substitutes comprise a "market".)

Context 2: A and B supply related, but non-substitutable, products/services

- A is a publisher of video games software, B is a manufacturer of video games hardware.
- In this case, B would like A's prices to be as low as possible, and A would like B's prices to be as low as possible.
- Reason: low software prices stimulate hardware purchases and *vice versa*.
- Customers are likely to benefit from co-ordination and agreement, so where is the harm?
- In this type of context the products/services are said to be *complementary* (lower price for one product *increases* demand for the other.
- The economic landscape when dealing with complementary supplies or activities is very different from that when dealing with substitutable supplies or activities.
- Hence, need to be wary of implicit intuitions/presuppositions.

Context 3: A supplies goods/services to B

- How can an agreement fixing or constraining A's price be avoided?
- *Reductio ad absurdum*: agreements necessary/indispensable for a decently functioning market economy cannot sensibly be held to prevent, restrict or distort competition.
- Agreements of this type are generally referred to as *vertical* agreements.
- Vertical supply relationships are typically characterised by some degree of complementarity between activities.
- Example: Manufacturers benefit from active marketing (lower prices, more promotional effort) by retailers.
- More significant cases arise when, say, the agreement between A (the supplier) and B (the buyer) constrains or fixes the prices of B's products/ services.
- But, given complementarity, why would A want B to do anything other than seek to serve downstream customers as best it can? Where's the motivation for a restrictive agreement?

Where does complexity come from?

- Article 81 refers only to ‘agreements’.
- Context 1 is relatively simple: presumption against traditional conspiracies against the public/consumer. Role of economic assessment may be limited to that of quantification of harm (e.g. to determine magnitude of financial penalties).
- Ditto for Context 2: analysis leads to a presumption that agreements are beneficial.
- However, agreements may occur in contexts involving a matrix of substitutable and complementarity activities.
- Many vertical agreements have this characteristic. Example: exclusive supply agreements.

Vertical supply agreements

- Some economists argue that Article 81 should not apply to vertical agreements (e.g. the ‘Chicago School, and compare with A. Smith). The ECJ, in *Consten & Grundig* (1966), determined otherwise.
- That judgment implies a potentially very wide scope for the legislation, which could be commercially damaging in the absence of extensive exemption possibilities, whether by block exemptions, the Article 81(3) route, or application of appreciability tests (e.g. there needs to be evidence of harm ”on a market”, meaning that competition among suppliers of reasonably substitutable products must be prevented, restricted or distorted).
- Leads to more emphasis on balancing pros and cons (benefits vs harm done), and to a potentially greater role for economic assessment.
- Example: arguably on the economics, very strict interpretation of the indispensability test is warranted when dealing with simple (Context 1) conspiracies, but not when dealing with vertical supply arrangements.

Economic assessments by the Courts

- Laddie J: *"… the court should not have any part to play, it seems to me, in deciding whether an agreement or course of conduct contributes to improving the production or distribution of goods or promoting technical or economic progress."*
- Too imprecise for justiciability?
- But depends on interpretation of Article 81 and on judgments concerning the burden of proof.
- And, very arguably on the available evidence, the courts make a better fist of the economics than administrative agencies and many experts.
- Why?

Simplicity, complexity and context

- Simple cases (dominated by relationships of substitutability or of complementarity) are simple – at least in terms of the economics, though not necessarily in terms of fact finding.
- Where complex patterns emerge, economic effects tend to be highly sensitive to context. Every case is different.
- Danger of substituting assumptions, presumptions, models and theories for relevant facts. These are not good substitutes.
- The virtues of ignorance (*ex ante*) -- "I don't know anything about this situation, tell me the facts" – and of basic questioning: Who is affected? How? By how much? What is the motivation? Where is the harm?
- Economics can assist in understanding the context, but (currently) it has a general bias toward over-abstraction (from the facts) -- the "Ricardian Vice" – not necessarily corrected by an increasing emphasis on evidence-based approaches (select the evidence that fits the theory, ignore the rest).

Examples

- *The Supply of Beer*, *Note of dissent*, MMC 1989. *"Of course, there is a theoretical attraction in making major changes to the tied estate and the loan tie. However, the attraction smacks a little of the academic question 'the brewing industry may well work in practice, but does it work in theory?'. The proposals seem designed to fit the structure of the industry into some sort of theoretical Procrustean bed."*
- *BHB v OFT*, CAT judgment, August 2005. *"In our view, the evidence pointed to that conclusion and there was no reliable evidence supporting the different view that the OFT preferred, which appears to us to have been founded in theory rather than reality. We conclude that the MRA involved no infringement of the Chapter I prohibition."*

The final word to the ECJ

- *Tetra Laval v Commission*, ECJ Judgment (February 2005), Merger case, but with some relevance. The Commission had claimed that there would be anti-competitive "conglomerate" effects. We are therefore well away from Context 1.
- *"Whilst the Court recognises that the Commission has a margin of discretion with regard to economic matters, that does not mean that the Community Courts must refrain from reviewing the Commission's interpretation of information of an economic nature. Not only must the Community Courts, inter alia, establish whether the evidence relied on is factually accurate, reliable and consistent but also whether that evidence contains <u>all</u> the information which must be taken into account in order to assess a complex situation and whether it is capable of <u>substantiating</u> the conclusions drawn from it."*