LATIN AMERICAN COMPETITION POLICY: FROM NIRVANA ANTITRUST POLICY TO REALITY-BASED INSTITUTIONAL COMPETITION BUILDING

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> Definitions do not yield any knowledge about the real world,
> but they do influence impressions of the world.
>
> —George J. Stigler[1]

> [T]he problem that is usually being visualized is how capitalism administers existing structures, whereas the relevant problem is how it creates and destroys them. 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.
>
> —Joseph A. Schumpeter[2]

INTRODUCTION

Since the 1990s, several Latin American countries have adopted antitrust policies as part of their economic reform agenda.[3] Often, the policies have been based on an implicit assumption that they would have the beneficial effect of promoting pro-market goals in the region.

Since its inception, however, advocates of antitrust policy in Latin America have insisted on implementing the policies with little to no regard

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1. GEORGE J. STIGLER, MEMOIRS OF AN UNREGULATED ECONOMIST 94 (1988).

2. JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 84 (3d. ed. Harper Torchbooks 1962) (1942).

3. Gheventer explores the possible links between economic liberalization and the introduction of antitrust policy; in his view, there is a correlation between the intensity of pro-market reforms and greater autonomy for the antitrust body. Alexandre Gheventer, *Política Antitruste e Credibilidade Regulatória na América Latina* [Antitrust Policies and Regulatory Credibility in Latin America], 47 DADOS 335, 358 (2004) (Braz.), *translated in* 1 DADOS (SPECIAL EDITION) (2005), http://social-sciences.scielo.org/pdf/s_dados/v1nse/scs_a05.pdf.

for the institutional setting for which they are intended.[4] After more than a decade of practical experience, it is time to make an institutional assessment about the real effects of such policies in the region.

Assessing antitrust policy is not easy due to the lack of reliable empirical research about its effects.[5] According to Hylton and Deng, the reason for the scarcity of data lies in the lack of "useful statistical information on the law, enforcement policies and penalties."[6] In my view, however, the failure to measure antitrust effectiveness lies instead in the lack of a unanimously accepted normative yardstick to measure the success of the policy. As we shall see in this article, the notion of competition used in antitrust theory—that is, perfect competition—leads the analyst to make misleading, normative conclusions about the causes and consequences of business practices.

Conventional critiques of antitrust policy have avoided discussing whether the policy stands on a firm intellectual foundation; instead, commentators have engaged in a futile discussion about the particular ethical goal the policy should seek (namely, efficiency or equity). Hence, analysts of antitrust policy have been driven into a fruitless dispute about the completeness and accuracy of empirical evidence collected in support of their preferred normative goal.[7]

4. Kovacic notes: "In their enthusiasm for the adoption of antitrust laws in transition economies, international donor groups such as the World Bank and individual Western countries have tended to overlook grave problems that emerging markets have encountered in implementing the new statutes." William E. Kovacic, *Antitrust and Competition Policy in Transition Economies: A Preliminary Assessment*, 2000 FORDHAM CORP. L. INST. 513, 514.

5. From a quantitative perspective, there are few empirical studies on the effectiveness of antitrust policy in attaining its goals. For examples of such studies, see generally Arnold C. Harberger, *Monopoly and Resource Allocation*, 44 AM. ECON. REV. 77 (1954); Richard A. Posner, *A Statistical Study of Antitrust Enforcement*, 13 J.L. & ECON. 365 (1970); George J. Stigler, *The Economic Effects of the Antitrust Laws*, 9 J.L. & ECON. 225 (1966); Keith N. Hylton & Fei Deng, *Antitrust Around the World: An Empirical Analysis of the Scope of Competition Laws and Their Effects* (Boston Univ. Sch. Of Law, Working Paper Series, Law & Econ., Working Paper No. 06-47, 2006); Michael W. Nicholson, *Quantifying Antitrust Regimes* (FTC Bureau of Econ., Working Paper No. 267, 2004).

6. Hylton & Deng, *supra* note 5, at 1.

7. Adams and Brock noted this in sarcastic terms:

> Aficionados of the theatre of the absurd would find the character of the [antitrust] debate intimately familiar. There is an absence of communication—a terrifying diversity of utterances, with the actors on stage listening only to snatches and fragments of the dialogue, and responding as if they had not listened at all. At times the dialogue consists of statements that are in and of themselves perfectly lucid and logically constructed but lacking in context and relevance. At other times, absurd ideas are proclaimed as if they were eternal truths. In this dialogue of the deaf, the actors are animated by the certitude and unshakeable nature of their basic assumptions—one side relying on the wisdom of past experience, the other prepared to sweep away the beliefs that have been tested and found wanting, beliefs they consider illusions and self-deceptions.

WALTER ADAMS & JAMES W. BROCK, ANTITRUST ECONOMICS ON TRIAL: A DIALOGUE ON THE NEW LAISSEZ-FAIRE, at xii (1991) (citations omitted).

In view of these empirical limitations, this paper argues that the source of doubt about antitrust policy's effectiveness lies in the policy's internal contradictions. To put it another way, the pursuit of perfect competition as a normative goal leads antitrust policymaking into distorting, not reinforcing, institutional arrangements that are necessary for markets to function. To this extent, antitrust subverts competition rather than promoting it.

My focus in this paper will be different from the conventional discussion of whether transitioning economies should endorse efficiency-oriented competition policies (namely, consumer welfare) or some alternative goal. Instead, I concentrate on how the perfect competition model, upon which all antitrust theory rests, is beset with all sorts of limitations as a model of market dynamics, and why any policy reference to it will undermine policy analysis. In particular, I concentrate on how the model not only misreads the informative role of those institutions necessary for markets to function, but also—and more importantly—how it chastises these institutions as "market imperfections" that policymakers should eliminate from the system, if the system is to perform optimally.

The perfect competition model is the cornerstone of antitrust enforcement.[8] The model supports the appraisal of markets carried out through industrial organization, as well as normative precepts aimed at overcoming perceived "market failures" arising from misallocation of resources caused by anticompetitive business restrictions. Conventional market theory postulates that perfectly competitive industries set prices equal to marginal costs; therefore, they maximize consumers' rent. Under this theory, monopolies are objectionable because the absence of competitors allows monopolists to set prices above marginal costs.[9] From this perspective, it follows that antitrust policymakers assume their role should be to promote policies that align markets closer to perfect competition and further from monopoly. Alternative notions of economic competition employed in antitrust policy, such as "effective competition" or "workable competition," are surrogate forms that share the same conceptual criticisms as the perfect competition model.

8. This model depicts a market structure featuring an infinite number of market participants because: (i) entry and exit from the market is assumed to be free, so that any firms outside the industry can move in at any time to take advantage of any above-normal profits; (ii) products are assumed homogeneous, so there is no brand loyalty segmenting the market; (iii) no advertising is assumed to exist; and (iv) all sellers and buyers are assumed to know all information. In other words, the model conveys to the analyst a series of assumptions making up for the results expected from interactions under such markets.

9. *See generally* MASSIMO MOTTA, COMPETITION POLICY: THEORY AND PRACTICE 39–55 (2004); W. KIP VISCUSI, JOHN M. VERNON & JOSEPH E. HARRINGTON, JR., ECONOMICS OF REGULATION AND ANTITRUST 2–5, 73 (MIT Press 2d ed. 1995) (1992).

In this paper, I highlight the misleading normative treatment of market institutions that the perfect competition model encapsulates. Indeed, the perfect competition model leads analysts into condemning institutional arrangements that are necessary for entrepreneurs to display their capabilities—namely, to compete in the market place. I demonstrate that this model is internally contradictory and, as a result, leads policymakers to flawed conclusions.

This paper does not address the economic impact of the flawed policy (as seen in the erosion of the rule of law it creates on the already weak Latin American economic institutions), nor will it address the public choice explanation (for example, that modern antitrust policy arises out of political pressure from domestic industries that, in the wake of economic liberalization, are unable or unwilling to compete with far more resourceful foreign entrepreneurs). I therefore concentrate on the significant missing element of conventional antitrust analysis which underlies the perfect competition model: the role of economic expectations. Decisions are built upon beliefs; hence, expectations are key to understanding how businesses make investment decisions in the real world. From there, I examine what sort of competition policy should be implemented that will align with the alternative theoretical view of competition proposed in this paper.

I. THE AFTERMATH OF ECONOMIC LIBERALIZATION IN LATIN AMERICA

The introduction of antitrust policy in Latin America has been heralded as a mark of the new pro-market ethos brought about by economic liberalization. As Ryan and Faden recently observed:

> [T]he economic benefits of free competition are increasingly recognised and the need for a strong and effective competition law to underpin a competitive economy is now almost taken as a given. Thus many Latin American countries are dedicating increasing government resources, both human and financial, to establishing or developing antitrust laws and policy.[10]

The ultimate purpose of economic liberalization in transitioning and developing countries is promoting entrepreneurial creativity, innovation, and economic growth, all of which were stifled during previous decades of burdensome regulations, trade protectionism, and government dirigisme.[11] Consequently, policymaking should be judged by how effective the poli-

10. Alan Ryan & Karine Faden, *Managing Antitrust in Latin America*, 2007 GLOBAL COMPETITION REV. (SPECIAL REPORT: THE ANTITRUST REVIEW OF THE AMERICAS 2007) 61, 62.

11. Norberg provides an excellent empirical account of the welfare benefits accompanying trade and institutional reforms. *See* JOHAN NORBERG, IN DEFENSE OF GLOBAL CAPITALISM 114–20 (Roger Tanner & Julian Sanchez trans., Cato Institute 2003) (2001).

cies are at fostering these goals. As this paper will show, antitrust policy cannot do the job because its underlying logic necessarily results in enforcement decisions that prevent achievement of these goals.

From the economic point of view, under the postulates of the perfect competition model competitive equilibrium leads to an optimal allocation of social resources.[12] Regardless of whether such an allocation seeks Pareto efficiency or some alternative goal, such as the protection of small firms, it entails a departure from the spontaneous market outcomes that would occur without interference. Thus, it is necessary to appraise the logic of antitrust policy more closely before endorsing the conventional belief—that antitrust policy will eradicate economic government dirigisme and consolidate pro-market habits among otherwise anticompetitively-biased businesses.[13] Antitrust policy advocates may have a misconception about the particular nature of markets and the role of entrepreneurs, which could distort (and possibly delay) both genuine initiatives aimed at introducing new markets in Latin America and the real purposes behind antitrust policies.[14]

There is a clear risk that antitrust enforcement could reintroduce discarded government interventionist policies, albeit in a disguised fashion. Consider, for example, a decision to penalize a business for entering into an exclusive distribution contract that is allegedly an abusive or monopolistic attempt to foreclose market access to a downstream competitor. Such penalties represent administrative charges that businesses have to compute as unexpected production costs that undermine their competitiveness. There is no question that pre-merger control, as well as market surveillance that protects against restrictive anticompetitive arrangements and that challenges "excessive," "monopolistic," or "unfair" prices, or prosecutes unpopular dominant firms, has much in common with the old-style

12. Optimal efficiency in the allocation of resources, along with a state of equilibrium, would prevail in markets under perfect competition. AMARTYA SEN, ON ETHICS AND ECONOMICS 29–40 (1st paperback ed. 1988); Cento G. Veljanovski, *Wealth Maximization, Law and Ethics—On the Limits of Economic Efficiency*, 1 INT'L REV. L. & ECON. 5, 20 (1981). Under these conditions, market forces would allocate social resources amongst individuals where they would obtain their maximum value. Veljanovski, *supra*, at 20. The whole purpose of allocating such resources where their economic value is highest is to benefit consumer welfare. *See* SEN, *supra*.

13. Consider, for example, the following statement made in reference to the rationale of antitrust policy in Central and Eastern European countries: "The competition policy conducted by CIS Governments is directed at ensuring conditions for effective functioning of markets and promoting private initiative. The appropriate regulatory bodies created in CIS countries exercise State antimonopoly control and promote the development of market relations on the basis of effective competition and entrepreneurship." U.N. Conference on Trade and Development [UNCTAD], *Competition Policy in Countries in Transition—Legal Basis and Practical Experience*, 2, U.N. Doc. UNCTAD/ITCD/CLP/Misc.16 (2000) (*prepared by* Natalya Yacheistova).

14. *See generally* THE CAUSES AND CONSEQUENCES OF ANTITRUST: THE PUBLIC-CHOICE PERSPECTIVE (Fred S. McChesney & William F. Shugart II, eds., 1995).

government dirigisme. In this respect, Rajapatirana provides us with an interesting study on the effects of trade liberalization policies in several Latin American countries. She shows how the effectiveness of these policies has been limited by the reintroduction of many trade restrictions under new forms and disguises.[15] My hypothesis is that antitrust policy is one example of such disguised restrictions.

To be sure, my argument is not that competition policy is altogether unnecessary or harmful. Rather, I argue that the meaning of competition is open to alternative economic interpretations, and that such alternatives should define alternative policymaking routes. In my view, the conventional wisdom surrounding notions of competition has framed a sort of policymaking that undermines, rather than reinforces, market mechanisms. To this extent, antitrust policy principles are often oriented toward resurrecting old government customs, which consist of rearranging market outcomes, condemning certain market prices on considerations of fairness, and judging whether certain levels of output are "socially convenient" (or optimally efficient). If anything, this is a renewed form of government dirigisme, rather than a policy to promote effective competition and entrepreneurship.

Rather than being concerned about opening spaces for entrepreneurs to display their talent and creativity, the investigative activity of antitrust agencies usually centers around measuring market size in order to ascertain the proper market share of each market participant and to see if any particular participant's share is extremely large. Moreover, antitrust agencies typically assess the optimal levels of market concentration, establish the proper degree of contestability in suspect industries, count the appropriate number of firms, measure the right size of the relevant market, and undertake similar structural endeavors.[16]

15. The study to which I refer, which was conducted in Argentina, Chile, Colombia, Jamaica, Uruguay and Trinidad, gives a School of Public Choice-based explanation for the reasons that these countries slowed the pace of trade reform in different areas and levels of economic activity. The conclusions highlight the real problems that the promotion of competition faces in the region. In particular, Rajapatirana argues that "despite [trade] liberalizations, some sectors have continued to receive protection. . . . [and] there have been attempts to introduce measures to provide relief to activities which have been subject to increased competition from imports, on the grounds of [unfair] trade practices." Sarath Rajapatirana, *Post Trade Liberalization Policy and Institutional Challenges in Latin America and the Caribbean* 17–18 (The World Bank Latin America and the Caribbean Technical Dep't Advisory Group, Policy Research Working Paper No. 1465, 1995). Although the study explains the Latin American rent-seeking behavior in the field of international trade, its conclusions can be easily extended beyond, to trade in general.

16. To show this, one only needs to look at the items evaluated under the U.S. Merger Guidelines, which outline the standard analysis employed internationally to evaluate merger operations. U.S. DEP'T OF JUSTICE & THE FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (rev. ed. 1997), http://www.usdoj.gov/atr/public/guidelines/hmg.pdf.

Notably, none of the guidelines used by antitrust agencies to evaluate whether anticompetitive restraints exist give priority to the innovation of market participants or the intensity of innovation in the industry as a whole. Antitrust scholars' views of these arrangements appear biased inasmuch as they assume that market participants bear some "natural" monopolistic tendencies.

Hence, instead of analyzing competition from the idealized assumption that markets fail to achieve the idealized standard of perfect competition, I propose quite the opposite: due to its reliance on idealized market models that utterly disregard the institutional surrounding where market action takes place, antitrust analysis is inherently biased against any form of market arrangement entailing business coordination (which is viewed as an expression of monopolistic intent). Our problem, then, is not located at the empirical level, but higher, at the epistemological level: we need to explore the way the antitrust mindset operates and its conceptual limitations.

In my opinion, the implicit bias in antitrust thinking stems from a particular understanding of the world—one that misinterprets the arrangements entered into by entrepreneurs in order to solve their lack of certainty about the institutional environment where they must invest. Therefore, a wholesale reappraisal of markets and regulation, which conventional epistemology is unable to deliver, may be necessary before endorsing the optimism of regulatory reform in Latin America.

II. NIRVANA ANTITRUST POLICYMAKING

At the theoretical level, the lure of economic efficiency is rooted in policymakers' quest to achieve utopian social welfare through targeted intervention. This idea stems from the assumption that policymakers can attain a complete picture of the underlying forces that shape social reality and regulate them to attain optimal social welfare.[17]

17. *See generally* 1 F.A. HAYEK, *The Fatal Conceit: The Errors of Socialism*, *in* THE COLLECTED WORKS OF F.A. HAYEK (W.W. Bartley III ed., press ed. 1989); In the field of economic science, see Mario J. Rizzo, *The Mirage of Efficiency*, 8 HOFSTRA L. REV. 641, 641–42 (1980). Policymakers generally acknowledge that this goal is unattainable; hence, they make do with attaining second best objectives, namely, to merely improve market performance by intervening and eliminating market failures. On the theory of second-best, see David P. Baron & Roger B. Myerson, *Regulating a Monopolist with Unknown Costs*, 50 ECONOMETRICA 911 (1982). Rey critiques the second-best theory as applied in the field of antitrust. *See* Patrick Rey, Director of the Industrial Economic Institute, University of Toulouse, Antitrust Policy, Comments at the Economics for an Imperfect World Conference (Oct. 24, 2003), *transcript available at* http://www2.gsb.columbia.edu/faculty/jstiglitz/festschrift/Papers/Stig-Rey.pdf.

This nirvana mindset reproduces in the realm of economic policy what, in social sciences, Epstein has termed "perfect justice."[18] As a goal of policymaking, perfect justice requires rooting out error in every case, regardless of the costs.[19] Similarly, Sowell refers to "cosmic justice," or justice that is cost-free, and takes into account the particular welfare position of each individual in society so as to level his or her condition to that of the rest.[20] Sowell criticizes this endeavor on the grounds that it is impossible to devise an ideal standard of equality that would satisfy the individual condition of everyone, given the costs involved in such efforts. Thus, "[w]ith justice, as with equality, the question is not whether more is better, but whether it is better at all costs."[21]

Similar concerns arise in antitrust policymaking. Those who support economic efficiency and consumer welfare base their views on the welfare properties of the perfect competition model: if the model embodies optimal competitive equilibrium, it follows that policy initiatives should aim to achieve such a state. This is why such thinking has been branded as a "nirvana" mindset: if one takes into account the costs of attaining such optimality, it becomes clear that no such optimal state really exists.[22]

In the 1940s**,** Clark noted:

> [T]he conception of "perfect competition" has itself for the first time received really specific definition and elaboration. With this has come the realization [sic] 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.*[23]

Indeed, the perfect competition model has been used extensively to develop antitrust policy prescriptions.[24] In the 1970s, Hayek indicated with

18. RICHARD A. EPSTEIN, SIMPLE RULES FOR A COMPLEX WORLD 38 (1995).

19. *Id.*

20. THOMAS SOWELL, THE QUEST FOR COSMIC JUSTICE 12 (1999).

21. *Id.* at 27.

22. Harold Demsetz referred to this as the "nirvana fallacy," which is the intellectual error of considering the possibility of perfection, but ignoring how hard it is for the authority to obtain the necessary information to accomplish it. The tendency of anyone falling within this intellectual error is to consider his neighbor's garden always greener. Thus, compared to nirvana, reality always appears full of "market failures." *See* Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1, 1–3 (1969).

23. J.M. Clark, *Toward a Concept of Workable Competition*, 30 AM. ECON. REV. 241, 241 (1940) (emphasis added).

24. The use of surrogate models such as the workable or effective competition model does not invalidate this conclusion. These models are grounded on the assumption that the perfect competition model cannot be found in "reality"; yet, the epistemological flaws invalidating the latter also apply to the former. Thus, like the perfect competition model, the effective competition model also endorses the mistaken welfare duality between perfect competition and pure monopoly.

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."[25] More recently, Klein confirmed the importance of the perfect competition model for antitrust purposes by indicating that of all the various analytical toolkits that constitute contemporary political economy, "[p]erhaps the most important model for economists is the model of perfect competition."[26]

Naturally, by comparison with optimal idealized perfect competition, real world businesses are subject to a permanent state of failure. As Nobel Prize laureate Stigler commented:

> 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 . . . . This suspicion of small numbers was gradually reinforced by the antitrust cases.[27]

It is no coincidence that Oskar Lange, the most renowned economist to advocate economic socialism, shared the same contempt as antitrust regulators over non-perfect competition markets due to their less-than-optimal allocation properties.[28] Indeed, his conclusion was inescapable: since perfect competition can only be found in the imagery of the ideal world of equilibrium, the capitalist system is, by definition, a less desirable choice than economic socialism.[29]

25. 3 FRIEDRICH A. HAYEK, LAW, LEGISLATION AND LIBERTY: THE POLITICAL ORDER OF A FREE PEOPLE 66 (1979).

26. Benjamin Klein, *The Use of Economics in Anti-trust Litigation: Realistic Models of the Competitive Process*, *in* THE LAW AND ECONOMICS OF COMPETITION POLICY 420 (Frank Mathewson et al. eds., 1990).

27. STIGLER, *supra* note 1, at 94.

28. *See* OSKAR LANGE & FRED M. TAYLOR, ON THE ECONOMIC THEORY OF SOCIALISM 106–07 (Benjamin E. Lippincott ed., 1964).

29. In Lange's words:

> The possibility of determining the distribution of incomes so as to maximize social welfare and of taking *all* the alternatives into the economic account makes a socialist economy, from the economist's point of view, superior to a competitive regime with private ownership of the means of production and with private enterprise, but especially superior to a competitive capitalist economy where a large part of the participants in the economic system are deprived of any property of productive resources other than their labor. However, the actual capitalist system is not one of perfect competition; it is one where oligopoly and monopolistic competition prevail. This adds a much more powerful argument to the economist's case for socialism. The wastes of monopolistic competition have received so much attention in recent theoretical literature that there is no need to repeat the argument here. The capitalist system is far removed from the model of a competitive economy as elaborated by economic theory. And even if it conformed to it, it would be, as we have seen, far from maximizing social welfare. Only a socialist economy can fully satisfy the claim made by many economists with regard to the achievements of free competition.

Id. Of course, Lange assumed that in operational terms such a goal could only be achieved by nationalizing production and giving orders to public officials in charge of running state-owned enterprises. In the absence of extreme government intervention, there is no question that he would have seen antitrust

In conclusion, antitrust policy is conceived in terms of nirvana thinking to the extent it employs the ideal perfect competition model as a normative reference for implementing policy recommendations. This policy, also known as "competition policy" in Europe and Latin America, is a government instrument designed to intervene in markets in order to preserve rivalry among independent buyers and sellers in relatively unregulated markets. In other words, antitrust intervention is driven by the need to correct perceived market failures; the role of the authority is primarily to challenge the business conduct that causes such failures. Antitrust enforcement focuses on preserving "independent" business decision-making, and controlling the potential sources of market foreclosure that would otherwise limit the effective number of business operators.[30] In sum, antitrust thinking is grounded on the belief that industrial concentration is bad for competition—but where does that conviction come from?

III. MATHEMATICAL SIMPLIFICATION TRIGGERS AN ILLUSION

The nirvana approach is flawed due to its contrived view of market dynamics. But even more significant than its rejection of any trace of realism are its fundamental contradictions, which deserve further attention.

Under the nirvana approach, the underlying assumption is that the perfectly competitive firm is so small relative to the overall market that it cannot influence the market's course: its impact is negligible or, as economists usually put it, infinitesimally small. Under this logic, naturally, each firm has to behave as a price taker, in the sense that it cannot decide unilaterally what price consumers will pay. Thus, the perfect competition market will be the polar opposite of a pure monopoly market where, through output restrictions, firms unilaterally dictate the terms under which consumers will pay higher prices. This is possible because monopoly firms face a negatively sloped demand curve, so that prices exceed marginal revenues (P >

policy as a perfectly logical device to achieve the socialist allocation goals that he advocated, by prosecuting firms unwilling or incapable of behaving as social welfare dictates. Clearly, from a policy viewpoint the underlying logic is similar in both cases: governments must intervene in order to achieve optimal resource allocation because the market is plagued by market failures, such as those arising from monopolistic competition.

30. *See* Roger A. Boner & Reinald Krueger, *The Basics of Antitrust Policy: A Review of Ten Nations and the European Communities* 2–5, 92–93 (World Bank Technical Paper No. 160, 1991). This policy is also referred to as "antitrust policy" because it focuses on the ills of economic concentration arising from the collective action of trusts and cartels. *Id.* at 1. Hence, it condemns any business conduct that aligns competitors and any unilateral behavior that excludes or raises impediments to prevent third parties from joining the market; it strives to control mergers and acquisitions; it focuses on mechanical measurements of market size, based on the cross-elasticity of demand; and it views market power structurally. *Id.* at 1–5.

M_r). Under these conditions, monopoly firms will be able to set prices above the ideal point where consumers would otherwise maximize their income.

In perfect competition, by contrast, no such wealth transfer happens. In such markets prices equal marginal revenues and these are equal to marginal production costs ($P = M_r = M_c$); therefore, firms must yield to the price set by the market. Such prices force firms to produce efficiently so that their marginal revenues will equal their marginal costs ($M_r = M_c$), otherwise they will be expelled from the market (by going out of business). This is why, on paper, perfect competition appears desirable whereas a monopoly does not. The implicit assumption is that, due to their infinitesimal market share, firms placed in perfectly competitive situations must take whatever price they are offered in the market; the effect of their business decisions is therefore negligible.

Naturally, the welfare implications of such polar ends (monopoly versus perfect competition) rest on the assumption that such duality does exist; in particular, they rest on the assumption that at the market price perfectly competitive firms face individual flat demand curves, as displayed in the sequence of Figures 1–4, below:

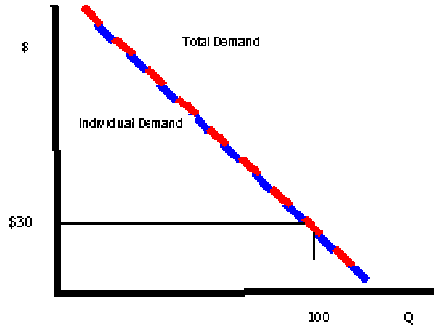

Figure 1
Individual demand of a monopoly firm

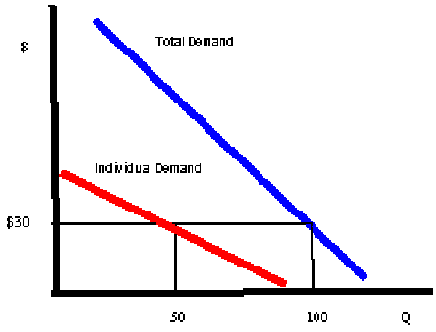

Figure 2
Individual demand of a duopoly

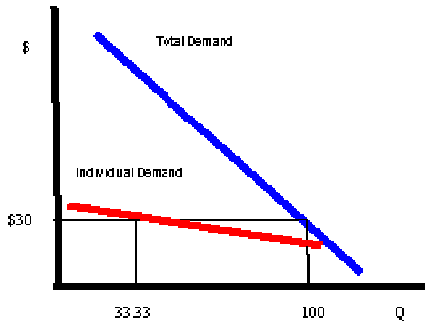

Figure 3
Individual demand of an oligopoly

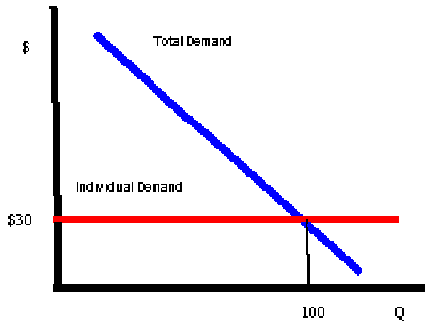

Figure 4
Individual demand under perfect competition

But are individual demand curves ever really flat?

As the conventional theory postulates, perfectly competitive firms are so small that they do not change their output in response to a change in output by other firms. Therefore, if a single firm happens to increase its output by one unit, the total industry output should also increase by one unit, since other firms will not react. Thus, under the terms of the perfect competition model, individual demand curves can never truly be flat, because an increase in the supply of one firm increases the total market output, causing market prices to fall. The only way individual demand curves could be flat would be if, in the event that one firm increases its supply, all other firms reduced their output by that same amount. Only then would the market supply curve and the price remain constant.

In other words, the two assumptions underlying the perfect competition model are mutually inconsistent: either firms operating in such markets do not face flat demand curves (for the price would then fall, even infinitesimally, in the event of an output increase by another market participant), or prices do not fall in the event of an output increase. Naturally, the latter choice would deny that individuals operating in perfect competition markets act under the same logic of economic behavior that applies to other markets. Hence, we are forced to conclude that the only viable choice is assuming that flat demand curves are as real as unicorns; that is, they exist only in fantasy. Indeed, the perfect competition model assumes that firms do not react to each other's behavior, yet experience and common sense demonstrate this is exactly what businesses do in the real world.

Consider the position faced by a firm such as PepsiCo in the soft drink market. PepsiCo must be as attentive to its competitors' moves as it is to its

customers' demands. It must see how Coca-Cola and other competitors perform in the market, what new products they advertise, what control they hold over their distribution networks, what productive capacity they have, how easily they can reach new and existing markets, what level of confidence Coca-Cola's consumers have in Coca-Cola's products, and so forth. As this simple example demonstrates, firms do not act in isolation; rather, they place themselves in a strategic setting, where they make investment decisions after taking into consideration the simultaneous moves of their competitors, suppliers, clients, and customers. From one perspective, these are indeed *competitive* moves, as they are intended to challenge competitors in the market, but from another perspective, they also can be regarded as *coordinative* strategies aimed at avoiding overproduction.

The real economic problem of interacting firms in the market is, then, how do they coordinate their activities in the event of a single firm's decision to change its output? This is not to pretend that coordination does not exist (or that it has been already understood and "worked out" by other firms). We shall come back to the fundamental problem of how economic agents develop their expectations about the conduct of other firms later. The problem I want to emphasize at this point is simply that the perfect competition model is not only unreal, in the sense that it does not consider this aspect of real-life markets, but also that it is internally flawed, since it is based on two mutually inconsistent assumptions: on one hand, it postulates that an increase in the supply by one firm would increase the total market output while the individual demand faced by perfect competitors would remain flat, yet at the same time it contends that prices would fall in the event of a market output increase—a situation in which total demand, no matter how little, would decrease instead of remaining the same.

In short, the demand curve faced by individual firms can never be flat; instead, it is infinitesimally sloped. Mathematically speaking, *infinitesimal* is not equal to *zero*. The addition of infinitesimally negative sloped individual demand curves will result in a negative sloped collective (namely, industry-wide) demand curve. Conversely, if the assumptions of the perfect competition model were true (namely, the slope of an individual demand curve is zero), then the addition of such curves would mathematically result in an industry demand curve with a zero slope. Therefore, the alleged distinction between firms operating in perfect competition markets and those operating in non-perfect competition markets is untenable. All firms will mark their prices at a level which is above the point where marginal revenues and marginal costs are equal. In other words, all firms will behave as

monopolists, even if in highly decentralized markets they will do so on an infinitesimally small scale.

It is evident that the drafters of the perfect competition model tried to simplify reality in order to isolate and better examine the market's constitutive forces, but in doing so they created a virtual reality that distorted the forces the analysis was intended to examine. Virtual reality embedded in economic models is useful only insofar as long as it preserves those essential traits of the phenomenon that it purports to analyze.[31] The question is whether the perfect competition model does so. The answer is obviously negative. By assuming that under perfect competition individual firms face flat demand curves, and that firms would become price takers no matter the increase in total output, the drafters of this model took away the most important trait of competition as we know it: the obvious fact that firms do not act in isolation, but take into account what other firms do in the market where they compete. No individual firm would increase its own output without paying due regard to the expected conduct of other firms. Coordination of expectations becomes the key economic problem to be addressed.

Although the coordination problem of economic transactions was identified and discussed by Hayek in 1937,[32] it was not until Richardson's work in 1960 that the contradictions of the perfect competition model were laid bare.[33]

Richardson noted that the very assumptions of the perfect competition model, summarized in the idea of "perfect knowledge," were inherently contradictory.[34] The assumption of perfect knowledge (namely, that knowledge is evenly shared by everyone in the market) denies individuals any chance of reaching the perfect competition state. Why? Because if the knowledge needed for individuals to attain perfect competition is equally and perfectly shared by all individuals in the market, then no one would be able to seize the profit opportunity:

> A general profit opportunity, which is both known to everyone, and equally capable of being exploited by everyone, is, in an important sense,

31. Popper contended that it is impossible to verify the perfect competition model, given that models are metaphysical statements. If this is the case, then we will have to accept the implications of the model as a matter of logical deduction and admit that the world may reach a state of perfect competition. In this case, though, it is crucial for the model to replicate the world. However, this is not simple; models in economics are merely tools for expressing certain relationships in mathematical terms. Reality, as Popper has indicated, is a non-verifiable issue—and, therefore, beyond the realm of science. *See* David Papineau, *Philosophy of Science*, *in* THE BLACKWELL COMPANION TO PHILOSOPHY 291–93 (Nicholas Bunnin & E.P. Tsui-James eds., 1996).

32. *See* F. A. von Hayek, *Economics and Knowledge*, 4 ECONOMICA 33 (1937).

33. G.B. RICHARDSON, INFORMATION AND INVESTMENT 1–2, 36–38 (1960).

34. *Id.* at 36–38.

> a profit opportunity for no-one in particular; it will create the incentive to invest only provided some people are less able to discern it, or to respond to it, than others.[35]

So the perfect competition model creates an illusion of business behavior that is never real, for all firms—even those whose influence on price is infinitesimal—behave as monopolists. In other words, there is no distinction between the welfare effects of these firms and those who command large chunks of the market. All firms price their goods above marginal costs in order to obtain profits.

Two questions follow, then: First, what remains of the antitrust admonition against firms who happen to operate in non-perfectly competitive markets? Second, given the lack of theoretical support for contemporary antitrust policy, what are the available alternatives? In other words, how should competition policymaking be redrafted in order to more accurately take into account how firms behave in the real world? Let us address these two problems in turn.

IV. IMPLICATIONS OF FOLLOWING PERFECT COMPETITION'S NORMATIVE INNUENDO

Having demonstrated that the perfect competition model is inherently flawed, what happens if we nevertheless insist on imposing perfect competition standards upon real-world firms? To put it differently, what is wrong with judging real life situations under ideal standards of "perfection"? Let us see how firms operating at perfect competition would fare if we dropped the assumption that they confront a flat demand curve. Let us see how they fare if, as we have already established, they do operate in markets where $P > M_r$.

Again, perfect competition assumes that $M_c = M_r = P$. Individually, perfectly competitive firms produce a level of output that maximizes their profit; but *collectively* such firms produce at a loss, because they will be forced to sell at a price where $P = M_c$, which is lower than the price that would maximize their profits ($M_c = M_r$). Such loss arises from the costs of firms acting without coordination between them. By forcing them to act independently, perfectly competitive firms will be unable to seize profits from market opportunities. These profits would accrue only at the point where prices paid by the market actually exceed marginal cost. Instead, perfectly competitive firms will undercut their competitors by forcing them into a price war, which will force them to sell a higher level of output at the

35. *Id.* at 57.

point where supply (marginal cost) and demand (price) intersect—but from the viewpoint of the individual firm (under our realistic assumption that $P > M_r$), that will yield collective losses for everyone.

To see this more clearly consider Figure 5:[36]

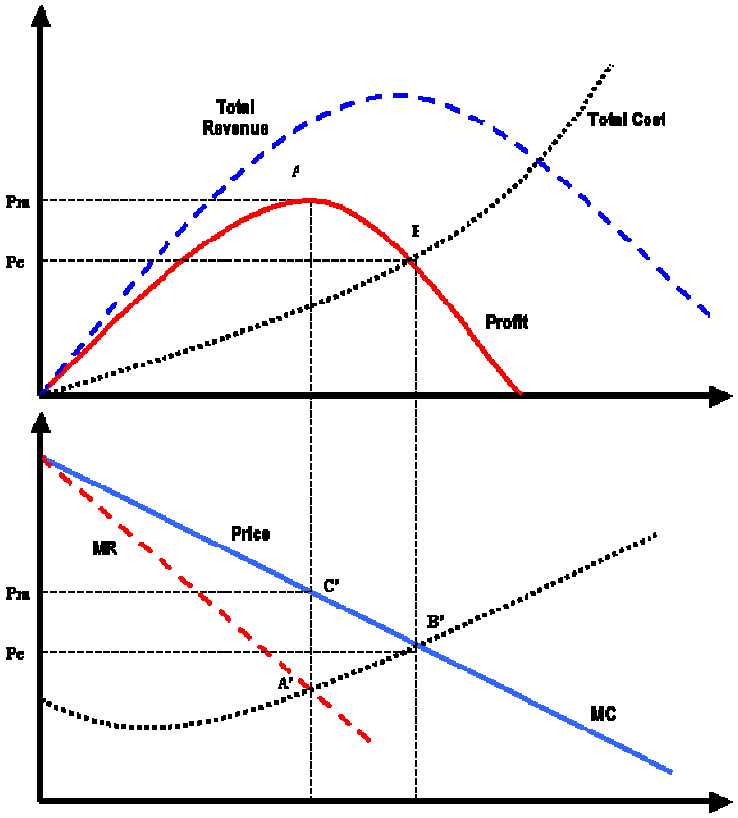

Figure 5
Monopoly profits vs. Perfect Competition losses

As this figure shows, by forcing firms to charge perfect competition prices at point B, where total supply (the sum of M_c) and total demand intersect, the firms individually obtain lower profits than they would if they charged monopoly prices, or prices above marginal revenues (C'- B'). At point A, firms would maximize their profits; past this point, their profits would diminish. Clearly, the addition of losses would lead everyone in the market to a loss (assuming, of course, perfect information).

36. This figure was adapted with permission from STEVE KEEN, DEBUNKING ECONOMICS: THE NAKED EMPEROR OF THE SOCIAL SCIENCES 95 fig.4.5 (2001).

As Keen explains, firms in perfect competition would face a loss because in these markets, marginal costs exceeds marginal revenue, unlike monopoly markets where the opposite is true.[37] The only possible explanation for profit-maximizing, where perfectly competitive firms produce at a higher level of output and lower price, is that they are irrational. The only possible way of making a profit is to collectively coordinate their actions in such a way as to avoid losses.

In short, antitrust policy enforcement brings about market losses, as it forces individual firms to sustain individual losses on the false assumption that under perfect competition, they would produce optimally. Antitrust policy thus ignores that, in the real world, firms need to collectively avoid losses (such as costs) that would otherwise impede them from attaining optimal results. These losses would be avoided through collective coordination.

Policymaking needs to address practical questions faced by flesh-and-bone individuals in their ordinary transactions. In order to do so, it needs to rest on sound economic theory. The perfect competition model is a futile imaginary device that does not explain how markets achieve optimality, except by postulating that the information of the system is already known to economic agents—*before* it has, in fact, passed to them. To put it differently, it assumes that collective coordination among economic agents has already occurred without telling us how. Yet knowing how economic agents coordinate their actions is precisely the key to achieving the optimality it seeks: to this extent, the model is totally hapless. The perfect competition model cannot explain this, because it rests on the flawed assumption that firms would maximize their profits individually without being affected by what other firms do in the market; the optimal production level is attained without considering the collective market outcome. For if, along with economic theory, we assume that economic agents are profit-maximizers, there is no reason to expect that, collectively, they would be willing to take losses.

For this reason, analysts end up twisting the motives of market participants. By taking perfect competition as the ideal of how markets should function, policymakers misleadingly look to uneven information coordination such as the "failures" or "costs" of the economic system that enlightened policymaking can easily spot and eliminate. Loasby observes in this connection:

37. *Id.* at 99.

> [The competitive equilibrium] program produces misleading prescriptions for policy. Those prescriptions are derived from the study of a system that is fully adjusted [*i.e.*, *perfectly competitive markets*] to existing data and in which there is no expectation that these data could ever change: thus any elements that might be necessary to recognize and respond to change are strictly superfluous. Once everything is agreed—and within the analytical convention, finally agreed—there is no further need for any of the apparatus of enquiry, communication, and control which might have been required to secure agreement. It is all to be condemned as [according to taste] organizational slack, *x*-inefficiency, wastes of competition, or monopolistic misallocation. There is not even any reason for the existence of firms.[38]

In the real world, where equilibrium is not gained by mere analytical postulation but through coordinative actions undertaken by entrepreneurs who lack knowledge about their optimal course of action, these so-called "failures" are in fact essential institutional means whereby they can obtain the necessary knowledge to induce them into action. In other words, these institutional "failures"—from the conventional antitrust viewpoint—are in fact necessary in order to coordinate the market system at all.

Richardson noted the pervasive effect of this model in the construction of a mindset for market analysis:

> [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 . . . .[39]

In order to adapt to the conduct of rational firms whose actions are dictated by the premise that prices exceed marginal costs ($P > M_c$), it is necessary for us to reconsider the notion of competition built upon the false duality of two extreme and idealized market structures, between which firms presumably would command some degree of market power. Further, in order to restate the notion of economic competition, we must focus our attention on the problem of collective knowledge, where firms must coordinate in order to avoid losses.

38. Brian J. Loasby, *Economics of Dispersed and Incomplete Information*, *in* METHOD, PROCESS AND AUSTRIAN ECONOMICS: ESSAYS IN HONOR OF LUDWIG VON MISES 113 (Israel M. Kirzner ed., 1982). In a similar vein, see SCHUMPETER, *supra* note 2.

39. RICHARDSON, *supra* note 33, at 39.

V. THE ONLY GOAL OF COMPETITION POLICY: ENABLING THE SEARCH FOR KNOWLEDGE

A restatement of competition policy, naturally, must reinstate the notion of competition along the lines of market process. In this sense, McNulty argued:

> That perfect competition is an ideal state, incapable of actual realization, is a familiar theme of economic literature. That for various reasons it would be less than altogether desirable, even if it were attainable, is also widely acknowledged. But that perfect competition is a state of affairs quite incompatible with the idea of any and all competition has been insufficiently emphasized.[40]

Perfect competition is no competition at all, for the very simple reason that it is a situation where all potential for exchanges has already been exhausted and all profit opportunities have already been seized.

Instead of assuming that knowledge about the *collective* behavior of firms is readily known to each market, I propose adopting a competition model governed by the opposite assumption—that such knowledge is missing and, therefore, no one in the system knows how others will behave in response to anticipated changes in future demand. This alternative vision of competition assumes individuals would react differently to anticipated events: individuals have differing capacities for awareness about new market information, prejudices and beliefs condition the type and quantity of knowledge which individuals internalize and assimilate, etc. Under this vision, institutions play a crucial role in explaining how market exchanges are brought about via a process whereby knowledge is conveyed to some individuals and denied to others.[41]

Market competition is a dynamic phenomenon whereby alert entrepreneurs seize unfolding profit opportunities that are constantly changing. In this model, labor division, specialization, and differentiation take place thanks to the creativity of entrepreneurs. However, since people are not equally creative, it follows that not all opportunities will be available to all entrepreneurs, as they will interpret market information about new goods,

40. Paul J. McNulty, *Economic Theory and the Meaning of Competition*, *in* THE COMPETITIVE ECONOMY: SELECTED READINGS 65–66 (Yale Brozen ed., 1975).

41. In this respect the institutional paradigm represented in schools of economic thought—such as the Austrian school (begun by Menger in the last century and developed in this century by Mises, Hayek, Lachmann, and Kirzner), the Subjectivist school (Shackle), and the post-Marshallian school (Penrose, Richardson, Earl, and Foss)—has emphasized the need to focus on the institutional restraints that determine trade, rather than on trade itself. Nicolai J. Foss, *Austrian and Post-Marshallian Economics: The Bridging Work of George Richardson*, *in* ECONOMIC ORGANIZATION, CAPABILITIES AND CO-ORDINATION: ESSAYS IN HONOUR OF G. B. RICHARDSON 138–43, 149–50 (Nicolai J. Foss & Brian J. Loasby eds., 1988).

consumer preferences, tastes, and needs differently according to their subjective perceptions. Indeed, progress is possible if only a few attentive entrepreneurs can spot and/or seize the profit opportunities presented by the changing circumstances in which markets constantly evolve. Only by enabling a few (as opposed to infinite) entrepreneurs to seize the opportunity would investments take place, since a simultaneous attempt by all to seize it would result in collective losses. Some individuals are excluded momentarily from obtaining access to certain social resources, while others are granted exclusivity.

This is the purpose of market institutions such as property rights, contractual devices, arrangements, and even informal collaboration that results, in the eyes of antitrust advocates, in "restrictive behavior." By contrast, Schumpeter, who clearly grasped the dynamic essence of market capitalism, noted the role of such devices thus:

> In analyzing such [restrictive] business strategy ex visu of a given point of time, the investigating economist or government agent sees price policies that seem to him predatory and restrictions of output that seem to him synonymous with loss of opportunities to produce. He does not see that restrictions of this type are, in the conditions of the perennial gale, incidents, often unavoidable incidents, of a long run process of expansion which they protect rather than impede. There is no more of paradox in this than there is in saying that motorcars are travelling [sic] faster than they otherwise would because they are provided with brakes.[42]

Naturally, these devices also interrupt or block outsiders' access to similar opportunities, but in doing so they ensure the effective exploitation of the available opportunity. Thus, "the availability of [the] kind of information related to competitive production depends in particular on the existence of restraints which, in varying degree, reduce the freedom of action of individual entrepreneurs."[43]

It is essential, however, that businesses are free from any other obstacle to their awareness of profit opportunities. Thus, in an evolutionary market setting, policymakers would only prohibit those restrictions that impose a fixed course of action on or exclude third parties (such as boycotts, cartels set up through government legislation, legal monopolies, etc.). In this setting, regulatory reform and the elimination of legal impediments to trade acquire particular relevance to the policy agenda of competition authorities. By the same token, competition authorities should abstain from intervening when third parties are not affected, even if competitors align their conduct

42. SCHUMPETER, *supra* note 2, at 84.
43. RICHARDSON, *supra* note 33, at 69.

with respect to prices. Richardson explains how increasing returns[44] are compatible with dynamic competition in evolutionary settings.[45] It is not the purpose of this article to embark on the details of this topic, but merely to visualize how embracing this alternative theory—which calls for abandoning the perfect competition premise—inevitably leads to framing an alternative agenda for competition policymakers.

Clearly, this alternative "market process" vision of competition explains the existence of those institutions that we currently find in real life situations: property rights, contracts, arrangements, practices, routines, business reputations, and similar other means of conveying knowledge across the system. Far from neglecting the role of these institutions in the market or treating them as an anomaly, the market process view of competition clearly explains their existence: these institutions are necessary for market competition to become operational. For example, without property rights, it would not be possible to know who has access to what social resources; without exclusive supply contracts, no entrepreneur would be certain about the conduct of other entrepreneurs in connection with the delivery of complementary inputs for her production, and therefore she would probably not invest in such activity; and in a world without business reputation or advertising, firms would find it extremely difficult to anticipate their own levels of output, given their ignorance about the likely output of other firms, and so on.

Institutionally-based (or market process) competition policy would look into the ease with which market processes evolve, unencumbered from contrived liens and burdens, and focus on attaining optimal outcomes. According to O'Driscoll and Rizzo, it is only possible to do so with reference to the processes of which those outcomes are the result: "There are not competitive results unless there is competition. . . . Without competition, there is no reference point to which comparisons with real-world results can be made. In the absence of competitive markets, economic theory cannot tell us what is optimal."[46] Therefore, "[c]ompetitive values or alloca-

44. In the short term, firms would tend to bear increasing production costs, thereby stimulating decreasing returns: costs will increase together with output levels. In the long run, however, industries usually diminish their costs, thereby increasing returns to all participating firms. Alfred Marshall termed this finding a "law of increasing return." According to this law, long term equilibrium would bring about lower production costs for all the firms participating in an industry—no matter the output increases. 1 ALFRED MARSHALL, PRINCIPLES OF ECONOMICS 318 (9th variorum ed. 1961).

45. G.B. Richardson, *Competition, Innovation and Increasing Returns* (DRUID Working Paper No. 96-10, July 1996), *available at* http://www.druid.dk/uploads/tx_picturedb/wp96-10.pdf.

46. GERALD P. O'DRISCOLL, JR. & MARIO J. RIZZO, THE ECONOMICS OF TIME AND IGNORANCE 143 (1985).

tions do not exist 'out there,' independently ascertainable apart from actual market results."[47]

In fact, "[t]here are a few abstract distinctions that can be posited about the outcomes of monopolistic as compared with competitive markets."[48] In a similar vein, Hayek declared: "[C]ompetition is a sensible procedure to use only if we do not know beforehand who will do best. . . . [I]t will only tell us, however, only who did best on the particular occasion, and not necessarily that each did as well as he could have done . . . ."[49]

Under these guidelines, competition agencies would be called to challenge any restrictions (either business- or government-created) that constrain market growth. As Adam Smith believed, economic progress depends on market size; therefore, competition agencies should encourage division of labor by lifting barriers to trade that would otherwise reduce market size. Competition policymaking will promote dynamic competition inasmuch it is capable of removing barriers that limit market size. In short, competition policymaking should not attempt to devise "optimal" market outcomes or surrogate market allocation; rather, it should direct its endeavors towards eliminating obstacles that artificially reduce market size.

VI. REDEFINING THE COMPETITION POLICY AGENDA

In view of the theoretical considerations already discussed, the alternative, institutionally-based competition policy demands an alternative policy agenda, as follows:

Promotion of regulatory reform and open trade as a means of opening legal bottlenecks to competition. Competition agencies should concentrate on eliminating official barriers to trade through deregulation and privatization on the one hand, and trade liberalization on the other hand. This would create the preconditions for firms to enter the market by reducing transaction costs in the system. Competition agencies also should concentrate on simplifying administrative rules so as to create a level playing field. However, the flexibility needed to adapt to market change should not be sacrificed for clear principles. Competition authorities should lay down clear principles with respect to intellectual property, to avoid deterring research and innovative activities by inappropriately interfering with them.

47. *Id.*
48. *Id.* at 144.
49. HAYEK, *supra* note 25, at 67–68.

Differentiating standards from trade restrictions. Competition authorities should promote competition between competing networks and standards. Markets, and not governments, should determine which new features and products should be introduced into the marketplace, which standards should succeed, and whether open standards should achieve general acceptance. Consumers should not be prevented from enjoying the benefits of the network externalities that result from the adoption of common systems and standards, even if this results in the universal acceptance of a single product. Competition agencies should rely on white papers and other means of identifying voluntary business standards for each industry. These instruments could enable the authorities to devise general principles of fair conduct, a necessary element to promote regulatory reform.

Targeting obstacles to potential third-party competitors entering the market. These restrictions include both quasi-legal restraints on those who would want to depart from standardized conventions, as well as corporate rules, such as fixing the professional fees of chartered liberal professions such as the law, medicine, and others.

Facilitating the means for settling disputes. Competition agencies should advocate means of dispute resolution that leave the allocation of rights in dispute to the economic agents involved in the controversy, rather than appealing to the dictum of a government regulatory agency that is potentially less connected with the particulars of the case in dispute. Also, competition authorities and sectorial regulators should improve their institutional cooperation in cases where public policy considerations other than the pursuit of innovation, entrepreneurship, and economic growth dictate legal regulations (such as preservation of labor, market access to less efficient competitors, and so on).

Enforcing pro-competition guidelines in privatization of public assets, by eliminating concessions to legal monopolies during transitional periods, or by requiring privatizing firms to fulfill strict pro-competitive conditions such as industrial restructuring and investment targeting during transitional stages.

In Latin America, these guidelines are seldom pursued consistently.[50] Instead, the bulk of competition agencies' work is devoted to antitrust prosecutions, in which cumbersome measures of market power coupled with an intuitive balancing of economic efficiencies consume most of their

50. *See* IGNACIO DE LEÓN, LATIN AMERICAN COMPETITION LAW AND POLICY: A POLICY IN SEARCH OF IDENTITY 161–65 (2001).

effective time, and ultimately compromise the predictability and stability of the rule of law.[51]

CONCLUSION

Conventional antitrust policy assumptions tell us that business' manipulations through contractual devices, exclusionary conduct, and "misuse" of property rights create market failures that are responsible for the sub-optimal allocation of social resources.[52] From this perspective, restricting monopolistic behavior is necessary if markets are to function properly. Instead of giving names to market arrangements, however, the question policymaking should ask is what would happen if such restrictions were absent altogether. This question is never answered, of course, because under perfect competition models such a problem does not exist: that is, monopolistic behavior is eliminated through antitrust policies, and remaining market participants' knowledge of each other's behavior is postulated by the model; hence analysts are left to grapple with a problem that does not exist in the real world.

As Richardson argues:

> [B]y neglecting the whole problem of information, the perfect competition model condemns itself not only to unrealism but to inadequacy even as a hypothetical system. It is no defence [sic] to appeal, moreover, to the analogy of mechanical statics which, though neglecting friction, can still identify the equilibrium position of a system of forces, for we cannot demonstrate that economic systems have such positions of rest without reference to expectations and information which could not be presumed to be available in the absence of restraints.[53]

The conventional antitrust perspective imposes a contrived view of market function that entirely disregards a fundamental problem: firms do not operate in an institutional vacuum; on the contrary, in order to maximize their profits they must take into account other market players' decisions. The coordination of knowledge among market players is thus the key economic problem in search of policy solutions.

This is a problem that requires an alternative understanding of the economic problems faced by entrepreneurs. Addleson states: "[T]he econo-

51. Judging the success of a policy on the basis of its capacity to achieve its goals creates problems because, as Rizzo reminds us, "[a] utilitarian or balancing framework would require us to trace the full effects of each (tentative) judicial decision, and then evaluate it against the particular utilitarian standard adopted," which places an unbearable burden of information on the shoulders of whoever must decide the success of a policy. Mario J. Rizzo, *Rules Versus Cost-Benefit Analysis in the Common Law*, 4 CATO J. 865, 873 (1985).

52. *See* Demsetz, *supra* note 22.

53. RICHARDSON, *supra* note 33, at 69.

mists' meaning[] of competition requires a taxonomy, not a definition; and a taxonomy needs a framework."[54] Wubben is even more assertive when contending that what is needed is a new epistemology.[55] If criticizing antitrust policy must begin at the epistemological level, where the relevant questions are determined and the premises of the analysis are laid down, it is necessary to define an alternative paradigm in order to understand market phenomena and competition.

Competition policy has to adopt an alternative perception of the way in which the market functions, where the knowledge coordination problem becomes central. In this alternative paradigm, one has to look into economic institutions shaping market transactions before condemning them as "anticompetitive," "monopolistic," and so forth. Competition analysis must be enriched with comparative institutional analysis, economic history, and other social sciences in order to gain effectiveness. Exploring the role of culture in competition policy development immediately raises important issues of law and economics that are far from settled. Given its broader perspective, institutional analysis overcomes the constraints of the legal wording of a competition statute that holds competition policy (understood as the development of entrepreneurial ways and promotion of creative innovation) in a very tight grip. Such reliance has driven policy makers away from a more complete understanding of those issues that explain the fundamental role played by institutions.

It follows from the foregoing that the substratum of economic institutions such as culture, learned habits, and ethical values play a fundamental role in shaping competition policymaking. To shape competition policy appropriately one must take into consideration the institutional development of the society, which will allow one to evaluate any potential restrictions on competition that may exist in the form of government policies.

An institutional perspective of competition policy grounds the analysis in the social rules where the policy is actually enforced. Acknowledging this fact reveals several crucial points. First, competition policy, like any human endeavor, is grounded in ideology and normative values, not hard science. This is not necessarily a disadvantage, provided analysts are aware of the nature of the ethical debate entertained by competition policy authorities. In this way, the necessary institutional constraints will be instituted to prevent competition policy from becoming unbridled or

54. Mark Addleson, *Competition*, *in* THE ELGAR COMPANION TO AUSTRIAN ECONOMICS 97 (Peter J. Boettke ed., 1994).

55. Emiel Wubben, *Austrian Economics and Uncertainty: On a Non-Deterministic but Non-Haphazard Future*, *in* NEW PERSPECTIVES ON AUSTRIAN ECONOMICS 106–07 (Gerrit Meijer ed., 1995).

uncontrolled. Indeed, such constraints are essential to reinforcing the rule of law, predictability of the policy, and transparency of market rules.

Second, the fact that normative standards are ultimately ethical does not necessarily undermine the conclusions drawn from an understanding of market dynamics. For this reason, rather than judging entrepreneurial behavior from a normative standpoint, competition analysts should concentrate on making surrounding institutions more transparent and open to entrepreneurs, so as to draw tentative guidelines about the best possible way to promote market exchanges. By doing away with imaginary constructions of contrived social welfare, and closely inspecting and looking at past business experience, the market exchanges have a greater opportunity to reach their utmost potential.

Third, competition authorities should avoid falling into the intellectual trap of endorsing contrived social welfare standards that essentially contradict market competition. Developing and transitioning countries should be particularly careful to remember that the ultimate goal of competition must be connected to the development of competitiveness, innovation, and economic development.

Fourth, culture is a fundamental factor that policymakers must take into account at the time of a competition policy's development. A central planning tradition perpetuates ways of conceiving policymaking that may run contrary to 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 in the markets.

These fundamental reasons suggest that the competition authorities' policy agenda should address regulatory reform and exercise strong "competition advocacy," thereby challenging government regulations and rules that inhibit innovation and business development. Based on the experience of Latin America and other countries outside the region, this should become a central concern of policymaking for competition authorities. It is essential that professional, independent, and highly motivated officials enforce competition policy. In addition, proper rules should be instituted to ensure that decisions are balanced, carefully drafted, quickly enforced, and above all, always controlled by a well-trained judiciary.

The conventional competition policymaking usually applied in developed countries has suffered evident mutation in the anti-market institutional constraints of Latin American societies; hence, optimal design of competition policy must be crafted to overcome the particular anti-capitalist bias prevailing in the region's economic culture. Instead of blaming the poor

market performance and low competitive levels of Latin American firms on the high industrial concentration that prevails among Latin America's domestic markets, competition agencies would fare better if they went one step further and asked themselves about the causes of such concentration. They probably will not find the "invisible hand" of markets which, if anything, has been absent from the region, dominated as it is by mercantilist trade policies and high government dirigisme. More likely, they will find the "visible hand" of governments behind such concentration. Godek has put it very simply: "Worrying about antitrust issues shows an unhealthy anxiety about the imagined ills of capitalism."[56]

56. Paul E. Godek, *One U.S. Export Eastern Europe Does Not Need*, REGULATION MAG., Winter 1992, at 20, *available at* http://www.cato.org/pubs/regulation/regv15n1/reg15n1-currents.html#godek.