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## Walter Eucken and Ordoliberalism: An Introduction from a Consumer Welfare Perspective

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This article serves two purposes, (i) to introduce “The Comparative Order and its Implementation,” a seminal article published in 1949 by Walter Eucken, ordoliberalism’s, or the “Freiburg School’s,” most prominent scholar, and (ii) to compare some ordoliberalist competition policy recommendations to those of a consumer welfare standard. The article provides an overview of the key concepts of ordoliberalism (such as “competitive order,” “economic constitution” and “Ordnungspolitik”) and outlines its implications for competition policy. It provides examples for the ordoliberal legacy in German and European competition policy, such as, inter alia, the market share thresholds for dominance, and the control of exploitative abuses such as excessive pricing. Finally, the article gives a critique of ordoliberalism from a consumer welfare perspective, and looks, among other things, at the implications of ordoliberalist policies for innovation and dynamic competition, the roots of the structure-conduct-performance paradigm, and the classification of certain forms of unilateral behavior (e.g., tying).

The authors are competition lawyers with Linklaters. The authors would like to thank Bill Allan, David Bailey, Liza Lordahl Gormsen, and Alison Oldale for their valuable comments. Any remaining blunders are, of course, the responsibility of the authors.

## I. Introduction

Many of the foundations for German and EC competition policy were laid at an unlikely time, in an unlikely place: in 1933, following Hitler's ascent to power, two lawyers, Franz Böhm and Hans Grossmann-Doerth and one economist, Walter Eucken, met in the sleepy German university town of Freiburg, close to the French and Swiss border.

They discovered that they shared similar views about the failings of the Weimar Republic and equally rejected Nazi totalitarianism and socialism. Their interdisciplinary research of law and economics shaped the Freiburg School ideas which in turn provided the core of ordoliberalism.<sup>1</sup>

Ordoliberalism saw itself as a “third way” between the centrally planned economy of socialism and the unregulated market advocated by laissez-faire liberalism. For ordoliberalism, competition in the market economy would ensure a prosperous and humane society but only where law (and the enforcement of law through a strong state) would create and preserve the conditions under which competition would function properly.

After World War II, ordoliberalism had a significant impact on German economic policy, with many ordoliberals in key positions, most prominently Ludwig Erhard, the Minister of Economics for the first fourteen years of the Federal Republic. Ordoliberalism also gained prominence at European level where its philosophy of open markets fit well with the idea of European integration.<sup>2</sup>

It has been pointed out that “despite its enormous importance, ordoliberal thought—and German neo-liberal thought has received little attention in the English-speaking world.”<sup>3</sup> The recent discussion about the modernization of European competition policy, and in particular Article 82 EC Treaty, where ordoliberal ideas clash with the views held by proponents of the consumer welfare approach, has fueled an interest in ordoliberalism.<sup>4</sup>

1 Key protagonists of ordoliberalism, in addition to Walter Eucken, Franz Böhm, and Hans Grossmann-Doerth, are Leonhard Miksch, Wilhelm Röpke, and Alexander Rüstow.

2 Walter Hallstein, the first president of the European Commission and Hans von der Groeben, one of the authors of the Spaak report and the first Competition Commissioner, were closely associated with ordoliberalism.

3 DAVID GERBER, LAW AND COMPETITION IN THE TWENTIETH CENTURY EUROPE: PROTECTING EUROPE 232 (1998). Things have improved since David Gerber made this statement in 1998. In addition to the clear overview of ordoliberalism in Chapter VII of his book on *Law and Competition in the Twentieth Century Europe*, further work on Ordoliberalism has been published in English, including VICTOR VANBERG, THE FREIBURG SCHOOL: WALTER EUCKEN AND ORDLIBERALISM (Walter-Eucken-Institut, Freiburg Discussion Papers on Constitutional Economics 04/11), NIELS GOLDSCHMIDT & ARNOLD BERNDT, LEONHARD MIKSCH (1901-1950) – A FORGOTTEN MEMBER OF THE FREIBURG SCHOOL (Walter-Eucken-Institut, Freiburg Discussion Papers on Constitutional Economics 03/2).

4 See, for example, Liza Lovdahl Gormsen, *Article 82 EC: Where are we coming from and where are we going to?*, COMPETITION L. REV. (2006).

It is, therefore, an opportune moment to republish, as part of the *Competition Policy International* series of antitrust classics, Walter Eucken's seminal article "The Comparative Order and its Implementation" which first appeared in *ORDO* in 1949.<sup>5</sup> The article has been chosen because it gives a broad overview of ordoliberalist foundations as well as policy recommendations for a number of policy areas such as competition policy and monetary policy, and thus, presents ordoliberalism the way it should be perceived in our view—a school of thought penetrating many areas of policy and not limited to competition. On the other hand, it also touches on a number of individual competition policy problems, which today are as topical as they were at the time Eucken published his article, such as the role of an independent competition authority at the core of competition policy's institutional framework and the (apparent) conflict between competition law and intellectual property rights.

This introduction to Walter Eucken and his work provides an overview of the key concepts of ordoliberalism (such as competitive order, economic constitution, and *Ordnungspolitik*) and outlines its implications for competition policy (Section II). It provides examples for the ordoliberal legacy in German and European competition policy (Section III) and gives a critique of ordoliberalism from a consumer welfare perspective (Section IV).

## II. Ordoliberalism and Competition Policy

### A. COMPETITIVE ORDER, ECONOMIC CONSTITUTION AND "ORDNUNGSPOLITIK": THE TRIAD OF ORDOLIBERALISM

#### 1. The Competitive Order

Eucken contrasts two extreme types of "economic orders" (*Ordnungen*):

- 1 On the one hand, the market economy or "transaction economy" (*Verkehrswirtschaft*) where private and autonomous decision making determines economic activity according to incentives created by the competition process;
- 2 On the other hand, the "centrally administered economy" (*Zentralverwaltungswirtschaft*) where economic activity is the result of a bureaucratic process.

For Eucken, the transaction economy, and more precisely the competitive order underlying the transaction economy, is the key to a prosperous and humane

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5 The article was originally published as Walter Eucken, *Die Wettbewerbsordnung und ihre Verwirklichung (The Competitive Order and its Implementation)*, 2 *ORDO, JAHRBUCH FÜR DIE ORDNUNG VON WIRTSCHAFT UND GESELLSCHAFT* 1-99 (1949), abridged version translated and reprinted in this issue as 2(2) *COMPETITION POL'Y INT'L* 219 (2006) (complete translation available at <http://cpi.esapience.org>). Hereinafter, where the Eucken article is cited, the first set of page citations refer to pages in Eucken's original article and the second set in parenthesis refer to pages in the reprint.

society. Competition and only competition would achieve sustained economic development.

However, not every form of competition can be expected to produce this beneficial outcome but only the form of “complete competition,” i.e., competition in a market where no firm has the power to coerce conduct of other firms. According to Eucken, “[i]f there is competition on the supply side, as well as on the demand side and if the economic planning of both sides is based on such competition, then the market form of complete competition is achieved.”<sup>6</sup> Eucken suggests two indicators to identify the market form of complete competition: first where “[t]he price is not forced upon the market by way of a market strategy, but is taken from the market,” in other words, where all market participants are price takers; second, “certain measures . . . clearly indicate that complete competition does not exist because these measures cannot be implemented under complete competition: for example, obstructions to purchasers or suppliers that have dealings with competitors, or loyalty rebates or predatory pricing or dumping or destruction of stocks,” in other words, complete competition is the market form of competition which ensures “performance competition” (Leistungswettbewerb).

Despite the fact that Eucken does not link complete competition to a particular market structure and despite Eucken’s criticism of neoclassical economics of perfect competition, the concept of complete competition does have an underlying structural assumption of a polyopol and can best be understood as the real world adaptation of the model of perfect competition, i.e., a concept which is inspired by the model of perfect competition but which does not necessarily rely on its unrealistic assumptions.<sup>7</sup>

At the same time, competition has not only an economic but also a very important political dimension to Eucken and other ordoliberalists: “Competition is by no means only an incentive mechanism but, first of all an instrument for the deprivation of power (Entmachtungsinstrument) . . . the most magnificent and most ingenious instrument of deprivation of power in history.”

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6 Eucken, *supra* n. 5, at 26 (at 230).

7 According to Moschel:

the scholars of ordoliberalism have also used economic models for the description of their ideas, for instance, the model of perfect competition as it was developed in the traditional theory of competition. Such models, however, served only for the description of general effects of a market system, illustrating them in what might be called a chemically pure form. That did not imply, however, that those partly unreal premises were to be integrated as goals into practical competition policy. Any attempts to disprove or ridicule the ordoliberal concepts of competition as unrealistic miss this point.

Wernhard Moschel, *Competition Policy from an Ordo Point of View*, in H WILLGERODT & A PEACOCK, GERMAN NEO-LIBERALS AND THE SOCIAL MARKET ECONOMY ch. 7 (1989), at 146.

For this reason, the economic characteristics of complete competition also have a political equivalent: “In the same way as a law-based state, so the competitive order should also create a framework in which the individual’s freedom to act is limited by the freedom of others, thereby ensuring a balance between every unit of human freedom.”<sup>8</sup>

## 2. The Economic Constitution

The analysis of the competitive order has led Eucken to a number of insights:

- First, the two fundamental orders, the transaction economy and the centrally administered economy, are incompatible. Bringing together elements from these two orders in an actual economic system inevitably harms the functioning of that economic system.
- Second, there is an inherent self-destructive aspect to the competitive process of the transaction economy and to economic freedom:

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“The supplier and the customer always—wherever possible—seek to avoid competition and to acquire or assert monopolistic positions. There is an omnipresent, strong and irrepressible urge to eliminate competition and to acquire a monopolistic position. Everyone espies possibilities of becoming a monopolist. Why should three bakers in a 13th century town compete with one another? They could simply come to an agreement and create a monopoly. This was the situation earlier and the same applies today.”<sup>9</sup>

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The conclusion which Eucken and other ordoliberals drew from these insights was that the competitive order needed to be protected through a political and legal framework which would safeguard the efficient functioning of the competitive order and which would protect from any self-destructive tendencies. Here, Eucken foresaw a clear separation of roles for the state and the private sector:

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“The policy of competitive order does not leave the choice of market forms and monetary systems to the economy itself because the experience of the era of laissez-faire policy speaks for itself. The development of the framework in which businesses and households can plan and act freely is governed by

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8 Eucken, *supra* n. 5, at 27 (at 231).

9 *Id.* at 5 (at 222).

the economic policy under which the framework is supervised. Businesses are free to choose what they produce, what technology they use, what raw materials they purchase and what markets they wish to sell on. . . . Freedom of the consumer exists, but not the freedom to choose how to define the rules of the game or the forms which the economic process takes. This particularly falls within the field of *Ordnungspolitik* (order-based policy).<sup>10</sup>

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### 3. Ordnungspolitik

The concept of “Ordnungspolitik” has been described as “the untranslatable soul of ordoliberalism.”<sup>11</sup> Eucken describes the Ordnungspolitik as follows:

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“[T]he crucial issue of modern economic policy should be treated as a crucial issue. This is to be achieved by making the establishment of a functioning price system of complete competition the essential criterion of every economic measure. This is the basic principle of the economic constitution.”<sup>12</sup>

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Eucken emphasizes that:

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“[this] does not only demand the avoidance of certain acts of economic policy: such as state subsidies, the creation of mandatory state monopolies . . . Rather, a positive economic constitutional policy is required and its aim must be to further the development of the market form of complete competition and thus comply with the basic principle.”<sup>13</sup>

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This general principle of the Ordnungspolitik means that “the body of doctrine of classical economic philosophy had to be translated from the language

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10 *Id.* at 23 (at 227).

11 GERBER, *supra* n. 3, at 246.

12 Eucken, *supra* n. 5, at 33 (at 232).

13 *Id.* at 33 et seq (at 232).

of economics into the language of legal science.”<sup>14</sup> Complete competition is, therefore, the guiding and, at the same time, the limiting principle for government policy.

## B. COMPETITION POLICY IMPLICATIONS

### 1. Competition Policy at a Macro Level

For Eucken, “every measure of economic policy” was ultimately competition policy, in the sense that it was intended to safeguard and enhance complete competition. At this macro level of competition policy, Eucken distinguishes between “constitutive principles” (konstituierende Prinzipien) and “regulative principles” (regulierende Prinzipien). Constitutive principles ensure the establishment of the competitive order, regulative principles its continuous functioning.

For Eucken, the constitutive principles were:

- (i) the primacy of monetary policy (“all attempts to implement a competitive order will fail, as long as monetary stability is not guaranteed”);
- (ii) the protection of open markets against state measures (for example, import bans) against private measures (among which Eucken included exclusivity arrangements) and against any combination of state and private measures (Eucken regarded in particular patents as a dangerous threat to open markets);<sup>15</sup>
- (iii) consistency of economic policy over time;
- (iv) private ownership;

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14 FRANZ BÖHM, WETTBEWERB UND MONOPOLKAMPF IX (1933).

15 See, e.g.:

Patent law also belongs to the multitude of more recent legal institutions which did not have the effects desired by the legislator. Patent law was intended to promote technical development as well as to protect and reward the inventor. . . . Contrary to expectations, despite certain statutory precautionary measures, patent law has triggered a strong trend towards the establishment of monopolies and concentrations in the industry. This is due to the fact that patents create an exclusive right to manufacture an object, to bring it onto the market, use it and sell it. Although many of the patents do not close supply, these are patents which only cover a minor part of the production process of a commodity and which can be circumvented by using other production methods, substitute products and the like. However, a different type of patent group exists, namely master patents, which close the supply of goods, such as *inter alia* the well-known Telefunken patents for the production of radio tubes, or the benzopurpurin patent of 1884, which became an important feature for the organization of the chemical industry.

Eucken, *supra* n. 5, at 40 (at 236).



- (v) freedom of contract; and
- (vi) the need for clear and unambiguous allocation of liability.

## 2. Competition Policy at a Micro Level

Competition policy at a micro level, in the sense of antitrust, was regarded by Eucken as one of the key regulatory principles.

### *General aspects*

According to Eucken, antitrust policy, and in particular the control of monopolies would ultimately fail, not least for political reasons, if large parts of the industrial sector were monopolized. By contrast, the situation would be different under the competitive order:

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“The creation of monopolistic power entities is prevented. Not only by prohibitions of cartels, but also—and far more importantly—by an economic and legal policy which breaks through the strong forces of competition, as exist in a modern economy, by applying the constitutive principles.”<sup>16</sup>

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As a result, according to Eucken, the pre-dominant market form in the competitive order is the market form of complete competition: monopolies and oligopolies are exceptions.

### *Regulation of monopolies*

Eucken foresaw an independent competition authority (Monopoly Office) in charge of monopolies whose task it was to break up “avoidable monopolies” and to regulate “unavoidable monopolies.” The basic principle for this regulation was the principle of “behavior analogous to competition” (wettbewerbsanaloges Verhalten) reflected in the “as if” approach: “The aim of monopoly legislation and monopoly supervision is to ensure that the bearers of economic power behave as if complete competition prevailed. The behavior of the monopolists should be ‘analogous to competition.’”<sup>17</sup>

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<sup>16</sup> *Id.* at 65 (at 239).

<sup>17</sup> *Id.* at 68 (at 241).

According to Eucken, in practice, this would mean the following:

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“Every form of impediment competition by embargos, loyalty rebates, predatory pricing, etc. is prohibited. . . . This creates a condition which would automatically arise in a complete competition situation, where impediment competition would be pointless. Admittedly, in order to achieve a result analogous to competition, it is necessary to introduce an obligation to contract, as here coercion is necessary to achieve the same result as would automatically arise under complete competition.

As is generally known, under complete competition the same prices will become established for the same goods and services. Supply monopolies for example, whilst striving for the highest profit, have a tendency to demand differentiated prices for the same goods or services from individual segments of demand. This price differentiation should be prohibited in the competitive order.

What is most difficult is to implement the fundamental principle within the scope of determining price levels. The price is to be fixed in such a way that offer and demand are in equilibrium at this price, and, at the same time, the marginal costs are just covered.”<sup>18</sup>

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### *Antitrust policy towards oligopolies*

Eucken regarded oligopolies as a transient market form: “[t]his oligopoly—or part oligopoly—situation often passes by rapidly, and soon leads to the creation of a cartel, i.e., to a collective monopoly or an individual monopoly, by overpowering the opponent.” However, as sometimes “the unstable condition of the oligopoly or part oligopoly exists for many years or decades.” Ordoliberals still saw the need to address the issue. Eucken records two conflicting views among the ordoliberals:

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“According to the first opinion, as has been put forward particularly impressively by Miksch, a special regulation is necessary for oligopolies and part oligopolies: namely the “tied competition” which takes place under state supervision.

. . .

According to the other view, this is too great a burden for the state. According to this view, an active monopoly supervision is indeed sufficient,

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18 *Id.* at 69 (at 242).

and it also offers something better for such cases. With a decisive monopoly supervision, the oligopolists have no reason to destroy the others by aggressive means or to attain a position of monopoly of their own. This is because it comes up against a rigorous monopoly control. Furthermore, the oligopolists themselves will attempt to behave as if complete competition prevailed, as they will otherwise come to the individual attention of the monopoly office. An example: a cement cartel is dissolved. As a result the seven members become oligopolists. That one company now seeks to overpower the others is unlikely. This is because all measures of impediment competition—predatory pricing, blockades, loyalty rebates etc. are prohibited and punishable. If, however, it becomes a monopolist by using competitive means, it would be subject to the comprehensive, deterring supervision of the monopoly office.”<sup>19</sup>

### III. Ordoliberal Legacy in German and European Competition Policy

Over time, ordoliberalism has inevitably lost influence over EC competition policy as the number of Member States of the European Union has grown from six to twenty-five and there has been a proliferation of national competition regimes.

Nevertheless, due to the huge impact ordoliberalism had on EC competition policy, many of the ordoliberal concepts have been hard-wired into the system, even when at times the link to ordoliberalism has been obscured or forgotten. During the discussion about the modernization of Article 82 EC these ordoliberal concepts, which are difficult to reconcile with a consumer welfare approach, have frequently been the focus of the debate. Examples are:

- the low threshold of dominance;
- the “special responsibility” of dominant firms;
- the formalistic (quasi per se) approach towards many types of unilateral behavior; and
- the prohibition of exploitative abuses.

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<sup>19</sup> *Id.* at 71 (at 245).

## A. MARKET STRUCTURE AND THE THRESHOLD OF DOMINANCE

EC and German competition law regimes rely on market shares as an important element in the assessment of dominance. This is by no means unusual. What distinguishes them from some of the other regimes, however, is the intervention threshold. Under German law, a company “is presumed to be dominant if it has a market share of at least one third.”<sup>20</sup> Under EC competition law, the (rebuttable) presumption of dominance kicks in where market shares are in excess of 50 percent.<sup>21</sup> This contrasts with an assessment under U.S. law where a market share of 70 to 75 percent for at least five years is required to lead to a presumption of monopoly power.<sup>22</sup>

The low threshold and the absence of any reliance on persistency of market shares can be traced directly back to ordoliberalism with its ideal of complete competition, i.e., a market where all participants are price takers, and its concern even about short-term market power. From an ordoliberal perspective, a market share with 10 suppliers of 10 percent each seems to be inherently better (both from an economic and political perspective) than one where one player has 40 percent of the market and 9 players have between 6 and 7 percent. This view seems to be reflected in the *British Airways/Virgin* case, where the Commission held:

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“Despite the exclusionary commission schemes, competitors of BA have been able to gain market share from BA since the liberalisation of the United Kingdom air transport markets. This cannot indicate that these schemes have had no effect. It can only be assumed that competitors would have had more success in the absence of these abusive commission schemes.”<sup>23</sup>

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Assuming that “effect” refers to anticompetitive effect (rather than just any effect), then the Commission seems to suggest in this paragraph that a counterfactual in which “competitors [of a dominant firm] would have had more success” is *per se* a more competitive outcome.

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20 Section 19(3) of the German Act against Restraints on Competition.

21 Case C-62/86, *AKZO v. Commission*, 1991 E.C.R. I-3359, at para. 60.

22 PHILLIP E. AREEDA & HERBERT HOVENKAMP, *FUNDAMENTALS OF ANTITRUST LAW* 801a, 319 (2003).

23 Case IV/D-2/34.780, *Virgin/British Airways*, 2000 O.J. (L 30) 1, at para. 107.

## B. THE “SPECIAL RESPONSIBILITY” OF DOMINANT FIRMS

Under EC competition law, the statement that it is not an offense for a firm to have a dominant position comes invariably with the qualification that by imposing such firms “a special responsibility not to allow its conduct to impair undistorted competition on the common market.”<sup>24</sup>

The scope of this special responsibility is not entirely clear. In a narrow sense, it can be interpreted as saying no more than that Article 82 EC imposes obligations on dominant firms which are not imposed on non-dominant firms. A wider interpretation would suggest that it must refrain from any action which would increase its market power and harm competitors even where the behavior is efficiency-based.

The origin of the special responsibility can be traced back to the ordoliberal “as if” principle according to which firms which are not price takers, i.e., which possess (significant) market power, do not only have a negative obligation (i.e., not to commit certain harmful acts), but also a positive obligation (i.e., to behave as if they did not have any market power).

## C. FORMALISTIC (I.E., PER SE) APPROACH TOWARDS ABUSE

The assessment of abuse under German and EC competition law has equally been shaped by ordoliberalism.

As described above, for Eucken and other ordoliberals, certain types of unilateral behavior, such as price discrimination, loyalty rebates and tying, were inherently abusive, i.e., clear examples of impediment competition with no redeeming features.

The view that certain types of unilateral behavior are per se harmful and therefore do not require any effects analysis has been re-iterated by the Court at regular intervals, most recently in *Michelin II* and *British Airways v. Commission*.<sup>25</sup> The Court took the view that it was sufficient for an abuse that the conduct “tends to restrict competition,” i.e., “is capable of having, or likely to have, such an effect.” According to the Court in *British Airways v. Commission*, “where an undertaking in a dominant position actually puts into operation a practice generating the effect of ousting its competitors, the fact that this hoped-for result is not achieved is not sufficient to prevent a finding of abuse.”

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24 Case 322/81, *Michelin v. Commission*, 1983 E.C.R. 3461, at para. 57.

25 Case T-203/01, *Michelin v. Commission* and Case T-219/99, *British Airways v. Commission*, appeal pending before the European Court of Justice, Case C-95/04.

## D. THE CONTROL OF EXPLOITATIVE ABUSES

The control of exploitative abuses reflects the ordoliberal principle of forcing dominant firms to behave “as if” they were subject to complete competition. Indeed, the wording of Article 82 (“Such an abuse may, in particular, consist in: . . . (e) directly or indirectly impose unfair purchase or selling prices or other unfair trading conditions . . .”) echoes Eucken’s list of prohibited monopoly practices in his chapter on the “monopoly problem in the competitive order,”<sup>26</sup> general terms and conditions which should alter general contract law to the disadvantage of the trading partner of the dominant firm,<sup>27</sup> and prices which are in excess of the equilibrium price, i.e., where prices equal marginal costs.<sup>28</sup>

In an attempt to make Eucken’s “as if” principal operational, methodologies for determining excessive prices have been developed in the early years of German and EC competition policy, for example, in *United Brands* which compared actual costs and prices and the prices of the dominant firm with that of its competitors.

The practical problems of price control which Eucken recognized (but arguably nevertheless underestimated) had the effect that only a small number of exploitative abuses were pursued under German and EC law.<sup>29</sup>

EC and German law contrasts with the U.S. policy under Section 2 of the Sherman Act whereby firms which have lawfully acquired monopoly power are entitled to exploit it, in other words where the concept of exploitative abuses does not exist.

## IV. Ordoliberalism: A Consumer Welfare Perspective

### A. THE CONSUMER WELFARE PERSPECTIVE

Contrary to ordoliberalism, the consumer welfare approach does not represent a coherent school of thought, but merely an agreed view on a number of general principles of antitrust enforcement.

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26 Eucken, *supra* n. 5, at 68 et seq (at 240).

27 *Id.*

28 *Id.* at 69 (at 243).

29 The most prominent cases under EC law are Case 27/76, *United Brands*, 1978 E.C.R. 207, Case 26/75, *General Motors*, 1976 E.C.R. 1367, Case 226/84, *British Leyland*, 1986 E.C.R. 3263, and Case COMP/36.568, *Scandlines Sverige v. Port of Helsingborg*, available at [http://ec.europa.eu/comm/competition/antitrust/cases/decisions/36568/reject\\_en.pdf](http://ec.europa.eu/comm/competition/antitrust/cases/decisions/36568/reject_en.pdf).

There is, in particular, the general agreement that the only goal of competition policy should be consumer welfare,<sup>30</sup> to the exclusion of other goals such as fairness or the limitation of the power of large firms. This, in turn, means that government intervention is only justified in the case of actual consumer harm or, where the analysis is prospective, likely consumer harm, i.e., the consumer welfare approach is effects-based. This is not to say that proponents of a consumer welfare approach are necessarily in favor of an assessment of the direct effect on consumer harm in the form of an unstructured rule of reason; arguably the contrary is the case, namely that the majority of advocates of a consumer welfare approach would accept that the antitrust tool box is not sufficiently precise to allow for a direct assessment of consumer harm and that an indirect screen (such as the “no economic sense” test advocated by Greg Werden)<sup>31</sup> is required. However, the link between the indirect screen and consumer harm has to be established rather than merely assumed.

## B. COMPARING THE INCOMPARABLE?

Is it appropriate to assess ordoliberalism from a consumer welfare perspective? It has been argued that ordoliberalism and the consumer welfare approach pursue fundamentally different policy goals: ordoliberalism has a political as well as an economic dimension with the preservation of economic freedom and complete competition as primary goals while the perspective of the consumer welfare approach is purely economic with the primary goal of consumer welfare maximization.

Clearly one should proceed with caution in comparing ordoliberalism and the consumer welfare approach, and in particular viewing one through the lens of the other. Nevertheless, a comparison seems feasible, despite the underlying differences in policy objectives:

First, while there is both a political and an economic motivation for the preservation of complete competition and economic freedom under ordoliberalism, at least from an ordoliberal perspective, there does not seem to be a conflict between the political and economic goals (in other words the optimal outcome from a political perspective happens to be the optimal outcome from an economic perspective); hence, ignoring the political aspect of ordoliberalism (at least according to ordoliberalism’s own logic) should ultimately not affect the comparison.

Second, while economic freedom is the guiding star for ordoliberalism, there is the underlying assumption that the preservation of economic freedom will indirectly lead to technological progress and allocative efficiency.

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30 As regards the dispute whether consumer surplus or total surplus standard should be pursued, see MASSIMO MOTTA, *COMPETITION POLICY* 19 et seq (2004).

31 Gregory Werden, *Identifying Exclusionary Conduct under Section 2: The “No Economic Sense” Test*, 73 *ANTITRUST L.J.* 413 (2006).

To the extent that ordoliberalism and the consumer welfare approach result in fundamentally different policy decisions, this raises questions about the validity of the two underlying assumptions, namely:

- (i) whether there is actually no conflict between political and economic goals, and
- (ii) whether the preservation of economic freedom does lead to consumer welfare maximization, at least in the long run.

A second possible objection to viewing ordoliberalism through a consumer welfare perspective is one of chronology. Ordoliberalism was developed by Eucken and others in the 1930s and 1940s while the consumer welfare approach reflects today's state of the art antitrust thinking, benefiting from the insights of the Chicago School and advances in game theory. This objection would indeed be valid were it not for the fact that ordoliberalism drives competition policy still today, in relatively undiluted form by the Federal Cartel Office in Germany and, at least partially and indirectly, by the European Commission in Brussels. Therefore, rather than contrasting economic thinking of the 1940s with economic thinking of 2006, we are contrasting two forms of intellectual underpinnings of current competition policy.

### C. COMPETITION POLICY AT THE MACRO LEVEL

It is difficult to appreciate fully the towering intellectual achievements of ordoliberalism when many of their key findings are nowadays so universally accepted that they sound commonplace. The view that "transaction markets" are far superior to centrally administered markets, both from an economic and political perspective and that the price mechanism in competitive markets should determine how scarce resources are allocated has become self-evident in a world with few supporters for socialism outside North Korea and Cuba. This was not the case at the end of World War II when "[t]hroughout Europe, liberalism had been so thoroughly discredited that few wished to be associated with it [and] socialist solutions had captured the public imagination and/or the fancy of intellectuals."<sup>32</sup>

The same is true for the idea that competition may need protection through the legal framework, both in terms of antitrust policy and through a coherent set of economic policies more generally. At the end of World War II, only the United States had an antitrust policy. The number of countries with competition policy enforcement now exceeds eighty and it is a fairly recent development that certain areas of the legal framework, such as intellectual property rights, are closely assessed according to their impact on the competitive process.

The ordoliberal proposal of an "independent competition authority subject only to the law, in order to make it immune against the dangerous influences of

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32 GERBER, *supra* n. 3, at 257.



third parties” is still gaining acceptance. Not long ago, the Office of Fair Trading in the United Kingdom gained greater political independent and other countries, such as Spain, still follow this path.

Finally, the ordoliberal “*idée fixe*,” namely that the right legal framework is a key element for a stable and functioning market economy which in turn guarantees a stable and functioning democracy, has lost much of the urgency it had in 1945. This does not, however, invalidate the point.

## D. COMPETITION POLICY AT THE MICRO LEVEL

### 1. Overview

The views of ordoliberalism regarding competition policy in the narrow antitrust sense are less universally accepted today. Developments in economic theory over the last forty years have raised doubts about the concept of complete competition, the “as if” principle of intervention, the goal of economic freedom, and the distinction between performance competition and impediment competition.

### 2. Complete Competition and Innovation

For ordoliberalism, the ideal form of competition is competition in a market in which none of the players has any (significant) market power or, as a second-best solution, in which firms with market power are forced to behave as if they did not have any market power, in terms of pricing (“[t]he price is to be fixed in such a way that offer and demand are in equilibrium at this price, and, at the same time, the marginal costs are just covered”)<sup>33</sup> and other parameters.

This approach overlooks the dynamic nature of competition and the role of (temporary) market power as a key driver for innovation. As the U.S. Supreme Court put it in *Trinko*: “[Striving for monopoly is] an important element of the free-market system. The opportunity to charge monopoly prices—at least for a short period—is what . . . induces risk taking that produces innovation and economic growth.”<sup>34</sup>

THE VIEWS OF ORDOLIBERALISM REGARDING COMPETITION POLICY IN THE NARROW ANTITRUST SENSE ARE LESS UNIVERSALLY ACCEPTED TODAY. DEVELOPMENTS IN ECONOMIC THEORY OVER THE LAST FORTY YEARS HAVE RAISED DOUBTS ABOUT THE CONCEPT OF COMPLETE COMPETITION, THE “AS IF” PRINCIPLE OF INTERVENTION, THE GOAL OF ECONOMIC FREEDOM, AND THE DISTINCTION BETWEEN PERFORMANCE COMPETITION AND IMPEDIMENT COMPETITION.

33 Eucken, *supra* n. 5, at 69 (at 243).

34 *Verizon Communications Inc v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407, 414 (2004).

This tension between static competition on the one hand and the exploitation of market power as an incentive for dynamic competition was also described by Attorney General Jacobs in *Bronner* where he cautioned against the frequent use of “as if” intervention such as imposing an obligation to deal on a dominant firm:

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“The justification in terms of competition policy for interfering with a dominant undertaking’s freedom to contract often requires a careful balancing of conflicting considerations. . . . For example, if access to a production purchasing or distribution facility was allowed too easily there would be no incentive for a competitor to develop competing facilities. Thus while competition was increased in the short term it would be reduced in the long term.”<sup>35</sup>

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Ordoliberalism does not seem to acknowledge this inherent tension between short-term (static) competition and long-term dynamic competition or, in any event, to decide clearly in favor of maximizing short-term static competition.

In light of the fact that innovation and dynamic competition are the key drivers behind increases in consumer welfare, such a policy choice is at least questionable.

### 3. Economic Freedom, Complete Competition, and Performance Competition

Eucken and other ordoliberals assumed a virtuous circle between deconcentrated markets (i.e., complete competition) and economic freedom on the one hand and performance competition on the other: performance competition would safeguard complete competition and economic freedom and, conversely, complete competition and economic freedom (re-enforced by *Ordnungspolitik*) would, ensure performance competition. Consequently, under the competitive order, complete competition would be the pre-dominant market form, with the odd unavoidable monopoly to regulate.

Reality does not seem to confirm either part of this virtuous circle. There is no indication that performance competition leads to or preserves deconcentrated market structures. Indeed many competitive industries, in particular innovative industries with high investment costs and considerable risks, such as the pharmaceutical or software sectors, tend to gravitate towards oligopolistic market structures, while in other sectors, performance competition may result in a wide range of possible market structures.

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35 A.G. Jacob’s Opinion in Case C-7/97, *Oskar Bronner GmbH & Co KG v. Mediaprint Zeitungs-und Zeitschriftenvertrag GmbH & Co KG and Others*, at para. 57.

The second part of the virtuous circle is known under the name of Structure-Conduct-Performance paradigm (SCP paradigm)<sup>36</sup> advocated by the Harvard School. The SCP paradigm implies that performance (e.g., profit margins, production levels, consumer benefits) in certain industries is dependent on the conduct of buyers and sellers (e.g., advertising, R&D, investment), which in turn is dependent on the structure of the market (e.g., number of sellers, concentration ratio, barriers to entry). The paradigm was largely based on empirical work which suggested that profitability of an industry increases with increasing levels of concentration and higher barriers to entry.<sup>37</sup> During the heydays of the Harvard School in the 1950s and 1960s, U.S. antitrust policy had some resemblance with ordoliberalism, in particular the focus on keeping markets de-concentrated and a hostility towards large firms.

Since then, the view of a simple causal relationship between market structure, behavior, and performance has been rejected (both in relation to static and dynamic competition) in favor of a more complex interaction between structure and behavior; in particular, it has been recognized that behavior (e.g., raising barriers to entry) may affect market structure and that the size of firms in an industry may reflect superior efficiency.

This has important implications: to the extent the virtuous circle between complete competition and economic freedom on the one hand and performance competition on the other hand does not hold, conflicts between political and economic goals of competition policy may well occur. In other words, deconcentrated markets with a relatively large number of players which are likely to be optimal from a political perspective may not lead to an optimal economic outcome and vice versa.

To the extent performance competition could lead away from complete competition and economic freedom, a policy which protects economic freedom risks treating efficiency as an offense. Economic freedom will therefore not necessarily provide a good proxy for consumer welfare; in other words, a competition policy which protects economic freedom may in certain circumstances lead to consumer harm.

#### 4. Performance Competition and Impediment Competition

Eucken and other ordoliberalism draw a clear line between performance competition and impediment competition: performance competition takes place in markets with complete competition; by contrast, impediment competition, according to Eucken, is a clear indication that the market is not characterized by

36 See E. S. Mason, *Price and Production Policies of Large Scale Enterprises*, 29 AMER. ECON. REV. 61 (1939).

37 J. Bain, *Relation of Profit Rate to Industry Concentration: American Manufacturing 1936-1940*, 65 Q.J. ECON. 293 (1951).

complete competition. Eucken lists price discrimination, tying, loyalty rebates, and exclusive agreements as examples of impediment competition.

In the last forty years, economic theory has made significant progress and many of the practices which were previously held to be primarily or exclusively anticompetitive, have turned out to have many pro-competitive explanations. Indeed, closer inspection has shown that most of the practices previously considered exclusively or predominantly anticompetitive occur in deconcentrated markets in which none of the market participants has any market power (i.e., real-world examples of complete competition).

### *Price discrimination*

Eucken's claim that price discrimination is a clear indicator of market power and a sign of a defective competitive process has not been confirmed by economic research.<sup>38</sup> While it is a truism that price discrimination requires some control over prices (i.e., a downward sloping demand curve), it is observed in many competitive markets which come close to the ordoliberal ideal of complete competition, such restaurants. Rather than being an unequivocal sign of abusive behavior, price discrimination may frequently be evidence of a welfare-enhancing allocation of common costs (i.e., some form of Ramsey pricing).

### *Tying*

Tying is equally a practice frequently observed in competitive markets.<sup>39</sup> Drugs companies tie cough and cold remedies, suppliers of electrical appliances bundle different foreign electrical adapters, and car manufacturers sell cars with radios (and CD players) as standard equipment. Again there are valid efficiency reasons, in particular product-specific scale economies.

### *Loyalty rebates*

Loyalty discounts are also persuasive in many industry sectors, including sectors in which there are no dominant firms: "Nobody would claim that the coffee shop on the street corner offering a free espresso for every ten Euro of sales is doing so for sinister exclusionary motives."<sup>40</sup>

Indeed, several pro-competitive motives for loyalty rebates have been advanced, ranging from aligning the interests of manufacturers and distributors to risk allocation and solution to hold up problems. This means that the clear

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38 See, e.g., MICHAEL E. LEVINE, PRICE DISCRIMINATION WITHOUT MARKET POWERS (Harvard Law School, Law-Econ Discussion Paper No. 276, 2000).

39 David S. Evans & Michael Salinger, *Why Do Firms Bundle and Tie? Evidence from Competitive Markets and Implications for Tying Law*, 22 YALE J. REG. 37 (2005).

40 David Spector, *Loyalty Rebates: An Assessment of Competition Concerns and a Proposed Structured Rule of Reason*, 1(2) COMPETITION POL'Y INT'L 93 (2005).

dividing line between performance competition and impediment competition, which Eucken and other ordoliberals saw, is not confirmed by modern economic theory. So-called impediment competition, rather than being a clear indicator of a defective competitive process, turns out to be behavior which is frequently efficiency motivated, as evidenced by such practices by firms without market power and where it is not easily apparent whether such behavior would be impediment competition even if carried out by a dominant firm.

If one accepts that types of behavior cannot simply be classified as either pro- or anticompetitive and that such behavior occurs in competitive as well as non-competitive markets, then it becomes clear that the ordoliberal approach does not provide an operational set of criteria which would allow it to distinguish between (permitted) performance competition and (prohibited) impediment competition. Eucken's definition of performance competition as competition which occurs in markets with complete competition (and of impediment competition as competition which does not occur in markets with complete competition) would leave the concept of impediment competition as an empty shell as most types of unilateral behavior which could be harmful if carried out by a dominant firm in certain circumstances would frequently also have efficiency justifications in certain circumstances and, therefore, would be regularly observed in markets without dominant firms. Conversely, a definition which marks as impediment competition any behavior which in the case of a dominant firm could in certain circumstances be harmful would be vastly over-inclusive.

## 5. Direct Intervention and Error Costs

Finally, while Eucken and the ordoliberals generally favor an approach of indirect regulation whereby the state determines the legal and political framework but does not intervene directly in the competitive process, this principle is abandoned in relation to the "as if" principle of intervention, particularly in relation to exploitative abuses.

Even in Eucken's relatively clear-cut world with many markets of complete competition and a few markets with (unavoidable) monopolies as well as simple pricing rules (i.e., price equals marginal costs), Eucken recognizes that price regulation is a difficult exercise.

In a world with many more shades of grey, with market structures which cover the full range from atomistic to monopolistic, where it is not obvious which market structures are "unavoidable" and where there are no clear forcing rules (e.g., because in many markets a price equal to marginal costs would not allow firms to recover their fixed costs) these difficulties multiply.

The question that arises, particularly in relation to exploitative abuses, is in which circumstances government intervention is superior to no intervention at all.

## V. Conclusion

The ordoliberalist school of thought as spearheaded by Walter Eucken was a critical contribution to setting Germany on a successful course (economic miracle) against all political odds after World War II. In many ways, Eucken and his colleagues were visionaries, laying the intellectual foundations for concepts that we today may take for granted, but that are in no way less relevant as they were at the time:

- the economic constitution as a nation's (and national economy's) fundamental choices for the prevalent economic system;
- the need to protect competition, both against certain state measures as well as against enterprises that command economic and eventually also political power to an extent that allows them to abolish competition; and
- political independence of competition enforcers, which were to be subject only to the law, in order to shield them from pressure groups.

In other areas, however, things have moved on and a true to original application of ordoliberalist competition policy recommendations seems not warranted

IN OTHER AREAS, HOWEVER, THINGS HAVE MOVED ON AND A TRUE TO ORIGINAL APPLICATION OF ORDOLIBERALIST COMPETITION POLICY RECOMMENDATIONS SEEMS NOT WARRANTED ANY LONGER.

any longer (e.g., in assuming that certain unilateral conduct such as tying is always anticompetitive or a form of impediment competition, which we today know it is not). This shall not be interpreted as a criticism to Eucken and his counterparts, whose contribution to the economic policy debate must be seen before the correct historical background. It is, however, a criticism to the guardians of ordoliberals of

today which have prevented that ordoliberalism reflects recent (and not so recent) economic developments. ▼