Towards a Broader View of Competition Policy

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Brief history of competition policy (anti-trust)

- Began as a *political* agenda, to limit market and *political* power of trusts (monopolies and oligopolies) in US
  - Broader than just ensuring efficiency in standard competitive equilibrium model
  - Broader societal focus than just *consumer welfare*
- Historical context also important for many other countries, which have inherited inequalities and inherited large monopolistic/oligopolistic firms that stifle growth and job creation
  - In South Africa, “legacy apartheid champions” may not be completely different from the Trusts of the turn of the century

Chicago School

- In US (and elsewhere) Courts have been captured by "Chicago School"
  - Holds that markets are naturally competitive
  - Presumption that firms' actions are efficiency enhancing
  - Presumption against predation
  - Presumption that distribution does not matter
    - Reflected in use of total welfare standard
    - Particularly perverse both from an economic and moral point of view in South Africa

Developments in modern economics

Modern economic theory (information asymmetries, even a little market power can have very large effects, game theory) have rejected all of the tenets of Chicago School

- Even competitive markets are not in general efficient
  - Invisible hand is invisible because it is not there
    - Whenever there are imperfections of information and risk markets, or endogenous knowledge (innovation)—that is always
- Markets are not in general competitive
  - Even small deviations from *perfect* competition matter
  - Shown wide range of mechanisms by which market power is acquired, maintained, and enhanced

Rejection of Chicago doctrines (continued)

- Inequality matters
    - Recent studies (IMF, OECD, Stiglitz *Price of Inequality)* have shown that distribution does matter for economic performance
    - And that the Second Welfare Theorem (suggesting that issues of efficiency and distribution can be separated, so that economics should only focus on efficiency, does not in general hold)
    - Increasing evidence that significant parts of inequality are a result of market power (e.g. Furman/Orszag)
- Key issue now: selectivity, most important abuses

New issues within more standard framework

- Monopsony (Amazon, Walmart) which may advantage consumers, but at the expense of producers
  - Long run effects may be just the opposite
- Network externalities
  - Generating new sources of market power
  - Sustained by contract restrictions
  - Abuse of two-sided market analysis
  - Similar barriers to competition created by distribution systems

New technique for exercising market power even when naturally acquired

- And more subtle forms of entry barrier
  - Contract provisions
- Amplifying and extending market power associated with IPR
  - Bundling (Internet explorer)
- Multiple examples within the drug industry
  - Data exclusivity
  - Evergreening
  - Contracts with generics
- Often with government connivance
  - Provisions in trade agreements
    - Restrictions on use of formularies
  - Provisions restricting government's ability to bargain

New approaches to anti-trust

- Recognition that standard approaches (defining relevant market) may be inadequate
  - Relevant market is affected by market imposed constraints
  - The key issue is simpler: power to raise prices
  - There can easily be a market with only one firm
  - There can even be market power when firm has small share of what might *seem* to be relevant market in traditional analyses (Discover card; theory of insistence)

Broadening the agenda: New Risks for Market Power

- Using market power to induce individuals to give up rights of privacy
- Using market power to induce individuals to give up rights to use public legal system for dispute resolution
- Too big to fail banks
- Inadequate competition in the market place of ideas
  - Effect of media concentration not measured by market power in advertising markets

Competition Policy can and should be broadened further

- To enhance the ability of developing and emerging countries to compete
- To promote development more broadly
- To promote greater equality—returning to the original objective
- To reflect new economic insights and changes in economic structure
  - Including importance of inequality
  - Globalization

Nature and intensity of competition depends on who is in the game

- Without industrial policy supporting the development of capabilities and learning by doing and overcoming barriers to entry (such as finance) countries will have low levels of domestic rivalry
  - Trade opening can increase disadvantages of domestic country and decrease competition
  - Finally recognized in *Aid to Trade*
  - Without aid for trade, removing of tariffs and other "artificial" trade barriers actually disadvantages developing countries
  - But earlier literature didn't recognize implications for domestic competition
- But domestic policies need to be wary of supporting national champions

Competition is a process

- Open competitive markets provides opportunity
- Standard approach undervalues the value of freedom to participate in markets
- Focuses more narrowly on “efficiencies,” e.g. transactions costs and network economies, which can tie up distribution and routes to market, creating entry barriers and reducing opportunity
- Competition may be welfare decreasing
  - Winners of competition may be those best able to exploit others, best able to raise rivals’ costs, most able to circumvent social objectives like climate change and fair employment practices
    - Phishing for Phools
  - Changing presumption of Chicago School

Important implications

- Competition authorities should *not* just focus on mergers that reduce competition
  - Or explicit agreements that lead to cartel or cartel like behavior or other "plain vanilla" anti-trust violations
- But should focus on *any* conduct that is likely to prevent, lesson, or distort competition
  - Facilitating raising prices (e.g. by changing elasticities of demand for those setting prices—e.g. vertical restraints (Rey-Stiglitz))
  - Creating entry barriers
  - Raising rivals costs
  - Even if there *might* be some "public good" justification
  - Changed presumption
- Use of public interest test, not just in mergers but in conduct
  - More general question: should competition policy not just ensure existence of competition, but nature of competition

Market power, inequality and development

- Market power one of major sources of inequality
- Inequality leads to poorer economic performance
  - Including lower growth
  - Market power is often associated with creating barriers to entry
  - Inequality means fewer people have resources to enter markets
- Problems particularly serious when foreign firms have market power
  - Resources get redistributed out of country—needed foreign exchange
  - Less demand for non-traded domestic goods—further impediment to development

Menu of Possible Antitrust Policies to Address Inequality/strengthen competition policy (from Salop and Baker)

1. Increase and focus agency enforcement
   - ✓ Increase antitrust agency budgets
   - ✓ Exercise prosecutorial discretion to prioritize cases that benefit less advantaged consumers
   - ✓ Design remedies to benefit less advantaged consumers
2. Rebalance toward more interventionist antitrust (and regulatory) standards
3. Recognize excessive pricing by dominant firms as an antitrust offense
4. Adopt reduction in inequality as an explicit antitrust and competition-regulation goal

Excessive Pricing as Antitrust Offense
(partially from Salop and Baker)

- EU competition law recognizes excessive pricing by a dominant firm as "abuse of dominance" ("exploitative" conduct)
  - Very few cases, however
- US Sherman Act is narrower
  - Monopolist with legitimately obtained and maintained monopoly power is permitted to charge high prices
    - Conduct element required: agreement or exclusion
    - US sets prices through anti-trust in at least one area—rates for music publishing rights
- US law could adopt EU approach
  - To implement under the Sherman Act, legislation would be needed
  - FTC could conclude that monopoly price or price discrimination targeting less advantaged consumers violates FTC Act
- Recent decision by Competition Appeal Court in South Africa may make finding of excessive pricing difficult

Setting the rules: balancing concerns of over and under enforcement

- Implies taking account of economies' different characteristics and histories
  - Because of sunk costs, history matters
- Smaller economies may face greater problems of entrenched dominant firms
- Natural entry barriers at earlier stages of development imply greater costs associated with exclusionary behavior with effects that may be more persistent

Setting the rules: balancing concerns of over and under enforcement (cont'd)

- Outweighing risks of chilling effect of stronger anti-trust enforcement
- Broad role of government to *encourage* competition
- Competition does not simply arise in absence of cartels
  - Contrary to Chicago School
- Industrial policies one important component
- Strong competition policy *encourages* entry

Competition and public interest

- Public interest should be over-riding concern
- But may be difficult to incorporate easily within rules-based competition framework
- And must take into account the existence of other instruments
- Mandates on domestic firms (like participation of historically disadvantage persons) should be imposed on foreign firms
- Even if it is more difficult for them to fulfill mandate
- No country should sign trade or investment agreement that makes this impossible

Broader philosophical issue

- What does “fair” competition mean, in the context of a developing and emerging market?
  - Where small local firms have to compete with foreign behemoths
- New approaches to development focus on “helping infant economies grow”
  - Recognizing externalities generated by new firms and industries
  - Market solution will not lead to (adequate) development
  - Argument for protection—tilting balance towards domestic firms
  - For instance by maintaining stable, real competitive exchange rate
  - But also argument for more aggressive enforcement for anti-trust

Global perspectives

- Competition is a global public good
- Should be cooperation in international enforcement
  - Mergers and cartels as well as conduct
  - Hypocrisy of export cartels (like oil and potash) needs to be addressed
- Unfortunately, competition policy increasingly seen as weapon of national economic policy
- US accusing Europe of using competition policy against American firms
- Incentive of US to under-enforce competition policy for firms with global economic power
  - Political economy—influence on US government
  - Even US government can benefit from tax revenues

Broader regulatory environment for multinationals

- Competition policy should be seen as part of establishing broader global cooperative framework
- Including taxation

BRICS cooperation

- Cooperation among BRICS can be an important step in creating that global framework
- Working together to understand better and create *a developmentally oriented competition regime*
  - One of the objectives of which is promoting *inclusive growth*
- Recognizing that many of the central economic doctrines that have dominated Western competition policy have been discredited
  - Or at least to have more limited reach than previously realized

BRICS cooperation (cont'd)

- And sharing insights, and perhaps more explicit cooperation, in ensuring more competition in areas where in the past competition has been limited
- Implementing broader agenda will not be easy
  - But not implementing broader agenda risks losing important opportunities for promoting inclusive development