

In Search of the Marginal Consumer

The FIPRA Study

Phil Evans



In Search of the Marginal Consumer

The FIPRA Study

Phil Evans

Professional Public Affairs In More Than 30 Countries

Index

i. Foreword	7
ii. Introduction	8
iii. Main Findings and Summary	10
iv. What Must be Done?	13
v. The Interviews	14
Chapter 1 The Academic Background	
1.1 Tools for Assessing Consumer Welfare	15
1.2 Innovation and Consumer Welfare	15
1.3 Distributional Equity and Flanking Policies	17
1.4 Consumer Behaviour and Competition Policy	23
1.5 The ‘End of History’?	33
Chapter 2 The Interviews	
2.1 Background	35
2.2 The Key Issues	38
Chapter 3 Conclusions and Recommendations	
3.1 Practical Conclusions and Recommendations: Towards an Alternative Model?	62
3.2 Policy Conclusions and Recommendations	67

i. Foreword

When Peter-Carlo Lehrell, Chairman of the FIPRA Group, mentioned this project a year ago, I welcomed the idea. So I was pleased to be asked by Peter-Carlo and Phil Evans to write the foreword to this FIPRA Study.

Competition authorities need to be regularly challenged to think hard about the fundamental assumptions and beliefs on which they base their work. This Study does a good job in making sure we are not resting on our laurels. It argues that we are not realistic in our analyses of consumer behaviour, consumer welfare, innovation and efficiencies. It warns us that competition policy may be facing challenges from civil society similar to those faced by trade policy in the 1990s. It also provides concrete recommendations for what competition authorities should do to improve the situation.

I am not sure I agree with everything said in the Study. However, I certainly welcome the contribution it makes to a vital debate – and the energetic effort it makes to keep us on our toes.

Philip Lowe

Director General

Directorate General for Competition

European Commission

Brussels, April 2008



ii. Introduction

During 2007 the FIPRA network carried out a series of interviews across the 34 countries where we operate. We spoke with past and present senior competition officials, lawyers, economists, commentators and leading figures from the global consumer movement. It falls to me to thank all those who gave so liberally of their time to discuss the issues surrounding consumer welfare, consumer behaviour, efficiency, and the history and philosophy of competition law and policy.



The conversations supplemented countless days of desk work on the development of a consumer-focused approach to competition policy that we have been engaged in for many years. This booklet brings you our findings. It aims both to illuminate areas of debate and to facilitate a dialogue to identify ways forward for some of the key issues that people raised with us.

In the long term, consumer welfare is about efficiency and innovation. In the short term, consumer welfare is about price, choice and access and the interrelationship between all three. For competition policy, consumer welfare therefore acts as a bridge to the greater good – namely well functioning markets – it strives to achieve.

Why did FIPRA undertake this Study? Quite simply because in our daily public affairs work, we have learned – some would say ‘the hard way’ – to consider the consumer at the beginning and at the end of the public policy outcomes and objectives that our clients ask us to help them achieve. This strategic view is therefore central to our business as it is relevant in all fields of policy, but perhaps never more so than in competition policy. As a result, we urge those looking at countless ‘cases’ to bring consumer welfare, now more broadly conceived, into its proper place in research: at the start of investigations during the market definition stage and at the end of cases in the assessment of remedies.

In the following pages, we will argue that consumer behaviour needs to be built into agencies and analysis much more effectively than it is today. If competition policy continues to retreat onto an island policy fortress it is only a question of time before it loses relevance and credibility in the eyes of the consumer it claims to be protecting. In many of the cases emerging at the time of writing, the need for competition authorities to be more willing – and able – to take on vested political and departmental interests that seek to undermine competition regulation through slow or inappropriate action is nothing less than palpable. The time to act is now – and with some degree of urgency.

Consumers' organisations too need to engage more in competition policy. Recalcitrant organisations should be spurred into action by competition authorities. Once they have proved skill and interest, consumers' organisations should be given standing in competition cases and interventions as a matter of routine.

Much is made by commentators of the EU/US divergences of policy. One way – and perhaps the only way – to allow the different traditions at the root of those divergences to meet and to understand each other is by focussing on a more nuanced behavioural approach to consumer welfare. We need to make a concerted effort to bring efficiency and innovation criteria more firmly into the assessment of long-term consumer welfare.

It is time to return to the sort of language used to promote the first wave of competition law in the US, which used terms like 'economic democracy' and 'empowering the little guy'. Such diction can place competition policy more firmly in a progressive set of policies designed to manage globalisation.

Peter-Carlo Lehrell

Chairman

FIPRA Group

London, May 2008

iii. Main Findings and Summary

We must accept the challenge of developing an alternative model if we are to allow competition and consumer policy to move forward to deal with consumer welfare issues in a more effective manner. There are many markets where consumers are not directly affected by alleged anti-competitive behaviour. We need to test if the questions we ask will allow us to apply the rules to intermediate markets as well.

In a properly functioning market, the marginal consumer, through their consumption decisions, will ensure that the firms that meet consumer needs prosper and those that do not fail. We need to know a good deal more about the marginal consumer than we currently do. We need to know, on a market-by-market basis, who the marginal consumer is, how they make choices and to what extent they can actually act as the market-disciplining marginal consumer. We need to work out how likely it is that the marginal consumer will act in as near to a rational manner as possible and we need to know what impediments there are in the way of the marginal consumer's acting in as rational manner as possible.

If we tie together our two concerns – consumer behaviour and the role of the marginal consumer – we end up with four sets of questions:

- What affects the way a consumer approaches a decision?
- How does the consumer make a decision?
- How does a consumer learn from the decision?
- How much does the decision count?

The long-term consumer interest lies in efficiency and innovation

The current debate has become polarised between a vision of the world that sees efficiency as the be all and end all of competition policy and one that sees it as a fall back defence for otherwise indefensible acts. Long-term consumer interest is safeguarded only by an economy founded on innovation and efficiency. Then we can start to see the whole of the argument rather than the constituent parts. We need to ensure that the overlap between efficiency, consumer welfare and innovation is at the core of decision making.

The short-term consumer interest is more prosaic

In the short term, the consumer interest in any case should focus on price as the *primus inter pares* (first among equals) of all the various factors, including for instance choice and access. In the first instance, a practice is against the consumer interest if it raises prices, reduces choice

or hampers access. This simple test on consumer welfare works well in most merger cases and indeed in many exclusionary behaviour cases.

A balanced view of consumer welfare acts as a bridge

The ideological splits between US and European regulators are more a result of the ‘priors’ or assumptions that underlie the different cultures of economic regulation than they are splits in individual cases. Where the division is most acute is in the assessment of exclusionary behaviour cases. In Europe, the priors of the competition community lean towards intervention; in the US, the priors lead toward a very limited willingness to act. We contend that a lack of a bridge between short-term consumer welfare and long-term efficiency gains, and an overly narrow interpretation of both terms, are primarily at fault.

It is at the beginning and at the end of things

If we are to treat efficiency, innovation and long-term consumer welfare as belonging to the same bundle of issues, the question then turns to where we need to treat them. None can, or should, be used as a trump or a defence. We need to bring consumer welfare, now more broadly conceived, into its proper place in research: at the start of investigations during the market definition stage and at the end of cases in the assessment of remedies.

Consumer behaviour needs to be built into agencies and analysis more effectively

There is an urgent need for competition officials to educate themselves about consumer behaviour and to find practical ways to build this learning into market definition and the assessment of remedies. Competition agencies should employ behavioural economists and begin to work with neuro-economists now, rather than wait the decades it has taken them to respond to the advances in behavioural economics.

Competition policy cannot be an island

Competition authorities need to develop closer ties and more effective links to ‘flanking policies’ that can help to provide a ‘pressure valve’ for civil society and divert political pressure away from the day-to-day work of authorities. Authorities also need to be more willing and able to take on vested political and departmental interests that seek to undermine competition regulation through slow or inappropriate action.

Consumers’ organisations have to do more and be encouraged to do so

Consumers’ organisations need to engage more in competition policy. Recalcitrant organisations should be spurred by competition authorities into action. At the same time, authorities and law firms should offer more direct aid by loaning staff or pro bono hours. Once they have proved skill and interest, consumers’ organisations should be given standing in competition cases and interventions.

Ideology matters

EU/US divergences are located in the ideological traditions from which regulation has sprung. They are further exacerbated by the fact that the lack of tools and a consensus on the balancing of consumer welfare, efficiency and innovation tends to drive the ideological traditions apart. The only way to allow these traditions to meet and understand each other is by focussing on a more nuanced behavioural approach to consumer welfare and a concerted effort to bring efficiency and innovation criteria more firmly into the assessment of long-term consumer welfare.

Greater input is needed from European thinkers

The ideological division in competition policy requires the differing viewpoints to be well debated. The increasing number of reports of EU cases on exclusionary behaviour is starting to resemble a canon of literature. There is a lack of well-argued and researched papers, particularly in economics, that places the developing European view within a wider theoretical context. The position of thinkers on exclusionary behaviour in the US is not as monolithic as it appears and the developing European position is more nuanced than critics allow. True debate about assumptions can only begin when both parties recognise their positions and can clearly articulate them.

Language matters

We should return to the sort of language used to promote the first wave of competition law in the US. It is instructive to note that US interviewees did not shy away from using terms like 'economic democracy' and 'empowering the little guy'.

iv. What Must be Done?

There is a section in every report that seems to demand more research. We will not do that. We think that there is enough research in behavioural economics, sociology and anthropology to allow competition agencies to feel comfortable adapting their methodology to take a more nuanced view of consumer behaviour. However, their tardiness in getting up to speed with the decades-old study of behavioural economics should spur them to engage early with the growing neuro-economics community.

Consumer welfare has to be rescued from the ideological morass that appears to ensnare it. We cannot allow it to be confused – or replaced – by total welfare assessments and we cannot allow it to mutate into social policy. We must strive to balance long-term and short-term consumer welfare assessments.

There remains a risk that the legitimacy crisis that has crippled trade policy for the last five years may spread to competition policy. Competition agencies are ill-suited and ill-prepared to deal with an all-out assault, should one come. Authorities need to develop coping mechanisms to interact with and counter those that may seek to derail their vital work. Governments need to craft mechanisms to allow competition agencies to distribute non-competition issues effectively to branches of government in a way that does not look like ‘passing the buck’.

Finally, consumers’ organisations have to do more to become more involved with competition issues and agencies – and competition agencies have to make it worth their while. Interactions should be incentivised through the granting of standing in cases or of ‘super-complaint’ status, and those that work in competition policy should establish a system of pro bono advice and staff placements to help consumers’ organisations become more effective in their interventions.

v. The Interviews

The object of this research project was to test a series of hypotheses and to tease out some nuances from the ongoing debate surrounding consumer welfare and competition policy. We did this by surveying our own experience and reading of the literature on competition and consumer policy. We wanted to ensure, however, that this was not just another paper exercise. We were fortunate enough to be able to interview some key players in the consumer and competition world and to explore some of the hypotheses that we have built up over the years.

All interviewees were generous with their time, their views and their willingness to entertain what may have seemed quite left-field suggestions at times. The conclusions drawn are, of course, entirely our own. By the nature of the process, our conclusions have emerged as much from a process of conversation as from a process of study. During those conversations, we were keen to explore and analyse some of the underlying issues and nuances in the debate that are often difficult to pin down in a written paper. However, it was precisely these sorts of ‘soft’, or ‘mood music’ issues that we were most eager to discuss. We were also interested to take some of the issues that we thought we had fleshed out and frame some recommendations for dealing with some of the problems thrown up – or hopefully make some constructive comments.

We have divided the report into three main parts. Chapter 1 outlines some of the work on consumer welfare, both from the academic literature and from reports produced by competition authorities. The objective here is not to be exhaustive, but to highlight some of the questions raised about consumer welfare in the literature. Chapter 2 seeks to bring together some shared themes that emerged in the interviews. We have sought to bring to the fore as many of the issues as we reasonably could and have tried to map out some of the regular topics of debate we had. Chapter 3 attempts to bring together the two previous sections and focus on some practical and policy focused conclusions and recommendations.

Chapter I The Academic Background

1.1 Tools for Assessing Consumer Welfare

Consumer welfare as a concept sits neatly within the microeconomic theories taught to undergraduates and thus most of the best analytical work on the subject comes from mainstream economics. The resulting price-focused consumer welfare function is limited and lacks much in the way of refinement. While price is certainly an important factor for many consumers, a simple focus on price presents the following problems:

1. Price may not be the primary factor in determining consumption decisions in all markets;
2. Consumers may face non-price related detriment, such as access, quality, information, reduced choice, or less innovation;
3. A single consumer may suffer different forms of detriment in different markets.

This more rounded assessment of consumer welfare is well established in the approach taken by many regulators and was pondered in a number of the interviews. Unfortunately, the recognition that additional factors must be considered when assessing consumer welfare has not yet produced a coherent, more rounded tool to evaluate consumer welfare.

One of the clearest statements of a workable consumer welfare tool comes in a recent UK Office of Fair Trading (OFT)¹ paper. The authors talk of a Simple Arithmetic Answer (SAA) when looking at identifying consumer savings from competition cases. The attractiveness of the SAA as a simple tool, however, raises questions about the important relationship between short- and long-term consumer welfare. The key factor in this area of the discussion focuses on the links between competition, innovation and consumer welfare.

1.2 Innovation and Consumer Welfare

The literature on innovation tends to be fairly equivocal in its assessment of the ties between competition and innovation. This may have something to do with the fact that much of the literature focuses on the process of rivalry between firms in intellectual property (IP) creation. The literature on innovation has thus been disposed to focus on 'patent races', where firms compete aggressively to patent a particular development. Here, competition is

¹ Stephen Davies and Adrian Majumdar. June 2002. 'The development of targets for consumer savings arising from competition policy: Economic Discussion Paper 4' OFT386 Office of Fair Trading.

a race for monopoly rent, which stimulates innovation. Conversely, the ‘escape from competition’ theory argues that firms will seek to innovate as a way of staying ahead of competitors. What is interesting in this particular approach is the view from Aghion, Harris, Howitt and Vickers (2001)² that innovation is “faster for more competitive regimes, but that ‘a lot of imitation’ is always bad for growth.” This negativity towards imitation also plays into the literature on choice and decision-making that suggests consumers can face difficulties when dealing with complex or over-burdensome choices.

This analysis would suggest that we need to be careful to distinguish innovation from imitation and that perhaps such a distinction is a useful measure by which to assess the state of consumer focused innovation in a particular market.

The overlap between innovation and consumer welfare occurs in markets where foreclosure or merger may lead to innovation being either stimulated or restricted by the resulting market situation. For example, we may have a market where a dominant player stops a rival from gaining access to the retail market, or forecloses an intermediate market. If we look solely at the innovation problem, then we have a competing explanation focused either on the problem of rewards for potential innovation, or on the need for the monopolist to earn supra-normal profits to encourage it to innovate. If, however, we combine the innovation issue with a series of questions about consumer welfare, then we ask a different set of questions of the case. We refocus the issue from what the firms may or may not gain onto a situation where we ask which market outcome is best for consumer welfare – a foreclosed market or an open one. Where the market outcome is driven by consumer choices, the solution to our problem market becomes clearer.

Innovation and Competition Agencies

What was also clear in some interviews was the concern about how innovation was considered by competition agencies. In a similar manner to the separation of discussions on efficiency and consumer welfare, there was some concern that discussions on innovation and consumer welfare were separated. Many interviewees agreed, in the same way as with efficiency, that there is a long-term overlap between innovation and consumer welfare. While the efficiency debate has triggered more discussion in the competition community, it is difficult to see how the innovation/consumer welfare debate could be of less importance. In markets that are heavily IP based, innovation and the protection of innovative forces are factors that enhance consumer welfare.

² Philippe Aghion, Christopher Harris, Peter Howitt, John Vickers (2001) Competition, Imitation and Growth with Step-by-Step Innovation. *Review of Economic Studies* 68 (3), pp 467–492.

What is interesting about the innovation debate is that it is not entirely about IP. The reasons for and stimulants of innovation are not necessarily focused on IP. IP rights can be a form of protection for markets where rewards from innovation can be captured by free riders. However, this is not true in all markets.

1.3 Distributional Equity and Flanking Policies

A second cluster of questions focused on two issues that we believe are linked. First, the interviews probed how interviewees viewed the manner in which competition policy deals with issues of distributional equity. The object of these questions was to identify whether or not the competition community was aware of or concerned with those cases that might fall between the gaps of enforcement policy. Secondly, we asked a series of questions about what could be called ‘flanking policies’. These are policies that some areas of governance can call on when issues extend beyond their competence. The most useful policy area for comparison in this regard is trade policy. This area was explored because of a nascent concern that competition policy may face civil society challenges similar to those faced by the trade community in the 1990s, and an allied fear that the relative isolation of competition policy leaves it ill-suited to bend, rather than break in the face of the oncoming storm.

Competition Policy and Distributional Equity

One of the key issues we wanted to explore in interviews was the way that competition policy deals with cases where some consumers gain and others do not. In short, is a situation that benefits 90 per cent of consumers but disadvantages 10 per cent a good situation? This sort of differential impact is most common in merger cases, although it can also occur in exclusion cases where particular groups are disadvantaged by the exclusionary behaviour. Such a question is not unique to competition policy and makes us focus on what might be called ‘degree of detriment’. If most consumers gain modestly as a result of a merger, but a few suffer significant losses, then there are different impacts in play. Such problems can occur in utility markets where those most able to pay can get discounts by using payment mechanisms such as direct debits, while those (often poorer members of society) who use more expensive forms of payment (cheques, meters) pay a higher unit charge.

Particularly interesting in the interviews was the wide range of views expressed about what we term ‘distributional equity’ problems. For many interviewees, distributional equity was not a problem at all. These positions echoed that of Carlton³ when he posited that

³ Dennis W. Carlton. 2007. Does Antitrust Need to be Modernized? *Journal of Economic Perspectives*. Vol 21, Number 3, Summer 2007, pp 155-176.

“[...]the antitrust agencies mainly look at aggregate effects. In other words, if consumers gain as a group, antitrust agencies generally do not distinguish among consumers.” As we will see below, this is disputed in Europe. For others, the problem was a legal one that mandated certain responses from agencies, even when more balanced approaches might be possible. What was telling was the fact that the idea of a ‘competition compensation principle’ had not really been aired in those jurisdictions that faced tight legal limits on decisions.

Outside competition policy the problem of differential detriments is to some extent dealt with by the ‘compensation principle’. Nicholas Kaldor argued in 1939⁴ that the Corn Laws’ repeal was beneficial for society because it had benefited consumers to such an extent that they could have afforded to compensate the farmers who had lost out as a result of the repeal, and still have been better off than before the regime had changed. As a result, Kaldor argued that the repeal of the Corn Laws was good even if consumers did not compensate farmers in the end; a policy is efficient if it results in such enormous benefits that they ‘potentially’ can compensate fully all those who have lost out and still remain better off. The Kaldor approach is rather mechanistic and compares the gains handoff from one group with the losses of the other and then see which comes out greater. However, such an approach leaves itself open to a tyranny of the majority; policies that benefit a large number of people but seriously disadvantage a few will always be pushed through. One of the most significant risks of this sort of approach is that there tend to be groups of individuals who suffer more than one type of detriment at any one time. For example, low-income consumers may face higher unit charges for utilities because they may not have bank accounts for direct debits; they may also pay higher interest rate charges because they are a higher debt risk; they may also have to pay higher prices for catalogue shopping because they pay a premium to spread payments. The Kaldor compensation principle works as a one off shot, but fails in situations where multiple detriments occur to the same group of people.

Kaldor’s balance sheet approach was expanded by Hicks⁵, who argued that a change will have improved societal well-being if – and only if – the beneficiaries of a change could fully compensate the losers and remain better off themselves, and the losers could not have compensated the winners sufficiently to get them to forego their benefits without themselves being worse off than before the change. A more recent variation on the Kaldor-Hicks principles was developed by Posner⁶, who argued rather simply that justice was best

⁴ Discussed in detail in Nicholas Mercuro and Steven G Medema ‘Economics and the Law: from Posner to Post-Modernism’. 1997. Princeton University Press, p19.

⁵ Nicholas Mercuro and Steven G Medema ‘Economics and the Law: from Posner to Post-Modernism’. 1997. Princeton University Press, p50.

⁶ Richard Posner. 1981. *The Economics of Justice*. Harvard University Press; Richard Posner. 1973. *Economic Analysis of Law*. Little, Brown.

served by efficiency and that the pursuit of the size of the cake should always outweigh the division of that cake. Such a position was favoured by a number of interviewees. In contrast, Tobin's⁷ idea of 'specific egalitarianism' produces a result that is less unequal than the result arising from a distribution on a simple ability to pay basis. Such a policy specifically targets deep detriment problems.

One of the concerns expressed by interviewees was that competition policy was ill-prepared for dealing with distributional equity in any form. They were also concerned that such an effort might drag competition policy into a more vague social policy setting – something that would severely harm it.

Intermediate Goods Markets

The citizen/consumer split in policy matters is one step on from the more common problem in competition enforcement and consumer welfare – markets for intermediate goods. The recent move toward consumer welfare as the guiding test for competition enforcement runs up against the many cases in which competition officials deal with intermediate markets with little direct relationship to the final consumer. In such markets the customer is often a firm or retailer one or more degrees removed from the end consumer. There are essentially two ways to deal with these markets in consumer welfare terms: One can make some rather tortuous efforts to make links between the intermediate markets and the end consumer, or one can simply accept that an end-consumer welfare test may not be appropriate as a deciding factor in all cases. In the latter case, we need to identify cases where the intermediate customer rather than the consumer is disadvantaged and then test whether or not the gains or losses are passed on to consumers.

Exit, Voice and Loyalty

In identifying the consumer/citizen and consumer/customer split, one of the questions worth asking is whether retail markets differ from intermediate or primary markets and whether this has an impact on the range of policy tools available to deal with problems. All markets exhibit, to a greater or lesser extent the range of behaviours that Albert O. Hirschman identified in his seminal work 'Exit, Voice and Loyalty'⁸. Hirschman argued

⁷ Tobin J. 1970. 'On limiting the domain of inequality', *Journal of Law and Economics*. Vol 13 (October, pp 263-77. Quoted and discussed in Blank, RM. 2000. 'When Can Public Policy Makers Rely on Private Markets? The Effective Provision of Social Services.' *The Economic Journal* (March). Blackwell Publishers, Oxford.

⁸ Albert O Hirschmann. 1970. *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations and States*. Harvard University Press.

that in modern markets, consumers expressed their disquiet with a company through ‘exit’ – that is, they could simply refuse to buy a product. Similarly, workers could show their disquiet by leaving the company. As ‘exit’ is a significant event, be it loss of customers or workers, Hirschman argued that consumers and workers could be given a ‘voice’ to communicate their frustrations and views. The provision of such a voice could limit the possibility of exit, something that may have long-term implications for the firm and, indeed, wider impacts for the community within which the firm operates. In fast-moving consumer goods markets, the relationship between voice and exit is a relatively straightforward one – a firm can either listen to its customers or lose them. The development of complex loyalty schemes and/or focus groups can allow retailers in particular to gain a better ability to listen to the voice of consumers. In regulated industries it is relatively easy to see the desire of policy makers to limit/replace exit through the provision of voice.

In intermediate markets the issues of exit, voice and loyalty can prove instructive when looking for a consumer welfare test. In intermediate markets the concept of consumer sovereignty, more broadly defined than in classical economics, provides a useful yardstick for assessing abuses of competition. This is because one can make a working assumption that customers are more likely to behave as classically rational consumers than retail consumers. The reason for this assumption is that intermediate firms are likely to employ people specifically to engage in purchase decisions – that is, professional shoppers. Of course firms can suffer from principal/agent problems in incentivising staff to purchase intelligently. However, we will assume that firms are generally rational purchasers of goods and services for their own consumption.

If we assume firms are likely to be more rational than individuals, then the trio of exit, voice and loyalty is instructive. When looking upstream at competition issues from the viewpoint of the intermediate firm, one can identify whether the customer has voice, that is, whether the needs of the customer are heard. Secondly, one can identify whether they can exit the commercial relationship easily. And thirdly, one can identify whether the loyalty shown to a supplier is the result of undue inducements, such as rebates. If the ability of an intermediate firm to have its voice heard or to exit a commercial relationship is impaired, or if the intermediate firm’s loyalty is induced, then it is likely that the end-consumer will face an impaired choice.

If we take as an example the reported contents of the Statement of Objections issued by the European Commission in the Intel case⁹, we can see clearly that the alleged market abuse refers to a primarily intermediate market. The customers for computer chips and associated components are intermediate computer makers. If their choices are limited, or

⁹ COMP/37.990 - Intel.

their loyalty induced, then we have a competition problem. Firms cannot exit their relationship with a super-dominant firm if rebates and loyalty payments are structured in such a way to make such exit commercially suicidal. The role of voice in this market is also interesting given the power relationship that appears to exist. If one then takes the analysis one step further into the end-consumer market one can see that consumers have difficulty expressing a voice in a market where loyalty rebates and exclusivity deals effectively foreclose the ability of end-consumers to exercise their voice in purchasing. If a voice is not given to consumers, they can theoretically exit the market. However, if the network of rebates and exclusivity deals is wide enough then exit is not really an option open to consumers. Loyalty to a particular chipset is thus provided effectively under duress.

Taking such an example through its iterative steps is useful in identifying a possible set of analytical steps that allow consumer welfare to be afforded its proper place in particular cases. In retail markets, the exit, voice and loyalty of consumers can be directly tested. In intermediate goods cases we need to take a two step approach and not burden the end-consumer with too much indicative power. In cases of exclusion in upstream markets, consumers have what may appear to be a competitive offering, but closer analysis shows that their choices are circumscribed by market power abuse further up the value chain.

If one takes this typology and applies it to retail market competition issues, one can see that the consumer-oriented mechanism of choice and information is a key and popular tool for competition regulators. The framing issues of planning and wider societal impacts are left to the citizen-oriented mechanism. For these citizenship issues, regulators tend to rely on the effectiveness of voice and representation. However, the trend in the UK for increasingly centralised and unaccountable decision-making through the creation of the regulatory state raises serious questions about whether the citizen-oriented mechanism delivers the level of accountability that exists in the citizen dimension of the retail market. If the wider issues of planning and social welfare are not delivered in a manner consistent with a citizen-oriented mechanism, then it is likely that such issues will become more important in the consumer-oriented mechanism of choice and information.

Limitations of the Traditional Approach to Competition

The increasing exposure of competition policy to non-traditional competition concerns and its inability to use flanking policies to deflect assault was a relatively new idea to many interviewees, particularly those in enforcement bodies. The development of market studies by the European Commission was pointed to by some interviewees as a possible route to deflect criticism of a lack of action over public concern, while the track record of the OFT in the UK on market studies that led to coordinated action with other public bodies was applauded by a number of respondents.

Competition Policy, Flanking Policy, and Citizen vs. Consumer Welfare

It must be noted that there is no bright line test to isolate consumer from citizen welfare. Is it even necessary to separate them? It is also worth asking what the purpose of separating consumer from citizen policy is and to what end? The answer to this question lay in another area we wanted to develop in our interviews. This discussion centred on a problem that has emerged in trade policy in the last two decades. Post World War II trade policy operated very much like competition policy did during the decades up until the 1990s. The agenda was limited and focused and success in reaching basic targets was impressive. The debate was also largely held within a very small community of interests, mainly lawyers, economists and officials. This calm was shattered when civil society groups challenged both the existing trade agenda and the manner in which the debate occurred. Interestingly, trade policy had a series of largely domestic mechanisms to deal with external challenges. These policies included regional policy and, in the case of the US, trade adjustment assistance, giving trade policy negotiators a means of deflecting the attentions of those that might otherwise undermine negotiations. The civil society challenges of the 1990s onwards, however, forced the trade policy community to develop new engagement processes and approaches. There is some evidence that the competition community, certainly in Europe, is starting to face similar challenges to those faced by trade policy in the 1990s. What competition policy lacks is any direct link to what can be termed 'flanking policies' that can deflect the interest or policies of groups that might otherwise seek to derail competition policy. In the UK, the 2007-2008 supermarket inquiry showed how difficult it was for competition regulators to deal with non-competition concerns raised by many of those who expressed an interest in the case.

The Need for Flanking Policies

Examining the table overleaf, one can see that the traditional competition approach can be rather neatly put into the consumer-oriented mechanism in Martin Lodge's model. However, for citizen-oriented measures the competition community is ill-equipped to take action. Representation and voice can be provided by competition agencies in a number of ways. For example, should the authority find that a planning regime is causing competition problems, it can make a number of recommendations that those regimes are reformed. The key problem with this sort of approach is that the competition agency suffers its own principal/agent problem in recommending reforms it cannot itself institute. Simply handing over an issue of concern to a government body or sectoral regulator may well not be enough to deal with the problem. This is particularly the case with government departments the world over, who are prone to capture by vested interests, such as those in agriculture, industry, health and transport.

	Individual transparency mechanism	Collective transparency mechanism
Consumer oriented mechanism	Choice	Information
Citizen oriented mechanism	Voice	Representation

Source: Martin Lodge. 2000. *Regulatory Accountability: Towards a Single Citizen-Consumer Model? Paper for the Political Studies Association 50th Annual Conference.*

1.4 Consumer Behaviour and Competition Policy

The third cluster of issues we worked through with interviewees was the importance and role of consumer behaviour in competition assessments. This discussion focused both on the practical application of understandings of consumer behaviour, from areas such as sociology and behavioural economics, and on the ability of agencies to take on board consumers' concerns and behaviour. This latter discussion presented some interesting issues around mixed consumer/competition agencies and stand-alone competition agencies.

The advances made in behavioural economics¹⁰ in particular mean that we have a much better grasp of consumer behaviour than we did when most competition laws were enacted. We also have a number of agencies, such as the Office of Fair Trading in the UK and Australian Competition and Consumer Commission, who have now gained a good deal of experience in enforcing both consumer and competition policies.

Differential Rationality

End-consumers are now faced with an ever-increasing number of choices. While many of these choices are relatively straightforward, when making choices in more complex areas consumers tend to look for 'choice editors' to enable them to make choices as efficiently and effectively as possible. But to be effective, consumers must be able to learn from their choices. As Tversky and Kahneman¹¹ argue, "[...] effective learning takes place only under certain conditions; it requires accurate and immediate feedback about the relation between the situational conditions and the appropriate response. The necessary feedback is often

¹⁰ Behavioural economics developed as a result of interactions principally between economists and psychologists. Some of the most interesting work has been carried out by people like Richard Thaler, Amos Tversky and Daniel Kahneman.

¹¹ Tversky, Amos and Kahneman, D. 'Rational Choice and the Framing of Decisions,' in Hogarth, Richard M and Reder, M.W (eds). *Rational Choice: The Contrast Between Economics and Psychology*. University of Chicago Press. London. 1987. pp90-91

lacking for the decisions faced by managers, entrepreneurs, and politicians because (i) outcomes are commonly delayed and not easily attributable to a particular action; (ii) variability in the environment degrades the reliability of the feed-back, especially where outcomes of low probability are involved; (iii) there is often no information about what the outcome would have been if another decision had been taken; and (iv) most important decisions are unique and therefore provide little opportunity for learning...”

Tversky and Kahneman make a distinction between what they term ‘transparent’ and ‘opaque’ versions of choice problems. Briefly stated, when a problem is presented in transparent form, choice behaviour does not violate basic tenets of rationality. When choice problems are formulated in an opaque manner, however, people may well violate basic principles “because of the effect of ‘framing’ and so on.”¹²

The differential impact of consumer rationality in individual markets was well recognised by some interviewees. One asked how we could understand how consumers might behave perfectly rationally in one market, while behaving less rationally in another. The problem of the same individuals acting with different degrees of what could loosely be termed ‘rationality’ posed particular problems for some interviewees. Most recognised the problem, but also recognised the difficulty this posed for policy.

Failure to Make Rational Decisions Results in Consumer Detriment

There was a fairly solid acceptance among interviewees that there had been a significant change in attitudes towards the importance of consumer rationality in competition investigations. However, there was also a wide acceptance that the consideration of consumer rationality had not been ‘mainstreamed’ in agencies. This was, in large part, due to the fact that there was no agreement on core methodological tools to enable this to take place.

The development of these tools is hampered by the fact there is relatively little literature on the issue of consumer detriment. The work that the OFT¹³ has published is one of the very few pieces that addresses it directly and their later work on developing a methodology for consumer impacts¹⁴ develops it further. Both reports take a relatively straightforward economists’ view of the issue, the former more than the latter.

¹² Hogarth, Robin M and Reder, M.W. ‘Introduction: Perspectives from Economics and Psychology’, in Hogarth, Richard M and Reder, M.W (eds). *Rational Choice: The Contrast Between Economics and Psychology*. 1987. University of Chicago Press. London. p7.

¹³ OFT. *Consumer Detriment*. 2000. HMSO.

¹⁴ Stephen Davies and Adrian Majumdar. 2004. *The development of targets for consumer savings arising from competition policy*.

The 2000 OFT report identified three main ways in which consumer detriment may occur:

- **price detriment:** consumers may not buy the product or service at the cheapest price available to them;
- **appropriateness detriment:** consumers may not buy the most appropriate product, given their tastes and preferences; and
- **quality detriment:** consumers may purchase a product or service which is not of the quality they assumed *ex ante*.

As we have argued above, this approach falls into some of the traps common in agency approaches: detriment is taken as an individual rather than collective issue and it tends to focus on markets with ‘imperfect information’. Such an approach assumes that consumers will become more rational if only the information they receive was better packaged. Of course, imperfections in information can come from soluble issues (for example, information provided is misleading or confusing) and insoluble issues (bounded rationality and warranted product complexity – such as car engines, for example). However, here it was pointed out by one interviewee that competition agencies have a particular problem. Dealing with markets where ‘little old ladies’ are misled and defrauded is traditionally the terrain of consumer agencies and not competition agencies, even when those agencies are one and the same! A discipline-focused response to the problem of exploited ‘little old ladies’ can lead to the sort of ivory tower enforcement that has plagued competition policy on occasion. However, as was regularly a topic in interviews, using competition policy to right every wrong in society is a pointless task. The ability to strike a medium that takes account of consumer detriment externalities caused by ill-functioning markets was something interviewees discussed, but few offered solutions on.

A New Approach to Consumer Behaviour is Needed

One of the main reasons for the lack of a decent consumer detriment methodology was put by one interviewee as being because we had no clear idea of the alternative view of competition policy and so could see no clear route from our current approach to the new approach. We cannot yet undergo a paradigm shift in the approach to competition policy because a convincing approach to consumer behaviour has yet to be developed to allow such a shift to occur.

The Information-Based Approach to Competition and Consumer Behaviour

The OFT argues that information problems tend to centre around three main loci:

- **Complexity or ‘newness’:** the product or service is intrinsically complex or new;
- **Information transfer is difficult:** there are no obvious and easy ways for information to be transferred to consumers by the better informed;
- **Information transfer is hampered:** differences in understanding are not addressed and consumers make decisions in ignorance.

As consumers tend to be individuals (with limited buying power), immobile (they tend to buy locally) and ignorant (they are not as educated about products as suppliers), they are prone to make ‘mistakes’. Of course, the internet has had some impact on the mobility of consumers since the OFT wrote their report. As a rough indicator, the OFT argued that the degree to which all three applies is a first function of detriment. In the sense that detriment centres on consumer ‘mistakes’. The key factors that point to the likelihood that consumers will make ‘mistakes’ include:

- Uniqueness of purchase
- Infrequency of purchase
- Speed of change of market
- Search costs
- Change in choices

The 2000 OFT report suggested that the measurement of detriment must rest on three information approaches:

- **actual beliefs (A)**, which describe the information the consumer has when making a purchase;
- **rational beliefs (R)**, which describe the information the consumer would have after having completed a rational search process; and
- **the true distribution (T)**, which describes the best possible information about the world.

The OFT thus defined consumer detriment as:

- the divergence between **actual beliefs** and **rational beliefs**;
- the divergence between **rational beliefs** and **true distribution**; and
- the degree of avoidability.

In other words, in looking at any particular market situation where it is believed that a consumer detriment may exist, one must assess whether it is:

- ‘an (R-A) problem’, where consumers do not appear to be receiving or acting upon information when it would be rational to do so; or
- ‘a (T-R) problem’, where consumers experience a rational informational shortfall.

To quote:

“If an (R-A) problem is found, it is necessary to establish why this information gap exists. If the market is changing rapidly and A just takes some time to catch up with R (there may be some historical experience of this), then consumer detriment is likely only to be transitory. However, if there is evidence of systematic exploitation of systematic biases in the way consumers evaluate information or of misinformation and false claims which cause a difference between A and R, then intervention may be required.

In case of a (T-R) problem, there may be very good reasons for the information deficiency (as in the market for medicines), and no detriment necessarily occurs. In other cases, this information shortfall may be the result of higher-than-necessary search costs (because some information problems cannot be overcome by appropriate market solutions) or of suppliers [suppliers here can include manufacturers, retailers or intermediaries] manipulating either R (by making information artificially complex or expensive) or T (by behaving in other non-competitive ways), such that some of this shortfall is avoidable (by preventing this manipulation).”

They argue that there are a number of reasons why differences occur between rational and actual beliefs:

- a consumer may be given **misleading advice** by suppliers. This may involve factually incorrect information (which is illegal), or may involve suppliers’ failing to correct mistaken beliefs held by consumers. Examples can be found in areas of food marketing and the promotion of cosmetic surgery. There may be an important distinction here between the intentional giving of bad advice and an ignorant salesperson simply making a ‘mistake’;
- suppliers may employ **high pressure sales tactics** which could include the provision of misleading information (as above), may change the consumer’s discount factor (a ‘limited time offer’), or may simply induce consumers to make a purchase that they otherwise would have not made (‘an offer you cannot refuse’); or
- the **product market may change** (a new product may be introduced) such that rational beliefs may change, while actual beliefs take some time to catch up. This may happen if new information is available but has not yet filtered through to a large proportion of consumers. Problems like this can occur in medical and financial services markets.

The underlying assumption in the OFT report appeared to be that consumers aimed ideally to be rational and would tend to be so if given the chance. This concurs with the work of economic psychologists, who point to the importance of transparency. However, such an approach has difficulty with markets where consumers are unable to behave perfectly rationally because of the absolute level of complexity in the existing market. A number of financial services products fall into this category.

The OFT report recommends a series of indicators be used to identify markets where a detriment may occur. These pointers are:

- **Price dispersion:** to what extent are prices widely dispersed?
- **Focal points of competition:** are there key indicators or areas within which competition is focused?
- **Secondary purchases:** is this the only product needed - or is it a secondary product to a primary purchase?
- **Commissions:** do they exist and why?
- **Complex products:** how complex are they and should they be?
- **Infrequent or credence purchases:** how often is the consumer in the market and what is the relationship to the good?

Limitations of the Information-Based Approach to Competition and Consumer Behaviour

While the latter indicators are useful pointers to potential problem markets, they are in many ways unrelated to the original indicators of detriment the OFT focused on. The disjuncture between the information-based analysis and structural-based indicators raises questions about the utility of the approach. This problem was raised by a number of interviewees, who recognised the problems of relying on information-based solutions to competition problems.

One of the added problems of looking at an information-based approach to competition and consumer behaviour is the rather limited view economists tend to have of information. The range of stimuli that consumers absorb in making decisions is broadly termed ‘information sources’. Such sources can take the form of advertising, package labelling, where the product is placed on a shelf, or whether it is part of a promotion or not. The OFT report focused on what might be termed the classical economists’ view of information – the specific pieces of information that a consumer needs to make a rational choice. Such a view has been summed up by Gary Becker: “all human behaviour can be viewed as involving participants who maximise their utility from a stable set of

preferences and accumulate an optimum amount of information and other inputs in a variety of markets.”¹⁵

Such an approach would have difficulty passing muster among anthropologists, who are more used to studying peer and family groups and see decisions in the light of these sorts of interactions. Such scholars would point to the clear existence of peer groups, which are particularly strong and visible among teenagers, for example. However, as a considerable amount of work by scholars such as Tversky, Kahneman and Thaler show, consumers will not always act in a classically rational manner. They fail to do so for two main clusters of reasons – one can loosely be termed ‘bounds to rationality’ and the second group can be termed ‘specific mental accounting issues’.

Why Consumers May Fail to Act Rationally

Bounds to Rationality

The general bounds to rationality that Thaler¹⁶ in particular has identified are bounded rationality, bounded willpower and bounded self-interest. The first of these, the idea of bounded rationality, has been with us since the work of Herbert Simon in the 1950s and essentially argues that individuals have limited computational abilities. In other words, we can’t remember everything and can’t calculate every possible option before us. Bounded rationality has entered the mainstream of economic thinking and is well accepted; however, its implications for competition enforcement have not been fully explored.

The idea of bounded willpower is an interesting one in both food markets and financial services markets. This form of bounded rationality means that consumers often take decisions in the short term that damage their long-term interests. Thus, as a response to people spending and not saving, we get regular debates about whether we should force people to save. Of course, not saving may well be rational if individuals are prone to take the Keynesian view that in the long term we are all dead. The operation of this bounding on behaviour is behind savings schemes, stamp schemes and Christmas hamper schemes.

¹⁵ Gary S. Becker. 1976. *The Economic Approach to Human Behaviour*.

¹⁶ Christine Jolls, Cass R. Sunstein, and Richard Thaler. 1999. *A Behavioural Approach to Law and Economics*. University of Chicago Law School. Working Paper.

The idea of bounded self-interest of individuals is perhaps the most surprising, and perhaps the one most likely to bring some comfort to the dismal scientists. This form of bounded rationality argues that individuals, in certain circumstances, care, or act as if they care, about others. This is illustrated in a standard economic experiment where two individuals are given a set sum, say £100, and one is told that s/he has the untrammelled right to divide that sum between the two parties. A rational behaviour solution would tell you that the person would give one penny to the stranger and keep the rest for themselves. Of course, in reality the person making the decision almost always opts for a 'fairer' division of the money. While this experiment might be rather neat, it does illustrate a rather interesting, but under explored, issue in retail markets.

The fact that people tend to act 'fairly' in distributing resources would suggest two possible avenues of inquiry. First, is this concept of fairness a culturally specific assessment of what is 'right' for any society? Secondly, is this 'fairness' an evolutionary calculation of the sum that will ensure that should the two parties meet again harm will not be construed to have been caused. This sort of embedded fairness is likely to operate in most circumstances where consumers come into regular contact with traders. The continual interactions frame the concept of fairness that consumers have in relation to particular transactions. Such concepts of fairness may well be different firm by firm or sector by sector and are likely to vary across countries. We could argue that consumers are likely to have a base level concept of fairness that is shaped by their experience in multiple markets.

The importance of this sense of 'fairness' may influence the ability of new entrants to gain a foothold in a market. For example, the airline industry in most European countries has been revolutionised by the entry of low cost carriers. The industry pre-deregulation was viewed as treating its customers unfairly, particularly in relation to fare levels. The understanding of what is a 'fair' price to pay for an airline ticket has been shifted so fundamentally that the established carriers have had to move to the lower prices to persuade customers to travel on their airlines. A similar situation has occurred in relation to CDs and DVDs. The concept of a fair price has been severely affected by online retailers and overseas travel combined with peer group discussions. What was seen as a fair price a decade ago is not the fair price accepted generally by the market now. It would be interesting to analyse how consumers' acceptance of fairness in a particular market has an impact on their understanding of fairness in other markets, and the circumstances under which this impact occurs. Thus, for example, does a changed concept of fairness in CD pricing affect understandings of fairness in DVD prices but not in mobile phone prices? Or does the changed concept of fairness in clothing prices affect the concept of fairness in shoe prices?

Mental Accounting Problems

The specific mental accounting problems that have been identified by researchers are many and varied. Perhaps the most comprehensive and detailed approach comes in Prospect Theory, which argues that the structure of a problem may affect the choices that are made. That is, the same problem presented in different ways may influence the decisions of participants. One can see such ‘framing issues’ in the selling of diet products – a product sold with a ‘95 per cent fat free’ sticker on it is likely to sell more than a product with a ‘5 per cent fat’ sticker on it. Secondly, outcomes received with certainty are preferred to outcomes that are uncertain. Thirdly, gains are treated differently to losses.

There are a number of further complications to consumer behaviour and the following issues must be borne in mind:

- **The endowment effect:** any product that is part of the already existing endowment of the individual will be more highly regarded than a product that is not. Individuals thus tend to rate what they already own more than a product that they do not.
- **The sunk cost effect:** individual sunk costs affect decision making.
- **The theory of momentum:** individuals will complete a task once work has begun, irrespective of the continuing validity of the decision.
- **Search costs are relative:** any difference in price between goods is seen in relation to the total price of the goods, including transaction costs.
- **Psychological costs of regret are large:** present decisions can often be limited on the basis of the individuals’ not being able to trust themselves to make the right decision in the future.
- **People segregate gains:** individuals prefer to treat multiple gains as a series of individual gains. For example, getting two Christmas presents wrapped separately is preferable to getting two presents in one wrapping.
- **People integrate losses:** individuals like to place all their losses in one basket.
- **People let big gains cancel small losses:** if the overall balance of gains and losses is toward the gain, then the losses should be pooled with the gains to cancel them out.

- **People segregate ‘silver linings’:** when large losses outweigh small gains, the gains may be separated out as a ‘silver lining’ to the cloud of the large loss. The picture becomes less clear when dealing with smaller gains and losses – here integration may be the preferred option.

Hopefully the above outline of developments in the understanding of consumer behaviour illustrates how far from ideally rationally consumers behave in reality. The question then remains: What impact does this have on policymaking? As one interviewee put it, “if the established model does not work, then what supplants the theory and what policy flows from this? What are implications of the alternative model?” We will return to this question in our concluding comments. However, before doing that we need to work through the rich discussions we had with interviewees about the interactions between consumer welfare and competition policy.

1.5 The ‘End of History’?

There is a danger in much of the current discussion around competition policy that many commentators appear to think we have reached the ‘end of history’¹⁷. We have an enormous number of states with new competition laws. We have a spread of the International Competition Network (ICN) and cementing of its work and influence and we have a more settled and secure set of institution heads than ever before. More evidence of the end of history can be found in the steady advance of economics in competition cases. This is viewed as making judgements more predictable and less prone to the individual whims of judges. If we look at our recent advances, we see a tale of unlimited progress and the forward march of economics-based regulation.

If we take a step back, however, we see a different picture, or the potential for a different picture. In the EU we have seen a commitment to free and open competition removed from the key treaty shaping the future of the EC. The ‘Sarkozy Debate’, as one interviewee put it, is likely to have an impact “in the area of Article 81 and in state aids. When we look at Article 81(3), Sarkozy raises the standards of proof when it comes to balancing various objectives; benefits in terms of more competition versus the pursuit of other policies such as the environment.”

¹⁷ Francis Fukuyama. 2nd Ed. 1993. *The End of History and the Last Man*. Penguin. London trumpeted, prematurely, the end of history and the triumph of Western Democratic Civilisation. At around the same time (2002) Samuel Huntington was publishing ‘*The Clash of Civilisations: And the Remaking of the World Order*’. Free Press.

In the US we have seen a near total withdrawal of competition authorities from action against exclusionary behaviour and the removal of a per se block on resale price maintenance (RPM). In France, Canada, and many other jurisdictions, we see increasing pressure for a return to a 1980s view of competitiveness, where large companies are deemed good because there are other large companies in the world.

If we look further afield, we see similar potential clouds on the horizon. If we look to the forward march of trade liberalisation as a potential provider of lessons, we see an even more worrying trend. Indeed, it is difficult to write about the 'forward march' of trade liberalisation with any seriousness. However, there are lessons for the competition community from what happened to the trade community during and since the 1990s. For perhaps 45 years, the trade community was left alone to its own devices by all but the academic and the obsessed. Civil society knew and cared little about it and, indeed, most officials outside of the hallowed halls of trade ministries and finance departments were largely unaware of its existence. However, the passing of the Uruguay Round changed all that. The much championed new world of trade regulation, with the creation of the WTO from the ashes of the Gatt, and the passing of the most comprehensive trade regulation regime ever seen, catapulted the trade community to the forefront of political debate. What we saw within a decade was the grinding to a halt of the trade agenda, the halting of progress on the bedrock of the worst forms of protectionism and the miring of the debate in issues often only tangentially related to the original agenda of the community.

Competition policy is starting to see some of the same pressures emerge that started to raise themselves in trade policy during the 1990s. Civil society is starting to take a greater interest in competition and competition policy, not always from a positive perspective. We are seeing old national champions – the competition equivalent of the French farmers – circling their wagons with the collusion of ambitious politicians. Finally, we are seeing agencies either voluntarily, unwittingly or unwillingly in retreat from important areas of enforcement and action.

The worrying tendency in current competition policy debates to view the current situation as the end of competition history has a faintly Panglossian hue to it. But if history and other disciplines teach us anything, it is that history is never over and we are rarely in the best of all possible worlds. With the revenge of Sarkozy in Europe and the long regulatory quietude in the US looking to shape the next few years, we have need of a vision of competition policy that will allow us to cement the progress we have made to date and to chart a future path that is less prone to political exigencies.

Chapter 2 The Interviews

2.1 Background

The relative scarcity of analysis has led to some confusion about exactly what a consumer is and is not. This conflict emerged during the interviews with a questioning of whether the ‘consumer dollar’ is really worth more than the ‘producer dollar’. While such a difference may initially appear trite, it does point to a number of considerably more important factors in the debate about consumer welfare.

The Relationship Between Short- and Long-Term Consumer Welfare

The first, and perhaps most important, discussion focuses on possible conflict between short- and long-term consumer welfare. As Dennis W. Carlton puts it: “The first and perhaps the most significant practical problem with a consumer surplus standard is that, as commonly applied, it tends to favour short-run price reductions over long-run efficiency gains.”¹⁸ A further question is perhaps more interesting: are short-run price reductions and long-run efficiency gains alternatives, complements or linked targets?

This conflict speaks to a more fundamental issue than simple time accounting. It points to an overlap between consumer welfare and efficiency/productivity concerns. The overlap occurs because it can be argued that long-term consumer welfare is only advanced by increases in efficiency and productivity. Only an economy that is growing through enhanced efficiency can produce higher standards of living and better products, spur innovation and deliver competition that gives consumers more choice and helps to drive markets forward. However, all efficiency and productivity gains take time to put in place and often do not materialise in the manner initially foreseen¹⁹.

If, as the argument goes, long-run productivity enhancements and efficiency gains essentially overlap with long-term consumer welfare gains, at what point do we see that overlap occur? How do we deal with the likelihood of an overlap and what mechanisms do we put in place to ensure that overlap occurs? How do we identify those cases where overlap is likely to occur and those where it is unlikely to do so?

¹⁸ Dennis W. Carlton. 2007. Does Antitrust Need to be Modernized? *Journal of Economic Perspectives*. Vol 21, Number 3, Summer 2007, pp 155-176.

¹⁹ The literature on post-merger performance provides plenty of evidence here. For example, Farrell J and Shapiro C (1990). “Horizontal Mergers: An Equilibrium Analysis”, *American Economic Review*, 80 (1), pp 107-126. Ashton, J and Pham, K (2007)

During the interviews it became increasingly apparent that while the consumer welfare/efficiency overlap was an area of concern, it was not really an articulated concern. In the US interviews it became apparent that the term ‘consumer welfare’ was itself an ideologically loaded one. For those outside the main body of competition officials and lawyers, it was very much part of the post-Chicago School consensus. For more mainstream interviewees, it was a term that was seen as fairly settled, although some did point to the lack of understanding of actual consumer behaviour as a fault in the established view. In Europe the ideological baggage that hung over the term in the US did not apply. Almost all European interviewees were fairly open-minded about what consumer welfare meant in practice. There were a number of interviewees who opened discussions with a standard economic definition, but tended to supplement this with some additional comments. There was also considerably more discussion among European interviewees of the relative benefits of approaches other than consumer welfare. This did not appear to be because of a philosophical opposition to using a consumer welfare approach, but more because of an open-mindedness about possible results.

Diverging Views on the Relationship Between Consumer Welfare and Efficiency

To date, the issue of consumer welfare and efficiency gains has tended to be discussed in two separate streams. This separation of consumer welfare from efficiency has had a rather polarising effect on attitudes to competition. In terms of the interview discussions this polarisation has taken on some ideological elements.

US View

The polarisation has tended to place many in the established US enforcement agencies/judiciary and economics community in an optimistic, quasi-Panglossian position where efficiency and consumer welfare have tended to become conflated in the short-run with possible efficiency gains in the long-run. The recent decisions in the *Maytag/Whirlpool* and *Leegin* cases and the relatively few exclusion cases occurring in the US perhaps sum this approach up best; consumer welfare is best advanced through the potential for competition to generate long-run efficiency gains which lead to better products and services, enhanced competition and thus improved consumer welfare. Restrictions on competition are transitory or necessary to enhance welfare in the long-run. During interviews, critics of the current mainstream view among US enforcers and defence lawyers spoke in pejorative terms about the reliance on an increasingly complex and detached view of economics. For those critics it is interesting to note that Dr Pangloss

taught ‘metaphysico-theologico-cosmologology’. For some interviewees, the reliance on a particular, Chicago-influenced branch of economics has made mainstream competition policy similar to the field Dr Pangloss taught.

EU View

The other pole is occupied more regularly by the European legal tradition and enforcement officials and civil society groupings globally. This view, as Martin opposed Dr Pangloss²⁰, tends to be that of the arch-sceptic or pessimist. This view tends to see efficiency arguments in cases as a ‘defence’, the last refuge of the economic scoundrel whose other arguments in favour of their actions have fallen by the wayside. Consumer welfare is generally a short-lived creature who cannot wait for illusory efficiency gains to arrive at some point in the future. The fact that efficiency arguments are structurally referred to as an ‘efficiency defence’ underlines the place that productivity and efficiency occupy in the European regulatory mindset. Such a placement confirms the mainstream pessimism about corporate behaviour and intentions and harks back to the Smithian notion that “[P]eople of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.”²¹ Of course, the remainder of the quote speaks of the impossibility of preventing such conspiracies, but the suspicion remains.

The Source of Disagreement

While the above description of the polar opposites is necessarily a caricature of the more subtle positions taken in the real world, it does hold true for what one interviewee referred to the ‘priors’ that the different traditions relied upon. The polar ‘priors’ on consumer welfare and efficiency may help to explain why European and US officials can take similar approaches in shared merger cases, but take divergent views in exclusion cases. One tradition is suspicious of intervention and is relatively sanguine about the chance of efficiency gains being passed on to consumers, while the other tradition is suspicious of corporate behaviour and nervous about firms not passing on efficiency gains. This characterisation largely ignores the fact that these traditions have strong roots in both US and European locations, in clichéd terms the University of Chicago and German/French administrations. However, as some interviewees pointed out, there was a hope among some in the US that the European tradition would be exported to the US

²⁰ Martin and Dr Pangloss were philosophical opposites, one pessimistic, one optimistic in Voltaire’s *Candide* (1759).

²¹ Adam Smith. *The Wealth of Nations*. Book 1, Chapter X.

via the ICN; and conversely a belief that, as evidenced in Article 82 review discussions²², that the US tradition was being exported to Europe.

The Role of Economics

What was clear in the interviews was the role seen by many for economics as either a bridge or a battering ram between the traditions. Some saw economics as part of the ideological pot driving a more sceptical view of anti-trust enforcement, while others saw it as a tool to allow different enforcers with different priors to find common ground in assessing individual cases. What was clear was that economics was seen by all as having a profoundly important role in the future direction of anti-trust or competition law. This was probably truer for lawyers than for economists.

2.2 The Key Issues

The interviews were designed to deal with a pre-set number of issues, but with enough flexibility to allow respondents to raise new issues or explore particular ideas in more detail than others. This structure reflected the high calibre and experience level of the interviewees. While we followed a broad grouping of questions, we allowed most discussions to follow their own natural course. What follows is a bringing together of the various strands of thought that flowed in the discussions.

The Status of Consumer Welfare in the Competition Community

The first cluster of questions was aimed at identifying where exactly interviewees thought consumer welfare sat in the collective consciousness of the competition community. The focus in interviews on consumer welfare sprang from a recognition that first, it was, as a concept, the flavour of the month among many agency heads and regulators; secondly, that this fashionable status was rarely backed by concrete analysis; and finally, that the use of consumer welfare arguments did not necessarily have a practical impact on the decisions made by officials or judges. The object of this cluster of questions was not to draw a line under any particular debate, but more to bring light to some of the issues and, perhaps more importantly, to help to draw up some parameters to enable the debate to focus.

²² In 2005 the European Commission's DG Competition began a review of Article 82, the legal provisions covering abuse of a dominant position. Following the publication of a staff paper reviewing key issues a public hearing was held in June 2006. The review is ongoing.

What is the Point of Competition Policy?

Every interview was started with what might appear to be too broad a question: What is the point of competition policy? Indeed there were many confused initial looks, a good deal of dead airtime and a few quizzical follow-up questions. However, the answers that were forthcoming were often extremely interesting and served as a useful springboard for teasing out some important differences between the positions taken by interviewees²³.

There were a number of broad themes that emerged in discussions:

Economic Democratisation

The idea of competition policy as part of the process of economic democratisation was raised by a number of interviewees, by US respondents in particular. Competition policy was seen as “broadening participation in markets” and as being “supposed to serve the political interest of the concept of checks and balances and decentralised power.”

It was argued by one that “we achieve a more egalitarian business environment for smaller entrepreneurs; large enterprise does not dominate and drive a loss of productivity. Firms are large because of superior performance[...]. We have to get rid of anti-competitive agreements and look for a more equal distribution of power for the democratisation of economic power. This helps to stop a distortion of the political process and gives more local control.”

This link between economic and political power was made by a number of respondents. Competition policy was seen as part of the “institutional recognition of the need to keep power fragmented; using factions within society to play one against the other and avoid permanent majorities where they can control everything.”

²³ It is interesting to note that a recent article by Dennis W. Carlton also begins by asking “What is the Objective for Antitrust?” His answer and a few side comments are interesting for this discussion. Carlton argues that “[T]he proper objective of antitrust should be total surplus, not consumer surplus” (p157). However, he notes that “[T]here is a semantic confusion in the economics and legal literature with some writers[...]. Using the term ‘consumer welfare’ to mean total surplus, while others use it to mean only consumer surplus.” This theme was particularly strong among some US interviewees, who saw the term “consumer welfare” to be politically and ideologically loaded. Carlton raises an interesting question when he argues that “[...]it would be theoretically possible to take a long-run perspective on future consumer surplus that would include future gains from new technologies and products, and then to estimate the present discounted value of such gains.” Unfortunately, he rejects such an approach on the basis of “difficult-to-estimate” benefits. After turning away from developing a possible long-term consumer welfare project, he then seeks to lambast the straw man of short-term consumer welfare and compare it to total welfare analysis.

In a broader sense, one respondent argued that competition was there to “support democracy, support the political process, because capitalism in financial markets is just one of the mechanisms of the political process. A democracy dependent upon free markets requires a robust competition policy to ensure that there is an equivalent financial democracy to the political democracy you want to have. In a non-democratic state you start with a skewed system. It is not in place for the purpose of allocating scarce resources appropriately to the people; they don’t care about that. They don’t care about satisfying citizens; they care about those that are capable of keeping you in power.”

The greater tendency for US interviewees to talk in terms of economic democratisation surprised some European interviewees, one of whom remarked: “I thought that it was only the German ordo-liberal traditionalists who spoke in this way.”

A common theme in discussions was the centrality of consumer welfare as a reason for having competition policy. Most respondents tended to point to the argument that you needed to use enforcement as a means of “making sure that markets operate to the benefit of the final consumers”, though a number pointed to a broader conception of what the consumer was. Indeed, one argued that the focus should be on the “citizen – be it as consumer, be it as an entrepreneur.” This broader conception of consumer welfare tended to be more common among those that saw competition policy as part of a wider political democratisation process.

One interviewee argued that the main focus should be on consumer sovereignty: “Here there is a deep connection between competition policy, consumer protection and consumer sovereignty that requires a broad array of choices so that consumers can ensure they can exercise choices free from fraud and deception both as consumer and competition protection.”

Most tended to agree that “the ultimate goal [of competition policy] is consumer welfare.” However, it was clear that in practical enforcement terms, consumer welfare was necessary, but not sufficient for practical action: “There are, of course, intermediate tests that have to be passed before a case can be prohibited or approved.”

The problem in applying a broader sense of consumer welfare was pointed to by one respondent when he argued that “a broad interpretation should not only be monetary but include such matters as happiness and environmental protection; things that make people happy. These are very important as well, although if you give this time for interpretation you have problems of measurement and the application of a legal test.”

One interviewee also wondered about how to balance “producer versus consumer welfare” and asked, “Why should the consumer dollar have a higher weight than the dollar for the producer? Ultimately the surplus goes to shareholders or to consumers in another shape or form.” The issue for this respondent was “how we gave differential weights to competing interests of producers and consumers.”

A more cynical view of the role of consumer welfare in official pronouncement was voiced by a number of European legal practitioners. As one argued, “there has been more talk of the importance of the consumer in competition policy for political reasons. It is a wider political thing. The Commission has got to start justifying their activities to the taxpayer. This they clearly recognise by doing more pro-consumer things, such as with energy and mobile roaming charges...”

Part of the Toolkit of Modern Capitalism

Almost every interviewee argued that the point of competition policy was to ensure that the modern economy functioned well and that agencies were able to “deal with deficiencies, get competitive prices, relatively narrow price differences, provide an overall fairly efficient form of resource allocation and means of distributing them.” As one argued, competition policy is seen as the “generally accepted way to operate the capitalist economy. Competition is presumed to produce efficiency and benefit business and the consumer. There is a presumption that rivalry will result in the market working well, so protecting competition is the aim.”

One interviewee argued that “competition policy mainly focuses on ensuring the best possible outcome of economic activities in the modern 21st century states, to make sure that the advantages of competition can be fully exploited and that restrictions on competition, abuse of market power [and] mergers which restrict competition are controlled and, if necessary, stopped.” Interestingly, the interviewee also argued that “of course this is a technocrat answer; all this is abstract; the citizen does not exist in this approach.”

Guaranteeing Progress

The place of competition policy as a tool for ensuring economic progress was also a theme that played out a number of times in discussion. One interviewee argued that competition policy could “generate growth in the economy through stimulating innovation.” One argued that in a “generic sense, the consensus is that competition

achieves wonderful results in terms of new products, lower prices, greater quantities available, higher quality – all that is the fruit of competition.”

One seasoned observer of the global competition scene put it thus: “If you want to look at the links between productivity and competition, look to the World Bank’s Global Economic Prospects 2003 and the World Development Report 2005, where you will see a number of references to the link; those economies with high local market competition have higher levels and rates of growth of GDP; those with a higher intensity of competition in local markets have more direct foreign direct investment and domestic investment. The same applies to regulatory barriers; the evidence is out there now; systematically we can’t say definitely, ‘Yes, I have the golden key to all this’ - that’s just not feasible. However, on sector-specific work it can be done; for example, telecoms, some areas of basic infrastructure, depending on framework.”

Competition-Consumer Policy Links

One of the more common elements in official discussions about competition policy is the link between it and consumer protection policy. However, this aspect of competition policy was only rarely pointed to by respondents. One argued that “it is correct to say that competition policy is to a very significant extent also consumer protection policy. That is not to say that you can forget about consumer protection because of competition policy, but I would pretend that competition policy well pursued is probably the single strongest ally of the citizen as a consumer.”

The practical problem of enforcing both consumer and competition policy was voiced by one: “I am not sure if competition policy is there to protect consumers or look after their welfare; consumer policy is much more consumer welfare orientated.”

Mixed Agencies

Linked with the relationship between consumer and competition policy is the place of that policy convergence in a regulatory sense. One of the perennial areas of debate for competition and consumer advocates is whether it is better to have consumer and competition enforcement bodies under the same roof. Those that argue that mixed agencies perform better point to the fact, as one interviewee argued: “you can see in mixed agencies there is more of a tendency to ask how they behave and what matters to consumers in the decision to purchase. There is more of an interest in how consumers change and behave in mixed institutions, because people are forced to think about the issue.”

As one interviewee put it, “the rationale of having a dual function involves organisational changes where you analyse problems more in terms that seek to unify two perspectives. A key question is What are people actually doing? Why was the unleashing of producer freedom so visibly powerful for airlines and opticians but stickier for retirement plans and financial services, telephony and utilities? Why do we see choice working in some financial services and not others?”

The pro-mixed agency approach argues that competition and consumer policy are ‘complementary’. Indeed, as Sir John Vickers, former Chairman of the Office of Fair Trading, put it: “Consumer and competition policies must work together in tandem if not as one. Competition policy must be consumer-oriented and consumer policy must have competition at its core. After all, good consumer and competition policies have one and the same goal – to help markets work well for consumers and for all the fair-dealing enterprises that serve consumers well.”²⁴

While the arguments for or against the theoretical benefits of mixed agencies can seem to be circular, the real problems appear to boil down to ‘cultural difference’. As one respondent put it: “Competition policy is populated by academics or lawyers and economists. They have a clear career path. Salaries in the private sector are huge and working in an authority is a stepping stone. On the other hand, consumer policy tends to be populated by people that range from well-meaning groups of local residents up to national consumer representation and enforcement bodies.”

It was not just the personnel and traditions of the two communities that caused problems in unitary authorities: “Consumer legislation has been written mainly as knee-jerk reactions to problems occurring. There is not one consistent piece of legislation.” In short, it was argued that consumer and competition policy had “different culture and different career routes” which could lead to tensions where “academic lawyers can be ‘sniffy’ about practical consumer people and can see them as a bit ‘open-toed sandals’, as things that get in the way.”

The differences between the approaches and staff have tended to leave mixed agencies as two separate and often warring camps. To get an agency to work in the modern economy, you have to “synthesise things from top-end of economic efficiency right through to case work chasing scallywags down the street.” In such a world you have to accept that “some people are worried about ‘little old ladies’, in a pejorative sense, while some argue that we can put them to one side. The key question is, how do you synthesise different traditions?”

²⁴ Sir John Vickers. 15 September 2005. Opening remarks at the European Competition and Consumer Day Conference, London. Office of Fair Trading.

These different traditions can be quite starkly oppositional. On the NGO side, one interviewee argued that they “haven’t got a clue about the world outside of the NGO world” and have a tendency to see themselves as the underdogs, which can lead to the “most oppressed people ever syndrome (MOPE).” Such an approach not only has the tendency to only focus on the ‘little old lady’, but to deify her, provided she behaves in the way the NGO wants. The MOPE approach also has a tendency to mistake multiple anecdotes as evidence or assume that the isolated case of severe detriment takes precedent over multiple smaller instances of detriment.

On the enforcer side they are “so weighed down with legal hindrances they have a slow throughput of cases and are stunned at how fast the NGO world can do things. The traditions are very different and very strong.”

One interviewee argued that the real “argument is not between consumer and competition policy, but between enforcers and economists.” The axes of the argument focus on the “notion of fairness, which is very hard to get into the neoclassical economic model.” Within this there is the real problem of a notion of unfairness that “does not just come from an information asymmetry.” It is argued that competition officials find it difficult to deal with cases, for example, where a “trader stays too long in someone’s home and refuses to leave, implying a threat, or where you have long-term contracts where things happen later down the line, such as unfairness in bank default charges.”

However, it was also argued by another interviewee that “we have to work with some notion of bounded rationality and choice, especially for mixed agencies.” This would suggest that both sides of the ‘house’, so to speak, deal with bounded rationality problems at the same time. However, what was also clear about mixed agencies was that both sides of the house did not always speak to each other and that they often developed different traditions of understanding of what should be shared ideas. Thus, a model of consumer behaviour developed in the competition directorates of mixed agencies may not take into account the many examples of problems in markets identified in the consumer directorate of the same agency. A good example of this occurred in the UK in the funeral sector when a model of consumer behaviour applied in a competition abuse case by the OFT²⁵ was inconsistent with the work that the consumer protection side of the body had carried out a few years earlier. In essence a case was dismissed in part on the argument that consumers would shop around if prices rose, while evidence produced by the consumer directorate showed that funeral care consumers almost never shopped around.

²⁵ Competition Appeals Tribunal Case No: 1044/2/1/04. ME Burgess JJBurgess and SJ Burgess (trading as JJ Burgess & Sons) v Office of Fair Trading. Case Number: 1044/2/1/04. Date Registered: 16/07/2004.

The greatest challenge was recognised by one interviewee as being the “extent to which we talk among ourselves.” The respondent argued that “the conventional answer on how we reconcile the different views is that on the competition side, the ethic of competition and the promotion of the expansion of choice, while on the consumer side we are dealing with the hazards of faulty choices.”

The solution to this problem was the “need to impose solutions that minimise the cost of poor decisions, where people are prone to error. We need to impose constraints and deal with utterly dishonest suppliers. Beyond that, in consumer protection we need to recognise the difficulties consumers face making some choices and limit the discretion to accept.”

The striking of the balance here – between limiting choice where it is difficult to make effective choices and empowering consumers to make better choices – lay at the heart of the problem for mixed agencies. As the interviewee put it, “we must ask what is the rationale for restrictions – is it that users are prone to make bad decisions if you make them pick.” The question remained “in what instances are constraints desirable, and if so, what kind? Secondly, in light of our conclusions, how far can we press to increase the range of choices?”

Antitrust/Competition Policy Development

Pendulums, Ideology and Technocracies

During discussions with interviewees one of the most interesting topics of conversation centred on the nature of anti-trust or competition policy development. A number of respondents were well versed in the history and development of competition law and policy and so offered some compelling visions of evolution and future trajectories. Some viewed the developments in competition policy as ideologically or politically driven, others saw it in terms of pendulum swings and others again as the culmination of a largely technocratic or discursive process.

The Development of US Competition Policy

The idea of competition policy as an ideological battleground seems strongest in the USA, with Europeans tending to view competition policy as a technocratic process. It

is useful to look to the work of William H. Page²⁶ for some guidance on this matter. He argues that competition policy is framed by two competing ideological views. On the one hand is the ‘evolutionary vision’ that argues that the market is a mechanism for allowing interchanges between individuals and that outcomes from that exchange are generally legitimate in the absence of state interference. This evolutionary vision generally looks on such matters as abuse of dominance or exclusionary behaviour as temporary problems and takes a less interventionist attitude to market problems and conversely takes a negative view of government intervention. The second ideological view, the ‘intentional vision’, tends to view markets as prone to monopoly and where firms are able to coerce consumers through the misuse of power. The intentional vision of competition law sees government intervention as the tool with which to limit the damage caused by unfettered markets.

In practice competition policy vacillates between the two. As Bill Kovacic has written: “(o)ne common narrative of US anti-trust experience depicts federal enforcement policy since 1960 as a swinging pendulum. In this narrative, federal anti-trust enforcement swings through three phases: too active in the 1960s and 1970s, too passive in the 1980s, and properly moderate in the 1990s. To borrow the classification scheme introduced in the famous children’s story, federal enforcement policy goes from too hot to too cold to just right.”²⁷

This pendulum view of anti-trust suits a system where decisions on competition policy were traditionally, as one interviewee put it, “the stuff of presidential campaigns and social movement.” It must be remembered how important politics was to the origins of US competition law. The rise of populism, embodied in the three times presidential hopeful William Jennings Bryan, and the revolt against the large urban ‘trusts’ triggered a reform movement that led to the Sherman Act of 1890. The Act itself, like so many progressive legal moves of its time, was promoted as a defensive bulwark against worse events that may have been triggered by inaction. It should also be remembered that the first real targets of US anti-trust were not companies but labour unions. In some ways the Sherman Act had its origins in a defensive form of the ‘intentional vision’ discussed above. It was relatively natural for that system to err on the side of government intervention if it was born of a suspicion of big business or a desire to vent social pressures for reform.

²⁶ Varies William H. Page, *Ideological Conflict and the Origins of Anti-trust Policy*, 66 *Tulane Law Review*. 1 (1991); John E. Lopatka & William H. Page, *Brunswick At 25: Anti-trust Injury and the Evolution of Anti-trust Law*, ANTI-TRUST, Spring 2002. William H. Page, John E. Lopatka. 2007. *The Microsoft Case: Antitrust, High Technology, and Consumer Welfare*. University of Chicago Press.

²⁷ <http://www.ftc.gov/speeches/other/0304modernevolution.shtml>

The Development of EU Competition Policy

In contrast, the European experience of the development of competition law has tended to be viewed as more ‘technocratic’ and evolutionary in nature, although in ideological terms certainly not of the evolutionary vision outlined above. The evolution of European competition law has followed many traditions but generally emerged from centuries old market regulation rules and regulations. European competition law has thus emerged from a process of gradual development rather than a single, ground-breaking legal change. If one looks at the Treaty of Rome as the European equivalent of the Sherman Act, one can see that it took many decades for individual Member States to bring their own national laws into line with the basic articles of the EC. Even now there are divergences between EU law and some Member States, although these are less pronounced than before. As one interviewee put it in the context of consumer policy: “What is the European legal tradition? It is rivers coming from different valleys, mixing where there can be a mutual enrichment and neutralisation. My feeling is that as of today there is not yet (and maybe there never will be) a coherent European and generally accepted consumer policy – despite efforts from the Commission and some national governments.”

As one respondent put it: “In general the way we talk about competition policy has been captured by what could be referred to as the ‘Chicago School’ view. This divorced it from the tangible interests of consumers. They (the Chicago School) have been largely, but not entirely, successful in redefining competition policy in terms of the promotion of allocative efficiency and wealth maximisation; which is nothing to do with what the consumer wants in the real world. The story involved capturing by persuasion first the legal academy and the economics community with the endorsement and support of the business community and then capturing and persuading enforcement agencies in the Reagan administration. This has been going on for the last 30 years.”

Consumer Behaviour

There was a large area of disagreement among interviewees about the role and status of consumer welfare in competition analysis. As one interviewee argued “it has to be said that within the bounds that the market works, we certainly need to know how consumers behave, how they make up their minds, how people decide; how can you absorb the information?” There was general agreement that the position had changed considerably from that seen thirty years ago. In a European context it was pointed out that “if you take the Metro II judgement of 1976, there you see references to unemployment, crisis cartels etc; we simply do not see these references in judgements now.”

However, it was also argued that the ‘revolution’ in attitudes to consumer welfare was not being seen ‘in decisions’. This view was supported by one interviewee who argued that consumer behaviour “does not get factored in” in current cases and that competition authorities fail to understand consumer behaviour, particularly the differences that exist between “consumer need and consumer want; one should recognise that consumers say one thing and do another.”

The relative recentness of interest in consumer welfare was remarked upon by a number of interviewees, despite the fact that many authorities and commentators have argued that consumer welfare is at the centre of competition analysis. As one put it: “only in the last decade has there been a keen interest in finding empirical tests for consumer behaviour.”

One interviewee pointed out that “the working assumption is that people are well informed enough and wise enough and that firms are motivated enough to sell to them.” This view was widely supported as setting out the key starting point for many competition regulators. Such a view of markets has been labelled by some as a Chicago or Orthodox/Neo Liberal view of the market – consumers and firms are generally rational and conform to the evolutionary model outlined above.

However, one interviewee argued that “the Chicago School has a logically consistent tautology; we are all rational wealth maximisers, therefore our societal goal is a macro version of this. Policy prescriptions are simple to understand and apply and keep consistent, but if their premises are horseshit it is all pie in the sky.”

There was considerable agreement that the consumer welfare focus used at present was a narrow one or “a micro-economic concept that focuses on short-term efficiencies and on keeping prices to end use consumers on the low side.” There was less agreement on whether it should or should not be broadened out to include other factors. The broader conception of consumer welfare that is often posited tends to come from other areas of social debate. As the interviewee above argued, a more environmentally conscious view of the world involves some conception of welfare. Of course the problem for competition analysis is that the competition world has had a broader conception of welfare in the recent past with the argument between consumer welfare and total welfare.

If there is a general acceptance that we have to know how consumers choose between competing choices, there is also a need to define where and when consumer welfare comes into play. Interviewees pointed to a number of key factors in identifying how to take forward an assessment of consumer welfare. One pointed to the fact that consumer attitudes to the “environment illustrates the consumer is a mysterious and unknown being to some extent.

We are not sure to what extent the consumer will also be motivated highly by environment-friendly policies; you can imagine a consumer who is contrarily interested only in lowest price.”

Questions of Semantics

Nature of Consumer Welfare

There was also some disagreement about the nature of the consumer interest itself. Some pointed to the fact that “the consumer’s interest is to have products of high quality at an attractive price and to have access to these products and because products of high quality or advanced technology require IP and research and development and new technologies this has implications for most of the policy areas.” Others argued that the concept of consumer welfare had been altered by the move towards a Chicago-School or Borkian world view where “consumer welfare had been appropriated to mean the welfare of corporate stockholders, as it might trickle down eventually to the rest of society.” The concept of the consumer as the ‘citizen at large’ was a more ‘common sense’ position. This position, argued one interviewee “states that what we want to do is take our existing resources and utilise them as efficiently as possible, therefore everyone gets larger share. The consumer welfare test recognises output increases may be spread around and that there could be a large time gap for trickle down. The main beneficiaries of a total welfare approach, shareholders, get additional profits generated.” A broader view leads to an “argument as to which measure total aggregate welfare or consumer surplus should be the desirable measure.” The respondent further stated, however, that “most economists argued for aggregate welfare while courts and enforcement bodies tended to have as their objective to provide some benefit to consumers.”

Demand Events and Consumption Events

An interesting point made in one conversation related to a nascent idea about the nature of consumer behaviour itself. The many studies of consumer behaviour indicate a multiplicity of drivers and indicators that govern how people choose and how they consume. Applying such a notion in competition and regulatory matters has, however, presented considerable problems. A suggestion from one conversation was that we consider the consumption behaviour of a consumer as a ‘consumption event’ rather than as a ‘demand event’. While such a notion may appear to be entirely semantic in nature, it does allow us to recast slightly the notion of what it is that we are looking at

in competition analysis. If we cast a choice as a demand event we tend to think of a relatively limited number of indicators to show that demand. Price is the most obvious and clearly delineated indicator. Indeed, moving beyond price to quality/service essentially forces you to compare across multiple decisions rather than allowing you to identify individual motivation. If, however, you look at a consumption event it is easier to contemplate the more rounded version of the consumption decision. For example, looking at a pension as a demand event forces one to conceptualise the problem as one of purchase. Looking at the decision as a consumption event allows one to bring in a more rounded view of the decision and its aftermath. Such an approach potentially opens up the investigator to a more holistic view of consumption decisions, feedback loops and post-choice experiences.

The Role of Economics

Almost every interviewee argued that the increasing role of economics in competition investigations has had a major impact on the way that consumer welfare is perceived. As one rather pragmatic interviewee put it, “economics has a clear focus on consumer welfare; the large majority of economic analysis is focused on the optimisation of welfare and the recognition that when it comes to enforcement, a justification focusing on consumer welfare is empirically more attractive when compared to other objectives.”

However, the role of economics in competition analysis was not seen as entirely benign. As one interviewee put it: “one of the big problems is that the economic foundations of competition policy are now so esoteric and jargonised that the person on the street has no idea why decisions are taken.” While public acceptance may seem a relatively minor issue, the same interviewee argued that it was most important, as the esoteric nature of arguments means that there was “little constituency for anti-trust, but a major constituency against it; big companies are opposed to anti-trust, while smaller firms want a level playing field.”

The Rise of Interest in Consumer Welfare

Political Economy

A further element of the rise of consumer welfare was a recognition by at least one interviewee that there was also “recognition of the fact that there are some good political economy justifications for focusing on consumer welfare compared to other interests; economic analysis and law and economics are naturally biased toward government and firms. We need to rebalance this by focusing on the consumer interest.”

Personnel and Training

A common reason given for the increase of interest in consumer welfare analysis was the change in the number and interests of people moving into the competition law field. As one interviewee put it, “you can’t identify one single reason [why the view of competition law has changed]. Maybe it is a combination of factors, like more people. When I was a student in the UK, only 15 of 200 LL.M.²⁸ students were studying competition law. If you go now, you have UCL, KCL, QMW, LSE²⁹ offering courses in competition law – more than half of the law students will study competition law. It only used to be at UCL. All those extra people went into private practice, etc.: this is how society has changed.”

However, the issue of personnel and training was raised in relation to the strength of a sceptical view of competition intervention. As one interviewee put it, “now it is only really law students who end up working for defence. Class action lawyers tend not to be anti-trust lawyers. The main institution for lawyers, the ABA³⁰, is almost entirely defence lawyers. In general, the anti-trust division heads have come from corporate bar and, with some exceptions, gone back to corporate bar.”

Politics Big and Small

Another factor pointed to by some interviewees for the rise in interest in consumer welfare analysis was the importance of politics, both big and small, in the competition process. As one put it, “if you have a particular type of government or commission, certain ideas develop. If you look at the environmental movement they could at least say ‘observe the damage to the environment.’ Even here it took years to feed through to policymaking.” Or as another put it more concisely; it is a “great bit of marketing.”

A more interesting view from one US interviewee focused on the relative ease with which a particular view of consumer welfare could become more influential: “the real tactical advantage the Chicago School has is that it has a simple, coherent story that institutional actors can apply with certainty and market it as apolitical and not normative, purely descriptive, but it is not; its premises are highly contestable – if indeed they reflect any reality we participate in.”

One asked, “Is there a way out? Anti-trust has got very technical and very complex economically and legally. As a result it has no fundamental purchase on the attention of

²⁸ A Law Masters Degree from the Latin Legum Magister or Legum Magistra.

²⁹ University College London, Kings College London, Queen Mary, University of London (QMUL - until 2000 Queen Mary and Westfield College), University of London and the London School of Economics.

³⁰ The American Bar Association.

individual politicians. They display a form of rational ignorance. A lot of it has to do with explaining and re-popularising anti-trust.”

Despite a view that politicians had little interest in competition policy, there was an acceptance that the particular view of competition enforcement was leading to some differences between European and US enforcement agencies and that this problem was “almost a matter of ideology.” While this ideological difference has been pointed to many times, it has rarely been set out in any convincing manner. One interviewee argued that the change in competition economics was leading to undue influence in Europe for US views. “The evidence is that the virus is spreading from the US to Europe. If you look at changes in merger policy in the EU, then the role of economics looks very much like what the US does – you would be hard pressed to tell the difference. The EU got it from the US; the Article 82 initiative could push the EU system closer to ours. What is interesting in this characterisation is that there was hope in some parts of the US debate that “globalisation would import EU notions of preserving competitive dynamics of markets. However, we are not seeing empirical evidence of that move.” This interviewee argued that “this point goes way beyond competition policy; the US is not likely to learn from foreign jurisdictions but rather exports its wisdom.”

While the recent discussions in the US on Section 2 of the Sherman Act and in the EU on Article 82 have shed some light on the differences between the two jurisdictions, they rarely come to the surface. Indeed at a case level or on matters of overall policy there are relatively rarely stark differences between the two jurisdictions. If, however, we recognise that differences between the two jurisdictions exist, it might be useful to analyse how those differences manifest themselves. One interviewee expressed the differences as being the set of basic assumptions or ‘priors’ that each jurisdiction has. The respondent argued that the major disagreements that occur between the EU and US tend to focus on these priors rather than on matters of detailed substance. The location of the difference “corresponds to a particular view of how markets function.” The argument continues that the prevalent view in the US is more laissez faire and less interventionist, while that underpinning European competition enforcement is more sceptical of corporate behaviour. In many ways this difference corresponds to the rift identified between evolutionary and intentional views of competition policy. However, it is important to note that this difference exists primarily in the underpinnings of attitudes to market intervention, rather than in the view of cases themselves.

Such a location of the differences between US and EU approaches in the underpinnings of competition policy explains why those working on merger policy can generally come to agreement, while those working on abuse of dominance or exclusion cases often do not. The largely shared toolkit for mergers and the fact that mergers trigger a regulatory

review as a matter of course allow differences in motivation to be ‘parked’ while the process of review is carried out. In contrast, action on exclusionary behaviour requires a desire to act on the part of the agency that will be driven in large part by the ideological view prevalent in the agency and jurisdiction.

If we accept the argument that competition policy is at least in part driven by the ideological approach of the agencies involved in enforcing the law, then we are more able to focus our interest in consumer welfare within this framework. Such an understanding allows us to accept that there are different conceptions of what consumer welfare actually is, depending on the priors one adopts. If one takes the evolutionary approach and argues that firms generally respond to market stimuli and that restrictions on competition are largely temporary, then your view of consumer welfare will tie the interests of consumers to relatively unfettered markets. At its extreme, it is also likely to allow an agency to be relatively uninterested in temporary losses of consumer welfare due to exclusionary behaviour. Perhaps the willingness of agencies to accept short-term consumer welfare losses is what sits at the heart of the ideological differences. If one takes an evolutionary view, then losses of welfare are likely to be temporary, while one who takes an intentional view will likely see consumer welfare losses as evidence of market failure. In the case of the intentional view of competition, one can see the bias in European competition law that tilts the system on evidence of a loss to a ‘significant’ force in the EU as evidence of a strong ideological bias in favour of intervention. In contrast, the recent acceptance by large parts of the competition community, and indeed the courts, that resale price maintenance can be acceptable, is evidence that a more extreme version of the evolutionary model is at play in the US.

One interviewee pointed to the *Leegin* judgement³¹ of the US Supreme Court as evidence of the importance of the ‘priors’ the courts were using in making judgements: “I was not surprised by the outcome, more by its formulation. I had expected the Supreme Court to be much more careful in expressing its priors. If you read the judgement you are struck by two things: First, the list of the potential benefits of RPM as well as a list of potential theories of harm, [...] which reads like a textbook without much judgement. I expected the Supreme Court to clearly express its priorities. Secondly, what was most striking was the statement that increases in price following RPM may not matter all that much. If prices go up, so be it, we don’t care; what really matters are the efficiency benefits from the use of RPM. This is a significant departure and indicates what you care about at the end of day.”

³¹ Supreme Court of the United States. *Leegin Creative Leather Products, Inc v PSKS Inc, DBA Kay’s K’loset, Kay’s Shoes*. No. 06–480. Argued March 26, 2007 – Decided June 28, 2007.

Looking Ahead

Challenges of the Future

Part of every interview focused on where competition and consumer policy might go. The object of this discussion was to provide some focus to the question raised by one interviewee, namely, “If the established model does not work then what supplants the theory and what policy flows from this? What are implications of the alternative model?”

The discussion about the future was also important because it was clear to a number of respondents that “consumer behaviour does not get factored in”, and perhaps more importantly because of a growing fear that the shift in competition enforcement towards a more consumer-focused methodology may not be permanent.

Distributive Issues

An issue that we wanted to explore with interviewees was the way that competition policy dealt with focused consumer welfare losses. We were particularly interested to ascertain whether interviewees had a view on those cases where the vast majority of consumers gain from, for example, a merger going ahead; but a very small minority lose considerably from that merger going ahead. We were also concerned to explore if competition policy had the necessary tools to enable it to handle the distributional effects of enforcement actions. Our discussion also served as a proxy to explore whether a process was occurring in competition policy that had occurred in other policy areas, most notably trade policy, where elements of social policy or distributive equity considerations were either encroaching on the traditional area of policy or were being shoehorned into the policy debate. This element of the debate arose largely as a response to the fact that competition policy has tended to move globally away from a broad public interest test (which provided often-abused flexibility) to a more focused consumer welfare test.

It is interesting to note that our American interviewees were less engaged with this issue than our European interviewees, although the views of the latter threw some interesting new light on the issue. A common response to the question about whether competition policy was able to cope with issues of distributional equity was that “competition policy cannot meet everyone’s needs.” There was also more than a little of a brutalist streak to some responses, one arguing that “capitalism and competition are part of a way of allocating resources. It is clearly not going to meet everyone’s needs or wants; there is always going to be someone who does not benefit.”

Competition Policy and Social Policy

There was a clear aversion to “trying to shoehorn public interest into the consumer interest” with wider policy objectives being rightly “met by social welfare policy.” It was fairly universally argued that we could not “use a competition investigation to solve all problems” while recognising that such a process could not “deal with things outside the remit.” There was a concern that this might not be ‘sustainable’ in the long run.

This issue of sustainability, as competition policy is exposed to greater scrutiny and pressure from non-traditional interrogators, prompted one interviewee to ask, “Can we have an equivalent in competition policy that is complementary to social policy?” While pointing to some possible overlaps, the interviewee was careful to argue that while “the two are not mutually exclusive”, it was important not to “extend the scope of competition policy.” It was much more important to ensure that it was “other policies coming in where competition policy finishes.”

The location of such policy complementarity was argued to be best outside of traditional infringement investigations: “you can only do it in market investigations[...]the only scope for the kind of comments outside competence are in market investigations, and therefore ad hoc as it depends on which market they are looking at.” While it was recognised that competition authorities were increasingly becoming involved in such situations, there was still a question as to whether or not they should. The interviewee felt “defensive on their behalf; their job is to deal with competition policy.”

While there was much discussion about the need to keep competition policy ‘pure’ and away from the problems of distribution and social policy, there was general acceptance that competition policy had to find some way to mediate the relationship between itself and wider social policy issues. One particularly insightful comment focused on the fact that the relationship between competition policy and distributive issues may not be the one we think it to be. Most respondents appeared to work on the assumption that competition policy had relatively little to do with distributive justice. However, one observer argued that “one of the striking aspects of competition policy in the EU is that it is supposed to care about subsets of the community. This has strong implications for policy. It means that you may have to prohibit a deal with a strong rationale because it may have a significant impact on a group in the EU.”

The importance of this for policy was that “if someone is hurt, we take action. You can see that very clearly in merger control and in enforcement towards price discrimination in the area of 81. Typically in the area of Article 81 the Commission does not care about

eventual benefits, taking into account all groups of consumers; if it finds someone has been hurt, they deem the action to be unlawful. This is definitely an area where old case law, developed in the 1960s, is still alive.”

The peculiar nature of the EU itself compounds this problem, given that the EC Competition agency “is not meant to do anything that is different from that which would arise from a combination of simultaneous enforcement activities in EU countries; it is striking that the EU is not doing anything different to Member States.” The interviewee argued that this was particularly disturbing, as “a supranational institution should have a role to play in balancing interests of different constituencies.” There was also a “wish that competition enforcement took part in arbitrage” and a concern that competition agencies “don’t have a compensation principle, but could use one.”

Efficiency, Consumer Welfare and Innovation

A logical corollary to the discussion of distributive justice was a discussion with interviewees about efficiency. As we have mentioned in our initial comments, the issues of efficiency and consumer welfare are – in our view wrongly – often discussed in entirely separate places. This may be because, as one interviewee put it, “the anti-trust programme is most consistent in dealing with allocative efficiency; in a sense that is a consumer welfare agenda. If you pressed enforcement officials, their view of consumer welfare would be allocative efficiency; static or dynamic.”

Efficiency and Competition Analysis

As discussed above, the direct association between allocative efficiency and consumer welfare can provide a point of division between the two ideological strands in competition enforcement, the ‘evolutionary’ laissez-passer model and the more interventionist ‘intentional’ vision. The strength of the evolutionary vision in the US in particular is in part due to the excessive application of the intentional vision in both the very early years of anti-trust enforcement and during the 1960s and 1970s. As one put it, the backlash meant that “more and more commentators argued that you cannot casually decide to sacrifice efficiency.” US respondents were more exercised about this point, one arguing that it was “cheap talk to shrug and say you could sacrifice efficiency when in the lead.” The ideological element of competition policy led many in the US to talk of a ‘pendulum’ move from the intentional to the evolutionary, with a slight shift back, under pressure from the private bar and State Attorneys General.

In contrast, the view in Europe was tagged by one interviewee as having its history in some rather dubious decisions in the European Court of Justice. The “efficiency defence has come from a long time ago. At the beginning of the Merger Task Force³², some decisions said that certain mergers were dangerous because they were too efficient and would drive out competitors.”

There was some debate as to how far the European Commission would, or could, go in bringing efficiency issues more into the mainstream of competition analysis. As one argued, “you should bring efficiency in from the very beginning. I am not sure how far the [European] Commission will go; there are people who think in terms of the hierarchy – you have a behaviour that is per se abusive; then you have to rebut the presumption. However, efficiency can come in very soon.”

Interviewees were considerably less voluble about the links between consumer welfare and innovation. While some recognised the link, only one was clear in connecting consumer welfare, innovation and efficiency as linked elements of the competition process.

The Role of Consumers’ Organisations

The final set of questions for interviewees focused on the role that consumers’ organisations played in competition policy. However, this part of the interview tended to be the shortest. One interviewee noted that there was an important ‘political economy’ problem of involving consumers’ organisations and indeed representing the consumer interest in competition cases. This interviewee saw it as an essential role of competition regulators themselves to ensure that the consumer interest was represented in competition analysis. However, the actual involvement of consumers’ organisations in competition policy was not the subject of long discussion. Most interviewees welcomed the involvement of consumers’ organisations in competition policy, although almost none had had much interaction with them.

Prioritising Competition Policy Matters

For consumers’ organisations, competition policy was rarely a key priority. A number of consumers’ organisations helped to found and work together through a network called

³² The original name of the Merger Unit that dealt with the review of mergers with a significant presence or impact in the European Union.

Incsoc³³ which has a global and broad membership. However, BEUC³⁴, the main umbrella body for consumers' organisations in Europe, Consumers Union in the US and the Transatlantic Consumer Dialogue³⁵ do not currently work on competition policy as a core policy issue. Consumers International³⁶ has competition policy as an area of work, but it is not a strategic priority and has relatively few resources attached to it.

Those organisations that work on competition policy tend to view it as “one of the key campaign tools we have.” The effectiveness of competition policy as a tool for use by consumers' organisations has been identified by a number of organisations both small and large. Some consumers' organisations, like Which? in the UK and CUTS³⁷ in India, have official standing in competition cases. Which?, in addition to a number of other UK consumers' organisations, has what is called ‘Super-Complaint’ status. This process requires the Office of Fair Trading to respond to formal requests for action within 90 days. There is, however, some suspicion among consumers' organisations that competition policy is a Trojan Horse for an aggressive policy of liberalisation and privatisation. This view is particularly prevalent in parts of Southeast Asia and Latin America.

Formal Involvement: EU vs. US Views

There was an interesting contrast between US and EU views. In the US there was a mix of views about formal involvement which was put down to the power of the ‘private bar.’ Indeed one explanation for the limited civil society involvement in competition policy was precisely the involvement of the private bar in a considerable amount of litigation. The privatisation of anti-trust enforcement through damages actions was seen as a good reason for consumers' organisations not to involve themselves in cases or in policy. In Europe, a much more common response was the political economy answer quoted above – consumers find it difficult to represent their interests; we would very much like to hear more from them but have heard very little to date.

Most interviewees argued that consumers' organisations paid lip-service to competition policy and were much more interested in regulation. Most interviewees categorised consumers' organisations as ‘interventionist’ in regulation but less interested in competition policy. One interviewee put this down to “self selection; people that get most

³³ The International Network of Civil Society Organisations Working on Competition Policy (www.incsoc.net).

³⁴ The Bureau European des Unions du Consommateurs.

³⁵ The TACD was launched in September 1998, and currently has 45 EU and 20 US consumer organisations as members.

³⁶ Consumers International (CI) was founded in 1960 and is the only independent global federation of consumers' organisations. It currently has 220 member organisations in 115 countries.

³⁷ Consumer Unity and Trust Society.

involved in consumer protection are people who identify with socialist-type policies. They tend to have confidence that government is the way to deal with things. They are often closely related to organised labour and tend not to be trained as economists[...]or[...]as anti-trust lawyers.” The link to the labour movement that some elements of the consumer movement have had interestingly was tagged by some as the reason for the lack of progressive interest in competition policy. This was particularly the case in the US, where the labour movement was viewed as largely antithetical to competition policy.

The positioning of the consumer movements within wider political debates was also seen as a factor in their attitudes to competition policy. The labour movement link was often seen as important, where the libertarian right was a well-funded opposition to more radical politics. The willingness of politicians and officials to discuss competition matters with consumer organisations was also seen as an important factor in the role that they played. Here, there was a stark contrast between European and US views. In the US there was a view that consumers’ organisations were much more welcome and willing to engage with Democratic Party administrations and Congressional representatives than with their Republican counterparts. Indeed there was a common view among US respondents that there was no chance of greater consumer influence without a regime change in Washington. This has led to what one respondent argued was a history of ‘internecine warfare’ within civil society and a tendency to “take out more extreme positions. They tend to work with more extreme positions taken in primary elections. This makes it much more difficult to compromise into the middle; but politicians are good at doing that.”

In contrast, in Europe, the more social-democratic nature of the political system meant that most participants in the competition community wanted more consumer involvement irrespective of political position. The European response was more focused on the bureaucratic process and ensuring that the system of enforcement was as effective and inclusive as possible. One interviewee argued that he “found it very stimulating and attractive to deal with Ralph Nader³⁸. Here in Europe it is extremely important to explore the unknown or unconventional, iconoclastic approaches, and see what you can extract and learn for your own policies and your own internal market or trade policy.” Talking to civil society and the wider competition community reflected the fact that the “world is a big training camp in how to develop the best possible structures and approaches for the various policies, and we have never had such an enormous chance to learn from merits and mistakes of other people.”

³⁸ Ralph Nader helped to kick start a wave of US consumer activism through highlighting safety problems in cars in 1965 through his book ‘Unsafe at Any Speed’. He went on to found Public Citizen and its many offshoots and has run for President four times.

There is a Lack of Involvement of Consumers' Organisations

The relative lack of consumer involvement was regretted by a number of interviewees. One stated that he would “like to hear much more from them. I wish they would actually represent the interest of consumers in the context of enforcement cases. It is very rare we hear consumers in Article 82 cases.” This is despite the fact, as one interviewee put it, that “case handlers come from personal consumer perspectives; you can get quite specific personal views.”

In contrast, consumers' organisations bemoaned the demands of competition officials and their ‘unrealistic timetables’ and ‘vague demands’ for information. There was a view that competition officials ‘didn’t get’ consumers' organisations and constantly asked for survey evidence and opinion polls when instead consumers' organisations wanted to express an opinion on a case.

The idea that individual case handlers might bring their own views to bear in cases, in the absence of formal consumer involvement, was highlighted by another interviewee who opined the lack of ‘formal guidelines’ on what the consumer interest might be. The granting of a ‘special status’ to some consumers organisations was considered by many, particularly given the generally positive experience of the Super-Complaint process in the UK, although this was argued to be a “great bit of marketing” by one. Such a special status was argued as likely to “help improve the quality of complaints” as would “the appointment of the Consumer Liaison Officer.”

What Consumers' Organisations Can Offer

There was some debate about what consumers' organisations might be able to bring to the competition process. One argued that consumers' organisations can intervene in “market definition issues by using client surveys and consumer behaviour views” and this was seen as particularly useful when you have “case teams with set views.” Another argued that it would make sense to have consumers' organisations intervene at the point of “market testing; consumers can be more involved. After all, this is important because mergers affect structure. It is better to intervene at this stage for big mergers where consumers are affected if you have available and specialised people to respond to market tests, because officials will be paying attention and there is room to influence the Commission.” It was also argued that consumer involvement would be welcome in “sectoral studies, both here and in the US. Lately, there may be cases where the picture on the ground is different to the position from Brussels and consumers could intervene.”

There was a view that “the organisational and institutional structure is there; but the consumer interest is diffuse and different. If you compare it with the environmental movement; they are much more specific.” However there was a recognition that it depended to some extent on “how much money you have to spend, although there must be room for improvement internally; the more you speak to the press maybe the better. As a general strategy, if you are sitting in a little corner and not visible, you tend to want to be more interventionist.” One interviewee pointed out that FIPRA were the “first to come to interview me about consumers” in almost 20 years of policy involvement.

An Insular World

Most interviewees tended to view the competition community as a relatively small and closed world with very few consumer advocates. One compared the situation to the world of trade policy: “Imagine how many people we had to interview for the environment. It is not the same for competition policy.” The lack of ‘real change drivers’ was considered a loss in some elements of competition policy.

Chapter 3 Conclusions and Recommendations

We chose to divide our conclusions and recommendations into two groups. First, we will make some practical for how the competition toolkit can be adapted to more effectively reflect our more nuanced view of consumer welfare. Secondly, we will make a number of comments that are more directed at influencing policy both at a governmental and competition enforcement level.

3.1 Practical Conclusions and Recommendations: Towards an Alternative Model?

We were regularly reminded in our discussions of the question posed by one respondent: “If the established model does not work, then what supplants the theory and what policy flows from this? What are implications of the alternative model?” We felt that this demand to be positive was one that we could not avoid. It is always easy to point to the deficiencies of an existing situation. It is more difficult to put forward some ideas for how those deficiencies can be corrected.

We must accept the challenge of developing an alternative model if we are to allow competition and consumer policy to move forward to deal with consumer welfare issues in a more effective manner. While it is true that the idea of the rational consumer has taken a fair bit of dismantling over the last couple of decades, the central tenet of the work of Tversky and Kahneman would appear to still hold, namely that individuals will tend to act rationally when they are presented with clear, transparent information, but will behave less rationally when faced with opaque information (‘information’ is broadly conceived in this context).

If we accept this tenet – that consumers will tend toward rationality in transparent markets – we need to ensure that transparency is a key factor in the assessments of markets. If so, then what questions do we need to ask? At what stage should they be asked? The asking of questions allows us to deal with consumer welfare as part of an iterative process rather than as a series of hard and fast rules. As we argued above, there are a large number of markets where consumers are not directly affected by the alleged anti-competitive behaviour. We need to test if the questions we ask will allow us to apply the rules to intermediate markets as well.

We also need to be clear about why we are asking the questions we do. The answer lies in perhaps the most basic assessment of a functioning market – the role of the marginal consumer. In a properly functioning market the marginal consumer, through their

consumption decisions, will ensure that the firms that meet consumer needs prosper and that those that do not fail. This is a basic tenet of most regulators' view of the marketplace. What is rarely assessed, however, is whether and how the marginal consumer can and does behave.

In short, we need to know a good deal more about the marginal consumer than we currently do. Essentially we need to know, on a market-by-market basis, who the marginal consumer is, how they make choices and to what extent they can actually act as the market disciplining marginal consumer. We need to work out how likely it is that the marginal consumer will act in as near to a rational manner as possible and we need to know what impediments there are in the way of the marginal consumer acting in as rational manner as possible.

Questions to Ask

If we tie together our two concerns – consumer behaviour and the role of the marginal consumer – we end up with four sets of questions:

- What affects the way a consumer approaches a decision?
- How does the consumer make a decision?
- How does a consumer learn from the decision?
- How much does the decision count?

What Affects the Way a Consumer Approaches a Decision?

Market cultures	What is culture of the market?	Are particular practices common?	How do participants view the market?		
Information transparency	How easy is it to understand the information provided?	In what environment is the decision made?	How much time does the consumer have to make the decision?	What other information is available?	Will the merger/practice improve transparency?
Search costs	How important is this consumer decision relative to the potential saving?	Are peer groups important in this market?	How long does shopping around take?	What are the physical bounds of the market?	How much of the market is migrating to the Internet, both in consumer and retailer terms?

The object of the first set of questions is to examine the background to a consumer decision. The softest area of questioning relates to the ‘culture’ of the market. This is an area that regulators and competition officials often find uncomfortable to deal with. However, most recognise that different markets have different cultures and that the belief systems of market participants can affect the way a market behaves. This cultural attitude is shaped by the history and development of each market. Central to this is the pattern of interaction between the market and the State, either in the form of direct State intervention or regulatory oversight. Such interactions frame the generally accepted view a market has of the likelihood and form of government intervention. If a regulatory decision is based on a market culture changing, then the regulator must be sure that such change can occur either from within the market or from without.

How Does the Consumer Make a Decision?

Sunk costs, momentum and self control	Are consumer sunk costs common, and legitimately so?	Are final decisions or payments made over time?	Is the final quality of work only ascertainable long after payment?	Do consumers have an opportunity to revisit original decisions?
Losses and gains	Can consumers bundle and re-bundle losses and gains?	Can objective calculations be made of relative costs/benefits?		

This block of questions is aimed at the precise moment that a decision is made and the way that decision is framed. We know that the manner in which a decision is made affects what that decision is and there are certain markers we need to identify to see the degree to which decisions may be affected.

How Does a Consumer Learn from the Decision?

Delay and variability	How long before a consumer understands the effect of their consumption decision?	How effective is the decision-effect-feedback loop? Who controls it?		
Frequency of choice	How often does the consumer participate in the market?	How many other decisions will the consumer have made in related markets?		
Time and importance	How important is the service/product to the consumer?	What other decisions-effect-feedback loops will the consumer be dealing with during a similar time frame?	Are peer groups important in sharing information?	How are consumers likely to value the time needed to interpret the transmission results?
Uncertainty	How certain is the relationship between decision-effect-feedback?	What is the consumer understanding of the balance of probabilities in the market?		
Gains and losses	Is the product/service a bundle?	How clear are the gains and losses in the market?	Do consumers have the opportunity to re-bundle gains and losses according to preference?	
Psychological	Is the market aimed at lower income consumers through discounting long-term fallibility in decision-making?	Is this business risky, warranting higher charges, opaque charging information or high credit charges?		

Consumer learning is perhaps the least regularly visited aspect of behaviour by competition officials. However, it is vital to the effective functioning of markets and is a very powerful indicator of a problem, or future problem, in a particular market.

How Much Does the Decision Count?

The von Thunen test	Have physical consumption patterns changed?	How do consumers view the physical bounds of the market?		
The Pareto test	Do small numbers of consumers buy large shares of total sales?	Do these consumers operate in a peer group?	Does the company know who the consumers are?	Are these consumers buying online?

This question we like to refer to as the von Thunen-Pareto test. This test is named after two pioneers in their fields, quite literally in the case of von Thunen. The von Thunen test is a consumer focused version of the theory of concentric crop circles. von Thunen essentially developed a theory to explain why certain crops were grown at a certain distance from the marketplace. The higher value crops were sown further away from the town centre because the relative payback of the crop was greater given the cost of fuel (usually feedstuff for horses) was taken into account. For our purposes we assume that consumers have individual von Thunen circles of consumption. A consumer is willing to travel certain distances for certain goods. Higher value goods will generally see a greater willingness to travel to purchase. The other side of our test, the Pareto test, is an application of the marketing rule that 80 per cent of your profits come from 20 per cent of your customers. Such a dictum does not apply to all markets, nor to all markets to the same degree. However, the issue here is the extent to which the rule applies. In combination, the von Thunen-Pareto test gives a rough indication of how much the marginal consumer will count. If we look at music retailing as an example, we find that consumers used to be willing to travel to town centres to buy their physical music products. For some genres a relatively small number of consumers purchased a large share of the total physical products (whether teenagers or middle class classical music buyers). With the arrival of the Internet, the von Thunen circle shifted from a willingness to travel to a town centre to a desire to sit at a computer and access the global market. For those genres where the Pareto rule had some application, we saw a combined effect where those most important to physical stores were those most likely to shop globally and/or digitally. The response of the book retailers to this phenomenon is instructive in their efforts to create a retail 'experience'.

Practical Recommendations

We have to adapt our current analysis in competition matters to build in a more nuanced and detailed analysis of consumer behaviour. We must go in search of the marginal consumer and discover the degree to which that consumer exists and the degree to which they can act as the market-driving marginal consumer.

We must develop the tools to enable us to answer those questions. Some exist already and some can be adapted from other areas of work. What is clear is that with a little imagination and flexibility we can make a good start at a practical reform of competition analysis. As we note below, where we utilise the new approach also matters. FIPRA recommends that the place for deeper analysis of consumer welfare and behaviour should occur during the market definition and remedy stages.

3.2 Policy Conclusions and Recommendations

We were challenged by the range of issues raised by interviewees. Issues covered the full gamut of discussion topics, from philosophical problems to practical and political issues. Our recommendations needed to reflect that diversity, while maintaining some form of consistency and utility.

The Long-Term Consumer Interest Lies in Efficiency and Innovation

We found very few people who could find fault with the idea that long-term consumer welfare dovetails with efficiency and innovation. However, the contexts within which the relationship was seen were different. As we discussed above, the current debate has become rather polarised between a vision of the world that sees efficiency as the 'be all and end all' of competition policy and one that sees it as a 'fall back defence' for otherwise indefensible acts. The recent spat between the US and EU authorities over Microsoft is perhaps the starkest example of this difference of vision.

If, however, we can agree that long-term consumer welfare is only safeguarded by an economy founded on innovation and efficiency, then we can start to see the whole of the argument rather than the constituent parts. There has rarely been much economic logic to having efficiency as a 'defence' or as an afterthought in merger or exclusionary behaviour cases. Similarly, there is little logic to having consumer welfare as some sort of final check or 'get out of jail' card. It is also illogical to treat efficiency as some sort of deity or trump card.

We need to ensure that the overlap between efficiency, consumer welfare and innovation is at the core of decision making. Thus, efficiency in a merger or as an excuse for exclusionary behaviour can only work if it is likely to enhance consumer welfare and foster innovation. Similarly, a deal that benefits consumers in the short term but harms innovation and efficiency in the long term may not make sense. However, we cannot allow one element of the triangle to trump any other.

Conclusions

- Enhanced efficiency and innovation deliver long-term consumer welfare gains;
- Efficiency can neither be elevated to ‘trump card’ status, nor relegated to be the last refuge of the desperate;
- Efficiency arguments must be upfront and at the forefront of all competition investigations;
- Efficiency only spurs innovation when competition drives the market.

The Short-Term Consumer Interest is More Prosaic

If we can accept that long-term consumer welfare is part of a bundle of issues with efficiency and innovation, then we need to take a more focused look at short-term consumer welfare. More importantly, we need to recognise that there are short- and long-term consumer welfare issues that may contradict each other. In the short term, consumer welfare in any case is likely to focus on price as the *primus inter pares* of all factors, including choice and access. In the first instance, an assessment of consumer welfare will mean that a practice is against consumer welfare if it raises prices, reduces choice or hampers access. The simple test on consumer welfare works well in most merger cases and indeed in many exclusionary behaviour cases.

Conclusions

- Price matters and should remain the first among equals of deciding issues;
- Short-term welfare analysis must consider long-term impacts – price reductions by a monopoly player now may kill innovation by smaller rivals or new entrants tomorrow.

A Balanced View of Consumer Welfare Acts as a Bridge

The exigencies and simplicity of short-term consumer welfare assessments are attractive to all regulators. The rather clumsy effort to slap efficiency onto the process as a trump card then is a good part of the reason for such ideological splits between US and European regulators. This is as much a result of the assumptions that underlie the different cultures of economic regulation than it is a split in individual cases. The division surfaces in particular cases, but more often than not it stays below the surface on those many nationally focused cases. Where it is most acute is in the assessment of exclusionary behaviour cases. In Europe, the priors of the competition community lean towards intervention; in the US the priors lean toward a very limited willingness to act.

We contend that a lack of a bridge between short-term consumer welfare and long-term efficiency gains and an overly narrow interpretation of both terms is primarily at fault. This lack of a bridge allows a more ideological slant to be placed on competition enforcement than is necessary. It allows the mainstream US competition community to effectively jettison short-term consumer welfare in favour of efficiency, while pushing some in Europe to a Sarkozyesque vision that jettisons consumer welfare in favour of short-term and long-term inefficiency. If an ideological clash is to be avoided, we need to find practical steps to bridge the various gaps that are emerging.

The balancing act between short-term and long-term consumer welfare can provide this bridge. If one looks at issues like retail price maintenance, one can see cases where short-term consumer welfare is damaged by price fixing in return for possible enhancement to innovation and efficiency. However, the balancing of efficiency and innovation in long-term consumer welfare ensures that only efficiencies that are very likely to be welfare-enhancing can be considered as important. Even then, such gains have to be balanced against the very real possibility of short-term consumer welfare losses from a rash of price fixing. Efficiency and innovation cannot be placed in front of the consumer like a carrot on a stick before a donkey – always visible but always out of reach.

Conclusions

- Short-term consumer welfare considerations must take consideration for long-term consumer welfare aims;
- Short-term assessments must prioritise room for innovation;
- The efficiency case in any merger or exclusion case must be tested for likelihood that benefits resulting from increased efficiency will be passed on to consumers;
- Competition authorities should spell out the short- and long-term implications of decisions for consumer welfare and should identify the balance of short-term savings/losses against longer-term efficiency and innovation effects.

It is at the Beginning and at the End of Things

If we are to treat efficiency, innovation and long-term consumer welfare as the same bundle of issues, the question then becomes where we need to treat them. Neither can, or should, be used as a trump or a defence. The three are in many ways the *raison d'être* of an efficient market economy. If we are to treat mergers and exclusion cases properly, then we need to ensure that the frame we use to judge cases allows a balanced assessment.

In this light, we need to bring consumer welfare, now more broadly conceived, into its proper place in investigations. This need not be traumatic. Consumer welfare most naturally sits at the start of investigations during the market definition stage and at the end of cases in the assessment of remedies. It is precisely at these points that an assessment of short-term (price, quality, time) and long-term (price, quality, time, efficiency and innovation) consumer welfare sits most easily. One cannot define a market without a thorough assessment of the consumer or of the relative efficiencies and innovative landscape of a market. Likewise, crafting remedies that consumers either cannot or will not use serves little purpose.

Recommendations

- Building a more effective model of consumer welfare should supplement rather than replace existing approaches;
- Consumer welfare assessments are most important in defining markets and in identifying effective remedies.

Consumer Behaviour Needs to be Built into Agencies and Analysis More Effectively

Our interviews illustrated the relatively sparse knowledge among many in the competition community about consumer behaviour. Part of the problem was the isolation of competition officials from consumer enforcers. Another part of the problem resulted from cultural and philosophical differences between consumer and competition agency officials.

Mixed consumer/competition regulators were often more aware of the issues than single issue regulators, but this did not mean that they necessarily did anything with this enhanced knowledge, despite the fact that behavioural understandings can significantly affect the view a regulator can take of a market.

There is an urgent need for competition officials to educate themselves about consumer behaviour and to find practical ways to build this learning into market definition and the assessment of remedies. There have been significant advances in the understanding of the metrics of consumer behaviour. There is a good body of academic research and practising academics working on behavioural economics that can be called upon by competition agencies. The advances made by behavioural and experimental economists are likely to be taken on further by neuro-economists who study the way the physiology of the brain responds to different stimuli. Competition agencies should begin work with neuro-economists now, rather than wait the decades it has taken them to respond to the advances in behavioural economics.

Recommendations

- Competition agencies and consumer agencies should ideally be under one roof;
- Consumers' organisations and competition agencies must work together on joint projects, share staff and integrate their analytical approaches to market problems;
- Every competition agency should employ behavioural economists;
- Every competition agency's economics unit should draw on the work of sociologists, psychologists, anthropologists and any other discipline with an insight to the behaviour of market actors;
- Competition agencies should engage with neuro-economists while studies are in nascent stages, in order to identify possible research avenues of benefit to them.

Competition Policy Cannot Be An Island

The lessons from other areas of policy point to the need for more integrated governance. Competition policy has been able to isolate itself from other policy areas for some time. However, the pressure that has been applied to trade policy in particular is starting to be felt in some jurisdictions. The response to this pressure has been notably ostrich-like. This is not sustainable in the long term. The efforts that competition authorities make in relation to reaching out to government departments are laudable. However, in some areas of governance, efforts can descend into little more than missionary work among the heathen masses.

Competition authorities need to develop closer ties and more effective links to flanking policies that can help to provide a pressure valve for civil society and political pressure to be deflected from the day-to-day work of authorities. These ties need to ensure that if an issue is brought to an authority that lies beyond their powers, they are able to both say they are unable to deal with the issue, but also pass it to someone who is, along with relevant recommendations for action.

These recommendations should then be followed up and reported on by the competition authority some time later. In essence, competition policy has to build links to related policies and departments and develop an oversight role for competition-related issues and regulations. Authorities also need to be more willing and able to take on vested political and departmental interests that seek to undermine competition regulation through slow or inappropriate action. The European Commission, with its mandated focus on the consumer, is in a strong position to push forward these sorts of issues.

Recommendations

- Competition authorities should be given the power to advise government departments on flanking policies to support competition and market investigations and to guide those departments in implementation. They should also report on that implementation publicly;
- Competition decisions should spell out the issues raised that are outside the competence of the agency and state to whom these issues have been passed;
- Mixed consumer and competition agencies are the most likely to develop flanking policies to underpin and support competition decisions.

Consumers' Organisations Have To Become More Involved

What was clear from our research was that consumers' organisations were not fulfilling the role that many saw for them. The irony of this situation was palpable. Competition policy is one of the few policy areas that is firmly based in the idea of advancing the consumer interest. The language, training and legislation in the competition world is increasingly reflecting a consumer-focused view of the world. Competition officials are often very willing to engage with the wider community, often more than the wider community wishes to deal with them. It is clear, also, that very few consumers' organisations engage in competition policy work on a serious scale.

There are only a handful of organisations who have invested in having trained staff able to intervene in cases. There are two ways to deal with this problem. First, to castigate consumers' organisations for not taking competition seriously enough and secondly, to offer greater help to consumers' organisations to enable them to take a more active role in competition policy matters. Recalcitrant organisations should be cajoled into action and competition authorities and law firms should offer more direct aid in the form of loaning staff or pro bono hours in the drafting of interventions and taking of positions.

However, as all competition agencies know, the most effective way to encourage dialogue is to change the incentive structure that exists between consumers' organisations and competition agencies. The UK system's 'Super-Complaint' status has worked well. A number of consumers' bodies also have the power to seek damages in competition cases. It is too early to know whether this has had any impact, as there have been too few cases.

Recommendations

- Consumers' organisations should make competition policy work a high priority;
- Consumers' organisations should employ specialists to carry out such work;
- Consumers' organisations should work together, ideally through organisations like Consumers International and Incsoc, to influence international discussions on competition issues, such as those at the ICN, OECD and Unctad³⁹;
- Law firms and economics consultancies should offer pro bono advice and help to consumers' organisations as a matter of course;

³⁹ International Competition Network, Organisations for Economic Cooperation and Development and United Nations Conference on Trade and Development respectively.

- Consumers' organisations should be able to apply to get standing in competition matters and to formally raise well-argued complaints with authorities;
- Competition agencies should follow the example of the European Commission and appoint a Consumer Liaison Officer (CLO) charged with interacting with consumers' organisations;
- The European Commission should expand the role, funding and staffing of the CLO to enable it to carry out its task more effectively.

Ideology Matters

Perhaps the most stark lesson from the interview process was how deep-seated the two ideological views of competition policy have become. Indeed the location of the major fault line between the EU and US is very deep-seated, often so deep that respective combatants cannot locate its source and identify why it is that they take such divergent views of, in particular, exclusionary behaviour.

This is in large part because the divergence is located in the ideological traditions from which regulation has sprung. It is further exacerbated by the fact that the lack of tools and a consensus on the balancing of consumer welfare, efficiency and innovation tends to drive the ideological traditions apart. On the one hand, we have a legal tradition that turns efficiency into a trump card that can hardly ever be used, and on the other an economic tradition that makes the pursuit of efficiency an almost idyllic state. We are increasingly of the view that the only way to allow these traditions to meet and understand each other is by focusing on a more nuanced behavioural approach to consumer welfare and a concerted effort to bring efficiency and innovation criteria more firmly into the assessment of long-term consumer welfare.

Recommendations

- The ICN should develop a work programme that seeks to identify the philosophical underpinnings of competition policy;
- Participants in reform debates need to recognise that inputs on what appear to be matters of impartial economics are often underpinned by particular ideological convictions;

- The ICN should develop a work stream employing historians, sociologists and organisational management theorists to chart the major strains of thought held by competition agencies;
- Discussions on consumer welfare can form the common ground for the two traditions.

Greater Input is Needed From European Thinkers

The ideological division in competition policy requires the differing viewpoints to be well argued out. The positions, particularly on exclusionary behaviour, currently in vogue among the majority of US officials and commentators are well-supported by research papers, conference speeches and legal opinions. In contrast the positions taken in Europe are more fluid and less well refined. The increasing numbers of cases on exclusionary behaviour are starting to resemble a canon of literature that could be taken to be a European view. However, the majority of discussion on positions comes almost entirely from the legal decisions themselves. There is a lack of well-argued and researched papers, particularly in economics, that place the developing European view within a wider theoretical context. The absence of literature is taken by some as an indication that the European view is not supported by rigorous academic thought, or that it is driven by a technocratic, ordo-liberal dogmatism.

In current debates around exclusionary behaviour, the US and Europe appear to be in almost diametrically opposed positions. The US appears to have a single laissez faire view of such behaviour; while Europe appears to have a desire to clamp down on large companies. Appearances can be deceiving, however: The position of thinkers on exclusionary behaviour in the US is not as monolithic as it would appear and the developing European position is more nuanced than critics allow. However, what is clearly lacking in the debate is a well-argued European literature that spells out why Europeans tend to take a different position to their counterparts in the US. This lack stems mainly from a lack of involvement in debates by officials. The European debate is dominated by lawyers and consulting economists. With no solid institutional anchor, there is a risk that the debate can be skewed by the interests of key clients, or by those who make the most noise. In contrast, US administrators appear to have time to engage more closely in the academic and policy debates. The lack of a well-developed institutional view hampers the recommendations made above in relation to bridging the ideological gap. Debate about assumptions can only really happen when both parties recognise their own positions and can clearly articulate them.

Recommendations

- The European Commission needs to give its key staff more time to contribute to policy debates not directly related to current cases;
- Funding should be secured to establish a mainstream competition policy research institute that can help to bring together the various strands of European competition policy thought;
- The European Commission's Directorate-General for Competition should build up a research unit to build a literature that informs its views and positions. It should encourage key European academics and policy staff to work inside the unit for limited periods.

Language Matters

There remain a number of countries where the citizenry are deeply suspicious of competition policy and law. Those countries who first adopted competition law at the behest of the International Monetary Fund or World Bank naturally harbour resentment to any policy foisted on them as part of a restructuring package, despite the fact that an effective competition law and policy can help to ameliorate some of the more negative effects of a misdirected privatisation process. One way to help bridge the gap between those promoting a competition culture and those suspicious of it is to return to the sort of language used to promote the first wave of competition law in the US. It is instructive to note that US interviewees did not shy from using terms like 'economic democracy' and 'empowering the little guy'. Such an approach can surprise opponents and place competition policy more firmly in a progressive set of policies designed to manage globalisation.

Recommendations

- Competition agencies should not be afraid of using campaigning language in promoting competition policy;
- Countries with a suspicion of competition agencies should use the language of the anti-monopoly office;
- All agencies should place effective communication at the top of their agendas. An agency that always gets it right, but tells nobody about it, will find it difficult to develop a constituency.

**Professional
Public Affairs
In More Than
30 Countries**

**Professional
Public Affairs
In More Than
30 Countries**



Public Policy & Regulatory Advisors

FIPRA Group Brussels Representation · Boulevard St Michel 47 · 1040 Brussels · Belgium

Tel: +32 2 400 0040 · **Email:** info@fipra.com · **Web:** www.fipra.com