"CONSUMER CHOICE" OR "CONSUMER WELFARE"? ORDOLIBERLISM AS THE NORMATIVE BASIS OF EU COMPETITION LAW

I. INTRODUCTION

Just a month ago, on October 6 of this year, the ECJ handed down a preliminary ruling concerning the interpretation of Art. 102 TFEU. The court was asked to specify the relevant criteria for the assessment of the abusive nature of retroactive rebate schemes operated by undertakings occupying a dominant position on the market ('dominant undertakings').

In her opinion, advocate General Kokott characterized the issue in the following terms:

"(3) The Court will have to clarify in this case whether, for the purposes of assessing the anti-competitiveness of rebate schemes from the point of view of Article 82 EC [now Article 102 TFEU], it is legally necessary to carry out a price/cost analysis in which the commercial conduct of the dominant undertaking is compared with that of an equally efficient competitor (the 'as-efficient-competitor' (AEC) test). …"

And then she went on to say:

"(4) These questions are particularly important at a time when there are mounting calls for European competition law to adopt a more economic approach. It is my view that, in its replies, the signal effect of which is likely to extend well beyond the present case, *the Court should not allow itself to be influenced so much by current thinking ('Zeitgeist') or ephemeral trends, but should have regard rather to the legal foundations on which the prohibition of abuse of a dominant position rests in EU law*."

The "more economic approach" is based on welfare economics. According to this approach, the anti-competitiveness of a specific

market conduct depends on its negative welfare effects, in short: on "consumer harm". If the Advocate General warns the Court not to follow this approach but rather to rely on the "legal foundations" of EU competition law, what then are these "legal foundations" on which the prohibition of abuse of a dominant position provided by Art. 102 TFEU – and we may add: also the prohibition of cartels provided by Art. 101 TFEU – rests?

The hypothesis that I shall try to justify is that it has always been and still is the ordoliberal approach to competition policy and law. It is this approach which initially shaped the drafting of the competition rules of the Rome Treaty, which later also informed the interpretation of these rules by the ECJ and which is still today the ideological basis on which European competition law rests.

I shall therefore first characterize the historical roots of the ordoliberal approach as well as its development towards its contemporary version (II.), then explain its impact on the drafting of the Rome Treaty and on the interpretation of the competition rules by the ECJ (III.), and finally analyze its continuing relevance for the application of Art. 101 and 102 TFEU (IV.).

II. THE ORDOLIBERAL APPROACH TO THE MONOPOLY PROBLEM

The first generation ordoliberals, i.e. the members of the Freiburg School such as Walter Eucken (the economist) and Franz Böhm (the lawyer), developed their innovative approach to what they called the "economic problem", i.e. the problem of allocating scarce resources, in opposition to how Nazi-Germany and the Soviet Union had organized

their economies. To begin with, Eucken conceived the "economic problem" as a problem of economic planning, i.e. of allocative decision making by relevant actors. Planning implies choice making. Ordoliberals clearly favoured competitive markets as the preferable way of coordinating consumers' and producers' choices, because their liberal convictions lead them to consider markets as the most promising combination of individual freedom to make choices and the resulting prosperity of society at large (today we would say: efficiency in terms of allocation of resources according to consumers' preferences).

Implicit in this approach is a concept of competition that had already been a centerpiece of Adam Smith's notion of a "system of natural liberty", i.e. competition as rivalry among individual market participants. As long as individuals are free to pursue their own interest, producers' motivation to make profits will quite naturally lead them to compete; consequently consumers will be able to choose so that resources are allocated according to their preferences (this is what we call allocative efficiency).

In a very important respect the Freiburg School of ordoliberalism did, however, not agree with classical laissez-faire liberalism and this is equally true for the generations of ordoliberals that followed. They did not and still don't share the optimistic expectation that - in Adam Smith's words - a "harmonious system of natural liberty" would establish itself if only all government intervention were taken away. Rather experience had taught them that mere *laissez-faire* would lead to untamed cartelization and concentration of market power, in other words to the self-destruction of competitive markets as means of serving consumers' preferences and achieving allocative efficiency. The

remedy that the Freiburg School suggested was an institutional approach to competition which has become the hallmark of ordoliberalism. Especially Franz Böhm (the lawyer) emphasized that competition is not merely rooted in individual economic freedom, but in individuals' use of their property rights guaranteed by a system of private law, rights which are limited, however, by rules which would determine the borderline between (lawful) competitive and (unlawful) anti-competitive market conduct. Ordoliberals therefore insist that competitive markets must be based on the rule of law, more specifically on competition rules which the state must enforce by administrative and adjudicative means.

Franz Böhm has emphasized time and again that competition rules must be regarded as "rules of the game". Enforcement of prohibitions based on such rules is fundamentally different from prescriptive state intervention. This distinction, which has most emphatically been stressed by Friedrich von Hayek, is fundamental for a proper understanding of the ordoliberal approach.

Apart from individual economic freedom and legally protected property rights, the third basic feature of ordoliberalism, is its systemic approach to competition, i.e. the concept of "ordo" as "order" in the sense of systemic arrangement. For ordoliberals, a competitive market is a system of decentralized economic planning based on individual economic freedom legally protected by the system of private law of property and contract. It is important to understand, however, that this individual freedom is conditioned upon the workability of the whole system of interaction, more precisely: on the freedom of all market participants to voluntarily engage in mutual transactions. Consumers'

freedom of choice is therefore dependent upon producers' freedom to compete and vice versa.

This brings us to the relevance of the "market structure" which reflects the number of producers (suppliers) and their market shares. Consumers' freedom to choose between alternative products or services offered on the market is dependent upon the degree of decentralization of production. The higher the degree of concentration, the lower is the number of alternatives available to consumers and the more limited is consumers' freedom of choice. It follows that a restraint of competition is characterized by a limitation of consumers' choice which depends on the rivalry among a sufficient number of producers. Hence, from an ordoliberal point of view, a restraint of competition may be found wherever (1) the number of freely competing producers is artificially reduced in ways that do not result from the normal process of competition itself, and (2) where this reduces the scope of alternatives among which consumers may freely chose.

The first generation of ordoliberals which formed the Freiburg School considered "perfect (complete) competition" as the ideal model for a competitive market structure. Cartels as well as monopolies (including, for that matter, dominant market positions) were therefore considered inherently harmful. Consequently, monopolistic power should be prevented from being established in the first place by adequate policies on the macro level. Existing but avoidable monopoly positions should be abolished as far as possible. Only unavoidable (natural) monopolies (which prevail mainly in infrastructure industries) would require supervision by a state agency so as to make them behave "as if" perfect or complete competition prevailed, i.e. they should be prevented from

pursuing particularly harmful exclusionary practices such as boycotts, predatory pricing or fidelity rebates as well as exploitative practices such as unfair prices.

Ordoliberalism has, however, never been a static and homogeneous school of thought.

Due to the influence of Friedrich von Hayek who is also associated with the ordoliberal school, competition became rather regarded as a dynamic process of discovery which produces all the information necessary to determine consumers' wants, their demand for specific goods and services and their willingness to pay as well as all the information necessary for producers to determine what to produce at which costs. The theory of "perfect competition" is instead assuming the availability of all the information that competition is supposed to produce in the first place.

Also, contrary to Walter Eucken, dominant market positions were no longer considered to be harmful per se where they result from successful competition on the merits. In order to consider market dominance as restrictive of competition, the showing of “abuse” (i.e. anti-competitive conduct) must be required.

Ordoliberalism was developed even further by younger generations of its adherents. The traditional learning was, for instance, complemented by the Schumpeterian notion of rivalry as a process of “creative destruction”, i.e. a process of constant emergence and erosion of market power, where one or some innovative firms strive to outcompete others who are then challenged in turn to overtake the lead by more effective innovation and so on (in Germany it became usual to

speak of “vorstossender Wettbewerb” [pioneering competition]). Others developed the Hayekian approach to competition further into the notion of a cybernetic, self-regulating and evolutionary system based on voluntary transactions whose concrete effects can neither be anticipated nor in any way measured. Another strand of ordoliberal thought has integrated the fundamental insights of the institutional economics movement, especially the relevance of transaction costs and incomplete information of market actors for the assessment of their competitive behaviour on markets. Ordoliberalism would be no more than a footnote in the history of competition law had it not been able to constantly reconsider its premises and notions especially in light of the judicial experience that evolved over time.

But the constituent elements of ordoliberalism never changed. They may be summarized as follows:

- Competition results from individual freedom of producers to choose what they want to offer and of consumers to choose what they want to buy.
- Competition is understood as a dynamic system (process) of interaction between choice making individuals who by making their choices reveal their preferences and produce the kind of information that other individuals need to make their choices.
- It is the fundamental role of the system of private law to provide individuals with legal rights the unrestricted use of which forms the basis of competitive rivalry among producers and of consumers' freedom of choice among alternative sources of supply.

- It is the task of the State to provide laws against restraints of such competitive rivalry and to enforce the as rules of the game with which market participants have to comply.

  These basic elements are generally shared by ordoliberals of all generations even though many of them have added one way or another further refinements.

III. THE IMPACT OF ORDOLIBERAL THINKING ON THE DRAFTING AND INTERPRETATION OF EU COMPETITION RULES

The impact of ordoliberal thinking on the drafting of the competition rules of the Rome Treaty cannot be overestimated. Germany and France were the only two Member States that were interested in competition matters, but had quite opposite views of competition. The German negotiation team was formed by second generation ordoliberals (among them von der Groeben who later became the first Commissioner responsible for competition). They managed to convince the French delegation to include in the Rome Treaty a prohibition of cartels subject to an efficiency defence and a prohibition of abuse of a dominant position in the market. Even though nobody had a fully developed and sufficiently sophisticated concept of "abuse" yet, the German delegation was at least successful in avoiding that it would allow continuing governmental price controls as the French would have preferred.

The development of an adequate concept of abuse was rather left to the future jurisprudence of the Commission and the ECJ. It took some 15 years, however, before the Court had a chance to lay down the legal foundations for a proper concept of abuse as well as for the concept of

restraint of competition generally. The case that is still today the leading case was the Continental Can case which was decided in 1973. It concerned what is called today a “structural abuse”, i.e. an acquisition by an already dominant firm of a competitor whereby the prevailing market structure would have been damaged by additional concentration. The case was in a sense academically prepared by a debate between two prominent law professors, René Joliet (who later became judge at the ECJ), on the one hand, and Ernst-Joachim Mestmäcker (a leading German ordoliberal), on the other. They disagreed fundamentally on the question what the competition rules – and especially the prohibition of Art. 86 EEC [today Art. 102 TFEU] – were designed to protect. According to Joliet, Article 86 EEC seemed

“to be concerned in the first place – if not exclusively – with the protection of the consumers and of the dominant firm’s purchasers or suppliers”.

For Mestmäcker the starting point was the fact that the Rome Treaty had placed the abuse concept in a unique and novel context. Article 86 was, according to him, one of the competition rules whose purpose it was, to establish a "system ensuring that competition in the internal market is not distorted" as specified in Article 3(f) of the Rome Treaty [later Article 3(1)(g) EC-Treaty]. The same still holds true with regard to Article 102 TFEU read in conjunction with Protocol 27 on “the internal market and competition”, according to which the “internal market” includes “a system ensuring that competition is not distorted”. Since that system of competition was regarded as a means of achieving the fundamental goals of the Rome Treaty as listed in its Article 2, in particular the goal of "raising the living standard" (i.e. the general welfare), efficiency, consumer welfare as well as economic progress

were considered to result from market integration and competition. This link of competition to integration is the specific European perspective that determined and still determines the interpretation of Article 102 TFEU.

As Mestmäcker emphasized, this approach is supported by Article 101 (3) TFEU which grants an efficiency exemption from the prohibition of cartels only if there is no substantial elimination of competition. This means that, in order that consumers profit from the efficiency exemption, a cartel must leave sufficient competition so as to make sure that efficiencies are passed on to consumers. The assumption clearly is that consumers may benefit from the efficiencies only due to the residual pressure of competition on the market. Similarly, a dominant firm should be prevented from eliminating residual competition either by way of merger or by pursuing exclusionary practices which reduce choice. An abuse therefore consists in particular of market conduct whereby the dominant firm suppresses actual or potential competition, especially by eliminating competitors by means other than competition on the merits, by hampering market access of potential entrants or by expanding its dominant position into neighbouring or downstream markets. The bottom line of Mestmäcker's approach was the principle that a dominant firm must not engage in conduct that would not be possible under competitive conditions (put differently: conduct that is only possible due to market dominance).

How then did this ordoliberal concept of abuse influence the interpretation of Article 86 EEC [now Article 102 TFEU] by the Commission and the CJEU in the *Continental Can* case? Recognizing that Article 86 EEC [now Article 102 TFEU] covered not only exploitative but

also exclusionary practices, the Court stated the purpose of the provision in the following terms:

“The provision is not only aimed at practices which may cause damage to consumers directly, but also at those which are detrimental to them through their impact on an effective competition structure, such as is mentioned in Article 3 (f) of the Treaty.”

Hence, in order to determine the exclusionary nature of a specific practice, the Court followed the notion of residual competition which must be protected against strategies that would significantly strengthen the dominant undertaking's market position at the expense of consumers' choice.

Little later, the ECJ refined in *Hoffmann-La Roche* the concept of abuse in the following terms:

“The concept of abuse is an objective concept relating to the behaviour of an undertaking in a dominant position, which is such as to influence the structure of the market where, as a result of the very presence of the undertaking in question the degree of competition is weakened and which through recourse to methods different from those which condition normal competition in product or services on the basis of the transaction of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.”

The Court also coined the widely misunderstood principle that a dominant firm has a "special responsibility not to allow its conduct to impair undistorted competition in the common market". This principle does not imply that dominant undertakings are responsible for the protection of their smaller rivals. The Court itself has explained later that "special responsibility means only that a dominant undertaking may be prohibited from conduct which is legitimate where it is carried out by

non-dominant undertakings" (and therefore would impair undistorted competition). The flip side of this holding is the ordoliberal idea that a dominant firm must not engage in conduct that would not be possible under competitive conditions (put differently: conduct that is only possible due to market dominance).

Coming back to the ECJ's recent assessment of the retroactive rebate system practiced by *Post Danmark*, the judgment of 6 October 2015 clearly reflects this idea. As the Court stated:

"(25) … within the scope of application of Article 82 EC [now Article 102 TFEU], a dominant undertaking is subject to certain restrictions that do not apply to other undertakings in the same form. A practice which would be unobjectionable in normal circumstances may constitute abuse of engaged in by a dominant undertaking."

Instead of relying on the notion of "consumer harm", the Court reiterated once more the relevance of notion of "exclusionary effect" of the alledgedly abusive conduct. According to the Court,

"(31) … it first has to be determined whether those rebates can produce an exclusionary effect, that is to say whether they are capable, first, of making market entry very difficult or impossible for competitors of the undertaking in a dominant position and, secondly, of making it more difficult or impossible for the co-contractors of the undertaking to choose between various sources of supply or commercial partners. It then has to be examined whether there is an objective economic justification for the discounts granted."

Hence, the Court clearly followed GA Kokott's recommendation not "to be influenced so much by current thinking ('Zeitgeist')" that would emphasise the – most of the time unmeasurable welfare effects – but "have regard rather to the legal foundation on which the prohibition of abuse of a dominant position rests in EU law".

IV. THE PROPER ROLE OF EFFICIENCY CONSIDERATIONS

Ordoliberalism has often been said to disregard efficiency concerns. This is wrong. There is a misunderstanding here of the role that efficiency plays in the context of an ordoliberal approach to competition as opposed to the "consumer welfare" approach. Ordoliberals have always appreciated and highlighted the positive welfare effects of competition in terms of productive, allocative and dynamic efficiencies. What they refuse, however, is to measure the allocative and dynamic efficiency effects of individual business strategies. The determination and materialization of these effects depends on consumers' choice in the market. In other words: allocative and dynamic efficiencies can only be the result of effective competition. These results cannot be specified *ex ante*, because that would require access to the full amount of information which competition is supposed to discover in the first place. Competition rules cannot, therefore, pretend to assess dominant firms' conduct according to their allocative or dynamic efficiencies but merely according to their impact upon competition and consumers' choice.

The efficiency defense that is available according to Article 101(3) TFEU as well as, according to the jurisprudence of the CJEU, within the framework of Article 102 TFEU, is limited to productive efficiencies upon the condition, however, that sufficient residual competition is left. This allows the determination of allocative and dynamic efficiencies to be deferred to the competitive process which allows consumers to make their choices. So, in the end, any business conduct that appears efficient on the micro-level of the individual firm(s) must pass the efficiency test on the macro-level of the system of competition where consumers decide what they want. Article 102 TFEU therefore does not prohibit

inefficient conduct, but conduct that restricts competition by exclusionary strategies. The prohibition of such strategies indirectly protects consumers by protecting workable competition.

Modern welfare economists tend to disregard the link between market participants' freedom of choice and allocative efficiency as a result of competition as rivalry; they rather believe that quantitative analysis of producers' conduct allows us to directly determine what is efficient or not. This optimism is shared neither by ordoliberals nor by the CJEU. They feel rather reassured by Richard Posner who once said that "[e]fficiency is the ultimate goal of antitrust, but competition a mediate goal that will often be close enough to the ultimate goal to allow the courts to look no further". If allocative efficiency means satisfaction of consumers' preferences, then we have to recognize that consumers' preferences must be revealed by market transactions based on consumers' choice. There is no way to directly measure allocative efficiency, let alone dynamic efficiency. What is measurable though is productive efficiency, but here we should be reminded of what Robert Bork once said:

"Economists, like other people, will measure what is susceptible of measurement and will tend to forget what is not, though what is forgotten may be far more important than what is measured."

The bottom line is that we simply cannot translate all qualitative criteria into quantitative criteria. To determine whether a dominant firm has abused its market power to the detriment of competition and consumer choice, will – in spite of the increasing relevance of econometric studies for the application of competition rules – remain a normative issue that requires not only an assessment of facts but judgment.