

COMPETITION ECONOMICS IN EUROPE



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This short introduction first takes stock of the increasing role that economists play in antitrust proceedings in Europe and discusses the activities of the chief economist team in this prospective.¹ Given the central role that economic analysis now plays in proceedings, whose importance is bound to increase further, we subsequently discuss how economic analysis, and its cross-evaluation by the parties concerned, can improve decision-making.

A SHORT HISTORY OF ECONOMIC ADVICE IN EUROPE

Economic advice was marginal in antitrust proceedings in Europe up until the late eighties. NERA opened an office in London in 1984 and London Economics was set up in 1986. Lexecon (Ltd) was set up in January 1991 and up until the mid-nineties, Lexecon, London Economics and NERA were the main suppliers with total fees around £2.5 million in 1995. This turnover corresponds to EU-related competition work but also to competition work in national jurisdictions. UK-related work accounts for the vast majority of the latter. The market for EU-related advice grew rapidly in the late nineties, as the number of merger notifications (as well as other types of cases) grew but also following the preparation and implementation of the notice on

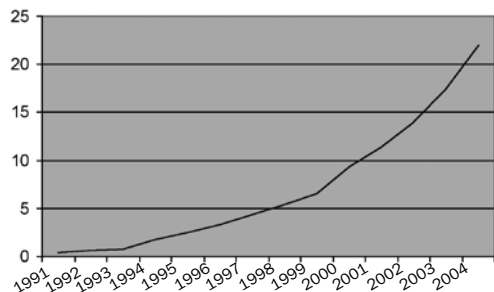
market definition. This notice,² inspired by the US practice, used economic concepts explicitly. As indicated by figure 1, for the following 10 years, total turnover grew³ at some 25-30 per cent per year, reaching about £24 million in 2004.⁴

It is also interesting to consider the turnover of economic consultancy relative to the turnover for legal advice. Lexecon Ltd estimated that economic consultancy amounted to about 5 per cent of the total amount of fees (legal and economic) in 1995.⁵

If one assumes that legal fees have increased at the same pace as the number of cases (the annual flow of cases has increased by a factor of about 2.5) in the last 10 years, economic consultancy would now amount to about 15 per cent of the total amount of fees. This is only a rough guess, which, however, seems in line with the perception of some key players in the market. Interestingly, it would mean that the European market has converged with the US in this respect as 15 per cent appears to be a commonly accepted figure in the US.⁶

Some evidence on the relative importance of economic and legal fees can also be gathered from the records of the *Airtours* case.⁷ *Airtours*, which attempted to acquire First Choice and was prevented from doing so by the European

Figure 1. Turnover of economic consultancy firms (current £ million)



Source: Neven, 2006

Commission, succeeded in its appeal in front of the CFI⁸ and the Commission was ordered to pay the cost that Airtours had incurred for the procedure. The Commission refused to pay the amounts that Airtours requested, claiming that they were exaggerated. Airtours asked the CFI to order the Commission to pay and the Court had to rule on the amount that the Commission should repay. Accordingly legal and economic fees became public.⁹ The Court judgment (T-342/99 DEP) revealed that fees charged by economists amount to about 21 per cent of the total (but interestingly only about 10 per cent of the fees eventually reimbursed by the Commission, as a result of the discounts applied by the Court).

The amount of economic input into the Airtours case is probably unusual (as the case revolved around some conceptual economic issues). On the other hand, one would expect economic fees to be lower in a Court case than in the initial administrative procedure (in which evidence is gathered). This particular case may thus confirm that a figure of 15 per cent is not unrealistic.

A survey by PriceWaterhouseCoopers¹⁰ for the International Bar Association lends further support to this estimate. The study, which focuses on the cost of mergers and acquisitions, found that about 20 per cent of the amount of legal fees was paid to other types of advisers. These presumably include lobbyists as well as economists but one can presume that the bulk of external fees went to economists.

The market structure has also changed over the last 15 years. Lexecon had a market share that could be referred to as ‘dominant’ at some point in mid-nineties. Entry by US firms (LECG and CRAI), domestic entry and split-ups increased the number of significant players over time. Currently, the industry appears to be more fragmented with comparable market positions for CRA International (which took over Lexecon in the summer of 2005), LECG, RBB Economics, with Frontier and NERA being possibly somewhat smaller.¹¹ This fragmentation has also been observed in the US market and from this perspective the two markets seem to have converged as well. The market structure is also characterised by the presence of three firms with global (or at least transatlantic) operations.¹² In this respect, economic consultancy seems to have followed the same path as legal advice, both

moves being triggered by clients with operations and antitrust filings across jurisdictions.¹³

A more qualitative estimate of the importance of economics in antitrust can be obtained by considering the proportion of decisions in which explicit reference is made to economic advice. According to Neven (2006), economic advice is referred to in about a third of phase II merger decisions and the proportion tends to increase over time. A closer look at the cases in which economic advice is referred to also reveals that economists are involved in the more important cases (those involving new issues, delicate competitive situations and large transactions).

RESOURCES FOR ECONOMIC ANALYSIS IN DG COMP

The amount of resources that DG Comp mobilises for economic analysis can also be roughly assessed. There are currently 83 professionals with a background in economics at DG Comp¹⁴ and 184 with a background in law (hence roughly a ratio of 1 to 2). The ‘Economist network’ within DG Comp (a loose network of self-reported economists) includes about 90 members. The ratio of economists to lawyers has however increased greatly over time; according to Wilks and McGowan (1996), the ratio was 1 to 7 in the early 1990s. Still, most economists do not undertake technical economic analysis. Only a quarter of them have a PhD in economics and until recently about 10 had a PhD with a specialisation in industrial organisation. The position of chief competition economist was only created in 2003 with a team of 10 economists. This can be compared with the (roughly) 150 professionals currently working in the economic consultancy firms considered above. Even if one assumes that only half of the time of those professionals is devoted to European work, the discrepancy between the resources invested by the parties and those invested by the EU is very large. The team of the chief competition economist can also be compared with the economists working at comparable agencies in the US. The antitrust division of the US Department of Justice and the US Federal Trade Commission have together well over 100 professional economists.¹⁵ This comparison is also biased to the extent that a significant proportion of the resources of the chief economist (and of the ‘economist network’) are devoted to issues related to state aids. This

striking imbalance is however being addressed; the team of the chief economist is being expanded and should have 20 professionals by the end of year. The steady state should probably involve a significantly larger team but faster short-term growth could hardly be achieved.

MAKING THE BEST OUT OF ECONOMIC EVIDENCE

Scepticism on the usefulness of economics is often supported by the fact that in some cases apparently sound, but contradictory, analyses are developed and submitted.¹⁶ This scepticism leads to the view that economic reports provided by different parties simply cancel each other with no apparent effect on the quality of decision-making. This view is often unjustified and it is based on the understandable, but incorrect, belief that the application of scientific methods to the facts of a case should produce unambiguous and consistent results.¹⁷ Contradictory results are therefore taken as evidence of advocacy or unprofessional behaviour.¹⁸ However, those apparent contradictions may result from differences in the data, differences in the approach to economic modelling or in the assumptions used to interpret the data, differences in the empirical techniques and methodologies, or may be the result of unintentional mistakes. The history of economic analysis exhibits numerous controversies in matters where economists holding opposing views had no obvious private interests (other than, perhaps, scientific pride).¹⁹

When alternative studies produce contradictory conclusions, their relative merits should be carefully investigated. The right approach cannot be to discard them all as if they were equally incorrect or unscientific. First, that approach could be easily manipulated: any valuable economic analysis could be in principle undermined by submitting another economic study with seemingly contradictory conclusions. Second, and most importantly, some of those analyses may contain valuable information and may help to improve the decisions of the competition authorities and courts, thus reducing the likelihood of both type I (false convictions) and type II (false acquittals) errors.

In fact, it may well be the case that all those studies prove valuable in spite of their apparent contradictions. Those inconsistencies may simply reflect some inescapable ‘ambiguity’.

That is, they may reveal that several alternative hypothesis are plausible and consistent with the facts of the case at hand. If the analyses submitted to test a given proposition in a case produced contradictory results but all of them were scientifically valid and none of them could be considered intrinsically superior to the other or others, the only legitimate conclusion would be that the available evidence can neither validate nor falsify or refute that proposition ‘beyond reasonable doubt’. However, if most of those analyses pointed in the same direction and the exceptions were not methodologically or otherwise superior to the studies providing a congruous result, the proposition would be established as ‘more likely than not’, ie, it would be supported by a ‘preponderance of evidence’. It should be clear, therefore, that whether economic evidence allows the decision-maker (whether the Commission or the Court) to conclude in favour or against a given proposition depends not only on the facts available to the researcher and the methods deployed to interpret those facts but also, and fundamentally, on the required standard of proof.²⁰

An assessment of the relevance and rigour of the economic analyses submitted in a case requires, *inter alia*, (i) understanding whether the data employed in those analyses is appropriate; (ii) assessing whether the underlying assumptions in their economic models are consistent with the institutional features of the industry under scrutiny and with all other relevant facts; (iii) ascertaining whether those models are well established in the relevant literature; and (iv) establishing whether the empirical approach adopted in order to test one or more hypothesis relevant to the case is appropriate. Furthermore, the conclusions of those analyses should be contrasted with other pieces of evidence (such as, eg, customer evidence, documentary evidence) in order to determine whether the evidence – factual, documentary or economic – provides a coherent picture or, alternatively, further research is needed prior to reaching a definitive conclusion.

The critical assessment of the merits of economic work constitutes standard practice in academia. Studies submitted for publication to leading journals are always reviewed by several (often two) anonymous referees together with the editors of the journal who evaluate the quality and relevance of the work submitted for

their consideration. No journal would reject an economic manuscript simply because it contradicts a previously published study. On the contrary, scientific progress is based upon the principle of creative destruction.²¹ However, the arguments and evidence provided in support for the reported discrepancies are always thoroughly scrutinised prior to accepting the controversial piece for publication. Many studies fail to pass that filter.

Economic arguments and evidence submitted in a case, including those developed by the Commission in support of its decision, need to be scrutinised with the same thoroughness and rigour. No doubt, the job of the decision-maker, whether the Commission or the Courts, is bound to be more complex than that of the journal referee. Unlike academic referees, competition authorities and Courts not only need to assess the scientific validity of the economic evidence that is submitted to them, but also need to decide the weight to be given to such evidence in their final determinations. This last decision, however, must be informed by a proper assessment of the scientific admissibility of the economic and statistical evidence in question.

In cases involving sophisticated economic evidence, the Commission has procedures at hand to give parties full access to the data and methods that it had used to develop the analysis which (partly) formed the basis for its objections. Conversely, the parties and their economic advisers are expected to provide the Commission with the data and details of the methods used to undertake their own work. No economic evidence which has not been scrutinised should be taken for granted and the office of the chief economist is committed to develop rules of conduct to allow for effective cross-refereeing of our work and that of the parties and their advisers. Hopefully, these rules of conduct should help extract most of the collectively available information and thereby contribute to more accurate decision making.

Notes

- 1 This section draws heavily on Neven (2006), *Competition Economics and Antitrust in Europe*, Economic Policy, October. I would like to thank colleagues in the chief economist team, Paul Seabright and Jorge Padilla, for useful discussions.
- 2 Notice on the definition of the relevant market for the purposes of Community competition law, OJ C 372 on 9/12/1997.

- 3 This rapid growth is to some extent a consequence of the fact that different parties in a competition case often have different interests – or, in other words, ‘where a single economist starves, two will make a living’.
- 4 This growth gives a biased estimate of the growth of competition work in Europe as some firms (like Lexecon) started to generate very substantial fees from work outside Europe (in particular South Africa).
- 5 Lexecon estimated the turnover of legal advice was estimated as follows: at the time, law firms in the UK had to obtain insurance from a common industry scheme. They had to publish their turnover for this purpose. In order to obtain the fees related to antitrust, it was assumed that each partner would generate the same amount of fees (an assumption which was validated with law firms) and partners undertaking mostly antitrust work were identified). These fees relate mostly to UK and European work (which was performed mostly from London at the time). However, it does not consider the turnover of Brussels-based law firms which were performing European work at the time (in particular the traditional Belgian law firms and the Belgian operations of US law firms). From this perspective, the figure of 5 per cent for economic fees is probably an upper bound.
- 6 Source: Lexecon, Inc.
- 7 Case IV/M 1524.
- 8 T-342/99.
- 9 The amount that the Commission spent on external economic advice is not publicly available.
- 10 See <http://archive.ibanet.org/news/Newsitem.asp?newsID=99>.
- 11 RBB economics was set up by former NERA consultants. LECG also grew markedly in 2004 as a number of consultants joined the firm from NERA.
- 12 RBB Economics has a cooperation agreement with Competition Policy Associates (the consulting operation set up by Ordovery and Willig) in the US.
- 13 Cross-border deals may not be numerous but they generate fees in excess of the average.
- 14 See www.euroPa.eu.int/comp/dgs/competition.
- 15 See www.oecd.org/dataoecd/53/15/2406946.pdf.
- 16 This point is raised and discussed in David Scheffman and Mary Coleman, ‘FTC Perspectives on the use of Econometric Analysis in Antitrust Cases’, in John D Harkrider and Daniel Rubinfeld (eds), op cit, 2005. See also Final Report of Economic Evidence Task Force, antitrust section, American Bar Association (ABA), 1 August 2006.
- 17 Charles F Manski, *Identification Problems in the Social Sciences* (Harvard University Press, 1995).
- 18 Final Report of Economic Evidence Task Force, ABA, op cit, 2006.
- 19 See for instance The Phillips Curve at http://en.wikipedia.org/wiki/Phillips_curve. See also Joseph A Schumpeter, *History of Economic Analysis* (1954, reprinted by Routledge, 1997).
- 20 See Emil Paulis, ‘The Burden of Proof in Article 82 Cases’, Fordham Conference, New York, 14-16 September 2006. See also Neven, op cit, 2006, sections 4 and 5, and Hubert Legal, ‘Standards of proof and standards of judicial review in EU competition law’, Fordham Conference, New York, 14-16 September 2006.
- 21 See Karl R Popper, *The Logic of Scientific Discovery*, (1952) and Thomas Kuhn, *The Structure of Scientific Revolution* (1962).