

# **SPEECH**

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"Consumer Welfare and Efficiency – New Guiding Principles of  
Competition Policy?"

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## **Introduction**

Ladies and Gentlemen,

It has already become a tradition for me to speak at the European Competition Days organised by each EU Presidency and I would like to thank the organisers for inviting me again.

The challenging subject of our panel discussion today is "Consumer Welfare and Efficiency" – are these the new guiding principles of competition policy as we understand it in Europe?

I think that probably most of you here would agree that the aim of competition policy is to protect competition on the market as a means of enhancing consumer welfare. And you would probably also follow me if I said that consumer welfare and economic efficiency are closely related. An economy is operating at maximum efficiency when society is squeezing the greatest value – the highest level of welfare – out of its scarce resources.

## **History**

These statements seem obvious today, but it is worthwhile to recall that we have come a long way to subscribe to them. The case-law of the European courts and also the decisional practice of the Commission were initially influenced by ordoliberal thought which has its origin in the so-called Freiburg School. Their members advocated a strict legal framework and a strong role for the State in protecting the basic parameters of competition. Competition was understood as a process of economic coordination on the basis of freedom of

action. The protection of individual economic freedom – as a value in itself – was regarded as the primary objective of competition policy.

The consumer welfare approach, with its focus on the effects rather than on the process, was therefore at first sternly rejected. Former Commissioner Sir Leon Brittan emphasised that the combined goals of achieving an internal market and promoting competition create a form of competition law which does not fit neatly with any particular school of economic analysis used in other jurisdictions. He continued to state that the Chicago School – which originally pushed the economic welfare approach – is not directly relevant to EC competition policy. *"Chicago does not need to worry about creating a single market. Rather, it presupposes the existence of an integrated market."*

### **Re-thinking the standard**

Towards the late 1990ies, however, we have slowly but surely come to think that the "competition" that competition policy is supposed to protect is best viewed as a process, the outcome of which is welfare, with welfare being the aim. In the *British Airways case*, the CFI put this shift in thinking in the following terms: *"The protection of competition is not an aim in itself. As a means of both enhancing consumer welfare, and of ensuring an efficient allocation of resources, competition helps to prevent other welfare-reducing effects. Society as a whole, including consumers, in this way benefits from competition."* More recently, the CFI reaffirmed in *GlaxoSmithKline* that the *"object assigned to Article 81(1) [...] is to prevent undertakings, by restricting competition [...], from reducing the welfare of the final consumer of the products in question."*

For us in the Commission this meant that in our enforcement we can place greater emphasis on the promotion of economic efficiency and

consumer welfare. It meant, first and foremost, that principally those practices should be prohibited which have the effect of harming consumers.

## **Article 81**

As you know, this policy shift has already led to far-reaching reforms. We started with Article 81. As a first step, we adopted a new Block Exemption Regulation and the accompanying Guidelines on vertical restraints, which together form the basis for a more economic and less regulatory competition policy towards vertical agreements. The new rules are clearly consumer-welfare oriented. They assume that, where the share of the relevant market does not exceed 30 %, vertical agreements which do not contain "hard core" restrictions generally allow consumers a fair share of the resulting benefits. Only certain "hard core" restrictions are per se prohibited in order to maintain effective price competition between distributors for the benefit of consumers and to guarantee the consumers' right to purchase goods and services wherever they want inside the Community.

The Block Exemption Regulations on Research and Development agreements and Specialisation agreements as well as the Guidelines on horizontal cooperation agreements constituted the next step in the policy overhaul. Their approach is very similar to that of the Block Exemption Regulation on vertical restraints.

The new Guidelines on the application of Article 81(3) published in 2004 make the policy shift even clearer. They explicitly state that *"the objective of Article 81 is to protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources"*. Consumer welfare is therefore used as a standard throughout the Guidelines. Some restrictions are classified

as restrictions by object, because it can be assumed that those lead to a reduction in consumer welfare. These restrictions are caught by Article 81(1) regardless of their actual effects on the market. The Guidelines also spell out under which conditions consumers receive a fair share of the efficiencies generated by the restrictive agreement, which is one of the conditions for an exemption under Article 81(3).

## **Mergers**

The shift in policy also warranted the adoption of new merger control standards. The Merger Regulation of 2004 moved away from the more structural concept of dominance to make clear that all anti-competitive mergers resulting in higher prices, less choice or innovation – in other words: causing consumer harm - are covered. The central question is whether sufficient competition remains after the merger to provide consumers with sufficient benefits.

The Guidelines on the assessment of horizontal mergers, published at the same time as the Merger Regulation, follow the same standard and apply it to efficiencies. Mergers can indeed be very good for consumers. Auto Firm A, for example, may be better than auto Firm B when it comes to coming up with innovative ideas and quality control, while auto Firm B may be better than auto Firm A when it comes to marketing and post-sale servicing. Combining the best of both through a merger can produce synergies, which in principle permit lower-cost production of an even better product. The Guidelines explain that such efficiencies will be taken into account where they are merger-specific and verifiable and – most importantly – benefit consumers.

When factoring in efficiencies, we apply an integrated approach. That means that we do not artificially distinguish between efficiencies on the one hand and other effects of the merger on the other. We

rather weigh all positive effects against all negative effects in one integrated step and assess whether the outcome is, on balance, positive for consumers.

Having said that, the practical relevance of the efficiency defence should not be overrated. Both here in Europe and in the US, it is rare that parties claim efficiencies and that authorities can be persuaded of their merits. One example where efficiencies played a major role is the DoJ's March 2006 decision to terminate its investigation of the merger of Whirlpool and Maytag. In this case the DoJ noted that *"the ability to expand sales significantly and large cost savings and other efficiencies that [the merged firm] appears likely to achieve indicates that this transaction is not likely to harm consumer welfare."*

## **Article 82**

The air of change has now reached Article 82. In December 2005, we published a discussion paper on the application of Article 82 to exclusionary abuses. In line with the stance taken in Article 81 and mergers, the Discussion Paper states that the objective of Article 82 is the protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. Effective competition brings benefits to consumers, such as low prices, high quality products, a wide selection of goods and services, and innovation. Throughout the paper, we therefore promote consumer harm as a standard for our enforcement and open up the possibility of an efficiency defence also under Article 82. Efficiencies will be assessed in an integrated approach as part of an overall weighing of positive and negative effects of the conduct, like in mergers. The basis assumption is, however, that competition will benefit consumers and that limits on competition will normally harm consumers.

Of course, it is not always easy in practice to ascertain what is in the best interest of consumers. It is also difficult to distinguish consumer welfare from other objectives which society may want a competition authority to pursue. Let me give you just three examples:

- The battle between the out-of-town hypermarket and the downtown store is currently raging throughout Europe. So too is the fight of the corner shop against the supermarket or the petrol station store. But ultimately, competition authorities or governments who want to interfere in this battle have to ask in the end whom they are protecting. Is it the consumer or a category of shop employee or a way of life?
- Or look at the current alarm among consumer groups and governments in a number of European countries about not being able to transfer downloads from your iPod to other MP3 players. What sort of problem is this? Are consumers who download music from iTunes locked into buying an iPod? Is it a debate about how far intellectual property rights should be protected? Or is it a competition problem? Apple certainly has a high market share but that does not mean much in the rapidly developing markets for proprietary MP3 and other music players. According to market research, only 2% of tracks stored on iPods are downloaded. The rest is music from CDs. So before we jump in to regulate competition on the market, it's worth asking whether competition is actually harmed. Is there not vigorous competition between different bundles of MP3 players and music libraries?
- Another area of interest – not covered by the Discussion Paper – is that of excessive prices. High prices certainly harm consumers in the short run. But is that a sufficient case for intervention by a competition authority? What if high prices would in the medium term attract entry and spur competition? If there are no high or insurmountable barriers to entry, it might well be that high prices

are actually likely to be, on balance and with a longer term perspective, good for consumers. There is much more for consumers to gain through increased competition than a mere decrease in prices: competition brings more choice, scope for differentiation in quality, innovation, etc.

Beyond the question of principle how consumer welfare must be defined in a given case, I do not want to hide that there might be other, operational difficulties in applying a more effects-based under Article 82. In our cartel work, there is no doubt that price fixing and other hardcore restrictions are per se bad for consumers. In mergers, the balancing exercise of positive and negative effects is a difficult exercise, but as far as fact-finding is concerned, we can count on the support of the merging parties. In our Article 82 work, we are on our own. Sometimes a complainant will help us to put together some arguments, but he will usually have more limited access to information than the defendant, the dominant undertaking. This makes it very challenging to gauge in a specific case the consequences, efficiencies or others, of a challenged practice.

We must therefore find ways of making this new approach operational, also for Article 82. Economists need to build workable models based on limited available data. Analytical techniques employed must be dimensioned to deliver results within certain time limits.

Moreover, like in mergers, where we have the HHI, market shares, dominance, cost benchmarks etc. as possible elements of a plausible economic theory of harm, we should also use proxies and presumptions when applying Article 82 to make enforcement more practical and swift. Indeed, a pure effects-based approach can be too costly in terms of enforcement. Cost benchmarks (such as average avoidable costs or long-run average incremental costs) can be used



for the assessment of predatory pricing. For example, pricing below average avoidable cost by a dominant company is not normally consistent with profit maximising behaviour. It therefore creates a rebuttable presumption that the conduct is intended to sacrifice profits in order to exclude a competitor and thereby recoup the initial sacrifices. In most cases, dominance will indicate likely recoupment of the lost profits and lead to consumer harm.

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Ladies and Gentlemen, my overall message is short and simple. Yes, consumer welfare and efficiency are the new guiding principles of EU competition policy. Whilst the competitive process is important as an instrument, and whilst in many instances the distortion of this process leads to consumer harm, its protection is not an aim in itself. The ultimate aim is the protection of consumer welfare, as an outcome of the competitive process. And believe me that as head of a competition authority charged with protecting consumer welfare, I am at least as concerned about false negatives, i.e. under-enforcement, as I am about false positives, i.e. over-enforcement. I am therefore committed to make the new rules work in practice.

Thank you very much for your attention.