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From the Editor

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From the Editor

CPI's Spring 2010 issue takes a comprehensive look at behavioral economics and its implications, if any, for the practice of competition policy.

Since the late 19th century economists have generally analyzed markets under the view that people and businesses have specific values they care about—utility for consumers and profits for businesses—and operate in systematic ways to maximize those values over time. The short-hand term for the various assumptions that go into this framework is "people and businesses behave rationally." This approach has resulted in a vast and influential body of work that underlies all economic fields, as well as related subjects including finance, marketing, and antitrust.

Over the years, however, many economists have questioned this assumption of rationality. The field that is now known as "behavioral economics" grew rapidly following a 1980 paper by Richard Thaler. He argued that people systematically deviate from rational utility-maximizing behavior and this deviation should be taken into account in predicting actual consumer behavior. Much subsequent work has relied on laboratory experiments—games played with undergraduates for example—both to identify systematic patterns of behavior and to document departures from the rational actor model. Behavioral economics writings have flourished and now form the basis for an increasing number of policy proposals: from "sin taxes" to discourage people from making bad choices they will come to regret to "opt-out" policies that encourage people to make choices that are better for them.

The traditional view that economic actors are rational has influenced the economics of competition policy. The analysis of the effect of business behavior on consumer welfare, for example, assumes that people are worse off when they have to pay higher prices or get less output. Given that premise, it is then assumed that people make the "right" decisions when they purchase goods and services. But what if, as some research in behavioral economics suggests, people make systematic mistakes when making purchase decisions and consume too much of some goods or too little of others. A merger of fast-food restaurants could make consumers better off by increasing prices and discouraging them from engaging in bad behavior. To take another example, the assumption that businesses maximize profits is behind every economic premise from critical loss analysis to price-cost tests for predation. But what if, again as some research suggests, firms do not focus on marginal costs in determining profit-maximizing prices?

Behavioral economics is still controversial and its implications for public policy are just now being fully explored. The articles in this issue make a substantial contribution in assessing where, if anywhere, behavioral economics is relevant to antitrust and the increasingly related field of consumer protection. The first three articles provide perspectives by several academic economists. Mark Armstrong & Steffen Huck lead the discussion with an initial review of what behavioral economics literature tells us about the behavior of firms and their management, and then look at the implications for antitrust. Roman Inderst & Marco Ottaviani focus on behavioral biases by consumers, how businesses can exploit those biases, and how to design consumer protection policies to prevent potentially harmful behavior. Michael Salinger then turns to an overview of behavioral economics and argues that, although it is relevant to consumer protection, it offers few insights for the practice of antitrust.

The next group of articles evolved from presentations made at the 2009 Jevons Colloquium. D.C. Circuit Court of Appeals Judge Douglas Ginsburg & Derek Moore examine what impact behavioral economics has had on court decisions, and whether that impact is likely to grow. Vivien Rose, a chairman of the U.K. Competition Appeals Tribunal, utilizes actual cases to argue that the courts have followed approaches that are closer to behavioral than traditional economics. Then we turn to the perspectives of several officials at competition authorities: Matthew Bennett, John Fingleton, Amelia Fletcher, Liz Hurley, & David Ruck from the Office of Fair Trading, which handles both antitrust and consumer protection issues in the United Kingdom; Alison Oldale from the U.K. Competition Commission; and Eliana Garcés who is in the cabinet of the Commissioner for Competition Policy of the European Commission.

In the Autumn 2009 issue of CPI, Paul Seabright, Harry First, Daniel Crane & Joshua Wright, and Barry Nalebuff discussed a recent Einer Elhauge article claiming that the Chicago single-monopoly profit theorem has been repudiated, and that many forms of tying and bundling should be considered suspect practices. Each of these authors disagreed with Elhauge in various ways. Seabright and Crane & Wright, in particular, disputed Elhauge's conclusions on the single monopoly profit theorem. The spirited debate continues in this issue with a rejoinder by Elhauge who, in particular, insists that the Chicago single monopoly profit theorem really is dead.

We continue our practice of presenting recent cases of special interest with the analysis by Antonio Bavasso & Mark Friend of Barclays' successful appeal of the Competition Commission's judgment regarding personal protection insurance.

Bavasso & Friend examine the implication of the Competition Appeals Tribunal's repudiation of the remedies adopted by the Competition Commission, relating this decision and related judgments to the larger topic of judicial review of competition authority decisions.

We conclude this issue with one of the early pieces in behavioral economics: Herbert Simon’s 1955 article on bounded rationality. As Lindsay McSweeney notes in her introduction, Simon imagines how actors that have limited information and computational abilities might behave. For many years, this article provided one of the leading alternatives to the traditional model of rational profit-maximizing behavior, bringing to the forefront of academic attention several of the key issues on which behavioral economics would eventually focus.

On behalf of CPI’s readers and its editorial team, I am delighted to extend my thanks to all the contributors to this issue.

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