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The Welfare Effects of Legal Uncertainty and its Implications for Enforcement Procedures

While the issue of legal uncertainty is widely discussed and considered of fundamental importance among those involved in the design and implementation of public policy and among legal experts and economists, the concept has never up to now been formalised and the welfare "costs of legal uncertainty" has never been analysed using economic theory. Our main objective in this paper will be to extend the framework that we have developed for analysing optimal legal standards (Katsoulacos and Ulph, 2009), in order to examine the welfare implications of legal uncertainty and to compare alternative decision and enforcement procedures of Competition Authorities under varying degrees of Legal Uncertainty. The degree of Legal uncertainty is made to depend on the

information available to the Authority concerning the characteristics of firms and their environment, that determine the harm/benefit generated by their actions, and on the information available to the firms about these characteristics and about the assessment criteria/models used by the Authority. Our analysis shows that:

- There is no automatic equivalence between *Effects-Based* rules and Legal Uncertainty.
- There is no monotonic link between Legal Uncertainty and welfare. While very great degrees of Legal Uncertainty are welfare reducing, welfare can be higher when there is some degree of Legal Uncertainty than when there is no Legal Uncertainty. This is true also when firms can invest into reducing Legal Uncertainty and it is more likely to be true when procedural uncertainty is also present.

If the tests on which *Effects-Based* procedures are based are good enough to enable the Authority to *effectively discriminate* then *Effects-Based procedures* will often be welfare superior to *Per Se* rules even though they involve Legal Uncertainty.