

NOTE

The Role of Economics in EC Antitrust

BY SIMON BISHOP

IT IS INCORRECT TO SUPPOSE that economics has played no role in EC competition policy prior to the appointment of a Chief Economist. Indeed, ever since the introduction of the Merger Regulation in 1990, economics has played an increasingly important role, first in merger decisions and then slowly spilling over into decisions in other areas of competition law. However, the appointment of Professor Lars-Hendrik Röller as the first Chief Economist of the EC Commission's Directorate of Competition still represents an important development in European antitrust law.

For one thing, the appointment of Professor Röller confirms the importance of economics across the full range of DG Comp's activities. In the past, the use of economics in Europe had been primarily confined to merger control. Although there has been a trend towards more explicit use of economics in the areas of Article 81 and Article 82, the appointment of a Chief Economist will surely accelerate that process.¹ Indeed, recent statements from senior DG Competition officials explicitly talk of subjecting all areas of EC competition law to economic principles.

Perhaps more importantly, the appointment is likely to result in an increase in the use of economics by national competition authorities throughout Europe. Currently, there are significant differences of style and approach towards the enforcement of competition law. Although, some differences are likely to persist, the recent Modernization program, according to which national authorities and national courts have for the first time the right to apply Article 81(3), ought to lead to greater harmony due at least in part

to the recent guidelines on its application. In those guidelines, there is a clear role for economics. However, it remains to be seen whether the role for economics in the guidelines materializes in practice and whether adherence to that guidance is uniform across the Community.

As an empirical economist, Professor Röller has assisted in the welcome shift from undue emphasis on theoretical concerns to a focus on the empirical testing of those theories. Contrary to the impression given by some, the critical judgments of the Court of First Instance during 2001 and 2002, which overturned decisions of the Commission in three merger cases, did not stem from a lack of economics on the Commission's part but rather from an overreliance on theoretical possibilities. Indeed, in each of the decisions criticized by the CFI, the Commission had relied on arguments prepared by academic economists. A unifying theme of these economic analyses was too much reliance on theory with little or no regard to the facts. But, as all those who are routinely involved in competition law know, the devil is always in the details. Against that background, cursory high-level analyses of the type relied upon by the Commission in those decisions will almost inevitably fail to take into account important industry facts and therefore likely lead to erroneous conclusions. ■

¹ The increasing use of economics in Article 81 can be seen in particular from the EC Commission's change in approach to vertical restraints.

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Interview with Lars-Hendrik Röller, Chief Economist, EC Directorate for Competition

Editor's Note: Lars-Hendrik Röller was named as the first Chief Economist of the EC Commission's Directorate of Competition in September 2003. He was previously Professor of Economics at Humbolt University in Berlin and also chair of the Institute for Competitiveness and Industrial Change (Wissenschaftszentrum Berlin für Sozialforschung (WZB)) in Berlin. Prior to these posts, among others, he was Assistant, Associate, and Full Professor at INSEAD, the Business School based in Paris. In 1993 he was a visiting scholar at Stanford Graduate School of Business. He received his Ph.D in Economics from the University of Pennsylvania.

In this wide-ranging interview, Professor Röller addresses a number of important issues currently before him as the first Chief Economist of the EC Commission's Directorate of Competition. In particular, Professor Röller discusses how his team of economists will interact with other parts of Directorate-Competition, his views on the role of efficiencies in merger control, and the apparent differences in the role played by economics in EC merger control compared to EC antitrust.

The interview was conducted for ANTITRUST by Simon Bishop.

ANTITRUST: How do you think the post of the Chief Economist will change the use of economists in EC competition policy?

RÖLLER: I think that it is one step in a process. There have been several measures at DG Comp which strengthen the economic analysis. I see the Chief Economist as a facilitator in that process. I don't see my role as creating an elite police force of ten people in one corner of DG Comp, but as trying to work as much as possible with economists—those who are already there, and others who are being hired in other areas of DG Comp—in terms of facilitating economic analysis across the field.



ANTITRUST: Is your team more like a center of excellence in which economists can exchange ideas?

RÖLLER: I think that's not the right term. We are a unit that has a considerable amount of expertise in economics. I feel confident that I now have a highly motivated team of economists, all of whom have a Ph.D in industrial organization, and who are very knowledgeable in economics and also on competition policy issues. The idea is not to build a great economics department at DG Comp, something I might want to do in a university; the idea is to actually work through the existing organization and help others to apply economic analysis in different ways.

ANTITRUST: One of the complaints made by economists in DG Comp prior to the creation of the new position is that they felt a bit isolated and were not given enough opportunities to use their economic training. Do you see your team as giving the economists in other parts of DG Comp a sounding board for their economic ideas?

RÖLLER: Yes, I do. It's also a question of critical mass in an organization. If you have fewer economists, it would be very hard for them in the context of a case to contribute in a significant way. I do feel that we have moved in a direction to strengthen our economic expertise, not only because of the Chief Economist's appointment, but also because other parts of DG Comp are hiring very good economists, which is very encouraging for me. In some sense, that's more important than me hiring good economists, which I have done as well. I believe we are in a process where economic analysis in-house or through outside experts or submissions from the parties will have a more important and more prominent role to play.

ANTITRUST: One of the issues is—and perhaps this is related to using people in other areas of DG Comp—you have a relatively small team. There's yourself, Pierre Buigues (the Deputy Chief Economist), and then building up to eight economists, as I understand it.

RÖLLER: Yes, we have now hired all that staff.

ANTITRUST: So the issue is—and I can imagine that this is a

problem inside and outside the Commission—that people are saying to you all the time, “I have a case, what do you think?” And, in order to do an economist’s job properly, you need to get involved in the real details of the case rather than reading a three page summary.

RÖLLER: Exactly.

ANTITRUST: So how are you going to allocate your resources given the potential demands on them?

RÖLLER: Given the small size of my team, we need to focus. As a result, we have to choose very carefully the cases we get involved in. In addition, we also work on guidelines. There are some important guidelines in the making and there have been some important guidelines recently. For example, the horizontal merger guidelines, the technology transfer block exemption guidelines, as well as the 81(3) guidelines.

Going back to the question, which was more on the case work, we choose cases which are complex in terms of the economic issues. We also get involved in cases that make general points, to have the economics done in a certain way in a particular case, which also feeds back into the guideline issues.

How we become involved in a case can happen in a number of ways. We can choose the cases we can get involved in, subject to the approval of Director General, Philip Lowe. The Director General has full control over which cases the Chief Economist gets involved in. We can also initiate a case and so far, this has worked very well. We can also be requested by other Directors in other parts of DG Comp to get involved in a case, but we don’t have to, and I think it’s very important for us not to get involved in too many cases. So we’re very selective and choose cases carefully. We are currently involved in something like the order of 20–25 cases and guideline working groups.

Where we are fully involved in a case, one member of my team joins the case team, with full access, and will be at all the meetings with the outside party and be involved if there’s an economist on the other side. In sum, I have someone on the case team, helping in terms of the economic analysis while reporting back to me.

There are some other cases where we’re asked to contribute towards a specific aspect of a case, say an econometrics study. However, I believe it makes more sense for us to get involved in all aspects of a case. To me, separating out the analysis from the rest of the case is not optimal. But still, if there is an econometric study and the case team needs some help, we will help them in those exceptional circumstances.

ANTITRUST: To what extent will there be direct economist-to-economist dialogue between the economists from your team and those advising the parties?

RÖLLER: As far as economic issues, and especially econo-

metric issues are concerned, a member of my team is the one who would be very much involved in interacting with the outside economists. I think there’s also an issue in terms of thinking about the process in which we do this. I’m not a lawyer, but I do believe that it is an early and transparent exchange that facilitates the process of making economic analysis more constructive in the context of the case.

I understand that the FTC has published some informal best practice guidelines on interacting on econometrics and empirical financial studies. They spell out some general procedural issues about interacting with the FTC on empirical studies, in terms of sharing information; what sort of information; software and issues of that sort. It is important to find a process that enables us to make econometrics or empirical analysis work for both sides.

ANTITRUST: My own experience has sometimes been that you put in the empirical study or econometrics and that there is no feedback at all until the Statement of Objections comes out and it is at that point that the Commission reveals its concerns with your empirical analysis. Now, on some occasions the Commission will raise legitimate issues that are justified. But on others, those issues raised by the Commission go away once further explanation and/or analysis is provided and therefore to dismiss such analysis would be wrong. What steps can be taken to make sure that that doesn’t happen in the future?

RÖLLER: I was just talking about the best practice guidelines, and that is very much related to that. As I said, it is important that the exchange takes place early. Once an empirical study has been submitted, one would look at it, one would come back, one would have some sort of exchange and transparency on the issues raised. I agree with you, being asked at the end to pass judgment on an empirical or econometric study is less than ideal.

ANTITRUST: What are the main differences you see between how your team gets involved in cases with that of your counterparts in the U.S.?

RÖLLER: There is a difference in the way we’re organized. In the U.S., if I understand it correctly, the economists are more independently organized. In Europe, we have more of an interdisciplinary approach. We work together with the lawyers in a case team at an early stage. Fundamentally, I don’t think that this is a weakness. It does not prevent the case team from doing the appropriate amount of economic analysis. In this way, our model is somewhat different from that in the U.S. I suppose that one can wonder which model is a better model, or whether it matters much in practice. Overall, I believe that coming together at an earlier stage, if it’s done in a proper way, has its advantages.

Another difference may be that there are more economists in the U.S. antitrust authorities, even though this depends on

whom you call an “economist.” There is also, of course, something about the way decisions are made and my role in making those decisions, which is different from the U.S.

ANTITRUST: In EC competition policy, mergers have traditionally been the area in which economics has played an important role, and increasingly so. An important question is whether the recent publication of the EC horizontal merger guidelines represents a change in the use of economics or indeed of the interpretation of the law, given the introduction of a new standard for assessing mergers?

RÖLLER: It’s not that obvious to me that necessarily a lot of things are going to change dramatically. However, the guidelines are important for the way we do the economic analysis.

I think the new test certainly clarifies the issue of any potential gap. You might dispute that there ever was a gap under the dominance criteria. But now we’ve clarified it. I also think that, from an economic point of view, it is sensible to talk about unilateral and coordinated effects. The question is, how many cases will still be covered under the classical dominance criteria? My expectations are that there won’t be that many cases where unilateral effects will actually come into play.

The other big change in the horizontal guidelines is that we are more explicit—in a conservative way—about efficiency arguments. I have always argued that this would be useful. Certainly from a theoretical point of view, you can’t argue with the fact that efficiencies are important for competition policy and mergers, but the question is how to assess them from a practical and a legal point of view. This is a more difficult issue. But from an economic point of view, I think it was always pretty obvious that we need to incorporate them into the assessment of merger and we’ve done it in a very conservative way.

In summary, I think both the new test and the efficiencies claims are going to open up avenues to do more economic analysis.

ANTITRUST: The classical approach to efficiencies states that only efficiencies that affect marginal costs should be taken into account. But most efficiencies arising from mergers are fixed costs. So an important issue is how reductions in fixed-cost efficiencies will be taken into account. This is particularly important since fixed costs may give rise to important dynamic efficiencies.

RÖLLER: The guidelines are clear to the extent that we will not be ignoring fixed costs, but they’re going to be less important. In the long run, fixed costs do matter and can have an impact on consumers. However, long-run analysis is much more difficult, and the evidence you have to provide as to how, in the long run, savings on fixed costs benefit the consumers, is more subtle and empirically much more demanding. For that reason, we have chosen not to include fixed costs

with the same weighing factor as we use for marginal cost efficiencies.

For example, take the claim that fixed costs savings benefit consumers because they can be used for innovation. This only works if capital markets are imperfect, because otherwise, if there was a return to innovation, why did it not happen before? So, in order to claim that fixed costs are efficiencies that benefit consumers, one has to show that financial markets are imperfect, which may be rather difficult. This is just one example to show that the link between fixed costs and consumer benefit is more demanding than the link between variable cost savings and consumer benefit.

ANTITRUST: If we go back to the change in the merger test, it has been argued that the new test effectively expands the scope for regulatory intervention.

RÖLLER: If you argue that there wasn’t a gap, then it’s not lowering the intervention threshold—that’s one answer. If you believe that there was a gap, then you might argue that now we will scrutinize mergers at lower levels of market shares. In any case, the explicit introduction of the analysis of efficiencies introduces another dimension. From an economic point of view, it makes sense to look at the competitive assessment and the efficiency analysis through an integrated approach. Given this integrated approach, we might have an oligopoly—or even a dominant firm—with relatively high market shares where efficiencies would be accounted for in a more positive way than they were previously viewed.

ANTITRUST: The HHI thresholds in the EC merger guidelines mirror those in the U.S. merger guidelines. Are these thresholds rather low in the sense that even in relatively unconcentrated markets, lots of mergers that under most standards raise no competition problems would still be caught?

RÖLLER: If you look at the historical data of the HHIs of those mergers we have looked at in the past you will find that the thresholds are well chosen. I believe that the HHI thresholds do make sense and I think they are picked in a conservative way of not letting things go through that raise potential concerns. Note that even if you do not pass the thresholds, it’s not automatic that there are competitive concerns.

ANTITRUST: But doesn’t this raise an issue concerning the burden of proof—namely, if the merger results in HHIs above the threshold, the Commission will have a presumption that the merger is anticompetitive unless persuaded otherwise?

RÖLLER: I think that the burden of proof is the way it’s always been, except possibly on the claimed efficiencies, where we emphasize that they should be verified or quanti-

fied whenever possible. The HHI thresholds in the guidelines are not a *de minimis* rule in the sense that if you are below the threshold, you're in a safe harbor. At the same time, it doesn't mean that above it, there are automatically problems in the sense of creating anticompetitive concerns.

ANTITRUST: So to be clear, you would not subscribe to the view that if you are above the HHI thresholds then this necessarily means the merger is anticompetitive?

RÖLLER: No, I would not automatically subscribe to that view. The basic idea is that the higher the HHI and the delta, the more likely we need to look at other factors in order to assess the competitive nature of the transaction. Quite simply, I believe that we should concentrate on cases where these indicators are relatively high.

ANTITRUST: There's been a lot of discussion about simulation models; and some economists argue that such models provide all the answers to merger analysis. What would be your reaction?

RÖLLER: They don't provide all the answers to merger analysis. Simulation models are a very useful tool which should be used whenever it's appropriate. I think there are a number of different empirical methodologies that all are potentially useful: you might look at simple correlations over time or across markets to make your point; you can look at simple hard facts; you can look at econometric evidence; you can look at simulations; you can look at both econometrics and then simulations together.

I believe that simulations are a very useful tool that pulls together a number of factors simultaneously. In this sense, simulation models are much like any economic model—it analyzes three or four factors—as well as their interactions—at the same time. Simulations typically use market shares, demand elasticities (which you may or may not have estimated), cost structure efficiencies, and even an equilibrium concept. Then you simulate the merger and ask what is the concentration going to roughly give me? Results should be robust and confidence intervals should be given as well. If, for all reasonable parameter values—which need to be cross-checked with reality—the simulation tells you that consumers are never hurt with a 99 percent probability, then I think this is convincing evidence.

ANTITRUST: But aren't all simulation models static in the sense of not taking account of repositioning of product offerings or consumer responses?

RÖLLER: True. However, if you tell me what the dynamic scenario would be, one could build that into the model and simulate it. Again, it's a tool against which one can check scenarios quantitatively. Sometimes it is too easy to argue qualitatively, which is why it is instructive to check certain

claims. In a way, simulation is one way to add more rigor, where you really have to spell out exactly what you mean. On the other hand, simulations should be checked and complemented with other sorts of evidence.

One difficulty with simulation analysis is that, if you wanted to estimate the parameters which go into the simulation, you need to have the data. In the context of a merger investigation, it's quite a bit of work. The other issue is robustness. If you change something and you get a different result, then simulation results are less credible. In this case, you're in a grey zone as far as simulations are concerned and you have to use other types of evidence.

ANTITRUST: But a problem with the simulation models is that they also predict a price increase. Does this mean we should have some tolerance threshold for price increases?

RÖLLER: You're absolutely right that most economic models of horizontal competition lower consumer surplus when markets concentrate, unless there are synergies or efficiencies. So as a matter of principle you need a sufficient amount of efficiencies. That is why it makes sense to look at efficiencies.

Simulation models allow you to assess this trade-off. One way of doing this is to put a threshold on the price increase and compare this threshold with the predicted price effect. By not looking at efficiencies explicitly, this approach assumes that an average level of efficiencies must exist in every merger. The problem with this is that there is little empirical evidence to support this assumption. Studies have shown that the distribution of efficiencies across mergers has a mean that is pretty much around zero, or even negative. So, on average, there is not much efficiency, if any. However, some mergers are very efficient and others are not, which implies that the price thresholds should depend on the efficiencies. A second approach takes this into account and asks how much efficiency gain one would need to offset the predicted price increase. This answer might be an efficiency gain of 5, 10, or perhaps 20 percent, which can then be compared to the actual efficiency, or the claimed efficiencies by the parties.

ANTITRUST: What role should be given to the submissions of complainants in merger cases?

RÖLLER: I think they are important input in the process. Their interests may or may not be aligned with the merging parties. That depends again on the efficiencies, among other things. As our standard is a dynamic consumer orientation, I see no problems with taking the concerns of third parties into account.

ANTITRUST: Will the Commission's guidelines on horizontal mergers be complemented with guidelines on assessing vertical and conglomerate mergers?

RÖLLER: Yes, that is planned, but we are in an early stage of internal discussions on non-horizontal guidelines. My team is involved in the internal debate.

ANTITRUST: Is there a timetable for their publication?

RÖLLER: I am not aware of a firm timetable.

ANTITRUST: Let's now move to considering the role of economics in the area of antitrust. In the area of mergers, the judgments of the Court of First Instance have confirmed the need for more economic analysis. In contrast, in the area of Articles 81 and 82, the courts appear to be very much endorsing a formalistic approach to the law. How can these judgments be reconciled with the stated intention of improving the economic analysis conducted under Article 82?

RÖLLER: I think that it is correct to say that the recent decisions have endorsed the approach we have taken in Article 82, and that the current approach can be characterized as an approach where dominance plays an important role—but is not the sole criterion—in the analysis of abuse in a large number of Article 82 cases. We come from a tradition, both a legal and historically, where dominance implies a special responsibility.

You may call that a formalistic approach, but let me think about this from an economic view. It is relatively easy in certain areas of potential pricing abuses to come up with economic scenarios where these pricing practices are good for the consumer. They do not necessarily foreclose or predate and may have big efficiency gains and, therefore, might benefit the consumer in the long run. The challenge is to differentiate those cases from harmful ones. I agree that this is an area where economics can help. It is clearly, as your question suggests, an area where the Chief Economist will contribute.

ANTITRUST: Should empirical analysis play a more important role in the assessment of Article 82?

RÖLLER: Yes, empirical analysis can help identify harmful conduct. But we first have to decide precisely what the empirical conditions are. Using insights from economics is, in my view, the correct approach, as confirmed in recent speeches by the Commissioner, Mario Monti, and the Director-General, Philip Lowe.

ANTITRUST: What would you say the biggest differences are between life as an academic and life as the Chief Economist?

RÖLLER: Actually, I am enjoying it a lot more than I thought I would. The big difference is that I am involved in actually making decisions, whereas before I was writing about what to do. So the hands-on experience is a lot of fun and responsibility. Also, I have to be a lot more careful about what I say.

ANTITRUST: What are the biggest differences between the Chief Economist posts at the U.S. agencies, which are often quite short term, and yours, which is three years?

RÖLLER: My term is three years, non-renewable. Given that I am the first person in such a position in Europe, I spent quite some time to build the team and find its proper role and function. The fact that my term is limited is important because it gives me quite a bit of independence, which is why I was appointed. Perhaps for the next Chief Economist, one could reconsider whether two years is not enough.

ANTITRUST: Would you say that there is a difference between academia and the policy-orientated world of the Commission in the way one thinks about economic problems?

RÖLLER: Part of my job at DG Comp is to look more at the longer term and to be controversial. That's not that different from what an academic mindset is. I have taught at a business school for seven years, but teaching and writing are very different from my responsibilities here. My previous job as a Director at the Wissenschaftszentrum Berlin—a large social science research center located in Berlin—involved large research projects. This is not the role of the Chief Economist; it's sort of in-between—providing academic know-how in the decision process and, of course, very practical case work.

ANTITRUST: In the U.S. there is a Deputy who tends to be a very long term appointee. Do you see such a position as providing valuable continuity when the Chief Economist changes?

RÖLLER: In principle, my Deputy should provide that for the team. Several members of my team are permanent officials, which assures a degree of continuity. Others are temporary agents, like myself.

ANTITRUST: It is some time in the future, but can you predict how your successor might affect the way things are done?

RÖLLER: That's an interesting question, which I haven't thought about much yet. Clearly, my own emphasis is more on empirical analysis. Someone else, who might be more theoretically oriented, would have possibly slightly different priorities. On the other hand, priorities are also determined by what is currently happening. So whoever is the next Chief Economist, there are going to be a set of issues that are important. Of course, given my focus on capacity building in empirical know-how, there would be a bit of problem if you'd then have a Chief Economist who takes no interest in empirical analysis. But I find that hard to believe and would therefore predict a good amount of continuity. ■