

## **SPEECH**

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# **The role of economics in modern competition policy**

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Seul le texte prononcé fait foi  
Es gilt das gesprochene Wort

## The role of economics in modern competition policy

First of all, thank you to the International League of Competition Law for inviting me to speak here today. I am pleased to have the chance to share the Commission's thinking with such a well-informed audience.

I would also like to thank the League for responding in such a careful and considered fashion to our White Paper on private enforcement. One phrase in particular struck us in that response - the description of the White Paper's aims as '*both commendable and difficult*'.

I am tempted to suggest that this remark could be made for what we are aiming for with our competition policy in general. What we are trying to do is simple enough: we want to help markets work better. It is a commendable ambition, but it is also a difficult one.

As markets become more international, and as the pace of technological change quickens, so the challenges we face become more complex. To keep ahead of this change, or even to keep up with it, we need sound economic analysis in order to take the right cases and reach the right decisions. It is easy enough to say that – but what are we actually doing?

What I will try to do is to set out an overview of how we have dealt with economics in antitrust, mergers and state aid in recent years, and what our plans are for the future.

It is clear that sound economic analysis is central to competition policy. In turn, competition policy shapes fundamental economic decisions by business on investment, on consolidation and on pricing.

As a competition authority, the Commission therefore has a clear responsibility to ground its work in sound and up to date economics.

We have tackled this challenge in three key ways.

### **First, we have strengthened our resources.**

In 2003, we created a new Chief Economist function. We accelerated the recruitment of economists throughout the service and introduced new control checks to our investigations and case evaluations. The Chief Economist – Damien Neven - now heads a team of around 20 specialised economists.

In the early 1990s the ratio of economists to lawyers in DG Competition was one to seven. It is now roughly one to two. I realize that I am among lawyers today, but I still hope you will agree that the new ratio is an improvement.

**Second, we have worked hard to improve the regulatory framework.**

This has both helped us prioritise our work and enabled our economic analysis to have more effect.

You could say that we have been working at this for the last 10 years or so. Arguably, you can trace it back to 1997, when we issued new guidelines on defining relevant markets. These used economic concepts to recommend the SSNIP test (Small but Significant Non transitory Increase in Price by a hypothetical monopolist).

And we continued to work on it in 1999 and 2000 when we radically revised the rules on vertical and horizontal restraints. This signalled a shift from a formalistic rule based - per se - approach towards a more economic – effects based - approach. A long list of specific contractual requirements and prohibitions was replaced by an approach that took real account of market circumstances. Companies with little market power, like nearly all small and medium businesses, have been freed from the worry about the compatibility of their agreements with EU competition law.

2002 was something of a watershed year for us. In that year as you know the Court of First Instance rejected three Commission merger decisions in four months. The CFI's criticisms sharpened our focus on increasing our capacity for economic analysis, and on developing better enforcement instruments.

By 2004 the new test in our revised merger regulation made clear that we were interested not just in dominant firms, but also in other situations of unilateral market power. In that same year, the horizontal merger guidelines were adopted and these provided a clear framework for the analysis of such unilateral effects.

Our decision in the *T-Mobile Austria/Tele.ring* case for example involves analysis of possible impediments on competition even in the absence of dominance.

Three years later, in 2007, we adopted non-horizontal merger guidelines, which recognized that most vertical and conglomerate mergers do not harm competition and can often be good for consumers. At the same time we recognized that our analysis of proposed mergers has to also pick up on risks such as competing companies being denied access to an important supplier, or facing increased input prices.

### **Third, we are using increasingly sophisticated quantitative techniques.**

We are not alone in this of course. The OECD noted last year that merger analysis has become more complex and ever more grounded in quantitative studies. Across the OECD the analysis of agreements between firms has moved away from the formal notion of dominance towards that of effective competition. And the analysis of the factors that determine effective competition has become ever more detailed. For example, there is an increased focus on the role of bidding markets, barriers to entry, potential competition or buyer power. Up to date quantitative techniques are of paramount importance in much of this.

A recent example is the *TomTom/TeleAtlas* case, where a qualitative and quantitative analysis established that the parties, despite their significant market position, would lack the incentives to foreclose competitors. The quantitative analysis in this case was particularly interesting because it involved both sophisticated econometric estimation and – using the econometric estimates – the construction of a model that allowed the Commission to assess the effects of the merger.

Or take the *Ryanair/Aer Lingus* case, where econometric studies showed that the two parties had a significant impact on each other's pricing. This case illustrates that a competition authority can be in a position to perform analysis that the notifying party cannot do itself. The case was a hostile takeover bid, and Ryanair therefore did not have access to Aer Lingus data. The Commission could combine data from the two companies and therefore work on a better data set.

What I am trying to outline is that it is now normal for quantitative analysis to help shape our approach. But actually the main message is to stress that such analysis is used only as a complementary tool. We use it to strengthen our cases. It will never replace our qualitative analysis. The Ryanair case is a good example of that: if you read the decision, you will see the close inter-relation between the qualitative and quantitative evidence.

So far, I have spoken mostly about mergers. Let me now turn to a brief overview of **antitrust** issues. We are well aware that the Commission and the Courts have been accused of focusing on form instead of on effects, and therefore of underestimating the pro-competitive element of some practices, and the potential efficiency benefits that may stem from them.

I should also mention, however, that focusing on form rather than effects also risks the opposite problem – of underestimating the harm of some practices. It is unlikely for example that we would have been able to bring our tying case against Microsoft using a form based analysis.

## **Work in progress**

When we published in 2005 the Discussion Paper on the application of Article 82 to exclusionary conduct by dominant firms, we advocated an enforcement approach based on the assessment of actual or likely anti-competitive effects. We received many responses, and most broadly endorsed that approach.

Since then, we have continued to reflect on our Article 82 enforcement policy. The policy is based on the belief that the ultimate objective of Article 82, like Article 81 or of merger control, is to increase consumer welfare by protecting competition. Therefore, we are working on a text that sets out an analytical framework to establish likely harm to consumer welfare. This framework is consistent with the enforcement approach we have been following in recent years, focusing on cases where there was a real risk of consumer harm, such as Microsoft or Telefónica.

We have also begun to reflect on the review of Community rules on vertical restraints, to prepare for the expiry of the current framework in May 2010. Our horizontal restraints rules also expire at the end of 2010. This work is still at an early stage. Let me just say that for now we are not expecting that we will propose major change here, but we do not rule out some significant tweaking.

Amongst other things, we will examine the treatment of resale restrictions where internet sales are involved.

In broad terms, in antitrust, we will continue to revise and reform both regulation and guidance so that it has a sharper focus on economic effects.

Finally, let me turn to **State Aid**.

As many of you will be aware, both the European Parliament and the European Council have asked the Commission to introduce more economic analysis in this field, and to concentrate on the most distortive cases.

This is exactly what Commissioner Kroes announced she would do through the State aid action plan at the beginning of her mandate. This plan signalled clearly that State aid policy should support growth and jobs, by helping aid be better targeted. This rests on using an economic approach, which will allow for a better analysis of the effects of the aid and so for a better State aid regime for the EU.

I do not want to overstate the change. The Commission did not just discover in 2005 that economics was relevant to State aid. What the State aid action plan does is make our thinking on economic analysis more consistent and more thorough. We have been re-writing the state aid rule book accordingly.

As part of this, we have developed a test for evaluating the effects of aid. The idea behind this test is to disentangle the positive and negative effects resulting from an aid, to evaluate them and then to balance them.

The test requires us to first look at the purpose of State aid: is there a market failure that needs to be corrected? Or would State aid increase fairness (equity) by changing an efficient but undesirable market outcome?

The test also looks at the design of the aid measure and tackles questions such as whether State Aid is an appropriate policy instrument, whether it would change behaviour (is there an incentive effect), and whether it would be proportionate.

Such questions make it possible to grasp more precisely and in more economic terms what the positive effects are, and how they stack up against the potential negative effects of aid. For example, we might want to consider if a State Aid reinforces market power, or distorts dynamic incentives, or supports inefficient companies, or affects business location or trade flows.

This approach is hard-wired in the state aid legislation adopted during this Commission, and is followed through in individual cases.

One last remark before I finish. Economics is both an art and a science, and strengthening our economic analysis does not, therefore, mean reducing everything to a mathematical formula. Competition policy will never be a simple case of feeding numbers into one end of a model and expecting straightforward answers to come out at the other end.

What a strong framework for economic analysis can do is to make our approach more coherent and more persuasive. I hope you will agree that we have made significant progress on this, and I also dare hope that you will support our efforts to continue improving.