The role of Competition Policy in promoting Competitiveness and Institutional Reform in Latin American countries.[1]

Ignacio De León.[2]

I. Introduction.

This essay highlights some of the institutional challenges of competition policy in the promotion of competitiveness in Latin America. In particular, it explores the need of developing an alternative policy agenda oriented to the promotion of competitiveness through competition policy enforcement.

More broadly, our interest is to highlight how institutions shape competition policy making and regulatory reform, as well as to pinpoint the implications of this phenomenon on the adoption of a pro-market strategy for the promotion of competitiveness and successful insertion of Latin American countries in the World Economy.

The policy drive towards competitiveness represents institutional change, and change triggers resistance on adverse interest groups who regard this as a threat to their economic privileges. If not properly addressed, such resistance could easily frustrate the whole transition process. Thus, it is important for the policy maker to identify these institutional constraints in order to deal with them effectively. For this reason, institutional analysis is useful for identifying potential obstacles to policy initiatives aimed at promoting competitiveness.

But more importantly, institutional analysis provides a connecting thread between competitiveness and competition policy. In order to understand to what extent

1 Brown Bag Lunch paper presented at the Inter-American Development Bank, 23 May 2003.

2 Ph.D. (Lon), M.Phil. (Lon.), LL.M. (Lon), LL.B. (Caracas). Professor of Law and Political Economy, Universidad Catolica Andres Bello, Caracas; former chief of Venezuela's Competition Authority, Pro-Competencia.

competition policy can promote competitiveness, it is necessary to refer to the set of shared values about the role of competition policy in society, which will determine the direction ultimately to be followed by policy makers in this field.

In order to shed some light on these issues, and better understand the impact of social institutions on competition policy enforcement, this paper suggests that competition policy enforcement is defined by a combination of institutional factors, which create positive incentives to encouraging on policy certain policy outcomes. These institutional factors influencing competition policymaking could be organized at three levels:

1. The ideological, which comprises the personal beliefs of the individuals in charge of designing the policy. This factor determines the personal policy priorities and normative choices of the decision maker towards business arrangements;
2. The organizational, referred to the structure of the decision making process. This factor creates external constraints towards policymaking which influence the expediency of policy decisions; and
3. The cultural or social, which is referred to the set of social values shared within which the competition authority is called to apply the policy. This institutional constraint determines the long run sustainability and legitimacy of the policy choices implemented by the authority.

This paper will examine to what extent each level influences policymaking, and then will propose some guidelines for policy enforcement, in line with the set of institutional constraints prevailing in Latin America.

II. The triumph of efficiency is not the triumph of market values.

Competition Policy entails policy choices about how social resource allocation should proceed. There are some who believe that such allocation should be carried out on the grounds of economic efficiency, whereas others think that economic efficiency should be tamed, and allow other goals which for them are also socially valuable, such as market integration, or the protection of smaller competitors. The former view is commonly associated with the kind of policymaking pursued in the United States, whereas the latter is associated with the policy enforcement undertaken in the European Union. In their support, the proponents of efficiency and Consumer Welfare as a goal of competition policy claim that seeking economic efficiency is much more transparent and predictable than other social welfare goals; in addition, they claim that it is not the goal of competition policy to seek social justice; indeed, distributive policies such as taxation or subsidies, more aptly target these concerns.[3] Europeans, on their defense, contend that other values are equally important; nevertheless one finds that over the years their policy enforcement has yielded to the efficiency standard. All in all, there seems to be increasing consensus towards accepting economic efficiency as the goal that should rule competition enforcement endeavors.

More broadly, efficiency seems to have won the upper hand as a reference concept for guiding economic regulation. In this, the adoption of economic efficiency as a normative standard for policy enforcement seems to represent a victory for free markets over central "developmental" planning, which used to dominate in past industrial policies. Thus, compared to redistributive policies, efficient resource allocation places social resources in the hands of those individuals who value them the most; this ensures market functioning to be optimal, provided the absence of transaction costs. Under this view, economic efficiency provides an objective and impartial standpoint from which it is possible to make social welfare-enhancing allocations without risking being "contaminated" by distributive considerations that rather fall within the realm of foggy, discretional equity values.

This is the prevailing view among those who defend "efficiency" as a normative standard to be followed by developing countries that aim at improving their economic performance record, enhance their competitiveness and economic growth.

In closer inspection, however, the efficiency social welfare standard suffers from serious epistemological deficiencies that undermine its value as a normative yardstick to policymaking. This is particularly so in the case of Competition Policy, where the pursuit of standard efficiency may even frustrate the very competitive nature of markets which is supposed to be preserved through competition policy.

---

3 Notably, Robert Bork has emphasized this point. See R. Bork, The Antitrust Paradox: A Policy

Thus, a detailed analysis reveals that normative efficiency (and its correlate concept, the Perfect Competition Model) plays in conventional competition analysis a similar role to that of ideology in social affairs, namely, it lays out a utopian normative standard, which is impossible for entrepreneurs to meet; hence, it only can stand as an ideal devoid of practical sense for policy judgment. As a consequence, the mirage of seeking utopian economic efficiency drives the attention of the policy maker away from the practical policy making questions she ought to be concerned about, namely that of institution building, which is fundamental to developing countries.

To be sure, Competition Policy should avoid getting involved in distributive justice it is wants to remain “transparent”. However, it is unclear whether economic efficiency (much less “distributive” criteria such as equity) supplies policymakers with a clearer standard to follow, or that it enables decision making to be more predictable or transparent compared to any other criterion. In fact, a closer look reveals that the strict enforcement of the Pareto efficiency standard would undermine the rule of law, and could become potentially a bogus to achieving market competition.

Moreover, I would like to visualize an alternative perspective of competition policy enforcement, which in fact may be much more conducive for the creation of a pro-market business environment and playing level field rules of behavior in developing and transition countries. In the end, this is what it counts. This view, in fact, is increasingly becoming part of the current competition enforcement activities that are taking place in many developing countries, especially in Latin America.

Let me explain why I believe that social welfare goals like economic efficiency might undermine rather than promote competition in the marketplace.

III. <u>The Nirvana mindset and social policymaking.</u>

The lure of economic efficiency is ultimately rooted in the quest of policymakers for achieving a utopian standard of social welfare through targeted intervention. This stems

---

at War with Itself, Basic Books Publisher, New York, 1978.

from the assumption that policymakers can attain a full picture of the underlying factors that comprise social reality, and regulate it over to attaining social welfare. However, in order to achieve this, policy makers should meet two conditions: first, they must possess adequate analytical tools in order to understand and appraise reality properly; usually, they refer to market "models" which enable them to capture the essence of market forces. Therefore, it is necessary to explore more in detail the nature of these models, what do they exactly mean, and, of course, what are their epistemological flaws, in order to see why policymakers' picture of reality is often dimmed.

A second condition for attaining social welfare, of course, is for policymakers to identify what exactly does optimality entails in terms of the costs which the social system (i.e. governments and entrepreneurs) must bear in order to reach this ideal point. Indeed, it is dubious that social welfare can be attained if the costs of achieving it largely exceed those benefits accruing from the Nirvana. Yet, policy makers often take for granted the costless nature of such an exercise. This flows from the belief that the goal of social policymaking is to recreate a world without costs.

These two premises are deeply ingrained in the mind of policymakers. They stem from the Cartesian assumption whereby reality is an objective self, located outside the individual mind, which we can fully appraise and understand[4] thereby leading social policymaking into a "pretense of knowledge" where "optimality", "social welfare" and other synonymous expressions of "social perfection" appear accessible, hence become a moral imperative on the shoulders of policymakers.

Such Nirvana mindset equates to the attainment of "perfect justice". As a goal of policy making, perfect justice demands rooting out error in every individual case, regardless of the costs involved in order to make this possible.[5] Similarly, Thomas Sowell refers to "cosmic justice", as that justice which is cost-free, and that takes into account the particular individual welfare position of each individual in society in order to level its condition to that of the rest. Thus, Sowell criticizes this endeavor, on the grounds that it is impossible to devise an ideal standard of equality that would satisfy the individual

---

4 F.A.Hayek, Law, Legislation and Liberty, Vol. 1, University of Chicago Press, Chicago, 1973.

5 R. Epstein, Simple Rules for a Complex World, Harvard University Press, Cambridge, 1995, p. 38.

condition of everyone alike, given the costs involved in such efforts. Thus, “with justice, as with equality, the question is not whether more is better, but whether it is better at all costs.”[6]

In Sowell’s view, “those pursuing the quest for cosmic justice have tended to assume that the consequences would be what they intended –which is to say, that the people subject to government policies would be like pieces on a chessboard, who could be moved here and there to carry out a grand design, without concern for their own responses.”[7]

In the realm of economic science and competition policymaking similar concerns arise. Those who support economic efficiency and Consumer Welfare ground their views on the Pareto efficiency as a guiding policy standard; the normative reference stems from the assumption that markets resembling the Perfect Competition model are “optimal” and enhance social welfare. Using such substitute standard, as the “Workable Competition,” follows the same logic, namely, that somewhere in our minds we can devise models enabling us to see how things would be different if we not lived in a world full of market failures.

The conventional learning of competition policy tells us that market failure is responsible for the sub-optimal allocation of resources. Monopolistic behavior runs markets into such failures, as it creates special conditions within which information asymmetries are exploited to the advantage of alleged monopolists. As a result, market performance will be driven away from the optimal conditions laid down by the Perfect Competition model, where production is undifferentiated, information flows freely, and firms are price takers, rather than price manipulators.

Therefore, the gist of this view is the comparison between the mental or idealized model of perfection on the one hand and reality on the other hand, which we perceive through our senses. This is a faulty intellectual exercise because comparing reality with such ideal standards leaves aside from the analysis two kinds of costs that are also part of

---

6 T. Sowell, The Quest for Cosmic Justice, The Free Press, New York, 1999, p. 27.

reality, which for obvious reasons regulators must take into account: The first one is the cost of acquiring that information which optimal regulation requires in order to achieving optimality. Harold Demsetz referred to this as the "Nirvana Fallacy", namely the intellectual error of considering that we can attain perfection and leaving aside how hard is for the authority to obtain the necessary information to make this happen. Evidently, the tendency of anyone falling within this intellectual error is "to consider his neighbor's garden always greener," as Demsetz himself put it. Thus, compared to Nirvana, reality always appears full of "market failures".

In second place, comparing reality with the Nirvana also leaves aside the costs that members of society have to bear upon themselves in order to invest on productive actions. These actions would never take place (and therefore, could not be considered part of the regulatory analysis) in isolation, but they only occur once investors have internalized their costs.

This is a fact of the real world that regulators simply cannot afford to ignore. Consider the following example. Imagine, if you will, that we visit a children's swim club and ask the kids if they're willing to make the sacrifices necessary to become Olympic champion swimmers. We'd probably get many positive responses, despite the fact that perhaps only one in ten thousand young swimmers really is willing to pay the costs of becoming an Olympian. Efficiency analysis implies that we'd be better off if we just asked the swimmers what they would sacrifice to make the Olympics, and then appointed those who bid the highest to the Olympic team. In the opinion of those who promote this way of thinking, this intellectual exercise would certainly save all the time it takes to do costly training. Thus, reality "fails" because many individual swimmers do spend time in training in spite that most of them fail to make it to the Olympics.

In the world of business, such comparison between ideal standards of perfection and the business world leaves the regulator with the pervasive impression that any business behavior is suspicious of restricting competition, for entrepreneurs enter into costs and limit their own possibilities of action, in order to achieve certain degree of certainty with which to pursue productive investments. From the viewpoint of the efficiency,

---

7 Id. at 40.

these limitations in rivalry somehow represent a departure from the perfection of the Perfect Competition Model. It is not examined whether the limitations imposed are in fact necessary for entrepreneurs to seize a business opportunity which, in order to happen, must necessarily displace other competitors in the market. The very purpose of competition entails the success of some alert entrepreneur in "getting there first," before other competitors do; this does not necessarily mean that our entrepreneur has got these at the expense of another. The conclusion does not necessarily follow such a premise.

Therefore, applying the Perfect Competition model as a normative standard is at odds with the purpose that allegedly it should serve to policy makers. In other words, instead of promoting entrepreneurial alertness in order to improve competition, it tells regulators that competition is less likely to happen the further we identify the examined market is from the idealized "perfection" of Perfect Competition.

In criticizing the use of the Perfect Competition model (or similar surrogates, such as the Workable Competition model) as a normative standard, Professor George Richardson, from Oxford University, emphasized that such model is meaningless as a normative reference, because in such analysis the economist cannot simply do away with the economic organization which is necessary for economic actors to compete in the marketplace and outdo other businesses, which is the very goal that a competition policy should have in sight. Thus, in 1960 he published a book entitled "Information and Investment"[8] in which he highlights the inadequacy of the Perfect Competition model for appraising reality, since the viewpoint it adopts in one of equilibrium, whereas reality is, in a permanent process of change and evolution or, to quote Professor Schumpeter, in a state of "creative destruction."

Richardson's critique is, in fact subtler than what appears at the surface. The very assumptions that could otherwise make the Perfect Competition model useful for policymaking purposes, namely, that information in the system so modeled does get passed on throughout all economic agents, thereby making possible equilibrium at all and bringing about perfectly competitive markets. Not only these conditions are absent in the real world but even more importantly, *the model itself denies them*. For there is no

---

8 G. B. Richardson, Information and Investment, Oxford University Press, London, 1960.

other way of explaining how –real- social systems achieve equilibrium but by postulating that the information of the system is already known by economic agents *before* it has in fact passed on to them.

Richardson says so, because being at equilibrium, the model assumes that information has already passed on to individuals who then will rest in their actions; yet, in order for this to happen, individuals coordinate their actions, construe routines, create rules, which enable information to be codified and understood by all. Thus, contrary to what the Perfect Competition model assumes, coordination, rule creation and standardization of market behavior drives the market away from the world predicated in the Perfect Competition model, where individuals act independently from the rest. It is a paradox that, in order to attain equilibrium, individuals must coordinate their actions, but the very coordination leads real markets away from the world of Perfect Competition, where Industrial Organization is virtually non-existent. Thus, in the words of Richardson: **"there is no reason to expect that the hypothetical market conditions which define perfect competition would in fact ensure that production would be carried on by the most efficient means, for there is no reason to believe that the supposed equilibrium position would ever be reached. The link between market structure and the scale of investments is to be sought more in the particular modes of adjustment, than in the supposed equilibrium situations, with which the structure can be associated. Here, as elsewhere, much that is of importance has been denied adequate analysis as a result of the tyranny which the equilibrium concept has exercised over modern economic theory".**[9]

Economic organization, business arrangements, coordination and cooperation among businesses are essential for information to flow across economic agents. But at the same time, such arrangements make reality depart from the equilibrium. This is a critique that equally applies to those models of "imperfect competition" which appraise reality from an equilibrium perspective; that is, by assuming that the information which is necessary to attain the optimal point is readily available to those individuals who play into the model's equation. Therefore, it also undermines the efficacy of the Workable

---

9 Richardson, Information..., p. 89.

Competition model and the Pure Monopoly model, as normative references to be enforced upon reality.

However, the Perfect Competition Model **"undoubtedly stood, for many people, as an ideal or model form of organization –strictly speaking only a logical as opposed to an ethical ideal, although this distinction was not always sharply made. It does not seem to have been recognized that the fact that 'imperfections', in some forms and degree of strength, are clearly an obstacle to adjustment, does not entitle one to conclude that it would be best if (market) 'imperfections' were absent altogether. Yet the pedagogic convenience of perfect competition, and its suitability as a base for extensive formal and mathematical elaboration, gave the system a central place in theoretical discussion".10**

In sum, evaluating market functioning with the standard of ideal perfection entailed by the Perfect Competition standard is not only naïve, -as it assumes that such information necessary to attain perfection will be readily possessed by the government authority. It is also deceitful, as it will tell the regulator very little about the true nature of the behavior that he is faced with. The truth is that we do not live in a world of perfection, but one in which individuals must bear costs in order to achieve goals. Assuming that reality would be different if we had angels instead of human beings, does not really contribute much to the real task which the competition authority must do, namely,

---

10 Richardson, Information ..., at 39. Klein emphasises the importance of the perfect competition model for antitrust purposes as follows: "(...) of all the various analytical toolkits that constitute contemporary political economy, perhaps the most important model for the economist is the model of perfect competition". B. Klein, "The Use of Economics in Anti-trust Litigation: Realistic Models of the Competitive Process" in The Law and Economics of Competition Policy, F. Mathewson et al. (eds.) (Vancouver: The Fraser Institute, 1990), p. 420. Also, Clark argues: "The conception of 'perfect competition' has itself for the first time received really specific definition and elaboration. With this has come the realisation that 'perfect competition' does not and cannot exist and has presumably never existed (...) *What we have left is an unreal or ideal standard which may serve as a starting point of analysis and a norm with which to compare actual competitive conditions. It has also served as a standard by which to judge them*". (Author's italics) (J. M. Clark, "Toward a Concept of Workable Competition", 30 The American Economic Review, [June 1940]: 241). Finally, Hayek indicated with regard to the perfect competition model that: "This ideal case (...) came to be regarded as the model and was used as a standard by which the achievement of competition in the real world was judged". (F. A. Hayek, Law, Legislation and Liberty: The Political Order of a Free People, Vol 3 (Chicago: The University of Chicago Press, 1976), p. 66.) A recent analysis on the use of perfect competition as a normative yardstick is found in J. Burton, "Competition over Competition Analysis: A guide to some Contemporary Economics Disputes", in Frontiers of Competition Law (Birmingham: Institute of European Law, 1994.)

promoting market exchanges. Comparing with perfection only leads to misjudge the important role played by economic organization in conveying knowledge to market participants, since it makes such organization to look as devious attempts to manipulate markets away from Perfect Competition.

Schumpeter warned us about this normative spin in the regulators' mind. He said:

"…The problem that is usually being visualized (by regulators) is how capitalism administers existing structures, whereas <u>the relevant problem is how it creates and destroys them</u>. As long as this is not recognized, the investigator does a meaningless job. As soon as it is recognized, his outlook on capitalist practice and its social results changes considerably."(our emphasis)11

To put it more simply, the Nirvana mindset is epistemologically flawed, since induces the analyst to focus her attention on irrelevant equilibrium problems of resource allocation, which are futile for understanding how markets actually evolve endogenously.

IV. <u>Practical consequences of the Nirvana mindset of competition policy regulators</u>.

This section outlines some of the implications of the conventional ideology embodied by the model of Perfect Competition on competition policy enforcement.

First, from the viewpoint of legal enforcement, comparing frail human beings to the optimal standard of perfection, leads policy makers to develop ambiguous and hesitant enforcement, thereby sacrificing the rule of law and market transparency. Any level of cooperation between actors, will be regarded with suspicion, unless it is justified under a reason of economic efficiency, but we have seen that such efficiency rests only in the mind of whoever enforces the policy, and therefore, anyone else -i.e., prosecuted

---

11 J. Schumpeter, <u>Capitalism, Socialism and Democracy</u>, Harper & Row Publishers, New York, [1942] 1950, p. 84.

businesses- have no way of predicting whether their particular arrangements will match the standard of efficiency devised in the regulator's mind.

The distinction between "per se" and "rule of reason" behavior will not help much to distinguish right from wrong, because this is only a legal, not an economic distinction, which merely purports to spare the competition agency the costs of examining cases which, from the viewpoint of competition authorities appear "obvious," such as horizontal price fixing, which is then regarded as "per se" prohibited. It can be easily seen that this is simply another way of saying that "per se" prohibited behavior will always be prohibited because it is already regarded as a conduct that cannot ever be allowed. In other words, it is a tautology, which doesn't say much –as any other tautology- about *under what factual circumstances* should the authority tolerate or allow restrictive behavior on the basis of efficiency.

The truth is that given that the standard of economic efficiency is ultimately found in the ethical preference of the regulator, his judgment cannot be subject to any rule of precedent. What he finds today as efficient may well be found tomorrow as inefficient. Predictably, his own inability to make meaningful judgments on the basis of efficiency induces him to look on other factors telling him what is right and what is wrong. Naturally, his natural tendency will be to lean on his own perception according to which industrial high concentration is suspicious and should raise concerns to competition authorities.

In this connection, the Nobel Laureate from the University of Chicago, George Stigler observed that **"definitions do not yield any knowledge about the real world, *but they do influence impressions of the world*. If only markets with a vast number of traders are perfectly competitive, and if markets with few traders are called oligopolistic (literally, "few sellers"), that suggests that these latter markets are not competitive, as well as not perfectly competitive. [Consequently] the suspicion of small numbers was gradually reinforced by the antitrust cases"**[12]

12 G. Stigler, Memoirs of an Unregulated Economist, Basic Books Inc., Publishers, New York, 1988, p. 94.

Therefore, it is not surprising that the perception of illegality has changed so dramatically in the jurisprudence of the United States and the European competition policy enforcement, if one examines contemporary trends from those prevailing at the moment the policy was inserted. Conducts regarded in the past as "per se" illegal, today are regarded under the rule of reason; conducts that were prosecuted in the past are tolerated today. Consider the evolution of policy making in the field of resale price maintenance, monopolization, mergers and acquisitions. In all these the change in the jurisprudence has been notorious.

True, all in all, antitrust enforcement has been more or less stable over the years; but the relative stability of competition law enforcement over long periods of time is probably due to the positive effect of other institutional factors which we also need to examine in addition to the personal views of the policymaker as an individual; these factors include the organizational arrangements within which the policy takes place, and the cultural setting in which the policy is enforced.

Surely, the stability of the rule of law surrounding the organizational structure of competition policy enforcement in developed countries has prevented competition enforcement from falling out of bounds. By contrast, such institutional stability cannot be taken for granted in many transition and developing economies. It is for this reason that is so important to deal with this second question too.

In this connection, the very transition from plan to market introduces a great deal of uncertainty among economic agents, which is absent from the jurisdictions of developed countries. This is a consideration which is often overlooked, especially by those who recommend the adoption of traditional competition policy enforcement in developing countries; yet, it shows the importance of tying competition enforcement analysis to the institutional framework within which is inserted. This uncertainty on policy enforcement adds to the already uncertain business environment that prevails on developing countries, which could be quite chilling on investments and economic development.

A second consequence of focusing policy attention on achieving social welfare goals such as efficient "resource allocation" is that such exercise neglects the role of "resource creation" through innovation. Clearly, this focus leaves aside another essential goal for developing countries, namely, promoting innovation, resourcefulness, entrepreneurship and competitiveness.

The reason for this insensitivity stems from the static or equilibrium view of competition introduced by the model, which by definition neglects the role of innovation and creative entrepreneurship in driving efficiency what economists refer as "the production frontier." Conventional models have attempted to address this limitation by introducing some dynamics into model building. Unfortunately, these models still are unable to grasp the evolutionary changing nature of market systems, and the role played by innovation in introducing new knowledge into the market. Even under this analysis, antitrust policy still upholds its structural bias inherited from the old days of the Sherman Act, when industrial firms dominated the landscape of the economy. Today, however, in the light of fast innovation in the high-tech industries, such definitions appear somewhat constraining to the policy maker. Consider the elements of market analysis examined under competition analysis in order to determine a firm's dominance or possession of market power. Under such analysis product substitution is strictly referred to competing products that already are in the market; yet, as the IBM case shows, the pace of innovation in some industries is such that new competing products may well emerge into the market before legal proceedings are over.

It is not surprising that all comparisons to the equilibrium state of Perfect Competition are doomed to fail in explaining reality, which is constantly evolving. The intellectual error of those believing in such comparison lies in the fact that markets cannot be compared to equilibrium positions such as the Perfect Competition model (or, at the other extreme, the Pure Monopoly model) simply because markets are, to put in Schumpeterian terms, under a constant process of "creative destruction," of evolutionary change. In his words:

"The essential point to grasp is that in dealing with capitalism we are dealing with an evolutionary process."13

---

13 Schumpeter, p. 82. More specifically he states: "Capitalism, then, is by nature a form or method of <u>economic change and not only never is but never can be stationary</u>. And this evolutionary character of the capitalist process is not merely due to the fact that economic life goes on in a

Finally, a third implication of the epistemological spin of the conventional approach on market competition as a "perfect" (or imperfect, as the case may be) state of affairs, not an ongoing process of entrepreneurial discovery, is that it forces the analyst to focus his attention on the assumed welfare implications arising out of the particular conditions prevailing in the marketplace at that moment in which the analysis is made.

Thereby, all concern about the role of institutions is virtually excluded from the analysis. This is no casual, as the focus of regulators is on allocating resources using equilibrium models, which, again, takes for granted the role of those institutions that make market exchanges possible at all. Therefore, their attention is not on the institutional conditions that make markets, but on comparing isolated points of such move against the optimal standard of the Perfect Competition model.

Consequently, no attention is placed on the institutional conditions enabling or frustrating the ongoing market process to carry out its "destructively creative" advancement towards innovation and economic progress. Economic analysis stops short at the point of comparing optimal (i.e. ideal) states of equilibrium with those of "real" markets.

In order words, no meaningful research is aimed at answering the vexing institutional questions that are important for development, such as: what are the springs of economic development? How do entrepreneurs strive for outdoing their rivals? These are the questions that any sensible Competition Policy should target.

In conclusion, the ideology element of competition policy is responsible for driving competition authorities into adopting one of two alternative types of policy initiatives; that is, either they emphasize the pursuit of contrived "efficient" allocation of resources, regardless of how markets would in fact allocate such resources, or alternatively, they emphasize the need to strengthen those institutions enabling the market process to

---

social and natural environment which changes and by its change alters the data of economic action. (…) The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumer goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprises create." (pp. 82-83) become viable at all, regardless of what market outcomes would be in a particular moment.

In sum, it is important to highlight the role played by the cultural setting of the society in which competition policy is to be enforced. Culture plays a fundamental role in policymaking design that ought to complement, not distort, competition policy enforcement. For this reason, it is so important to check the institutional development of the society concerned, to see to what extent potential restrictions on competition may accrue in the form of policies, which are not simply tolerated but actively promoted by the government himself. This level reveals how important is for transition and developing countries to deal with such government restrictions.

V. <u>Towards an alternative institutional competition policy making for developing and transition countries</u>.

In order to overcome the heuristic limitations of conventional competition policy making, and design competition policy in a way that it is conducive to challenging the anticompetitive culture prevailing hitherto, let me try to put forward an alternative conceptual framework for the design of competition policy in a way that is meaningful for developing countries. This alternative view may well be summarized as follows: “If the world is at permanent disequilibrium, why should we worry about attaining equilibrium? Let’s worry about the process of change and disequilibrium.” How would this view be incorporated into public policy? What would be the implications of this perspective in the process of enforcing competition policy?

As mentioned above, during transition, the most pressing problem for these countries is the lack of a clear rule of law. This creates undermines the expectations of economic actors, thereby raising transaction costs. Competition policy should address these questions right upfront. A proper policy agenda should therefore avoid creating further distorting factors that could undermine the rule of law even more. As I stated earlier, it is very difficult to achieve this through enforcement based on Pareto efficiency, or indeed, other social welfare goals, as they ultimately reflect the preferences of those in charge of the policy, which could easily differ and cause the erosion of what another Nobel Laureate, Friedrich Hayek referred to as “market legitimate expectations.”

How could competition authorities reinforce the rule of law in market exchanges?

The answer lies in **the development of a precise agenda aimed at addressing both government restrictions as much as business created anticompetitive restrictions**. Given the different scope and source of each of these, it is necessary to develop policy tools well-suited to develop this task. Up to now, competition initiatives have merely emphasized the need of developing statutes, more alike to those existing in the jurisdictions of developed countries, where the surrounding institutional environment is significantly different, and much more settled, compared to that of developing countries. Unsurprisingly, these statutes overemphasize the business nature of those anticompetitive restrictions which affect market performance, while simultaneously leaving aside government restrictions challenging competition in the marketplace. The negative effects of these is two-fold: businesses are burdened with highly technical regulations which impose on them additional administrative and litigation costs to those which already they are forced to bear in these jurisdictions; while at the same time, much more extended and significant government restrictions are left unscathed.

Concerning government restrictions, competition authorities should be given effective powers to undertake active regulatory reform. Mostly, this is referred to as "competition advocacy," but the policy initiative proposed here conveys a much more proactive role. Competition advocacy has often been confined to an advisory role on the side of competition authorities, which in practice turns out to be ineffective to deter anticompetitive policy initiatives embarked by governments. The proposal for advocacy suggested here is much broader, as it would enable competition authorities even to challenge before the courts those measures and policies clearly undermining the transparency of markets and economic freedom. Such initiative would seek to dismantle government rules through deregulation and institutional reform, in support of competitiveness, trade liberalization and privatization.

The competition advocacy role, thus, would entail more than simply advising governments on how to deregulate the economy in a way of promoting competition. It stands as a tool enabling society to protect their rights before the courts, against government encroachment on economic freedom.

Some guidelines could help in this task:

- Simplify administrative rules in order to create a "level playing field" and eliminate unnecessary costs of red tape compliance.
- Rules should be flexible to adapt to market change: Freedom of contract is possibly the most important flexible rule enabling market adaptation.
- Regulatory reform should draw general principles of fair conduct from past experience; thus, given the limitations to devise "optimal" states of social welfare, policymakers have no other recourse but to rely on the past experience of market participants, in order to draw rules of fairness. Similarly, policymakers should identify voluntary and effective industry standards.
- Introduce effective dispute settlement mechanisms to encourage parties themselves to assign their rights through negotiation.

In addition to these guidelines, competition authorities should also develop some policy priorities regarding the assessment of business behavior. On the basis of previous comments, these could be as follows:

- In the area of <u>horizontal restraints</u>, be particularly concerned with cartels created by government fiat, through regulations or legislation. Liberal professions are a good example of this.
- <u>Vertical restraints</u> should be tolerated unless the claimant, proving the anticompetitive effect, provides specific evidence that impedes trade. In principle, long-term contracts are indicia of such intention, provided they are exercised in areas where import competition cannot counteract these restrictive effects.
- <u>Unilateral dominant behavior</u> should be reviewed in cases where network access to smaller firms is exercised; especially where evidence shows a connection between the dominant firm denying access and the victim's downstream or upstream competitor. In general, the notion of "fairness" is to be found in the past experience of the industry concerned; or similar ones.
- <u>Mergers and acquisitions</u> should in general be tolerated, especially if import competition remains open. In the case of the services industry, foreign

competition should be ensured through the elimination of licensing and special permits.

VI. <u>Conclusions.</u>

Institutions embody individual values and beliefs collectively shared. But where do these values come from? How do they acquire shape? And perhaps more importantly, what role do they play on policymaking design and implementation? These are all questions suggesting that, far from being a science, policymaking is closer to art. Hence, it cannot do without all the surrounding institutional circumstances conditioning businesses' behavior.

It is important, for this reason, to acknowledge that:

1) Competition policy, like any human endeavor, is grounded on ideology and normative values, not on hard science. This is not necessarily a disadvantage, provided society is fully aware of the nature of the ethical debate entertained by competition policy authorities. In this way, the necessary institutional constraints will be placed in order to prevent competition policy from becoming unbridled or uncontrolled. Indeed, such constraints are essential to reinforcing the rule of law, predictability of the policy and transparency of market rules.

2) The fact that normative standards are ultimately ethical does not necessarily qualifies the conclusions that anyone can genuinely draw from the mere understanding of market dynamics. For this reason, rather than judging entrepreneurial behavior from a normative standpoint which is impossible to attain anyway, competition policy authorities should concentrate on making surrounding institutions more transparent and open to entrepreneurs, doing away with contrived social welfare imaginary constructions, and looking past business experience in closer inspection, so to draw tentative guidelines about the best possible way to promote market exchanges to the best of its potential.

3) Competition authorities should, therefore, avoid falling into the intellectual trap of endorsing contrived social welfare standards essentially contradictory with market competition. Developing and transition countries should be particularly careful not to forget that the ultimate goal of competition has to be connected to the development of competitiveness, innovation and economic development.

4) Also, culture is also a fundamental factor that policymakers must take into account at the time of competition policy's inception. The development of a central planning tradition perpetuates ways of conceiving policymaking that may run against the logic of introducing markets, thereby making the initial work of competition authorities particularly cumbersome. It is necessary to give them the right tools to devise alternative policy solutions to government interference on the markets.

These fundamental reasons suggest that the policy agenda of competition authorities should address regulatory reform and exercise strong "competition advocacy," thereby challenging government regulations and rules that inhibit innovation and business development.

Of course, it is essential that professional, independent, and highly motivated officials enforce competition policy. Also, proper rules should be instated in order to ensure that their decisions are balanced, carefully drafted, quickly enforced, and above all, always controlled by a well-trained judiciary. But none of these will necessarily ensure that competition enforcement is addressed where the real problems are. In fact they could create new problems if they are not properly checked.