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The Limits of Competition Policy

The Shortcomings of Antitrust in Developing and Reforming Economies

A. E. Rodriguez

Ashok Menon

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Law & Business

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To Lesley,

for your patience and support.

To Ashleigh,

for your infinite wisdom.

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About the Authors

A. E. Rodriguez is an Associate Professor in the Department of Economics and Finance of the University of New Haven in Connecticut, United States of America. From 2005 to 2009, he was an advisor on antitrust matters to the office of the attorney general of the State of Connecticut. He is a former U.S. Federal Trade Commission (FTC) staff economist. As an FTC economist he served as liaison to the competition agencies in several developing countries, actively contributing to their training and operations. He also served as a U.S. representative on the North Atlantic Free Trade Agreement (NAFTA) negotiating group on competition policy.

Over the years, Dr. Rodriguez has worked as a consultant in competition policy for various international agencies including U.S. AID, the World Bank, the Inter-American Development Bank, and the Asian Development Bank. He has assisted the competition policy efforts of Mexico, El Salvador, Honduras, Venezuela, Panama, Peru, Egypt, Ethiopia, Mozambique and Indonesia. He continues to work as an independent expert in domestic and international private antitrust litigation.

Dr. Rodriguez has a Ph.D. and a B.S. in Chemical Engineering, both from the University of Texas at Austin.

Ashok Menon is a Principal Associate at Nathan Associates Inc., an economic consulting firm that provides litigation support for antitrust cases in the United States and assists developing countries implement market-oriented reforms. Mr. Menon has served for seven years as the Director of the United States Agency for International Development (USAID)-funded Trade and Investment Project in Mozambique, where he worked closely with the Government of Mozambique on evaluating the pros and cons of creating a competition policy, related laws and an institution to monitor competition in Mozambique. In his 11 years of experience in economic consulting, Mr. Menon has worked with numerous governments on various trade and competition issues. Mr. Menon has a Masters Degree in Trade and Commercial Diplomacy from the Monterey Institute of International Studies.

List of Abbreviations

AIDS	Acquired Immune Deficiency Syndrome
DBI	Doing Business Initiative
DR-CAFTA	Dominican Republic-Central America Free Trade Agreement
EU	European Union
FTC	US Federal Trade Commission
GATT	General Agreement on Tariffs and Trade
GCR	Global Competitive Report
GDP	Gross domestic product
HHI	Herfindahl Hirschman Index
I-S	import-substitution
ICN	International Competition Network
ICPAC	International Competition Policy Advisory Committee
ITO	International Trade Organization
JFTC	Japan Fair Trade Commission
NAFTA	North Atlantic Free Trade Agreement
OECD	Organization for Economic Cooperation and Development
ROL	Rule of Law
RPM	Resale Price Maintenance
SCP	Structure, Conduct, Performance paradigm
SMEs	Small- and Medium-Sized Enterprises
SSNIP	Small but Significant, Non-transitory, Increase in Price
UNCTAD	United Nations Conference on Trade and Development
USAID	United States Agency for International Development
WEF	World Economic Forum
WTO	World Trade Organization

Preface

Many developing economies embarked on privatization and deregulation efforts in the 1970s and 1980s. Many others, especially Latin American countries and those countries once in the orbit of the former Soviet Union, followed along in the 1990s. Most have introduced modern antitrust legislation and are in the process of inaugurating antitrust enforcement agencies. As a result, at the time of this writing, practically every nation north, south, east and west of our borders will have an antitrust policy program in place or is contemplating one.

How did this come about? This ''boom'' is perplexing, especially when in the United States, where competition policy is known as antitrust, it has entered a stasis that is best summarized by the belief that less antitrust intervention is good and where in recent years the U.S. Supreme Court has trended toward severely limiting antitrust liability.

The market policies toward which reforming and developing economies had avidly turned after the collapse of the Berlin Wall started to sputter in the 1990s. There emerged a sense of disappointment. The realization that the much heralded benefits of liberalization had failed to arrive was inescapable. Among those held culpable for this unexpected failing of market programs were large businesses, oligopolies, cartels and private monopolies. In some countries these enterprises had existed for years. Others were newly emerged as privatizations replaced former state-owned monopolies with privately owned monopolies.

Among the package of reforms offered by the Western countries and the multilateral lending institutions as a solution to the seemingly underwhelming performance of market policies were recommendations to adopt antitrust legislation and the associated antitrust enforcement agencies, in effect reproducing the antitrust programs of the United States and other Western nations. These recommendations were quickly embraced by harried, heretofore promarket technocrats without a trace of irony.

Notwithstanding the underlying rationale, many nations soon adopted, or are in the process of adopting, antitrust laws and antitrust enforcement programs despite little understanding of the elements and consequences of antitrust policy. In these efforts to enable antitrust programs they have been, and continue to be, fully aided and abetted and in fact often obligated by Western governments, multilateral lending agencies, Western antitrust agencies and, of course, the antitrust bar.

Was this good a policy then? Is it a good policy today? After all, the programs were put in place despite the fact that the effectiveness of antitrust has long endured withering skepticism and even though economics had long claimed that antitrust enforcement did little good in economies that favored free trade because imports sufficed to discipline anticompetitive behavior. Perhaps economics had nothing to do with it. It is possible that antimonopoly program adoptions were simply incumbent administrations cynically attempting to shift the blame for policy failures.

In the United States (although not the case elsewhere) it has increasingly been recognized that antitrust is an unwieldy, blunt instrument, routinely ensnaring in its wide nets any number of innocuous and often procompetitive business practices in its clumsy attempts to find violators, what the U.S. Supreme Court has blasted as the ''chilling effects of false positives.''

The allusion to false positives is a term-of-art taken from concepts in the decision-making under uncertainty literature. Specifically, the error-cost framework, as the methodology is known in antitrust law, underlies concerns with legal uncertainty created by antitrust enforcement. This approach has gained numerous influential adherents since it was introduced into antitrust legal theory a little over two decades ago. It appears to organize (or certainly influence) the U.S. Supreme Court's reasoning in several of the recent string of decisions limiting the scope of antitrust liability. The Court's reliance on this methodology constitutes a tacit recognition that antitrust is fundamentally a probabilistic field, where it shares commonalities with investment and medical testing and many other fields. In medical testing, investment, earthquake forecasting and the like, one must take action with limited information in the form of indices, precursors, screens, tests or metrics. The name varies, but the intended use is to aid decision-making by exploiting a relationship between the index or metric and the likelihood of an event. Based on the information provided by the indicator one will invest, build, export, alert the citizenry or intervene surgically – or not. The outcomes are unknown ahead of time. Yet the likelihood (and importantly, the cost) of outcomes are contingent on the decision taken and the particular resolution of the unknown event. Thus, we can inform our current decision-making by tracing out the outcomes (and associated costs) based on the potential decisions we can make.

We succinctly explain and use the error-cost framework here to appraise the performance of competition policy. We do so to understand the connection between the process of deciding, in a manner that includes the institutions involved, and the outcomes and consequences associated with the decisions taken. This appraisal is indispensable – informing future programs and decisions. For example, divining when an earthquake will strike is a vexing problem. The destructiveness and sheer terror associated with large-scale earthquakes

naturally led humans to search for precursors that could offer reliable warnings. Ideally, these warnings could be conveyed with sufficient lead times so as to alert those in danger and enable them to move to safer areas. Those who have lived in earthquake prone regions know that earthquakes are a part of life and lore. Everyone has a favorite earthquake predicting sign or omen – chickens going berserk and birds suddenly and eerily going silent are some.

But despite the faith placed on these measures by individuals, the exercise is futile. We now know this to be the case with modern, scientific variants of berserk chickens. We appraise prediction capability by accounting for not only getting it right but also for getting it wrong. And there are two ways to get it wrong – we call it and it fails to happen. Or, alternatively, we do not, and we get hit with a massive earthquake. In earthquake forecasting we often fail to call it. But recognizing the underlying limitations of forecasting earthquakes and accounting for the costs associated with the consequences has led us place considerable attention to earthquake preparedness, damages-minimization and changing the way we build, deploy aid and react.

Our analysis illustrates two interrelated critical flaws in antitrust policy. First, there is the potentially unintended corrosive impact antitrust may have in the economies recently adopting Western-style antitrust – the costs associated with the false positives mentioned earlier. These nations are, for the most part, characterized by limited information, weak institutions and fragile market economies. Importantly, they desperately need to foster innovation, entrepreneurship and other features of modern economies that have readily become the targets of antitrust policy. Thus, the unintended consequences of antitrust enforcement programs are considerably more costly in the developing world than they are elsewhere. Second, the technical difficulties in the practice and enforcement of antitrust laws become unsalvageable problems in developing economies. Constructing the appropriate decision-making metric, one with even modest capabilities of detection, is a difficult and often today bitterly contested exercise even in the United States with more than 100 years of experience with antitrust.

It is immensely difficult to calculate accurate price-cost margins, profitability measures, concentration indexes, elasticities or whatever other metric is chosen to serve as an indicator, alerting authorities to the possible presence of anticompetitive practices. The problem emerges as an especially difficult and controversial one with the novelties introduced by the new economy – in which technology and innovation are the engines of growth.

The difficulty lies in the transition from economic theory to antitrust practice. And it lies elsewhere. Administering antitrust is compounded by a scarcity of properly trained professionals, scant or poorly developed institutional bulwarks that both assist and limit enforcement (and other problems of this sort endemic to developing countries), lack of political support and differing cultural mores. The result is ambiguity and considerable subjectiveness in the antitrust enforcement decision-making process itself. It fosters a lack of confidence that breeds business uncertainty that conflates with the general wariness against the unpredictability of the state, a habit wearily borne by citizens of developing economies.

This aversion and apprehension to the unpredictability and arbitrariness of the state is the very sentiment that forged the historical norms of behavior and group dynamics that now serve to hold antitrust inferences at bay.

On numerous occasions, competition legislation was adopted without any serious examination of the capabilities or the capacities of either the recipient country or of the donor nations. It glossed over serious difficulties, failed to explore unfavorable consequences and, remarkably, explained away the availability of cheaper and more effective alternatives to fostering competition. We know. We actively participated in many of these exercises. In fact, the genesis of this book emerged from our combined experiences providing antitrust support and training in many developing economies as well as serving as antitrust experts on behalf of private parties targeted by the same antitrust agencies we once assisted.

Proponents of competition policy reasoned that trade liberalization programs did not bring the full effect advertised precisely because, contrary to free-trader's observations, imports had not adequately tempered what was viewed as blatant and abusive domestic market power in some countries that had liberalized trade. According to this logic, domestic cartels and monopolies were actively impeding entry, thereby limiting the envisioned competition. Proponents also noted that nontradeables are largely immune to trade discipline and that the nontradeables sector thrived with anticompetitive practices. The two-pronged critique of the classical argument, sadly left unchallenged, persuaded many heretofore antitrust skeptics.

Further, the arguments raised by Neo-Institutionalists swayed any remaining skeptics. These constituted arguments that in an altogether different context provide a sound, theoretical and mainstream rationale for the presence of market institutions as a necessary condition for viable and sustainable market competition. These were arguments that antitrust supporters easily appropriated as a basis for competition policy programs. In our view, this is faulty reasoning – a nonsequitur. Antitrust policy does not naturally follow from a project designed to seed and nurture the institutions necessary to support effective market competition.

There is common ground between the Neo-Institutionalists and the relevance of uncertainty on decision-making. Thus, the Neo-Institutionalists teach us to understand the limits confronting antitrust in developing economies. We examine the reasons for antitrust policy's poor performance by carefully analyzing the nature of the informal rules that characterize business practices in developing economies, their long-standing symbiotic relationship with the state and their genesis in the need to defend against the unpredictability of state action. Policies consist of changes in formal institutions, but the poor outcomes observed so far are a result of the nature of the interaction of both the formal and informal rules.

We believe that the observed failure of liberalization in developing economies should not uncritically recommend antitrust policy. Rather, we believe that it reveals antitrust to be a blunt instrument aimed at the wrong problem. First, legal uncertainty is costly, especially costly in developing market economies. And the costs overwhelm any benefits antitrust may convey. The consequences – to the extent that antitrust does develop some ''bite'' – are likely to be considerable,

engendering uncertainty, chilling behavior and fostering an unhealthy climate for business. Small, fragile market economies are especially susceptible and vulnerable. Second, domestic market power does curtail entry and trade competition. There is considerable evidence of its presence in reforming and transition economies. But the continuance of market power is due to interest group rent-seeking, typically resulting in government-sanctioned preferential treatment and not as a result of price-fixing, cartelizations or other private horizontal activity proscribed by competition law. Rent-seeking is an economic phenomenon whereby private parties try to control or influence the powers of government for their own advantage. Policymakers everywhere, but especially in developing economies, are institutionally susceptible to the informal rules and practices that facilitate rent-seeking.

Rent-seeking is not illegal; in fact, in many places, including the United States, it is widespread and at times a constitutionally protected ''right.'' Rent-seeking is not a violation of the law and thus is beyond the reach of antitrust law enforcement efforts. Interest groups find soliciting preferential treatment from the state, which leads to state-sponsored cartelization, more attractive than private cartelization. Thus, trade liberalization gives rise to significant state-sponsored nontariff barriers, against which antitrust is powerless. We set forth many other reasons, ranging from the lack of a political constituency to conflicting and often contradictory goals to operational and practical difficulties.

Shifting focus away from the poor performance of enforcement programs, antitrust advocates argue that another tool in the competition agency's toolkit readily challenges rent-seeking and preferential treatment – known as competition advocacy. Competition advocacy ostensibly enables an antitrust agency to proffer critical commentary on behalf of consumers. It takes aim, in principle, at state entities that propose regulations, programs or any type of activity that may result deliberately, or unwittingly, in supracompetitive pricing and associated reductions in consumer welfare. To put the point another way, the competition policy enforcement agency presumes to stand ready and vigilant, unfazed by the need to criticize the actions of a Minister of Agriculture who is actively seeking price supports for the nation's milk producers.

This speaking truth to power just has not happened, and it will not happen. And if it does in any particular instance, it will not persist. Competition advocacy programs are wan challenges flung at powerful lobby and interest groups, groups constituted by long-standing practices arising from the natural limits present in economies untutored in market-based competition. It is unlikely that a small, technocratic agency with no political base and little support beyond the multilateral agencies and the local USAID economic programs specialist will prevail in a political fight against the agricultural interests that hold the ear of the nation's minister of agriculture (and manufacturing interest, tourism and so forth).

We argue that competition policy in developing economies is a (remediable) mistake. More importantly, continued and unchecked support of these efforts is likely to solidify yet another layer of bureaucracy and red tape in deplorably inefficient economies. Ironically, in instances in which the competition programs are likely to be effective, in developing economies thirsting for innovative,

entrepreneurial initiatives, the chilling effects of false positives (and the associated unintended consequences) stand to inflict more harm than good.

Our objective is to describe and provide a framework to understand the limits to antitrust in developing and, especially, in least-developed countries. At the very least, we hope that this text increases the debate that should precede any consideration of (further) embracing competition policy in its current version. It should shift the burden and elicit a more careful accounting of its benefits and costs to those that favor such policies.

Who do we intend to reach? Who is our audience? Obviously, because we are asking for a recasting of the terms of the debate, we hope that those in the field of antitrust read our work. But the stakes extend to others far beyond the antitrust bar and antitrust economists. Thus, we primarily presume to reach others: McCloskey's ''smart people willing to pay attention.''[1] (McCloskey 2000).

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1. Deirdre N.McCloskey, *Economical Writing* (Prospect Heights, IL: Waveland Press, 2000), 39.

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