

Kerber, Wolfgang

**Working Paper**

## Should competition law promote efficiency? : some reflections of an economist on the normative Foundations of competition law

Marburger Volkswirtschaftliche Beiträge, No. 2007,09

**Provided in Cooperation with:**

Faculty of Business Administration and Economics, University of Marburg

*Suggested Citation:* Kerber, Wolfgang (2007) : Should competition law promote efficiency? : some reflections of an economist on the normative Foundations of competition law, Marburger Volkswirtschaftliche Beiträge, No. 2007,09, Philipps-Universität Marburg, Fachbereich Wirtschaftswissenschaften, Marburg

This Version is available at:

<https://hdl.handle.net/10419/29851>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

**Wolfgang Kerber**

**Should Competition Law Promote Efficiency?  
Some Reflections of an Economist on the  
Normative Foundations of Competition Law**

**No. 09-2007**

*[forthcoming in: Drexl, Josef, Idot, Laurence, and Joel Moneger (eds.),  
Economic Theory and Competition Law, Cheltenham: Edward Elgar 2007]*

Prof. Dr Wolfgang Kerber  
Philipps-University Marburg  
Faculty of Business Administration and Economics  
Economic Policy  
Am Plan 2, D-35032 Marburg  
E-Mail: [kerber@wiwi.uni-marburg.de](mailto:kerber@wiwi.uni-marburg.de)

## **Should Competition Law Promote Efficiency? - Some Reflections of an Economist on the Normative Foundations of Competition Law**

Wolfgang Kerber\*

### **I. Introduction**

After the introduction of the "more economic approach" in EU competition policy the question of the importance of economic efficiency as goal of competition law has become even more relevant. To what extent should competition law promote efficiency? What is the relation between competition and efficiency? This problem has always been relevant for exemptions on the ban of horizontal and vertical agreements according to Art. 81 (3) EC (with its balancing test). It also emerged in the discussion about efficiencies in merger control, leading to a major change in EU merger control in 2004. Recently, this problem has also popped up in regard to the discussions about the application of the "more economic approach" in regard to Art. 82 EC. Whereas economists vehemently emphasize the importance of efficiency considerations for competition policy, legal scholars are much more uneasy about this development.

This article (written by an economist) intends to contribute to a better understanding between economists and legal scholars about the goals of competition law. My main point is that the discussion on the normative foundations of competition law is not well developed: The main problem on the side of economics is that the theory of industrial organisation, which dominates the "more economic approach", does not focus its research on normative questions. Usually the normative issues are narrowed down to the question of total welfare standard vs. consumer welfare standard. However, normative approaches in economics can offer a much broader set of arguments, which might allow for a more differentiated discussion about the goals of competition law. In the legal discussion, the main problem is that the goals of competition law primarily emphasized by legal scholars, such as economic freedom or legal certainty, do not easily relate to modern economic approaches. Economists often do not understand the arguments of legal scholars and legal scholars are appalled by the apparently exclusive reliance of economists on economic efficiency. These problems stem partly from misunderstandings between economists and lawyers, and partly from an underdeveloped normative discussion about the goals of competition law. Therefore, more interdisciplinary research is necessary to clarify the relevant normative issues and to develop more sophisticated concepts for the goals of competition policy.

In this paper, I can only discuss some of the relevant issues and will briefly suggest some ideas for a broader perspective on the normative foundations of competition law. In section II, I will try to clarify the normative key concepts which economists use in regard to competition

---

\* Professor of Economics, Philipps-University Marburg, Department of Business Administration and Economics, D-35032 Marburg, Am Plan 2, email: kerber@wiwi.uni-marburg.de. I would like to thank Oliver Budzinski, Arndt Christiansen, and Eleanor Fox for important discussions as well as the NYU Law School and the Hauser Global Law School Program for providing manifold support and a stimulating intellectual atmosphere during my stay as Global Professor of Law in the spring term 2007.

policy – such as static and dynamic efficiency as well as the problem of redistribution through market power. Section III presents another normative perspective based upon constitutional economics which may lead to a more differentiated normative approach to competition law. Its basic idea is that the preferences of citizens are the relevant normative criterion for appropriate decisions about the objectives of competition policy. This will lead to a different perspective on the questions of how, to what extent, and what kind of economic efficiency should be considered in the different realms of competition law. It might also allow for more consideration of normative issues currently emphasized primarily by legal scholars, such as the protection of rights of market participants or concepts as "competition on the merits".

## **II. Current discussion about goals of competition policy: Some clarifications and comments**

### **II.1 Introduction**

Current overviews about the goals of competition policy from an economic perspective primarily emphasize allocative and productive efficiency, based upon welfare economics. Also dynamic efficiency, i.e. incentives for innovation, is often seen as important. Much more controversial is the question of whether competition law should prevent redistribution through market power, leading in turn to the question if the total welfare standard or the consumer welfare standard should be pursued. Although most economists would prefer the total welfare standard, many of them accept the consumer welfare standard (as used by the European Commission). However, nearly all economists are reluctant to accept additional goals of competition policy such as economic freedom, fairness and justice, the protection of small- and medium-sized firms, the international competitiveness of domestic firms, and (in regard to the EU) economic integration.<sup>1</sup> The European Commission's interpretation of the goals of European competition policy is not entirely in line with this perspective, but it is also not so far away. Besides the specific goal of market integration, the EU competition rules should protect "effective competition", which "brings benefits to the consumers, such as low prices, high quality products, a wide selection of goods and services, and innovation" (European Commission 2004: Horizontal Merger Guidelines, para. 8). In the following, we will mainly discuss the goals of allocative and productive efficiency, dynamic efficiency, and the problem of redistribution through market power.

### **II.2 Static efficiency: the concept of efficient allocation**

Modern economic theory focuses on the optimal allocation of the resources of an economy. This is connected on the theoretical level with general equilibrium theory and normatively with the Pareto-criterion.<sup>2</sup> Pareto-criterion is fulfilled if there is no possibility to increase the utility of any person in the economy without reducing the utility of any other person. Its normative attractiveness in economics stems from the widely held belief that interpersonal comparisons of utilities are not possible. This leads logically to the Pareto criterion, on which individuals easily can agree on and which does not require interpersonal comparison of utilities. Allocation theory assumes the existence of sets of factors of production (resources), produc-

---

<sup>1</sup> See for such overviews, e.g., de la Mano (2002), Motta (2004, 17-30), Van den Bergh / Camesasca (2006, 16-53), and Kerber/Schwalbe (2007, para. 93-108).

<sup>2</sup> For the following, see any intermediate or advanced textbook in microeconomics, as, e.g., Varian (1992).

tion functions (technologies), products, and preferences, which do not change. The goal of efficient allocation implies that the resources of an economy should be allocated to the production of products in that way that the Pareto-criterion is fulfilled for the whole economy: No person can be made better off through a reallocation of these resources without reducing the utility of another person. General equilibrium theory demonstrates that this requires the fulfillment of a number of marginal and total conditions. On the one hand, general equilibrium theory has succeeded in defining the concept of "efficient allocation" (mathematically) precisely. On the other hand, it has also demonstrated that for any economy an infinite number of efficient resource allocations exists, depending on different initial distributions of these resources to the persons in the economy. Therefore for different distributions, different allocations of resources are efficient.

The link between efficient allocation and competition is depicted by the first theorem of welfare economics: If the assumptions of the model of perfect competition are fulfilled by *all* markets (product and factor markets), the decentralised optimising behaviour of all agents (persons, firms) will lead to an efficient allocation throughout the entire economy, i.e. the Pareto-criterion will be automatically fulfilled without the necessity of state intervention (Adam Smith's "invisible hand of the market"). It is understandable why the model of "perfect competition" (despite all its unrealistic assumptions) still has such a central position in economic theory. From the perspective of the goal of efficient allocation it is an ideal form of the market and, even more generally, of organizing the entire economy. Consequently, the welfare-theoretic market failure theory (as the dominant theoretical basis for economic policy) is based upon the approach that any deviation from the assumptions of "perfect competition" leads to some kind of allocative inefficiency and, hence, calls for some correction of the allocation through economic policy. From that welfare-theoretic perspective, a number of economic policies (for solving different kinds of market failure problems) are seen as necessary, and competition policy is only one of them. Therefore, for the economic theory of allocation competition is an instrument which has the only task of bringing about allocative efficiency.

In competition policy, distinctions are often made between allocative and productive efficiency. Productive efficiency is fulfilled, if, in any firm the output is produced with the lowest amount of inputs or factors of production, i.e. with minimal costs. Productive inefficiencies can result from the inability to exploit economies of scale, and so-called X-inefficiencies, due to the problem that managers might pursue goals other than profit maximisation. This distinction plays a prominent role in the Williamson-trade off, regarding the welfare assessment of mergers (Williamson 1968): It calls for a balance between an increase of productive efficiency through a merger (e.g., through economies of scale) and allocative inefficiencies that arise through larger market power ("dead weight loss"). However, it is misleading to view allocative and productive efficiency as two goals on the same level: Efficient allocation requires all firms to produce efficiently. Therefore, the goal of productive efficiency is subsumed by the ultimate goal of efficient allocation. This does not preclude trade offs between different kinds of efficiency effects (as in the Williamson-trade off).

It is important to note that "allocative efficiency" is defined precisely in welfare-theoretic allocation theory and is closely linked to general equilibrium theory (elaborated by Arrow and Debreu in the 1950s) and the model of perfect competition. This efficiency concept is also referred to as static efficiency, because the set of products, production technologies, production factors and preferences are assumed as given and constant. They are not supposed to change as a result of competition. The mathematical models are static equilibrium models which do not consider dynamics (for dynamic efficiency, see the next section III.3). From this

general equilibrium concept of efficient allocation, conclusions can be derived for the optimal conditions on particular markets: Under certain assumptions the efficient solution is achieved through equilibrium prices at the intersection of the demand and supply curve (implying price = marginal costs and the maximisation of the sum of consumer and producer surplus). However, the theory of "second best" demonstrated that maximizing the surplus in a particular market need not lead to an efficient solution, if there are, e.g., effects on other markets.

From this theoretical perspective, a competitive market is only an instrument used to achieve efficient allocation. For many economists it is hard to understand that there might be a real trade off between competition and efficiency. From this welfare-theoretic perspective, it is plainly evident that efficiency is the ultimate goal, and if agreements between firms or mergers lead to a higher degree of efficiency, then they should be allowed. Balance between competition and efficiency effects, as it is assumed in Art. 81 (3) or (as an efficiency defense) in merger control, does not make much sense. It might be necessary to balance between positive effects on efficiency of a certain business behaviour ("procompetitive effects") and negative effects on efficiency ("anticompetitive effects") but not between competition and efficiency.<sup>3</sup> If a trade off emerges between competitive markets (defined as a market structure with many competitors) and efficiency, then from this perspective this trade off always must be decided in favour of efficiency.

### **II.3 Dynamic efficiency: Innovation**

Since it is an undisputed empirical fact that technological progress is the most important determinant for long-term economic growth, there is also a wide-spread consensus that innovation and diffusion of new products and technologies is one of the important results effective competition should bring about. This innovation dimension of competition is often linked to the term "dynamic efficiency". However, it is very important to understand that the term "efficiency" in "dynamic efficiency" does not have a comparably clear theoretical definition like the above-mentioned concept of allocative efficiency (or static efficiency). In the end, "dynamic efficiency" does not mean much more than that it is normatively preferable that innovations are generated and spread. Although the question can be raised as to what the optimal amount and velocity of technological progress should be, the specific characteristics of innovation processes make it impossible to define such an optimum clearly. The main problems are the high uncertainty and unpredictability of innovation processes, which renders it impossible to know the outcome of research ex ante. Innovation processes cannot be treated as production processes (with predefined inputs and outputs), and, hence, they cannot be satisfactorily analyzed as a pure problem of efficient allocation.<sup>4</sup> This is also the reason why the normative concept of "efficient allocation" has been defined on the basis of given sets of products, production technologies, production factors and preferences. The whole dynamic dimension of the generation and spreading of innovations (and therefore the change of products and production technologies as well as preferences) is theoretically excluded from the concept of allocative efficiency.

---

<sup>3</sup> From the perspective of a Chicago School argumentation, the distinction between Art. 81(1) and (3) was never clear, because if the net balance of efficiency effects is positive (according to Art. 81 (3)), then they would have argued that they are not anticompetitive in the first place, and therefore also should not be prohibited according to Art. 81 (1) EC.

<sup>4</sup> See, in general, Dosi (1988), Nelson (1995), Kerber/Schwalbe (2007, para. 66-78).

Since economic theory has not successfully integrated the innovation dimension into general equilibrium theory, the problem of technological progress and, therefore, dynamic efficiency remains, to a large extent, outside of mainstream neoclassical equilibrium theory. This is also the reason why innovation economics is largely influenced by approaches of evolutionary innovation economics. Schumpeter (1934), who emphasized the importance of the entrepreneur and innovations for economic development, suggested the need to develop an alternative to traditional equilibrium theory. For example, in modern innovation economics variation-selection-models (in analogy to biological evolution theory) are used to explain technological progress and economic growth (Nelson/Winter 1982, Nelson 1995). In this tradition, a number of dynamic (or evolutionary) concepts of competition have been developed. These concepts see competition as a dynamic process of innovation and imitation (Clark 1961, Hoppmann 1968, Metcalfe 1998) or as a knowledge-generating process of parallel experimentation ("competition as a discovery procedure"; Hayek 1978, Kerber 1997, Kerber/Saam 2001). This perspective vehemently criticizes the model of perfect competition (as an ideal form of competition). Well-known is the critique of Hayek (1948) that the model of perfect competition (with its knowledge assumptions) already presupposes the knowledge that is generated through the competition processes. Particularly interesting is also the critique of Demsetz (1982), who argued that perfect competition is not a theory about competition, which he sees as a rivalrous dynamic process, but a theory about the economic effects of perfect decentralisation.

What is normatively meant by "dynamic efficiency"? It is not as clearly defined as allocative or static efficiency. Rather, it is used loosely. Without wanting to discuss here different normative concepts that have been developed in evolutionary economics, the most convincing approach uses consumer preference as the normative criterion. Innovations can be seen as normatively positive when they allow a better fulfillment of consumer preference, i.e. that they lead to an increase of their utility. However, it is not possible to define what "dynamic efficiency" in the sense of an optimal dynamic solution really means. In some respects both static and dynamic effects of competition can be normatively measured with this criterion, namely consumer preference fulfillment (which, however, are treated as constant). This can be seen as a consequence of the most fundamental normative criterion in economics, namely, normative individualism, the idea that all normatively relevant values in society derive from preferences (i.e., value judgments) of individual members of this society. If we use the term "welfare" to the extent that consumer preferences are fulfilled, then we can say that both allocative efficiency (static efficiency) as well as innovations (dynamic efficiency) increase the welfare of a society. This perspective on static and dynamic efficiency is widely accepted in economics. It also seems to be fairly compatible with the normative concept of "effective competition" in EU competition policy, because "low prices, high quality products, a wide selection of goods and services, and innovation" presumably reflect important preferences of the consumers.

To what extent do trade offs exist between static and dynamic efficiency? The consensus is that perfect competition does not provide appropriate incentives for innovators, leading to discussions about the public good character of innovation and the necessity of intellectual property rights to ensure innovation incentives. However, the problem of potential trade offs between static and dynamic efficiency is much more complex than this discussion suggests. Research about the determinants of innovation has shown that the conditions for the appropriation of innovation's advantages can be very complex (Dosi 1988); often "market imperfections" (heterogeneity, "tacit knowledge", and limited imitability) can improve innovation activities. Another aspect of the relation between static and dynamic efficiency refers to the

question of whether a competitive assessment, e.g., of a merger, should only take into account the short-term effects on prices and quantities (as in merger simulations) or also consider the long-term effects on innovation. For example, there is considerable concern that in the "more economic approach" of EU competition policy, the long-term effects of business behaviour and mergers on dynamic efficiency are neglected compared to short-term static efficiency effects (Kirchner 2007).

## **II.4 Prevention of redistributions through market power**

Though there is a consensus that competition law should help increase welfare in regard to static and dynamic efficiency, some dispute has arisen about the aim of competition policy to prevent market participants from being exploited by firms with market power. Since the beginning of modern competition policy, the fight against cartels, monopolies, and firms with market power was largely motivated by the goal to impede the exploitation of individuals and firms on the opposite market side through market power, especially consumers through firms with market power on the supply side. Redistributions that are caused not by better performance but only through restraints of competition and market power should be prevented. However, the recent debate about total welfare standard vs. consumer welfare standard and about the importance and design of an efficiency defence in merger control shows that this goal of preventing redistributions through market power is no longer undisputed - despite the clear pledge of the European Commission for the consumer welfare standard.

The difference between a total welfare standard and a consumer welfare standard is well known and can be explained easily. The total welfare standard implies that in a particular market the sum of producer and consumer surplus should be maximised (total surplus).<sup>5</sup> Within the analytical framework of the Williamson-trade off analysis of mergers the total welfare standard asks whether additional producer surplus, which might accrue through an increase of productive efficiency created by merger (e.g., by economies of scale), is larger than any additional allocative inefficiency (dead weight loss) that results from an increase of market power. However, it is not necessary to consider the distributional effects that turn a part of the former consumer surplus into market power profits (and therefore into producer surplus): Such a redistribution between consumer and producer surplus does not affect total welfare as the sum of consumer and producer surplus.<sup>6</sup> If a consumer welfare standard is used, then the assessment of mergers - within the price-quantity-scheme - implies to ask only whether the consumer surplus after the merger is larger or smaller than before the merger, irrespective of its impact on the surplus of the producers. This seems to lead to the simple assessment criterion, whether the future market price after the merger is larger or smaller than before the merger.<sup>7</sup>

---

<sup>5</sup> It also can be made a distinction between "total surplus" (as the sum of consumer and producer surplus on a particular market) and "total welfare" (as the sum of all welfare effects in the whole economy, which, in particular, would include additional welfare effects on other markets) (see Crampton 1994). In the following, we ignore welfare effects on other markets, and use both terms as synonyms.

<sup>6</sup> See Williamson (1968), Farrell/Shapiro (1990), de la Mano (2002, 11-16), and Van den Bergh / Camesasca (2006, 31-35).

<sup>7</sup> However, de la Mano (2002, 28) is right "to emphasize that the price effect is only one of the several elements to be considered ... . In fact, consumer welfare ... is a multi-dimensional concept, including, together with prices, other aspects such as the quality of the product, the speed and the security of the supply etc."



It is well known that total welfare standard and consumer welfare standard can lead to different results. In the case of merger control, there might be a number of mergers, whose price-decreasing effects through efficiencies are smaller than the price-increasing effects through additional market power (non-coordinated or coordinated effects) but whose gains in productive efficiency are larger than the additional allocative inefficiencies. In these cases, a consumer welfare standard would lead to a negative assessment of these mergers, even though these mergers would increase total welfare. Consequently, the consideration of efficiencies in mergers can only impact their clearance under the consumer welfare standard, if these efficiencies are very large - as in European merger control after its 2004 reform. Many economists cannot understand why merger control ignores the positive efficiency effects of many mergers and, therefore, also prohibits mergers that increase total welfare. Many economists would suggest the total welfare standard as the relevant normative criterion. These economists readily admit that there might be distributional effects through mergers from consumers to producers, but these redistributions should not be considered. A well known position in the law and economics literature argues that analysis of legal rules and regulations should focus only on efficiency effects, whereas distributional effects should be dealt with through taxation and social policy (Kaplow/Shavell 1994).

What is the result of a deeper analysis of the relationship between total welfare, consumer welfare, and efficient allocation (static efficiency), as defined in section II.2? Many economic texts give the misleading impression that total welfare is identical to allocative efficiency (as a Pareto-optimal allocation of resources in the entire economy), and that it is the consumer welfare standard which additionally includes distributional issues. In welfare economics, it is clear that allocative efficiency says nothing about distributional questions. On the contrary, each "efficient allocation" is defined on a particular initial distribution of the resources of a society. If this distribution is changed, then the "efficient allocation" changes as well. It is not possible to make any normative statement about the preferability of an efficient allocation  $A_1$ , based upon distribution  $D_1$ , compared to an efficient allocation  $A_2$ , based upon another distribution  $D_2$ . This is also shown by the well known conclusion in welfare economics that there are an infinite number of "efficient allocations" in a society, and that the theory of efficient allocation cannot determine the "optimal" efficient allocation (there is no so-called "optimum optimum"). This is the result of standard welfare economics, which can be found in any advanced textbook about microeconomics (see, e.g., Varian 1992). It is also a logical consequence of the Pareto-criterion itself: Since the Pareto-criterion assumes that no interpersonal comparisons of utilities are possible between different persons, no balancing is possible between positive effects on one person and negative effects on other persons.

The total welfare standard is not compatible with the Pareto-criterion, because it allows for redistributions between consumers and producers and, therefore, a balancing between positive and negative wealth effects between different persons. This implies that the total welfare standard can be derived neither from the Pareto-criterion nor from the goal "efficient allocation".<sup>8</sup> It might be argued that the consumer welfare standard can be derived from the Pareto-criterion, because it stipulates that through mergers no one should be worse off, i.e. the criterion that consumer surplus should not be reduced through a merger can be seen as an application of the Pareto-criterion. The total welfare concept corresponds to the so-called Kaldor-

---

<sup>8</sup> These problems do not depend on the aforementioned discussed question, whether also dynamic efficiencies should be included or not.

Hicks-welfare criterion (principle of wealth maximisation).<sup>9</sup> The Kaldor-Hicks-criterion means that a state of society  $Z_4$  is normatively better than  $Z_3$  if those individuals who are better off in  $Z_4$  are able to compensate those that are worse off in  $Z_4$  to such an extent that the latter are not worse off as those in state  $Z_3$ . However, such compensation need not be made. Regarding merger control, this means that those who benefit from a merger should be able to compensate consumers made worse off, but compensation need not be paid. If total welfare as the sum of consumer and producer surplus is increased by a merger, then the Kaldor-Hicks-criterion is fulfilled, because the increase of producer surplus is larger than the reduction of consumer surplus.

In law and economics literature the Kaldor-Hicks-criterion (or "wealth maximisation" criterion) is the standard normative criterion for the economic analysis of legal rules. However, there is also much criticism in regard to the Kaldor-Hicks-criterion. Besides a theoretical problem of inconsistency (Scitovsky 1941), the most important problem is that the Kaldor-Hicks-criterion allows for all kinds of uncompensated redistributions between individuals or firms. Whereas the Pareto-criterion can easily be agreed on because it ensures that nobody is made worse off, it is not easy to argue why persons should agree to a normative rule which allows society to reduce their wealth (without compensation) counterbalanced only by the argument that the gains of other persons or firms through policy measures outweigh the losses. Although the argument has been made that repeated application of the Kaldor-Hicks-criterion can lead to a Pareto-superior situation, if all persons are both winners and losers in different situations (Posner 1980; Schäfer/Ott 1995, 33-35). This argument presupposes that the gains and losses are evenly distributed among the whole population. Somewhat along this reasoning is the wide-spread argument for the total welfare standard in competition policy that many consumers might also be shareholders of firms under merger control, i.e. that the increasing producer surplus through a merger ultimately might also accrue to the consumers. However, this presupposes certain unfulfilled assumptions about the distribution of wealth.

Despite the dominance of the Kaldor-Hicks-criterion within the law and economics-literature a number of other normative concepts, which limit the application of the total welfare concept have also been discussed.<sup>10</sup> The total welfare standard cannot be applied to many legal problems, because balancing the advantages of one person with the disadvantages of another is considered inappropriate ("Abwägungsverbote"; see Schäfer/Ott 1995, 45). Particularly interesting is the concept of "liberal rights": "If a person A as owner of a liberal right prefers social state  $x$  to state  $y$ , then state  $x$  should be better, independent from the preferences of all other members of society".<sup>11</sup> This normative concept implies that if one person has a certain liberal right, he or she is allowed to decide according to his or her own preferences, even if the utility of other persons or the total welfare of society is reduced. In such a case, society is not al-

---

<sup>9</sup> For an explanation and critical discussion of the Kaldor-Hicks-criterion and wealth maximisation criterion, see Posner (1979, 1980), Schäfer/Ott (1995, 29-35), Feldman (1998), and Kornhauser (1998). Please note that in the case of the actual payment of the compensation even the Pareto criterion is fulfilled. Therefore the Kaldor-Hicks-criterion is also called a potential Pareto improvement test. For a very broad and deep critical analysis of economic efficiency in regard to the law, see Eidenmüller (1998). For a detailed application of the Pareto-criterion and Kaldor-Hicks-criterion to the discussion on total welfare standard vs. consumer welfare standard in regard to merger control, see Van den Bergh / Camesasca (2006, 29-38).

<sup>10</sup> For a broad overview see Schäfer/Ott (1995, 21-48).

<sup>11</sup> Schäfer/Ott (1995, 44; translated by W.K.); see, in particular, also Sen (1970).

lowed to balance the positive effects for these persons with the negative effects on others. The most elementary rights of individual freedom (leading to core notions of private autonomy, private property, freedom of contract) have such characteristics, i.e. their use is not allowed to be generally subjected to an overall balancing of the positive and negative effects on society. "Voluntary consent" as an additional normative criterion, developed in constitutional economics, will be introduced in section III. As a consequence, there are a number of other normative criteria in economics besides the Pareto- and Kaldor-Hicks-criterion, leading to a more complex normative discussion of economics.

There are also many industrial economists who accept a consumer welfare standard as normative criterion - either as result of a political decision or by relying on additional arguments. For example, there are arguments that a consumer welfare standard might compensate for other advantages producers have, e.g. through better possibilities of lobbying (rent seeking-advantages) or through information asymmetries between firms and competition authorities. Another practical argument is that the consumer welfare standard is much easier to apply, because it is "only" necessary to estimate future market prices.<sup>12</sup> All of these arguments are somewhat pragmatic and do not justify the consumer welfare standard very well. Another approach uses intermediate solutions between total welfare and consumer welfare which put different weights to consumer and producer surplus (weighted surplus standard). If consumer and producer surplus are weighted equally, a total welfare standard is applied, if the weight for producer surplus is zero, then this corresponds to a consumer welfare standard; also weights between 0 and 1 can be chosen, leading to intermediate solutions. An interesting variant is that the weighting factors might even depend on whether the product is an everyday or luxury item. In the latter case, consumers might need less protection from market power, which would allow a shift of the normative standard to a total welfare standard, whereas in the first case a consumer welfare standard should prevail.<sup>13</sup> From the perspective of most economists the crucial problem of these solutions is that it is unclear where the criteria for deciding on these distributional questions will come from.

## **II.5 Protection of economic freedom and other goals**

Other goals of competition policy as, e.g., economic freedom, fairness and justice, protection of small- and medium-sized firms, international competitiveness, and economic integration (in regard to EU competition law) are usually viewed critically by most economists.<sup>14</sup> In German competition law (and, in the past, also in EU competition law) the protection of economic freedom is seen as an important goal of competition law. This goal of competition policy has been developed by economists as well. It can be traced back to Ordoliberal concepts of competition policy and to Hoppmann's concept of "freedom to compete" ("Wettbewerbsfreiheit").<sup>15</sup> In competitive markets, consumers should be able to choose between different suppliers (freedom in the exchange process). Freedom of competition also encompasses the freedom of firms to decide on their action parameters (freedom in the parallel process).

---

<sup>12</sup> See for this discussion, e.g., Besanko/Spulber (1993), Neven/Röller (2000), Lyons (2002), de la Mano (2002, 18-35), Motta (2004, 20-22), Camesasca/Van den Bergh (2006, 35-45), and Gual et al. (2006).

<sup>13</sup> See, e.g., de la Mano (2002, 33), Ross/Winter (2005), and Bian/McFetridge (2000) for the so-called Hillsdown standard (used by Canada's competition tribunal in its "Hillsdown decision").

<sup>14</sup> See, e.g., Motta (2004, 22-30) and Van den Bergh / Camesasca (2006, 39-53).

<sup>15</sup> See Hoppmann (1968), Möschel (1989), Gerber (1998), and Hellwig (2006).

Market power might restrict both freedom of choice in the exchange process as well as freedom to decide on firms' action parameters in competition with other firms. From this perspective, competition law should protect the economic freedom of firms and other market participants. Although most economists view economic freedom as very important, so far no convincing solutions have developed how to integrate an analysis of economic freedom with an industrial economics approach to competition. Due to a lacking theoretical access to the concept of "economic freedom", most economists either tend to think that it is somehow also encompassed by economic efficiency, that it should be ignored altogether or that other fields of law (outside competition law) should be used to protect economic freedom (Van den Bergh / Camesasca 2006, 39-53).

Legal certainty aims to limit administrative costs, an important objective in any field of law. There is a broad consensus that these costs must be taken into account in competition law. However, most economists are not sufficiently aware that there might be large trade off-problems between the approach of analysing the effects of business behaviours (or mergers etc.) upon consumer welfare on a case-by-case basis and the necessary administrative costs as well as the direct and indirect costs of legal uncertainty resulting from case-by-case decisions. To this point, economics has failed to sufficiently analyse the problem of legal uncertainty.<sup>16</sup>

## **II.6 Conclusions**

The discussion in this section should have helped clarify the economic concepts of efficient allocation, static and dynamic efficiency, total welfare and consumer welfare. It has been shown that (1) these concepts have different meanings, (2) economics has large problems in dealing with distributional effects, and (3) the economic discussion about the goals of competition law has mainly focused on the question of total welfare standard vs. consumer welfare standard. In the following, a broader normative concept for deriving goals of competition law will be sketched. It is mainly based upon constitutional economics.

## **III. Normative foundations of competition law: Sketching another perspective**

### **III.1 Starting-point: Normative individualism, constitutional economics, and rules for the market**

The normative perspective of constitutional economics<sup>17</sup> starts with normative individualism, i.e., that all relevant values and goals in a society have to be derived from the preferences and values of individual members of society. In contrast to traditional welfare economics, Buchanan (as the most important representative of constitutional economics) argued that the decisive normative criterion is voluntary individual consent (Buchanan 1986). By consenting to transactions or to mandatory rules of society, they reveal their preferences and legitimise contracts and mandatory rules. This notion is entirely compatible with notions of private autonomy and democracy, as developed in the Western legal tradition. Consent as normative crite-

---

<sup>16</sup> The importance of "legal certainty" can be translated into the direct and indirect costs of legal uncertainty. This might open up a pathway for an economic analysis of this issue (see Christiansen/ Kerber, 2006, for an example, how to deal economically with the problem legal uncertainty in regard to the question of rule of reason vs. per se rules). See for the problem of legal uncertainty in merger policy also Voigt/Schmidt (2005).

<sup>17</sup> See Brennan/Buchanan (1985), Buchanan (1986), Vanberg (1999, 2005).

tion is very close to the Pareto-criterion, because if, as a result of policy, at least one person is better off and no one is worse off, then it can be suggested that all persons can agree on the measure. In contrast, the fulfillment of the Kaldor-Hicks-criterion need not be sufficient to lead to the consent of all persons involved, because there can be persons who will be worse off.

The constitutional economics approach succeeded in showing how the state with its monopoly of legitimate power and its central functions (as protective state, productive state, and redistributive state) can be derived consistently from the preferences of the members of a society (Brennan/Buchanan 1985). Using the basic idea of society as a "social contract", constitutional economics could show that the state can be seen as the result of a constitutional contract, on which all members of society might agree under a "veil of uncertainty", i.e. under the hypothetical situation that no person in a society knows its strengths and weaknesses before consenting to the basic rules of this society. In an additional step, constitutional economics was able to justify the transition from the unanimity principle on the level of the most important constitutional rules to other (more pragmatic) decision rules (on the post-constitutional level of normal legislation). Different kinds of majority rules can ensue, which balance the decision costs for requiring large majorities with the costs for minorities which might lose through majority decisions. An important implication of this approach is that there might be realms, in which a simple majority rule is deemed acceptable and there might be other realms involving certain basic rights and freedoms which are seen as part of the personal freedom (or property) of persons. Nobody should have the right to interfere in these protected domains, even if this would lead to positive welfare effects on other persons or the whole society.

Before deriving more specific conclusions for competition policy, some general implications of the constitutional economics approach for the institutional framework of markets will be presented. Constitutional economics differentiates strictly between the rules (of a game) and the actions (of the players) within this game. Therefore the relevant question is: What is the appropriate set of rules for the market game? Institutional economics could demonstrate that different sets of legal rules (institutional settings) lead to different kinds of market processes - due to different sets of incentives. Changing the rules of the market implies a change of the market game, leading to different outcomes (Kerber 2006). Based upon this constitutional economics perspective, Vanberg (1999) argues that the decision on the rules for the market game can be seen as a "constitutional" decision,<sup>18</sup> and, according to the consent principle, this set of rules for the market should reflect the preferences of the citizens. As a consequence, Vanberg (1999) distinguishes "constitutional liberalism", which acknowledges this normative and theoretical dimension of the institutional framework for markets, from "free-market liberalism" that does not sufficiently take into account the fact that markets always work under a set of rules. Of course, the institutional framework for markets and therefore the relevant set of legal rules for markets encompasses a large number of different legal rules: rules that define property rights, contract law, consumer regulations, tort law, environmental law, corporate law, labour market regulations, rules about unfair business practices (as e.g., in regard to advertising) etc.. Legal rules against private restraints of competition are only a small part of this entire set of rules that firms have to comply with in their business behaviour on markets.

---

<sup>18</sup> There is a close relationship to the Ordoliberal concept of "economic constitution" ("Wirtschaftsverfassung") that cannot be analysed here (see Vanberg 1999).

What is the different perspective of this normative approach in comparison to a welfare economics approach? The decisive difference is that the preferences of citizens are viewed as the ultimate normative criterion. They should decide on the question, to what extent allocative efficiency and/or dynamic efficiency should be strived for, to what extent competition law should protect consumers from exploitation or competitors from being hurt through predatory strategies, and to what extent society is willing to sacrifice some "total welfare" in order to prevent redistributions through market power. The task of economics is the analysis of the effects of legal rules in regard to these goals, as, e.g., allocative and dynamic efficiency, consumer welfare or other goals, and the extent of trade offs that might emerge (see, e.g., Kornhauser 1998, 683). However, this approach should not be identified with the often mentioned position the goals of competition policy should be decided purely politically. Although the goals of competition policy will be determined politically through legislation, constitutional economics would claim that the outcome of these political decisions should reflect citizens' preferences. In the case of defective political processes the goals of competition law might be distorted through the rent seeking activities of interest groups. This is connected to the well-known discussion in constitutional economics (and public choice theory) about institutional reforms to make political processes more responsive to citizens' preferences. The constitutional economics approach to the goals of competition law is a purely economic one: It argues that market rules are "optimal", if they correspond to their preferences (and values).<sup>19</sup>

### **III.2 Total welfare, consumer welfare, and protected rights: Some tentative conclusions from a constitutional economics perspective**

The arguments in this section should be viewed merely as suggestions as to how a deeper and more sophisticated normative analysis might be developed. Different sets of rules for competition lead to different kinds of competition. Economic theory has developed different concepts of competition. Although the most important one is still represented by the model of "perfect competition", there is a broad consensus that it is not able to grasp all relevant dimensions of competition processes, as, e.g., the innovation dimension. Dynamic concepts of competition try to integrate innovation into their notion of competition (e.g., Schumpeterian competition or Hayek's "competition as a discovery procedure"). However, what kind of competition should be strived for and protected through competition policy is the result of a *normative* decision of the citizens. Their preferences should decide the kind of competition that prevails in the market game. For example, what "effective competition" means in EU competition law is a normative question. If the EU Commission defines "effective competition" as competition that "brings benefits to consumers, such as low prices, high quality products, a wide selection of goods and services, and innovation" (European Commission 2004, para. 4), then this is a normative decision, and the relevant question is whether this corresponds to the preferences of the EU citizens. The following will demonstrate how a more specific discussion about appropriate goals of competition law might look like from the perspective of the interests and preferences of the citizens.

First, it can be suggested that citizens would appreciate both an efficient allocation of resources and the generation and spread of innovations, because it can be expected that both increase their wealth. This implies that static and dynamic efficiency are important and that

---

<sup>19</sup> "Voluntary consent" as the ultimate normative criterion leads constitutional economics also to another interpretation of "efficiency": Efficiency is achieved, if the unanimity requirement, i.e., voluntary consent by all citizens, is fulfilled (Buchanan 1986, 247).

any potential trade off between these two goals would be solved by the empirical question about the relative importance of static and dynamic efficiency for increasing the fulfillment of the citizens' preferences. Much more difficult is the question of whether the citizens would agree on an unconditional application of the total welfare standard (Kaldor-Hicks-criterion). Restrictive agreements, mergers, and business behaviours of dominant firms would always been allowed if total welfare increases, irrespective of any redistributive effects between the involved firms, the competitors, the firms on up- and downstream markets, and the consumers. Firms and consumers would not be protected against redistributions through market power. Although the total welfare standard would ensure that "victims" of market power or (total welfare increasing) predatory behaviour could be compensated, they would lose without having a claim for compensation. It is very doubtful, whether a sound argument can be made that, in the long run, all persons would win through the total welfare standard, because they can be both winners and losers in different situations. Although this is an open research question, the assumptions that have to be made about the evenness of the chances of being a winner and loser suggest that such an argument might only be used in a subset of cases. We also know from developments in other parts of the law (e.g., in tort law) that citizens prefer to be protected against all kinds of negative effects on their individual wealth. Therefore it is very hard to imagine that citizens would be willing to give up all protection against the negative distributional effects of market power.

Beyond the question of whether citizens would accept any distributional effects through market power, the redistributive effects of the total welfare standard can also lead to negative effects on total welfare. The application of the Kaldor-Hicks-criterion leads to the situation that - due to non-compensated distributional effects - the private gains from business behaviours or mergers are larger than the net gain in total welfare. For example, in the trade off-model of Williamson the private gains from the merger are the sum of the additional productive efficiency through the merger and the part of consumer welfare that is changed into profits through additional market power, whereas the net gain in total welfare is only the difference between the additional productive efficiency and the additional dead weight loss. As a consequence, these redistributive effects can lead to wasteful overinvestment in the search and implementation of activities (as mergers and business behaviours) that increase total welfare. Posner's argument about the danger of the dissipation of monopoly profits through the "competition" of firms for a monopoly (or market power) position are an example for such an argumentation (Posner 1975; Van den Bergh / Camesasca 2006, 28). Such an overinvestment, which is triggered by the private gains from redistributions would lead to a waste of resources and, therefore, to a reduction of total welfare itself.

Although it can be expected that citizens would like to be protected against redistributions through market power and therefore would reject a general application of the total welfare standard, the question arises whether citizens, vice versa, would agree on a pure consumer welfare standard. On first sight, this seems plausible, because all citizens are also consumers. However, on second thought, the citizens of a society are not only consumers but also owners of production factors as, in particular, capital and labour, and are therefore interested in income from interests, wages, and profits. From the perspective of the interests of the citizens it is not obvious why competition policy should only take into account the welfare effects of mergers and business behaviours on the citizens as consumers but not the welfare effects on the same citizens as owners of firms and production factors. The often mentioned argument against a consumer welfare standard that the additional producer surplus (through efficiencies) in mergers also accrues to the "consumers", and therefore should not be (entirely) neglected, goes along with this constitutional economics argument that, ultimately, all interests

of the citizens - and not only their interests as consumers - are decisive for their consent. Therefore the normative asymmetry which holds that competition law is only about the protection of the consumers' interests and that the interests of all other firms on the upstream markets are irrelevant, is hard to justify from a constitutional economics perspective.

For example, an interesting question is whether competition and competition law should protect firms on the supply side of a market from the buying power of other firms. Whereas there seemed to be a broad consensus that market power can be a problem on both market sides, this is no longer clear from a pure consumer welfare standard. Why should buying power that leads to a reduction of input prices (and therefore eventually also to lower prices for consumers) be assessed negatively (if we assume that these market power-induced price reductions for suppliers do not lead to other negative effects for consumers as, e.g., lower quality, less variety etc.)? If, for example, the crucial criterion for assessing a merger is the question of whether the prices for consumers increase or not, then all price-decreasing effects through any buying power that emerge through the merger would facilitate the clearing of the merger. Therefore the consumer welfare standard tends only to protect against a part of distributional effects of market power, namely those that have a negative impact on consumers. It is not clear why the citizens as owners of capital and earners of wages in firms should not be interested in being protected against the negative distributional effects of market power through buying firms, which would deprive them from some of those earnings that would accrue to them under competitive conditions.

Therefore, neither a pure total welfare standard nor a pure consumer welfare standard seem to be the most appropriate solution. One possibility might be the application of intermediate solutions. Then, preferences of citizens can decide on the weight they want to give producer surplus in relation to consumer surplus ("weighted surplus standard"). It would also be possible to use different weights in regard to different realms of competition policy. Although this is a first interesting step to a more differentiated approach, the normative problems seem to be much more complex. It is not easy how to proceed from here without getting into the swamp of vague concepts. This is precisely the point where much additional and interdisciplinary research is necessary. In the following, I would like to present some ideas that can be used for developing a much more precise and clear argumentation on the basis of this constitutional economics perspective. The buying power example suggests that it might be worthwhile to develop (also from an economic perspective) an approach that competition law has also the task of protecting certain rights of market participants against market power and predatory behaviour. Such an approach of "protected rights" might be directly in line with the recent "Courage"-decision of the European Court of Justice which ruled "that effective protection of the rights granted by the Treaty requires that individuals who have suffered a loss arising from an infringement of Articles 81 and 82 have the right to claim damages". Also the Commission has started an initiative to promote private litigation through damages actions for breach of the EC antitrust rules, which uses the idea of rights that are protected by competition law.<sup>20</sup>

From a constitutional economics perspective, it is not difficult to justify a normative position that each member of society should have a set of rights as participants in markets that are protected against market power and predatory behaviour. Constitutional economics can show that members of society would agree on very differentiated solutions about the extent of the pro-

---

<sup>20</sup> See European Commission (2005a) and "Courage v. Crehan", Case C-453/99, Judgment of the Court of 20 September 2001.



tection of their lives, their private property, their freedom of contract, and their entrepreneurial freedom. It can be expected that they will greatly value freedom to decide what to consume, what to produce and when to enter a market. Therefore private property, freedom of contract, and basic rights of entrepreneurial freedom (including free market entry) should be especially protected ("economic freedoms"). The decisive point is that members of society might not be willing to accept interference with a basic set of these rights, although this might lead to an increase of overall consumer or total welfare. As discussed above in regard to the concept of liberal rights, the citizens of a society can decide that there should be a (limited) set of rights, whose value cannot be easily balanced with the effects on the wealth of other persons.

In the same way the citizens can have preferences about what kinds of business behaviours should be accepted as "normal" competitive behaviour, and what kinds of conduct are deemed as (perhaps "morally") no more acceptable, leading then to "infringements" of rights of competitors, buyers, or sellers. Part of these preferences might refer to the wide-spread normative notion that the emergence of profits and losses in market competition should be linked somehow to firm performance ("competition on the merits"). In any society citizens have more or less strong convictions about the question of whether the profits of firms or the income of others are justified. This is only partly a question of the "inequality" of wealth distribution ("distributional justice") but reflects more the dimension of "commutative justice". To a large extent the answer depends upon whether firms deserve their profits or losses due to their good or bad performance. If firms have been able to incur large profits because they have carried out successful strategies, lobbied for protective measures or built up market power positions, then most citizens would view these profits as less justified than those which are the result of the innovation of new and better products or cost-decreasing production technologies. A logical consequence is that such considerations might be legitimate arguments in the discussion about the goals of competition policy from a constitutional economics perspective.

In Germany, it was the Ordoliberal legal scholar Böhm (1933) who, when working on the problem of unfair competition ("unlauterer Wettbewerb"), developed the idea that competition should be seen as a kind of contest in which competitors try to outstrip one another by offering good performance, and that consumers exert the role of arbiters in regard to the relative quality of these performances. The central tenet of this concept of "Leistungswettbewerb" ("competition on the merits") was that the rules for this market game should be shaped so that only the overall quality of performance (merit) should determine market success.<sup>21</sup> This would imply that the competition rules for the market should ensure that profits and losses of firms (as feedback mechanism from the market) reflect the relative quality of their performance for the consumers, and not, e.g., superior knowledge in regard to rent seeking-activities or predatory strategies. The citizens of a society might view such an approach, which, in the theory of justice, corresponds to the concept of "commutative justice", as normatively desirable.<sup>22</sup> Then all kinds of market power profits through redistributive effects, which can emerge as a consequence of the application of the Kaldor-Hicks-criterion (total welfare standard), must be assessed as undesirable from the perspective of the preferences of the citizens. This would be a powerful argument against accepting the distributive effects of all kinds of

---

<sup>21</sup> This does not preclude that this concept of "Leistungswettbewerb" has also been abused for defending restraints of competition, especially in the German law of unfair competition (see Mestmäcker, 1984).

<sup>22</sup> For an application of the concept of "corrective justice" in regard to sanctions in competition law, see Van den Bergh / Camesasca 2006, 320-322.

market power, leading to an argument of protecting all market participants against these effects of market power and predatory behaviour.

The problem is that economics has not yet developed normative concepts that integrate the idea of protected rights for individual persons or firms into their normative approach. The traditional efficiency approach (static and/or dynamic efficiency, consumer welfare or total welfare concept) is too crude to be capable for including this dimension.<sup>23</sup> From this welfare-theoretic perspective, freedom of contract or entrepreneurial freedom have no particular value of their own. They are only justified as far as they help to achieve efficient allocation, total welfare or consumer welfare. Therefore they can be restricted or even abolished, as soon as another institutional solution leads to an increase of total or consumer welfare. However, this result is not a necessary consequence of using an economic approach. From the general normative starting-point of "normative individualism" it is no problem to derive the legitimisation of sets of protected rights of individuals and firms, which are not subject to the question, whether they contribute to an aggregate total or consumer welfare. Rather it is itself a normative decision - based upon the preferences of the citizens - what sets of rights should be subjected to an efficiency test (consumer or total welfare standard) and what set of rights should not allowed to be balanced in that way. As a consequence, it is possible to argue also from an economic perspective that competition law should not only take into account the effects of restrictive agreements, mergers, and business behaviour on consumer welfare but also on a set of protected rights of competitors and up- and downstream firms, which might suffer losses through the infringements of these rights.

What might this imply for the discussion on the application of the "more economic approach" to Art. 82 EC Treaty about abusive behaviour of dominant firms? The Commission has stipulated that also here the consumer welfare standard should be the only normative standard. In the DG Competition discussion paper (European Commission 2005) it is argued that the aim of the application of Art. 82 is the "protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. ... That means, it is competition, and not competitors as such, that it is to be protected."<sup>24</sup> The Commission is right that competitors should not be protected from the consequences of the better performance of dominant firms. However, this does not necessarily require that the question of whether a certain behaviour is abusive should only be assessed according to its effects on consumers. It can also be argued that all firms in a market have certain protected rights whose infringement by dominant firms is prohibited as an abuse of Art. 82.<sup>25</sup> The decisive point is the following: Is, for example, predatory pricing only prohibited because it might lead to a reduction of consumer welfare, or can certain (perhaps extreme) forms of predatory pricing also infringe the protected rights of competing firms (which would give the "victim" a claim

---

<sup>23</sup> For the difficult relation between "liberal rights" and "efficiency", see Sen (1970); for a fundamental discussion about the relation of fairness and welfare, see Kaplow/Shavell (2002), and critically Kornhauser (2003) and Waldron (2003).

<sup>24</sup> European Commission (2005b, para. 54); see for this discussion also Vickers (2005) and Van den Bergh / Camesasca 2006, 247-299.

<sup>25</sup> It is unclear to me whether the following sentence in the discussion paper can be interpreted in that way: "Furthermore, the purpose of Article 82 is not to protect competitors from dominant firms' genuine competition based on factors such as higher quality, novel products, opportune innovation or other better performance, but to ensure that these competitors are also able to expand in or enter the market and compete therein on the merits, without facing competition conditions which are distorted or impaired by the dominant firm" (European Commission 2005b, para.54).

for damages)? Therefore, a crucial distinction might be made between protecting the competitors from the effects of the strong market position of dominant firms, which is a problematic concept,<sup>26</sup> and the protection of a certain (limited) set of rights of competing firms that accrue to them independently from the question whether they are more or less efficient than the dominant firm.

The problem whether Art. 82 should also protect certain rights of market participants irrespective of their effects on consumer welfare cannot be discussed here in more depth. I primarily want to argue that an "economic approach" to Art. 82 does not require that only the effects on consumer (or total) welfare should be taken into account. Also the effects on a certain set of protected rights, which can be derived from the preferences of the citizens, can be considered. This certainly can also lead to additional trade off problems. However, such a more general approach is still entirely compatible with economic theory. It might also be much more compatible with the recent approach of the EU in regard to private enforcement of competition law: As far as private enforcement is not only seen as a pure instrument for improving deterrence in regard to antitrust rules, the whole concept of private enforcement (with its remedies of damages claims for compensation and/or injunctions) is only defensible, if the protection of the rights of consumers, competitors, and firms on upstream and downstream markets and the protection against (at least some) distributional effects through infringements of antitrust rules are part of the goals of competition policy. The initiative of the Commission would be hard to defend from the perspective of a total welfare standard. From the perspective of a consumer welfare standard, it would not be easy to defend damages claims from competitors. However, from the approach of constitutional economics that allows the legitimisation of sets of rights for consumers, firms and competitors as market participants, this approach to private litigation is much more compatible.

#### **IV. Conclusions**

The main point of this paper is that the discussion on the normative foundations of competition law is not well-developed. I have focussed my critical analysis on the discussion in economics. I tried to show that "economic efficiency" - as it is usually defined - cannot be the final answer to this normative question. On one hand, there are different concepts of efficiency, with their specific problems and deficits. On the other hand, the discussion in economics, which is narrowed down to "total welfare standard vs. consumer welfare standard", does not sufficiently grasp the complexity of the normative problems. In section III, another approach based on constitutional economics was briefly sketched, which allows for a broader normative discussion of the goals of competition law. The decisive difference is that here the preferences (and therefore also the values) of the citizens of a society are the relevant normative criterion, from which the goals of competition laws should be derived. They should decide on the relative importance of applying a consumer welfare standard, the extent of considering efficiencies, and to what extent market participants should have rights against the (distributional) effects of market power and predatory behaviour (with damages claims through private litigation). This economic approach also implies that different societies can come to different conclusions about the appropriate goals of competition laws.

---

<sup>26</sup> One rationale for such an approach is the attempt to impede a further worsening of the competitive structure of a market. The many problems with such an approach (as, e.g., the danger of assessing efficiencies negatively, leading to an 'efficiency offense') cannot be discussed here.

Our very preliminary discussion of the goals of competition law from this constitutional economics perspective has demonstrated that it seems very improbable that citizens would consent to a total welfare standard with its many entirely accidental distributional effects as a general standard. They presumably would prefer not getting damaged through market power in the same way, as they have preferences that their property is protected, e.g. through tort law. This does not preclude that in specific types of cases, e.g. if the potential wealth losses are small, an application of the total welfare standard might be defensible. It seems plausible that consumer welfare might be a very important normative criterion in competition policy, because all members of society are also consumers who benefit from such a standard. However, we also saw that it is difficult to justify why consumer welfare should be the only relevant normative standard. One argument is the citizens' interests as owners of production factors and firms, which suggest both an interest in protection also against the negative distributional effects of buying power and predatory behaviour of (market dominant) competitors as well as some consideration of productive efficiencies in competitive assessments. From that perspective, it is normatively possible from an economic perspective to defend also the protection of certain rights of market participants as a goal of competition law. Even normative conclusions derived from concepts as "competition on the merits" or notions of fairness might be defensible, as long as these normative notions reflect wide-held values of the citizens.

However, my argumentation here should not be misunderstood in that way that I would like to recommend such a broad set of goals of competition law right now. Even if such a set of goals would be desirable from a normative perspective, a lot of additional concerns must be taken account of: additional administrative costs, trade off problems, rent seeking problems etc.. My main claim is that we need much broader and deeper interdisciplinary discussion and research about the normative foundations of competition law. "Efficiency" or "welfare" is neither a sufficiently clear and satisfactory answer.

## References

- Besanko, D., and D.F. Spulber (1993), Contested Mergers and Equilibrium Antitrust Policy, *Journal of Law, Economics and Organisation* 9, 1-29.
- Bian, L., and D.G. Mc Fetridge (2000), The Efficiency Defence in Merger Cases: Implications of Alternative Standards, *Canadian Journal of Economics* 33, 97-318.
- Bishop, B., and M. Walker (2002), *The Economics of EC Competition Law: Concepts, Application and Measurement*, 2.ed., London.
- Böhm, F. (1933), *Wettbewerb und Monopolkampf. Eine Untersuchung zur Frage des wirtschaftlichen Kampfrechts und zur Frage der rechtlichen Struktur der geltenden Wirtschaftsordnung*, Berlin.
- Brennan, G., and J.M. Buchanan (1985), *The Reason of Rules. Constitutional Political Economy*, Cambridge: Cambridge University Press.
- Buchanan, J.M. (1986), The Constitution of Economic Policy, *American Economic Review* 77, 243-250.
- Christiansen, A., and W. Kerber (2006), Competition Policy with Optimally Differentiated Rules Instead of "Per se Rules vs. Rule of Reason", *Journal of Competition Law and Economics* 2, 215-244.
- Clark, J.M. (1961): *Competition as a Dynamic Process*, Washington, D.C.

- Crampton, P.S. (1994), Alternative Approaches to Competition Law. Consumers' Surplus, Total Surplus, Total Welfare and Non-Efficiency Goals, *World Competition* 17, 55-86.
- Demsetz, H. (1982), *Economic, Legal, and Political Dimensions of Competition*, Amsterdam: North-Holland.
- Dosi, G. (1988): Sources, Procedures and Microeconomic Effects of Innovation, *Journal of Economic Literature* 26, 1120-1171.
- Eidenmüller, Horst (1998), *Effizienz als Rechtsprinzip. Möglichkeiten und Grenzen der ökonomischen Analyse des Rechts*, Tübingen: Mohr Siebeck.
- European Commission (2004), Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ C 31/5 (5.2.2004).
- European Commission (2005a), Greenpaper "Damages Action for Breach of the EC Antitrust Rules", COM 2005, 672 (final) (19.12.2005).
- European Commission (2005b), DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses, Brussels, December 2005.
- Farrell, J., and C. Shapiro (1990), Horizontal Mergers: An Equilibrium Analysis, *American Economic Review* 80, 107-125.
- Feldman (1998), Kaldor-Hicks Compensation, in: Newman, P. (ed.), *The New Palgrave Dictionary of Economics and the Law*, Vol. II, London: MacMillan, 417-421.
- Gerber, D. (1998), *Law and Competition in Twentieth Century Europe: Protecting Prometheus*, Oxford: Oxford University Press.
- Gual, J. et al. (2006), Report by the EAGCP: An Economic Approach to Article 82, *Competition Policy International* 2, 111-154.
- Hayek, F.A. v. (1948): The Meaning of Competition, in: Hayek, F.A. v., *Individualism and Economic Order*, Chicago: University of Chicago Press, 92-106.
- Hayek, F.A. v. (1978), Competition as a Discovery Procedure, in: Hayek, F.A. v., *New Studies in Philosophy, Politics, Economics and the History of Ideas*, Chicago: University of Chicago Press, 179-190.
- Hellwig, M. (2006), Effizienz oder Wettbewerbsfreiheit? Zur normativen Grundlegung der Wettbewerbspolitik, in: Engel, C., and W. Möschel (eds.), *Recht und spontane Ordnung. Festschrift für Ernst-Joachim Mestmäcker zum achtzigsten Geburtstag*, Baden-Baden: Nomos, 231-268.
- Hopmann, E. (1968), Zum Problem einer wirtschaftspolitisch praktikablen Definition des Wettbewerbs, in: Schneider, H.K. (ed.), *Grundlagen der Wettbewerbspolitik*, Berlin: Dunker & Humblot, 9-49.
- Kaplow, L., and S. Shavell (1994), Why the Legal System is Less Efficient than the Income Tax in Redistributing Income, *Journal of Legal Studies* 23, 667-681.
- Kaplow, L., and S. Shavell (2002), *Fairness versus Welfare*, Cambridge, Mass.: Harvard University Press.
- Kerber, W. (1997), Wettbewerb als Hypothesentest: Eine evolutorische Konzeption wissenschaftlichen Wettbewerbs, in: Delhaes, K. v., and U. Fehle (eds.), *Dimensionen des Wettbewerbs: Seine Rolle in der Entstehung und Ausgestaltung von Wirtschaftsordnungen*, Stuttgart: Fischer, 29-78.
- Kerber, W. (2006), Competition, Knowledge, and Institutions, *Journal of Economic Issues*, XL, 457-463.
- Kerber, W. and N.J. Saam (2001): Competition as a Test of Hypotheses: Simulation of Knowledge-generating Market Processes, *Journal of Artificial Societies and Social Simulation (JASSS)*, Vol. 4, No.3 <<http://www.soc.surrey.ac.uk/JASSS/4/3/2.html>>.
- Kerber, W., and U. Schwalbe (2007), Economic Foundations of Competition Law, in: Säcker, F.-J., Hirsch, G., and F. Montag (eds.), *Competition Law: European Community Practice*

- and Procedure - Article-by-article Commentary of the EC Competition Law, London: Sweet & Maxwell (forthcoming).
- Kirchner, C. (2007), Goals of Antitrust Revisited in: Schmidtchen, Dieter, Albert, Max, and Stephan Voigt (eds.), *The More Economic Approach to European Competition Law*, Conference on New Political Economy 25, Tübingen: Mohr Siebeck (forthcoming).
- Kornhauser, L.A. (1998), Wealth Maximisation, in: Newman, P. (ed.), *The New Palgrave Dictionary of Economics and the Law*, Vol. III, London: MacMillan, 679-684.
- Kornhauser, L.A. (2002), Preference, Well-Being, and Morality in Social Decisions, *The Journal of Legal Studies* 32, 303-329.
- Lande, R.H. (1989), Chicago's False Foundation: Wealth Transfers (not just Efficiency) Should Guide Antitrust, *Antitrust Law Journal* 58, 631-644.
- Lyons, B.R. (2002), Could Politicians Be More Right Than Economists? A Theory of Merger Standards, Norwich University, Working Paper CCR 02-01, 2002
- Mano, M. de la (2002), For the Customer's Sake: The Competitive Effects of Efficiencies in European Merger Control, *Enterprise Papers* No.11.
- Mestmäcker, E.-J. (1984), *Der verwaltete Wettbewerb: eine vergleichende Untersuchung über den Schutz von Freiheit und Lauterkeit im Wettbewerbsrecht*, Tübingen: Mohr Siebeck.
- Metcalfe, J.S. (1998), *Evolutionary Economics and Creative Destruction*, London and New York: Routledge.
- Möschel, W. (1989), Competition Policy from an Ordo-point of View, in: Peacock, A., and H. Willgerodt (eds.), *Germany's Social Market Economy: Origins and Evolution*, Macmillan, 142 - 159.
- Motta, M. (2004), *Competition Policy. Theory and Practice*, Oxford: Oxford University Press.
- Nelson, R.R., and Winter, S.G. (1982): *Evolutionary Theory of Economic Change*, Cambridge, Mass.: Harvard University Press.
- Nelson, R.R. (1995): Recent Evolutionary Theorizing About Economic Change, *Journal of Economic Literature* 33, 48-90.
- Neven, D.J., and L.-H. Röller (2000), Consumer Surplus vs. Welfare Standard in a Political Economy Model of Merger Control, CEPR Discussion Paper No. 2620.
- Posner, R.A. (1975), The Social Cost of Monopoly and Regulation, *Journal of Political Economy* 83, 807-827.
- Posner, R.A. (1979), Utilitarianism, Economics and Legal Theory, *Journal of Legal Studies* 8, 103-140.
- Posner, R.A. (1980), The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication, *Hofstra Law Review* 8, 487-507.
- Ross, T., and R.A. Winter (2005), The Efficiency Defense in Merger Law: Economic Foundations and Recent Canadian Developments, *Antitrust Law Journal* 72, 471-499.
- Sen, A.K. (1970), The Impossibility of a Paretian Liberal, *Journal of Political Economy* 78, 152-157.
- Schäfer, H.-B., and C. Ott (1995), *Lehrbuch der ökonomischen Analyse des Zivilrechts*, 2.ed., Berlin: Springer.
- Schumpeter, J.A. (1934), *The Theory of Economic Development. An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, Cambridge/Mass: Harvard University Press.
- Scitovsky, T. (1941), A Note on Welfare Propositions in Economics, *Review of Economic Studies* 9, 77-88.
- Van den Bergh, R.J., and P.D. Camesasca (2006), *European Competition Law and Economics: A Comparative Perspective*, London: Sweet & Maxwell.
- Vanberg, V. (1999), Markets and Regulation: On the Contrast Between Free-Market Liberalism and Constitutional Liberalism, *Constitutional Political Economy* 10, 219-243.

- Vanberg, V. (2005), Market and State: The Perspective of Constitutional Political Economy, *Journal of Institutional Economics* 1, 23-49.
- Varian, H.R. (1992), *Microeconomic Analysis*, 3.ed., New York: Norton.
- Vickers, J. (2005), Abuse of Market Power, *The Economic Journal*, Vol. 111, 2005, pp. F244-F261.
- Voigt, S., and A. Schmidt (2005), *Making European Merger Control More Predictable*, Dordrecht: Springer.
- Waldron, J. (2002), Locating Distribution, *The Journal of Legal Studies* 32, 277-302.
- Williamson, O.E. (1968), Economies as an Antitrust Defense: The Welfare Tradeoffs, *American Economic Review* 58, 18-36.