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## The equality and social fairness objectives in EU competition law: The European school of thought

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## ABSTRACT

The protection of free competition based on equality is the most important social principle in a social market economy. Post-Lisbon, EU competition law is supposed to implement the social market economy concept as defined in Article 3 TEU. The European School of thought is the economic frame that applies this concept to real world cases. One aspect in this School of thought relates to the interpretation of the competition related treaty articles. Another one deals with the fair and equal distribution of wealth gains between the market actors. By guaranteeing equal conditions, the European framework assures free and fair play.

*La sauvegarde de la libre concurrence fondée sur l'égalité est le plus important principe social dans une économie sociale de marché. Suite au Traité de Lisbonne, le droit européen de la concurrence doit mettre en oeuvre le concept d'économie sociale de marché conformément à l'article 3 TUE. Ce concept est appliqué à des cas mondiaux réels grâce à la théorie économique de l'Ecole de pensée européenne. Cette Ecole doctrinale s'intéresse à l'interprétation des dispositions du Traité en matière de concurrence mais aussi à une répartition juste et équitable des richesses entre les opérateurs du marché. En garantissant des conditions équitables, le système européen assure une concurrence libre et non faussée.*

# The equality and social fairness objectives in EU competition law: The European school of thought

## I. Introduction

1. The Treaty of Lisbon<sup>1</sup> demands that the European Union is based on a social market system. Article 3 TEU states that alongside the establishment of an internal market, the European Union shall work for the sustainable development of a Europe built *inter alia* on a highly competitive social market economy. This means that when applying EU competition law, the social market economy objective is going to supplement—or in the long run even to replace—the internal market objective used so far. This shift has practical consequences with respect to the application of the economic analysis in EU competition law.

2. In general, a market system is an effective instrument to meet the demand from consumers for goods and services. It motivates profit-maximising companies to increase productivity, to expand, to innovate and to create jobs. These exposed market forces are the generator of prosperity thereby creating wealth. A social market system<sup>2</sup> controls the distribution of wealth gains between the market actors. Thus, an economic analysis of competition rules that are based on a social market economy concept differs from an economic analysis of antitrust rules that just focus on a market system without a social aspect. This article discusses the differences.

1 The Lisbon Treaty (used in the following) or Treaty of Lisbon entered into force 1 December 2009 and amends the two treaties which form the constitutional basis of the European Union (EU): the Treaty on European Union (TEU) and the Treaty establishing the European Community (TEEC), which is also known as Treaty of Rome (1958) and renamed at Lisbon to the Treaty on the Functioning of the European Union (TFEU).

2 A social market economy is based on the following four main pillars: (1) Individual freedom, personal responsibility and private autonomy vis-à-vis the state and powerful interest groups, embedded into a strong civil society. (2) Free markets, that is, functioning competition, private ownership of the means of production, free pricing, freedom of contract, private liability, controls against monopolies and abuses of power, free international trade and monetary stability. In short, a market is free only when there are common rules which are clear, applicable and provide legal certainty. (3) Solidarity and subsidiarity with the goal of respecting human dignity and safeguarding social peace through policies compatible with a functioning market as well as with the principles of reciprocity and sustainability. (4) Respect for the creation as held in trust for future generations and as a common heritage essential to the harmonious development of every future human being.

## II. EU competition law and the social market economy concept

3. The social market economy, as referred to in Article 3 TEU, is a normative system based on values<sup>3</sup> unifying the principle of freedom with the objectives of social equality and fairness.<sup>4</sup> In such a concept, economic growth and social sustainability are compatible notions. A social market economy concept recognises that a functioning economy is indispensable for producing the material basis without which human society with all its other non-economic—human and cultural—dimensions cannot exist. “Where no wealth is created in the first place, none can be re-distributed.”<sup>5</sup> A social market economy then combines the efficiency of a market process with equal opportunities thereby representing an alternative to classic liberalism, which is based on efficiency without equitable development, and to socialism, which rests on equitable development without efficiency.

4. The tool that makes markets function in a social way is the equality principle in EU competition law: First, the EU competition law framework protects the competition process which creates wealth, and secondly, the law regulates and ensures that the results of the competition process are distributed fairly and on an equal footing within the society.

### 1. Creation of wealth and EU competition law

5. The EU competition law principles were developed in the first half of the twentieth century, in reaction to Europe’s experience with crisis, totalitarianism and war. Scholars found that World War II was caused mainly by the deterioration and eventual failure of a free and competitive market. This was due to a weak state which was then unable to control the emergence of monopolies and oligopolies, and the resulting lack of competition. The Nazi regime transformed these powerful private economic entities—by misusing in particular the German iron and steel industry—quickly into a war machine controlled by political power.<sup>6</sup>

Post-World War II Europe feared a revival of nationalism and fascism, on the one hand, and communism, on the other hand. At that time ordo-liberal scholars<sup>7</sup> identified that peace and the economic and social well-being of people are strongly correlated. It is less likely that a society with a high level of employment and social protection as well as a rising standard of living and quality of life is vulnerable to an ideology as experienced prior to World War II.

6. In the ordo-view,<sup>8</sup> a legal system is essential to protect the liberty of action by individuals as well as by the government.<sup>9</sup> The law should ensure that the market is safeguarded from the destructive influences of political and economic power.<sup>10</sup> Thus, according to the ordo-liberals, a market should be embedded in a constitutional framework which protects the process of competition and minimises state intervention in the economy.

The logic is that economic freedom entails the potential for its own destruction. The inherent and unavoidable tendency of private business to restrict competition for the sake of monopoly profits induces companies to agree on cartels, on tying arrangements, on exclusive dealership clauses and other restrictive practices. Thus, companies have a tendency to use their liberty to narrow their own and their competitor’s freedom of contract. Such a decomposition of the market economy has to be prevented by legislation designed to protect competition.<sup>11</sup>

7. Competition law was viewed as a means of preventing the degeneration of the competitive process. In this respect, competition law was supposed to enforce competition by creating and maintaining the conditions under which it can flourish.<sup>12</sup> Rooted in a pro-regulatory philosophy the economic order should be defined upfront and implemented by independent authorities and courts accordingly. This ordo-liberal thinking found its way into the Treaty of Rome 1957 by defining the “rules of the game” that are essential for a competitive market economy.

As early as 1955, the Spaak Report<sup>13</sup> contained, in Title II on Rules and Common Action, regulations concerning competition. Section 2 discussed the rules concerning financial assistance granted by the states. The following drafting process of the Treaty provisions was subject to

3 These values express a philosophy committed to a humane society which aims at the dignity, well-being, self-determination, encouragement, freedom and responsibility of all individuals.

4 Müller-Armack, 1956, p. 390.

5 Monti, 2000, p. 3.

6 Gormsen Liza Lovdahl, 2007, p. 332; Röpke, *German Commercial Policy*, 1934, pp. 24-27.

7 The Freiburg Ordoliberal School was founded in the 1930s in Germany by the economist Walter Eucken (1891–1950) and the two lawyers, Franz Böhm (1895–1977) and Hans Großmann-Doerth (1894–1944). As Böhm later said in retrospect, the founders of the school were united in their common concern for the question of the constitutional foundations of a free economy and society. Vanberg, 2002, p. 38.

8 In this view, the weakness of the state to establish a legal system resulted in unrestrained economic and political freedom thereby enabling a dictatorship that finally led to World War II.

9 Möschele, 2001, pp. 4, 8.

10 When competition cannot generate the expected results due to market failures like natural monopolies, external effects, or asymmetric information of the parties, legislation regulating specific economic sectors can be used.

11 Eucken, *Grundsätze der Wirtschaftspolitik*, 1990; Mestmäcker, 1980.

12 Gerber, 1994, p. 50.

13 Von der Groeben wrote these ideas for the Spaak Report together with Pierre Uri in a period of just four weeks at Grand Hotel Cap Ferrat. See von der Groeben, 2002.

fierce negotiation with numerous different versions of the competition-related provisions.<sup>14</sup> Two German experts, Alfred Müller-Armack and Hans von der Groeben, contributed to this process. In contrast to the belief in the self-healing forces of markets, Europeans have applied a “framework” approach since then.

## 2. Distribution of wealth and the social market economy concept

8. Within Germany the *ordo-liberal* view was further developed towards the social market economy concept which recently found its way to the Lisbon Treaty in 2009.

The German founders of the social market economy concept believed that to secure their economic and political future neither state intervention, nor control along Communist lines, nor a state powerless in the face of private economic interests, would be able to rebuild Germany after World War II. They thought that a socialist planned economy would ultimately destroy people’s legitimate pursuit of happiness, their freedom of choice and right to self-determination. On the other hand, they did not underestimate the consequences and the excesses of a weak state, unable to guarantee the rules of free competition and safeguard the rule of law and social justice. Thus, a so-called “third way” in-between the two extreme notions was developed, the so-called “social market economy concept.” To seek wealth as well as a fair distribution of this wealth throughout society lies at the heart of this concept.

9. Alfred Müller-Armack<sup>15</sup> is one of the founders of this social market economy concept. As Germany was faced with the results of its military catastrophe post World War II, the need for social responsibility was strongly felt. Müller-Armack blamed capitalism for betraying the basic principles of the market economy, namely competition and price freedom. In his view, consumer choice has the power to establish real prices and encourage production. On top of that a liberal market economy should not be left to function by itself. It should be steered in a socially acceptable direction.

In such a concept, all economic players meet as legal equals. A private law society consists of equally free people with equal rights, a society in which “*everyone should have the same rights and status, namely the status of a person under private law.*”<sup>16</sup>

10. Ludwig Erhard, another important contributor to the social market economy concept, confirmed that: “[a] *social and economic policy faces the task of providing all individuals in the economic process with the greatest possible equality of opportunity. It is also the duty of policy makers to eliminate economic privilege and power-concentration.*”

Thus, a social market economy does not work with the idea of *laissez-faire* capitalism. Instead, it requires government involvement. The state’s responsibility is to actively improve market conditions and simultaneously to pursue a social balance.<sup>17</sup> For this very reason, the idea is not to leave a market economy alone to any development it might take, but to create a strong framework that ensures: (1) that social standards and other objectives of the society are respected; and (2) that the beneficial workings of the market forces are not blocked, restrained or distorted by short-sighted actions of the market actors themselves. Ultimately, such a social market economy concept—as referred to in Article 3 TEU—defines the frame within which the EU competition law provisions should operate.<sup>18</sup>

Moreover, the social market economy concept works in practice as the development and status of the German economy prevail. Due to the lessons learned during World War II, the social market economy model has not only been the path to success of post-World War II German recovery, the so-called “*Wirtschaftswunder*,” but even serves today as a role model for economic prosperity and social stability thereby making the German economy the engine within the European Union. The 2009 Lisbon Treaty clarified that all Member States should pursue such a highly competitive social market economy model.

11. EU competition rules neatly implement the social market economy concept in practice. Both—the EU competition rules and the social market economy concept—are in fact interchangeable notions. This is not really a surprise since both notions have been developed by the same people based on the same ideology post World War II (see above).

14 It is understood from the minutes of a meeting of the Common Market Group that the German position was, after declaring that it was necessary to distinguish between monopolies and oligopolies, on the one hand, and cartels, on the other, that monopolies and oligopolies were not necessarily incompatible per se with a system of competition. From this point of view, it was only necessary to address abuses to which certain monopolistic situations could lead. By advocating two separate rules—one for anticompetitive agreements and the other one for the abuse of dominance—the German proposal differed significantly from the other ones. Moreover, the German position was that these two rules should be applicable for both private and public entities.

15 He was also a member of the Common Market Group when the EU competition rules were drafted for the Treaty of Rome (see above).

16 Böhm, *Freiheit und Ordnung in der Marktwirtschaft*, 1980, S. 140; Böhm, *Private Law Society and the Market Economy*, 1989, p. 54; Nicholls, 2000, p. 155.

17 This responsibility lies according to the Lisbon Treaty with the European Commission as an independent authority.

18 It seems that then Commissioner Mario Monti was the first one who explicitly pronounced the link between the European model of a social market economy and EU competition law in 2000, quite some time before the European model of a social market economy was declared as a European Union objective in Article 3 TEU. See Monti, 2000.

# III. The European school of thought

**12.** The protection of free competition based on equality is the most important social principle in a social market economy.<sup>19</sup> Since 2009, EU competition law is supposed to function as a pillar in such a social market economy concept by putting economic policy on a par with social policy. Post-Lisbon, EU competition law should help to maintain and foster social market economies throughout Europe. The competition process as such should be steered in a socially acceptable direction based on the values “social fairness” and “equality”.

These two objectives are already inherent in the EU competition rules. In the following there are some concrete examples. The European School of thought represents the economic frame that helps to reveal these objectives in the law.

## 1. Creation of wealth and the equality and social fairness objectives

### 1.1 Article 101 TFEU

**13.** The equality principle inherent in a social market economy as outlined above is implemented in Article 101(3) TFEU. Where an agreement restricts competition but, on the other hand, improves the production or distribution of goods or promotes technical or economic progress, the resulting benefits/wealth gains should be redistributed fairly and on an equal footing between the market participants—producers and consumers alike. The pre-defined economic approach in the EU competition law provisions states that in order to escape the nullity provision of Article 101(2) TFEU, consumers need to get their fair share of the wealth gains achieved.<sup>20</sup>

**14.** Again, the logic holds that market actors are treated equally. If an agreement restricts competition but contributes to improving the production or distribution of goods or to promoting technical or economic progress, such an agreement may produce efficiencies which benefit in the first instance the producer. In order to be exempted from the nullity provision, the pro-competitive benefits need to outweigh anti-competitive effects. Equality is introduced because it is not the producer alone who benefits; consumers must get their “fair share” as well.

This does not necessarily mean that consumers must get the same amount of wealth gains as producers since producers need to be compensated, for example, for their innovation efforts and risks. However, the distribution needs to be “fair” by considering next to price other non-price-related benefits a consumer might receive in compensation for an increase in market power. Tools to measure such non-price-related benefits are, for example, conjoint measurement.

**15.** In this higher European hierarchy canon of freedom, social fairness, equality and rule of law, economic efficiency is of lower importance. Benefits should be shared between the two market sides equally. If consumers do not receive a fair share, only producers would benefit. This would be single-sided thereby contradicting the equality and social fairness criteria of the social market economy concept (but perfectly in line with Chicago School thinking as discussed in the following sections).

### 1.2 Article 102 TFEU

**16.** When it comes to abuse cases (Article 102 TFEU), the pre-defined economic order in EU competition law applies the equality principle as well.

Monopolies or dominant positions themselves are not a problem in Europe. Instead, EU competition law stipulates that the behaviour of companies should be on an equal footing: A dominant company is supposed to behave in the same manner as a non-dominant company (“as-if” competition).<sup>21</sup> The true challenge is to identify normal acts of competition for both, dominant and non-dominant companies.

**17.** The key aspect in this regard is the assessment of performance competition or “competition on the merits.” That is regular competition which improves the performance of a firm and is in the long-term interest of the consumer: better goods, lower prices, better services and an increase in innovation. This type of competition translates directly into benefits to the consumer.<sup>22</sup> In this sense, the entrepreneur’s pursuit of profit is related to consumer benefits.<sup>23</sup> As frequently stated: “*The only road to business success is through the narrow gate of better performance in service of the consumer.*”<sup>24</sup>

**18.** However, performance competition needs to be distinguished from non-performance competition. This latter competition is not in the long-term consumer interest but takes place for other reasons such as the hindrance of competitors or undue enrichment. Non-performance competition is about lowering the

<sup>19</sup> (Müller-Armack, *The Meaning of the Social Market Economy*, 1989, pp. 82-86)

<sup>20</sup> Technically a balancing between the anti-competitive effects takes place against the pro-competitive effects for both groups, producers and consumers.

<sup>21</sup> This position neither is an *ordo-liberal* one nor can be found in German competition law. See Schweitzer, 2007, p. 15.

<sup>22</sup> Eucken, *Ordnungspolitik*, 1999, S. 43.

<sup>23</sup> Böhm, *The Non-State (“Natural”) Laws Inherent in a Competitive Economy*, 1982, p. 109.

<sup>24</sup> Röpke, *A Humane Economy: The Social Framework of the Free Market*, 1960, p. 31.

accomplishment of competitors thereby improving one's own relative performance (but without an absolute improvement).<sup>25</sup> And it is also about unduly increasing one's own profits at the expense of others, which clearly contradicts the social market economy objective. "Social" in European School thinking is not limited to producer-consumer interactions only. The social aspect covers producer-producer interactions alike. The social fairness objective in EU competition law is about unjustifiably enrichments in general.

**19.** The logic of equality implies that since non-performance competition is not a type of competition a firm would engage in as normal business conduct, a firm holding economic power should refrain from such a type of competition as well. This is consistent with the pre-defined "rules of the game" namely that firms with and without economic market power need to behave equally.

This means that individual firms with economic power must be controlled by applying an "as-if"-standard, firms need to refrain from conduct that they would not engage in at all if they had no economic power. The rule of law organises an equal treatment of these firms despite whether they have economic power or not. Thus, firms with economic power should behave equally, "as if" these firms do not hold economic power.

In other words, firms with economic power should not abuse this power. Their actions must not deviate from the actions of companies that operate in competitive markets. Otherwise their actions could be regarded as unfair and abusive even if they could prove to be welfare enhancing. In this respect, firms with economic power have the special responsibility to refrain from any abusive conduct.

**20.** Some cases are not clear-cut. A dominant company might apply a conduct that when performed by a non-dominant company is legitimate. However, the same conduct might produce negative competitive effects when applied by a dominant company. Again, the dominant company should refrain from such conduct. In this context, the implementation of the equality principle requires the assessment of the conduct in order to identify whether the behaviour of a dominant company is abusive or not.

**21.** Thus, competitive actions which are the result of normal competition are acceptable for both, dominant and non-dominant companies. In fact, the economic order in EU competition law requires equality between the market actors in this regard. Abusive behaviour is a conduct that infringes this equality principle since abusive behaviour is an action a non-dominant company has no (economic) incentive to engage in.<sup>26</sup>

<sup>25</sup> Eucken, *Die Überwindung des Historismus*, 1938, S. 81; Eucken, *Grundsätze der Wirtschaftspolitik*, 1990, S. 267, 329, 358f.

<sup>26</sup> This does not rule out the efficiency argument. A dominant company can produce efficiencies as non-dominant companies do. These efficiencies can be taken into account in the assessment.

**22.** Other applications of the equality principle relate to the EU state aid rules. Governments and companies are treated alike in EU competition law. The market investor principle, for example, requires the same treatment of subsidies no matter whether financial means are given by a government or a private investor. Competition needs to take place on an equal footing despite the fact that a recipient has received a government subsidy. Again, the protection of free competition based on this equality principle is the most important social principle in a social market economy.

## 2. Distribution of wealth and the equality and fairness objectives

**23.** Another important objective related to social fairness and equality in EU competition law and thus to the European social market economy concept is that wealth gains—as a result of a competitive market process—are distributed equally and thereby fairly between all market actors, producers and consumers alike. A fair distribution of created wealth means that no market participant receives a bundle that is worse for his preferences than an equal split of the available gains.<sup>27</sup>

In contrast to companies that are clearly profit—and thereby price—driven, consumers and citizens are not entirely rational behaving entities. Consumer benefits or utilities derive from multiple sources. This means that the satisfaction consumers receive from consuming a good or service depends on various attributes. One of them is price. However, a focus on price only in the assessment of consumer interests does not value the whole set of consumer preferences appropriately. It is the combination of price and other dimensions that defines consumer interests in a broad manner.

**24.** In a social market economy, these broadly defined consumer/citizen interests are balanced with the profit-oriented efficiency enhancing interests of companies.<sup>28</sup> Further below a simple graph illustrates this point. However, we start with a discussion about different school of thoughts first.

### 2.1 Different schools of thought

**25.** Schools of economic thought are used to structure thoughts and to shape the conditions for decisions necessary in the application of the law.

With respect to economic thinking, in the U.S. the Chicago School is a popular approach (however rarely applied in court) whereas in the EU the European School

<sup>27</sup> What actually matters from the citizens' perspective is not the amount of gains they obtain. What matters is how they value these benefits compared to alternative bundles.

<sup>28</sup> The US Chicago School, on the other hand, ignores the transfer of wealth within antitrust law since in their opinion there are other arms of public policy that are better suited. See Ahdar, 2002, p. 345.

has an increasingly significant profile. These two schools of thought apply economic concepts and value people's share in their respective societies. A comparison of these two schools of thought is used in the following to demonstrate the economic effects of a fair and equal distribution of wealth gains between market actors in accordance with EU competition law provisions.

**26.** The market concept applied in both schools of thought is similar: Competition among firms to obtain the backing of consumers spurs firms to produce those goods and services that are most highly valued by consumers at the lowest possible cost. Firms drive prices down towards the marginal cost of production thereby resulting in output up to the point at which additional value to consumers no longer exceeds the additional cost to society.<sup>29</sup>

**27.** The main distinction between the two systems is that within Europe the re-distribution of wealth gains within society is pre-determined by the legal order to assure that the benefits of the market are social equitably and fairly shared. This is a normative approach which lacks an equivalent in the Chicago School. In Chicago School thinking, social aspects are simply less popular. Consumer welfare in the Chicago style is enhanced by the creation of efficiencies as such, no matter which market participant receives the actual wealth created. The result of this approach is that producers mostly get a larger share of the wealth created.

**28.** The important point here is that between the two schools of thought some values are similar and some are dissimilar. They are similar in that market economies are the preferred system but dissimilar as the interest in social equality diverges in these two schools of thought. Such divergences on the normative level are logical considering the differences in historical development, political orientation and ideology of the people within these two societies.<sup>30</sup>

**29.** Chicago scholars begin with the premise that the sole goal of antitrust is the achievement of economic efficiency.<sup>31</sup> Then, they apply price theory as the vehicle for determining efficiency effects. Entry is generally thought to be easy and monopoly is therefore most likely self-correcting. Hence, Chicagoans have a strong belief in the functioning of markets, not competition, advocating a laissez-faire approach in antitrust law. The Chicago School is also confident that markets will manage and correct themselves without government interventions.<sup>32</sup> On the other hand, the European belief is that compe-

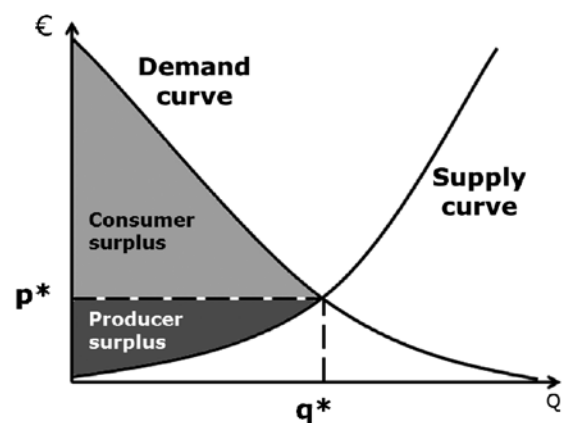
tion is the powerful engine for innovation, economic growth and strength thereby creating wealth for the society. The competitive process as such needs to be safeguarded by government and protected by competition law. The European School of thought adds emphasis on the social fairness and equality objectives in the law. In the following, we explain the differences of these two concepts by using basic economic insights.

## 2.2 The “consumer welfare” story

**30.** In practice, applied welfare economics uses the notion of consumer surplus to measure consumer welfare. When measured over all consumers, consumer surplus is a measure of aggregate consumer welfare. The following simple graph in the Marshallian<sup>33</sup> tradition (1898) illustrates that total surplus comprises consumer surplus and producer surplus.<sup>34</sup>

**31.** By focusing on costs Marshall noted that, in the short run, supply cannot be changed and market value depends mainly on demand. The excess of a price a consumer would be willing to pay rather than go without the product, over what he actually does pay, is defined as consumer surplus. Producer surplus is the difference between the amount a seller is paid for a good and the seller's cost of providing it (profit). Total surplus or aggregate welfare in the graph below is the joint area of consumer surplus and producer surplus.

**Figure 1: Marshallian Total surplus Model**



<sup>29</sup> Heyer, 2006, p. 5.

<sup>30</sup> The call for convergence at this level does not make any sense at all. It is perfectly agreeable that societies and schools of thought apply different ideologies that then lead to different (enforcement) results.

<sup>31</sup> This thinking may even lead to the “Efficiency Paradox” which in the name of efficiency protects inefficient conduct by dominant firms thereby protecting inefficiency. Fox, 2009, p. 88.

<sup>32</sup> Bork, *The Antitrust Paradox: A Policy at War with Itself*, 1978; Posner, *The Chicago School of Antitrust Analysis*, 1979.

<sup>33</sup> Marshall used price theory for describing the relationship of demand and supply.

<sup>34</sup> In the Marshallian tradition, price equals marginal costs. Short term production can be expanded by existing facilities. These fixed costs have little influence on the price. Marshall preferred partial equilibrium models over general equilibrium models since the dynamic element in economics made the former more practically useful.

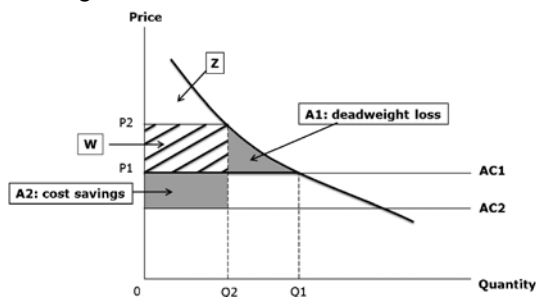
**32.** The Chicago School follows the paradigm that in a particular market the sum of producer and consumer surplus should be maximised (total surplus standard).<sup>35</sup> Thus, the logic in Chicago School thinking is that markets should maximise total surplus. Nothing is said about the distribution of total surplus between producers and consumers. On the other hand, the European School is concerned about the distribution of total surplus. Such a distribution should be fair and equitable.

**33.** Moreover, the graph illustrates that the focus of this type of analysis is on the relationship between price and quantity. The reason for this is that basic economics should be simple to explain interactions. Other non-price and non-quantity related aspects are not considered in this model thereby neglecting, for example, quality aspects or service level preferences that also might improve consumer utilities. These aspects are explicitly valued in the European School thereby going far beyond the traditional models. However, we use this basic total surplus model in the following to illustrate the differences in the two schools of thought.

### 2.3 Williamson's trade-off model\*

**34.** In 1968, Oliver Williamson discussed the need to weigh the benefits of improved efficiency against the costs of allocative inefficiency (“deadweight loss”). His trade-off model shows that in Chicago School thinking society is in most cases better off despite monopoly enhancement because of a merger. As illustrated in the graph below, following a merger, market power increases: output is reduced from Q1 to Q2 and price increases from P1 to P2. The loss in allocative efficiencies is represented by the triangle A1 (deadweight loss). The merger generates cost savings from AC1 to AC2. However, the industry is now less competitive. Since the firm is no longer a price taker, the price P2 it charges is above the (now lower) unit cost AC2.<sup>36</sup> The striped rectangle, W, represents a loss of consumer surplus (gain in monopoly profits) that the merger produces. Thus, income or wealth is transferred from consumers to producers. This means that the amount of consumer surplus, the area below the demand curve and above the price P2, Z, is lower post-merger. Previously consumer surplus was Z plus W plus A1 (area above P1).

**Figure 2: Williamson's Trade-off Model**



<sup>35</sup> Total welfare and total surplus are used in the following as synonyms.

\* Williamson, 1968. Deadweight welfare loss is a measure of allocative inefficiency.

<sup>36</sup> For a monopoly, the price will be set where the unit/marginal cost intersects marginal revenue.

**35.** The total welfare standard asks whether additional producer surplus (which might accrue through an increase in productive efficiency<sup>37</sup> created by the merger) is larger than any additional allocative inefficiency (deadweight loss) that results from an increase in market power. Williamson concluded that cost savings need not be very high to compensate for deadweight losses induced by price increases. The net allocative effect of the merger is assessed by comparing the triangle A1 (deadweight loss) with the rectangle A2 (cost savings) confirming that a merger quite often yields a net-efficiency gain. By applying a total welfare standard, income (or wealth gain) is transferred from consumers to producers. The European School denies such a single-sided transfer. Wealth gains should be distributed fairly and equitable between market actors.

**36.** When a consumer welfare standard is used the merger assessment needs to focus on the consumer surplus only. The consumer-surplus standard allows, in contrast to the total welfare standard, no disadvantages to the consumer. According to this approach, a merger that leads to increased consolidation, higher prices and negative effects for competition can only be approved if the consumer benefit increases post-merger. The achievable efficiency gains of a merger must be at least partly passed on to the consumer. In the traditional models, this “consumer pass on” of efficiency gains is mainly measured in prices. Accordingly, a merger that entails projected price increases would not be approved, independent of whatever advantages it may have for the total welfare.<sup>38</sup>

**37.** This means that depending on the welfare standard applied, the results in the economic analysis will differ. An antitrust standard which puts consumer interests at the forefront could never approve a merger without an increase in consumer surplus. Where price decreasing effects through efficiencies are smaller than price increasing effects through additional market power of producers, but gains in productive efficiencies are larger than the additional allocative inefficiencies (deadweight loss), a consumer welfare standard leads to a negative assessment whereas total welfare would be increased.<sup>39</sup>

<sup>37</sup> Productive efficiency (or technical efficiency) describes the level of utilisation of resources in the economy and is maximised at various combinations on the production possibility frontier (PPF) of the economy. It is a situation in which the economy could not produce any more of one good without sacrificing production of another good. Put simply, optimal productive efficiency exists where the economy utilises resources in the least expensive way possible. See OECD, 1993.

<sup>38</sup> See also Ahdar, 2002.

<sup>39</sup> Allocative efficiency: Every good or service is produced up to the point where the last unit provides a marginal benefit to consumers equal to the marginal cost of producing it. In the usual interpretation at the point of allocative efficiency, price is equal to marginal cost. In principle, at this point production equals consumer preferences by focusing on the consumer's willingness to pay. At this point surplus is maximised with no deadweight loss. Allocative efficiency can be referred to Pareto efficiency that occurs when resources are so allocated that it is not possible to make anyone better off without making someone else worse off. When referring to a situation as Pareto efficient, it is usually assumed that products are being produced in the most efficient (least cost) way. In antitrust economics, allocative or economic efficiency arises when inputs are utilised in a manner such that a given scale of output is produced at the lowest possible cost. An increase in efficiency occurs when an existing or higher scale of output is produced at lower cost. See OECD, 1993.



**38.** To conclude, the Chicago position is that consumer welfare is just another name for allocative efficiency or total welfare. This means that the Chicago School applies a total welfare standard and not a consumer welfare or consumer surplus standard (as wrongly articulated by some Chicagoan contributors). On the other hand, Europe prefers a consumer surplus standard by requiring that affected consumers receive their fair share of the created wealth gains. Moreover, the European position is not only price-cost-focused, as the traditional models suggest, but applies a holistic approach by appraising non-price related consumer effects as well.

**39.** Deciding which welfare standard shall be applied cannot be reached through welfare theory itself, but must be decided normatively. Practically, this means that the decision over which approach to apply is a political one.

**40.** In EU competition law both goals—efficiencies as a synonym for economic progress and a fair and equitable distribution of wealth gains between producers and consumers—are equally important. EU competition law has a built-in preference for how prosperity should be distributed too. The European position is that welfare gains because of a merger should not be attributed mainly to one group (such as the producer in Williamson’s trade-off model) but distributed fairly and equitably between both groups, consumers and producers alike. Whereas the Chicago School believes that in the long run consumers will benefit anyway, the European School prefers a fair distribution at the time the worsening of the competition process takes place.

**41.** Returning to the Williamson graph above consumer surplus before the merger is the entire area above AC1 (the triangle A1, the rectangle W, and Z the white area above W). Following the merger, consumer welfare/consumer surplus is reduced to Z alone. A1 is gone, a deadweight social loss, and W belongs to the producer. In the Chicago view, the redistribution of income in Williamson’s trade-off model is “neutral.” This is a strange definition considering the fact that producers get richer at the expense of consumers. In the U.S., there is already empirical evidence supporting this observation and indicating that monopoly power, past and present, has contributed significantly to the above average wealth of the already wealthiest families.<sup>40</sup>

<sup>40</sup> See also Ahdar, 2002, p. 346.

## 2.4 The “Chicago trap”

**42.** Probably the confusion over whether the “consumer welfare standard” relates to consumer surplus or total welfare was never intended by the Chicago School. The confusion was introduced to U.S. antitrust law by Bork, one of the founders of the Chicago School.<sup>41</sup> He mixed up in his work the term “consumer welfare” with “total welfare.”<sup>42</sup> To reach a maximum of confusion, Bork also called consumer welfare “the wealth of the nation,”<sup>43</sup> a term economists refer to as “social welfare.”

**43.** In Bork’s view, consumer welfare is the greatest when society’s economic resources are allocated so that consumers are able to satisfy their wants as fully as technological restraints permit. In his view, allocative efficiency and productive efficiency together make up the overall efficiency that determines the level of society’s wealth.<sup>44</sup> Bork further explained that consumer welfare is net social welfare, the sum of producer surplus and consumer surplus. “*Those who continue to buy after a monopoly is formed pay more for the same output, and that shifts income from them to the monopoly and its owners, who are also consumers.*”<sup>45</sup> Thus, Bork qualified both monopolists and normal people as consumers. In Bork’s view, consumer welfare is in fact total welfare.

**44.** Bork’s main contribution to the Chicago trap<sup>46</sup> is the call for maximising consumer welfare as a dominant goal of antitrust.<sup>47</sup> “*The whole task of antitrust can be summed up as an effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare.*”<sup>48</sup>

However, Bork maintained that antitrust law has nothing to say about the ways prosperity is distributed or used. In the Chicago view, there is no need to consider a distributional effect of income (or wealth transfer) since it does not affect total welfare as the sum of consumer and producer surplus.<sup>49</sup>

**45.** In this sense, according to Chicago School thinking, U.S. antitrust legislation is not a tool for deciding who should be rich or poor. Chicagoans simply ignore the transfer of wealth between the different market actors. In the Chicago view, antitrust policy is more rigorously

<sup>41</sup> In 1966, Bork analysed the legislative intent of the Sherman Act. He argued that economic efficiency should be the guiding principle which means total welfare but he called this “consumer welfare.” Bork, *Legislative Intent and the Policy of the Sherman Act*, 1966.

<sup>42</sup> Bork, *The Antitrust Paradox: A Policy at War with Itself*, 1978, p. 90.

<sup>43</sup> “Consumer welfare, in this sense, is merely another term for the wealth of the nation.” Ibid. p. 90.

<sup>44</sup> “These two types of efficiencies make up the overall efficiency that determines the level of our society’s wealth, or consumer welfare.”, Ibid. p. 91.

<sup>45</sup> Ibid. p. 110.

<sup>46</sup> Cseres, 2005, p. 332.

<sup>47</sup> Bork, *The Antitrust Paradox: A Policy at War with Itself*, 1978, p. 50.

<sup>48</sup> Ibid. p. 91.

<sup>49</sup> Kerber, 2007, p. 6.

economic and less concerned with protecting non-economic values that are difficult or even impossible to identify and weigh.<sup>50</sup>

Thus, in the Chicago School no distributional issues of income are included. Chicago scholars also argue that other public policies are better suited to deal with equity goals: “*Antitrust thus has a built-in preference for material prosperity, but it has nothing to say about the way prosperity is distributed or used.*”<sup>51</sup> The Chicago school considers efficiency gains as politically neutral but regards wealth transfers as politicised: “*Wealth should go where it is the most appreciated.*”<sup>52,53</sup>

**46.** In sharp contrast to this view, which is often applied even by European economists trained in Chicago School thinking, the European School of thought implements the logic of the 2009 Lisbon Treaty by putting the social market economy concept with its built-in fair redistribution of wealth gains between market actors at its forefront.

**47.** To conclude, a competition policy in the view of the European School focuses on the legitimisation of economic freedom based on social fairness and equality thereby preventing that freedom from being destroyed by its own preconditions. The European framework assures the free and fair play of the actors but also guarantees at the same time equal conditions for each actor and player. The equality principle employs the social aspect of competition: fair play and fair distribution of the wealth gains. Moreover, the application of the equality objective in EU competition law implements neatly the social market economy concept as defined in the Lisbon Treaty 2009. ■

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50 Hovenkamp, 2010, p. 1.

51 Bork, *The Antitrust Paradox: A Policy at War with Itself*, 1978, p. 90.

52 Posner, *The Economics of Justice*, 1981, p. 92.

53 It has to be noted that a total welfare standard is not compatible with the Pareto-criterion because it allows for redistribution between consumers and producers and therefore a balancing between the positive and negative wealth effects between different persons. This means that the concept of a total welfare standard is indeed not useful to address distributional issues. Kerber, 2007, p. 7.

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