The Need of a Behavioural Foundation of Regulatory and Competition Analysis

by

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Abstract

The article describes why behavioural insights are of substantial importance for the design and the enforcement of both, competition law and regulations. It is argued that considerations of bounded rationality are particularly important because the main subject of competition and regulatory analysis typically concerns oligopoly markets with few firms and often even (quasi) monopolistic conduct.

The dominant hypothesis about the behaviour of firms in economics, and in the applied competition and regulatory literature in particular, is that of "profit maximization". The main defence of this assumption is "market selection". In a nutshell, firms behave "as if" they were seeking to rationally maximize their expected profits because those that did not are eliminated in a selection process.

This argument implies that the empirical content of the assumptions underlying firm behaviour are irrelevant as long as "market selection" ensures that the behaviour of the successful firms can be characterized as (approximately) profit maximizing *ex post*. This methodological approach characterizes the large majority of regulatory and competition analysis conducted in the context of both, policy and individual cases.

The reliance on an often unspecified "selection mechanism" guaranteeing an *ex post* conformance of behaviour with profit maximization based on *ex ante* assumptions of proven unrealistic nature is generally problematic. It is particularly problematic for the analysis of oligopoly markets and individual firm behaviour, the prime subject of most regulatory and competition analysis. While conditions exist under which selection even of random behaviour can be described as profit maximizing *ex post*, these conditions are neither generally identified explicitly nor typically present in oligopoly settings even if specifically spelled out.

The role of experimental research in identifying realistic behavioural assumptions for corporate, firm level decision making is therefore of high importance for the type of empirical analysis required in a regulatory and competition law context. The article concludes with an antitrust example concerning predatory conduct to demonstrate this point. Economic analysis in a regulatory and competition law domain has to be based on solid empirical foundations in order to be appropriate.

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