Cognitive dissonance in the methodology of Competition Policy

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A recent assessment by the IDB Secretariat at the annual meeting of the Latin American Competition Forum examined the problem of “mainstreaming” antitrust policy among economic policies across the region. The background note advanced several hypotheses about why the policy does not scale to the forefront of countries economic policies. The IDB vividly stated: “Competition Policy (…) is still a second division player waiting to be promoted to the premier league.” (IDB, 2014: 7).² Antitrust policy has struggled for a long time to gain credibility among the core of economic policies, with uncertain results.

To be sure, disappointment over antitrust policy is not confined to Latin America. Assessing antitrust policy in the U.S., Crandall and Winston (2005: 4) conclude that they “find little empirical evidence that past interventions have provided much benefit to consumers.” Similarly, Teece (2012: 205) indicates “the lack of compelling evidence indicating that antitrust is not aiding consumers is a matter of concern, and motivates inquiry here.”

Two lines of thought have avoided answering the difficult question of why, unlike other regulatory policies, competition policies in Latin America (and elsewhere) have struggled to attain tangible results. The first line of analysis blames on the institutional setting of developing countries for failing to enforce antitrust policy “adequately”. In a recent paper, Fox and Gal (2014: 2) highlight particular traits within developing countries such as “scarce human and financial resources, malfunctioning markets and poor infrastructure, systemic poverty, cronyism, and corruption” as responsible for their incapacity to sustain competition enforcement along international best standards.

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² The Secretariat highlighted the problem as follows: “There is no clear picture on how competition policy principles are being used, or mainstreamed in the overall economic framework of LAC countries. The fact is that competition policy is not generally perceived by key policy makers as a fundamental pillar to boost the wealth of LAC countries. Therefore, competition policy is often inexistent in the political agenda of most governments leaving the institutional arrangements with a low-key profile and a scarce budget allocation. Moreover, competition policy issues are not generally a topic (at least directly) in most political campaigns, despite the fact that a large percentage of the population purchasing power (especially those with lower income) is affected by anticompetitive distortions in basic goods and services. In fact, in the LAC region there is a homogenized political discourse that often addresses the need to reduce consumer prices, but that seldom references competition policy as the necessary tool to that end.” (IDB, 2014: 7)
Clearly this ethnocentric view of the policy leads to a *non sequitur*. In this circular reasoning, the lack of development displayed by these proxies undermines antitrust policy, which is intended to stir development. Upon closer inspection, it also misconstrues reality by implicitly postulating the claim that consensus exists in the implementation of antitrust policy among developed countries, which is simply not the case. Yet, this view is actually quite extended, especially among international “reviewers” who have increasingly become a source of peer pressure on what competition policy “should” and shouldn’t be; these include steering mechanisms as diverse as the International Competition Network, the OECD Competition Policy Committee Recommendations, the OECD/IDB Latin American Competition Forum, the Centre for Competition Policy, and similar others.

The second line of interpretation assumes an exculpatory position, by taking “experimentation” in the policy’s wavering legal standards as a sign of virtuosity. Thus, Kovacic (2005) praises the “learning process” that allegedly accrues from tinkering with market outcomes through antitrust policy interventions, thereby resulting in changing rules developed through this process over time.7

By contrast, in this paper, we hold that differences do exist in policy enforcement but these should not be credited to the country’s level of development; rather they stem from contradictions in the policy’s theoretical foundations. Moreover, we contend that wavering legal standards, far from encapsulating a kernel of attributed wisdom, are severe policy flaws that undermine its legitimacy. Indeed, “experimentation” in the search of optimal antitrust policy, has affected the credibility of the policy to the extent that it has rendered impossible to define what actually the policy seeks and how it measures performance results. In fact, what seems uncontestable is the erosive effects of antitrust policy over the rule of law.

Lack of credibility towards competition policy follows a deeper crisis of identity. The façade of the policy, in truth, but adopts two separate, distinct operational frameworks: antitrust policy and competition advocacy, respectively. Initially, however, this was not the case. Antitrust policy historically emerged as a government attempt to curb

3 http://www.internationalcompetitionnetwork.org/
4 http://www.oecd.org/daf/competition/recommendations.htm
5 http://www.oecd.org/competition/latinamerica/
6 http://competitionpolicy.ac.uk/home
7 Kovacic (2005) states: “Competition policy is a work in progress. From the adoption of the first national antitrust statute in Canada in 1889, the history of competition law has featured a continuing search for optimal statutory commands, institutional designs, and operational techniques (Gavil et. al. 2002; Chs. 1, 9). Recent decades have witnessed extraordinary change as older and newer competition systems seek better practices for defining substantive commands, setting priorities, choosing cases, and selecting remedies.”
perceived monopolistic power of industrial conglomerates and “trusts” emerged in the U.S. during the reconstruction after the Civil War. This endeavor, which was sustained somewhat intuitively back then, found intellectual respectability within the economics profession in the studies of the firm and competition that were conducted in the 1930s. These studies, led by Joan Robinson’s model of Imperfect Competition, essentially misconstrued the competitive process into an equilibrium framework, which led scholars to support antitrust policy on flaky analytical foundations that completely disregarded the institutions where the competitive process takes place. This essay postulates that Robinson’s theory produced a “cognitive dissonance” between markets and institutions that resulted in the simplistic disapproval of business agreements or unilateral practices that entrepreneurs use to develop competitive capabilities, and to seize profit opportunities through a trial and error learning process.

In the dominant creed that emerged since then within the economics profession market failures allegedly made impossible it to achieve perfect competition in product markets; thus these “imperfections” had to be corrected through government antitrust intervention so to restore optimal equilibria lost to monopolistic behavior. Later, the policy shifted from this “rigid” analytical framework into varying degrees of more “flexible” interpretations that laid down the possible existence of “tolerable” imperfections due to their pro-competitive effects. Nonetheless, the wavering interpretation of these legal standards undermined legal certainty, which is the bedrock of market functioning.

In this essay we focus our attention on how the theoretical wellsprings of antitrust theory have rendered the policy unable to build stable legal doctrines, and to be executed consistently, which is reflected in no small part, in the lack of adequate metrics with which to measure policy performance.

The lack of precision on the policy goals has brought about a key difficulty to measure policy performance, and to make it accountable, judicially or otherwise. To be true, the literature has been very prolific in developing indicators, but these are indicators mostly related to competition agencies’ performance, rather than measurements on competition dynamics itself. Moreover, as Rodriguez and DeNardis (2008) have said, they are “perceptions-based” i.e. based on the mere opinion of those who conduct the measurement; hence, they are liable to heterogeneous understanding and personal bias.

In a broader sense, the imprecision of antitrust policy goals has led enforcers into dithering policy action and subsequent loss of legitimacy. Competition agencies in the region are either excluded or simply ignored from key decision-making in economic policy matters. These agencies are sometimes not even officially acknowledged,8

8 The case of the Argentine Competition court illustrates the point. Created by the Competition Act of 1999 it has yet to be appointed; similarly, lagging legal reforms in Costa Rica to improve the current
supportive competition legislation is blocked or national governments condemn them to oblivion as soon as they show a minimum degree of independence.\(^9\)

This paper argues that the reason for this record does not rest on the lack of willingness or political clout of the competition agencies themselves, usually integrated by highly professional officials. Rather, it is found in its analytical bias, which links competition analysis to theoretical models of industrial organization without any reference to the institutions, rules or customs under which such industrial organization takes shape. In light of this neglect, antitrust policy formulates a contrived set of normative goals that have little understanding of the rationale behind firms’ market conduct. Ultimately, the Achilles Heel of Competition Policy rests on its inherent disconnection with the set of institutional rules wherein business strategies take shape and can be understood.

This paper starts by highlighting how this cognitive dissonance creates a gulf of expectations between antitrust enforcement and the perceived results of such activity on the promotion of competition, as revealed in the Global Competitiveness Report survey.

Given the divergence found, we examine the historical roots of the theoretical background that gave rise to this cognitive dissonance, namely, the model of Imperfect Competition developed by Joan Robinson in the mid-1930s. We study the implications of this model into the normative analytical mindset that emerged hitherto for the assessment of competition, as well as the neglect that stirred over institutional analysis and a better understanding of the competitive implications of legal barriers.

Next, our analysis will examine how this analytical oversight made its way through antitrust policymaking. We will focus our attention on the lack of proper competition metrics with which to measure the effects of the policy; the unpredictable and unstable case law arising out of policy enforcement; the legal formalism that casts a shadow over economic substance and finally, the neglected role of competition advocacy, as opposed to the active antitrust enforcement role assumed by competition agencies.

The last section will outline some alternative metrics proposed for assessing competition.

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\(^9\) In 2001, the Superintendente of Colombia’s SIC, tendered his resignation after his decision to block a merger in the airline industry was objected by the Government, yielding to the pressure of vested interests in this industry; in Venezuela, the Superintendente of Procompetencia also tendered his resignation in 2000 due to the interference of the government on Procompetencia’s decisions.
1. The origins of cognitive dissonance in antitrust theory.

The antitrust policy agenda suffers from inherited ambiguity that is readily visible in its conflicting goals, whether economic efficiency (most often, short term efficiency also associated to Consumer Welfare) or some distributive goal (i.e. equity).\textsuperscript{10}

Yet, the point to be emphasized here is not about choosing between conflicting normative goals but rather to highlight that these goals emerge from the underlying inconsistencies of conventional competition theory. These theoretical inconsistencies render the ethos of the policy undefined, hence the proliferation of diverging normative policy goals.

These tensions in the agenda are traceable back to the origins of Neoclassical Industrial Organization analysis in the 1930s,\textsuperscript{11} inaugurated by Joan Robinson’s theory of Imperfect Competition (IC) (1933). Robinson’s theory was purely inspired by the search of “optimal” equilibrium thinking of markets. Assuming that optimal equilibrium represented under perfect competition (PC) was the best possible outcome of markets, Robinson displayed a picture of possible states away from PC, where businesses exploited knowledge advantages in order to seize monopoly rents.

By the same token, antitrust analysis ignored the problem of how competitive knowledge is transmitted through institutional channels; how cooperation between competitors is necessary to stabilize expectations and why contracts, customs, routines, standards, and the like emerge in order to pass valuable information on to market agents that help them overcome uncertainty that otherwise impedes investments to take place (Richardson, 1960) or to create new knowledge through disruptive innovation, to help them overcome technological barriers impeding them access to the market (Schumpeter, 1942). None of these research themes were part of Robinson’s quest, who was contented with modeling market exchanges under the hypothesized departures from the “perfect competition” situation, while postulating institutions as “givens” within which market exchanges would allegedly take place.

Under Robinson’s model, equilibrium was implicit in her assumption of unchanging consumer preferences that would make part of the producer’s negative slope demand curve. Each producer is a monopolist of his own production, thereby facing a negative

\textsuperscript{10} Martin (2008) does an updated discussion along with a review of the extensive literature on this matter. In his view, how one ought to measure market performance (consumer welfare or net social welfare) remains a subject of discussion. Moreover, use of the economic welfare standard is characterized by judicial application that is inconsistent with mainstream economics.

\textsuperscript{11} This analysis has received different names: “blackboard economics”; “equilibrium analysis,” or “neoclassical competition economics.” For the sake of simplicity we will brand it antitrust analysis, given the implications that later would have upon the conceptualization of Industrial Organization and antitrust analysis.
slope demand curve; likewise, oligopolies also are protected from third party competitors. Why? Simply because Robinson postulated it so.\textsuperscript{12}

Robinson thus postulated departures from the perfect competition case that resulted in more complex –yet always equilibrium- models of product differentiation and advertising, thus yielding to a vantage point that favored “imperfection” over “competition”. This construction, which Loasby (1989) vividly called “Joan Robinson’s Wrong Turning”, would be rejected by Robinson herself,\textsuperscript{13} but by then, the intellectual support of “equilibrium” Industrial Organization postulating competition along structural models of “imperfect competition”, while presenting monopolies as “exploitative” market structures was already set underway.\textsuperscript{14}

Hence, the antitrust analysis rejects, almost as a matter of principle, any analysis of the rules, contracts, laws, and standards that enable market transactions. These are simply assumed while it patronizes against the “imperfection” resource allocation within these markets, located away from perfect competition, wherever that is. Simultaneously, it ignores the assessment of these market institutions that focuses upon transmission of competitive knowledge among market agents. Robinson’s quest to formalize a competition model in terms of mathematical equilibrium analysis\textsuperscript{15} led her to implicitly

\textsuperscript{12} Of course, Robinson’s Imperfect Competition rested on contrived assumptions about the nature of demand. It is a demand curve conditioned by the existence of substitutes, where consumers’ preferences are well defined. Unlike the previous generation of economists (notably, Alfred Marshall\textsuperscript{12}), who clearly foresaw changes in demand, resulting from changes in the underlying consumer preferences as the short term evolved towards the long term, Robinson did not bother with this; nor she clarified what sort of preferences would enable economic agents to reach “optimality.” She simply assumed that businesses manipulated individual preferences to their benefit –i.e. monopolistic conduct, and that, in her view, explained eventual changes in the system.

\textsuperscript{13} Explicitly she said: ‘When I prepared Economics of Imperfect Competition on static assumptions, I took a wrong turning; the right road would have been to abandon static analysis and to reconcile the analysis with Marshall’s theory of development.’(Robinson, 1951: viii) Later, she would reaffirm this conviction: ‘I took the wrong turn in my analysis of imperfect competition, by concentrating on the “imperfect” and ignoring “competition”.’ Thus, instead of abandoning static analysis and trying to reconcile my analysis with Marshall’s theory of development, I followed Pigou and prepared Economics of Imperfect Competition on static foundations.’

\textsuperscript{14} By 1934 the static vision of (imperfect) competition, had been firmly established in economic thought, as well as the widespread misunderstanding on Marshall’s equilibrium system. This is clearly revealed in Kaldor’s impeccable logic, as follows: “long-period static equilibrium and perfect competition are incompatible assumptions.” (Kaldor, 1969: 46) Thereafter, public policy arising from such theoretical assumption was biased against increasing returns, as potential source of monopolistic power. Evidently, such model misconstrued the creative, ongoing nature of markets. Under a dynamic perspective of markets, Kaldor’s long-term equilibrium under such static bounds would have never been postulated; much less the assumption that Marshall ever founded his analysis upon the notion of perfect competition, as Kaldor naively seems to argue.

\textsuperscript{15} Interestingly, Robinson would later acknowledge her own mistake in developing her competition theory in equilibrium terms: “The neoclassical economist thinks of a position of equilibrium as a position towards which an economy is tending to move as time goes by. But it is impossible for a system to get into a
assume institutions away as exogenous “givens”, rather than endogenous variables to reckon. It also bequeathed the next generation of economists (and eventually, competition scholars) a contrived “blackboard” view of static markets dominated by monopolies of varying size and “power”.  

This analytical paradigm, based on the “perfectibility” of markets through enlightened elimination of business “contrivances” built a naïve dent that riddled policymaking ever since. For it focused the attention into selecting whether short run Consumer Welfare should prevail over long run Productive Efficiency, instead of questioning whether the whole exercise was pointless, as it ignored the very object in need of analysis, namely, business institutions. Objections against the unrealism of the premises of the antitrust analysis (Chamberlin 1950, 1957; Clark, 1957: 158-156; Richardson, 1960; Kirzner, 1973) were dismissed on methodological grounds by arguing in favor of predictability over realism of the models. (Friedman, 1955)

position of equilibrium, for the very nature of equilibrium is that the system is already in it, and has been in it for a certain length of time. (Robinson 1953-4; quoted from Robinson, supra n 21, p.120, italics in original).

16 The modern theory of industrial organization was born out of a number of academic projects in the U.S. already yielding significant results by the early 1950s. It focused on industry-wide studies, tested the hypothesis that market or industrial structures determined member firms’ conduct and performance. (Corley, 1990: 88) This “finding” resulted in the core Structure-Conduct-Performance “paradigm” which still today dominates much of antitrust policy analysis. Already in 1970 a scholar said that “the public policy interest and applications are now propelling the field of industrial organization so strongly that it would be impossible to stop the momentum. Consequently, professional workers in this field have a high responsibility and an unusual opportunity. The market structure-conduct-performance approach is now a basis of analysis and for judgments in much of the work in the antitrust field in both the Department of Justice and the Federal Trade Commission. The selection and analysis of cases is being influenced to some extent by this framework of analysis as is much of the basic research and data collection.” (Grether, 1970: 86)

17 Chamberlin (1957: 72) noted the incongruity of using perfect competition as a point of departure for measurement of reality “If all rents are included within the cost curve of the firm, equilibrium for the firm under pure competition will always involve tangency of the demand curve and the cost curve at the minimum point for the latter, and hence the equality of price and marginal cost. But it does not follow that the equilibrium of a firm under monopolistic competition may be compared with such assumed conditions for the same firm in order to obtain a measure of the departure from pure competition. The reason is that the definition of pure competition involves conditions beyond the individual firm. Pure competition could be realized for the firm in question only if there were a very large number of what does not and cannot exist when as in real life the demand is for a diversified product. To imagine its existence is to indulge in flights of fancy which deprive the comparisons of any useful meaning.” Chamberlin rightly notes the absurdity of this exercise when used for any other purpose different from pure mathematical conjecture.

18 Interestingly, in 1960 G.B. Richardson, focused his attention not on the “realism” of the analytical premises, but on the inner consistency of the perfect competition hypothesis as a theoretical construct, by pointing the logical contradictions implicit in the antitrust analysis, namely, that a state of competitive equilibrium can neither be maintained, achieved, or even approached unless there are entrepreneurs with differing capabilities, and the system has some level of “asymmetric information”, because if they all had equal chances and knowledge of profit opportunities (i.e. the conditions that were supposed to
Due to its analytical bias focused on market ideal outcomes, rather than on connecting institutions, antitrust analysis (and, by implication, antitrust policy) fell into a sort of “cognitive dissonance”, whereby the policy has sought to attain idealistic normative goals (most often, Consumer Welfare) that have little to do with the way institutions shape business conduct; thereby rendering the policy highly ineffective in explaining the rationale behind businesses carrying out limitations to their rivalry, collaboration, and merging activities, with impact on the competitive processes. The following sections explore more in detail the implications of this phenomenon.

However, before we move on into exploring the implications of the “cognitive dissonance” on the assessment of antitrust policy; and its inability to fulfill its role, we should devote a few words to the nature of business practices and institutional means devised by entrepreneurs to compete in the marketplace.

Entrepreneurs compete through a trial-and-error learning process, whereby institutional arrangements are set forth and rearranged as change in the circumstances dictate. This concept is far from the “positional” character of competition that underlies in the antitrust analysis, where competition is gauged according to its distance from optimal perfect competition.

In the trial-and-error competitiveness process, entrepreneurs profit from knowledge gaps and cracks of the market that make opportunities available only to a few. They do so through awareness that leads them into building capabilities for innovating which, by definition, entails seizing opportunities that were unseen or unreachable to others. Thus, business competition is about controlling knowledge that, if it were equally available to everyone, it would leave no business opportunity to seize. As Richardson (1960: 57) noted “a general profit opportunity, which is both known to everyone and equally capable of being exploited by everyone, is, in an important sense, 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.” Control of knowledge is therefore essential to the competitive process; exactly the opposite assumption of the antitrust analysis.

Thus, in the real world, away from idealized abstractions that assume information is available to all (but never explain how this is possible), constraints on some can simultaneously be resources on others. In fact, the notion of property, essential for economic development, is sustained on this very recognition. Thus, the concept of the

prevail under perfect competition), no one would in fact be able to seize it or they would all race to seize it causing the market to collapse, due to overinvestments. Richardson was ignored altogether, in no small measure, due to the prevalence of the equilibrium paradigm, which simply could not assimilate the criticism into its analytical framework.
felix culpa applies here in all its dimension. Bellante (2004: 17) put it eloquently: “Society gets as much product diversity as it is willing to pay for.”

In short, the “perfection” in the real world would be one where monopoly and competition coexisted. As Chamberlin (1950) had stated, in real world transactions, away from blackboard economics, “the welfare ideal itself involves a blend of monopoly and competition and is therefore correctly described as one of monopolistic competition.”

Yet, the antitrust analysis misconstrues the connecting role of market institutions between short run and long run market outcomes, the first being merely related to resource allocation of existing resources, while the long run ones is associated to the creation of new resources through innovation. These institutions (i.e. contracts; rule of law; etc.) allow market agents to reduce their uncertainty enough to induce them to carry out investments that will enhance output in the long run (Richardson, 1960).

In sum, business restraints are not only inevitable; they are indispensable to frame the trial-and-error competitive process. Yet, most antitrust scholars regard many of these practices “anticompetitive” due to their conceptual “imperfect competition” framework. Moreover, this framework neglects proper assessment of the institutional role played by these conducts in the market order.

Several consequences accrue from this antitrust analysis’s cognitive dissonance upon the institutional role of business conducts otherwise deemed “anticompetitive”. We believe this is ultimately responsible for alienating the policy from addressing the practical tasks any policymaking should accomplish: accountability, predictability and consistency. We will see them in order.

2. Unfathomable competition metrics.

The first, and perhaps most significant instance of antitrust analysis’ cognitive dissonance is the lack of adequate metrics to measure antitrust policy performance. Lack of accountability, thus, undermines the credibility of antitrust policy.

Competition metrics are not scarce, but abundance of alternative indicators does not yield a better understanding of the phenomenon, because these policy indicators range from those that give idiosyncratic assessment of economic competition (Rodriguez and DeNardis, 2007) to those that simply elude examination of the phenomenon, and instead focus their attention on the capacity of competition agencies to deliver results.

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19 Richardson (1960: 39) also said: “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.”

20 According to these authors the extensive list of indicators of antitrust policy performance found in the literature “rely on subjective performance metrics that have undergone little direct scrutiny by users.”
In other words, these are not metrics associated to objective ends, as one would expect out of policy intervention such as $x$ number of houses built, $y$ number of students graduated from high school, or $z$ number of criminal cases prosecuted. In antitrust policy cases objective ends are impossible to attain because diverging views on what economic competition actually is makes policy goals a moving target. On the contrary, personal views abound on whether competition on the market has actually increased (e.g. through improved services; better quality; enhanced access to products) or not as a result of policy interventions, simply because there is no clear indication of whether ensuing short-run price reductions compensate long-run productive efficiency losses (Tardiff, 2009).

Clearly, this is not possible in the case of antitrust analysis because it compares imperfect states of reality with the idealistic (thus impossible) conditions that would exist if perfect competition prevailed. Such analysis cannot yield any meaningful metrics measuring tangible results, but opens the way for each analyst to include her own view of what is missing from departed “imperfect” situations away from perfect competition, to use it as proxy of what then needs to be measured. In other words, each analyst surrogates her own opinion for what is actually “competitive” and what is not. Policy interventions are seldom followed through to check whether practical results are attained due to this lack of clarity on what the goals of intervention really are.

Rodriguez and DeNardis (2007; 2008) reaffirm this view, as they put the blame not so much due to the surveyors’ sensitivity to external biases, but on a deeper and fundamental “misunderstanding of the role, methodology and objectives of antitrust policy by survey respondents across countries”, or the fact that those involved “hold a heterogeneous understanding of competition policy”. These authors highlight how metrics of antitrust policy have focused on idiosyncratic parameters that rely on heterogeneous views of businesses on economic competition. These authors enumerate a comprehensive list of authors that include those who have relied on traditional industrial organization structural measures and variables; on qualitative assessments; on idiosyncratic surveys; and on subjective, perceptions-based surveys of performance. They additionally observe that these survey measure also figures prominently as an original source in the World Bank’s composite measures of governance database (Kaufmann, Kraay and Zoido-Lobaton 1999) and the WEF Competitiveness Rankings, databases that have been richly mined by researchers and practitioners.

According to Kovacic (2005) there are two basic ways that competition agencies might go about measuring the quality of their performance. The first is to evaluate the contribution of the agency’s outputs (…) A second approach to evaluation is process-based. In lieu of or in addition to evaluating outcomes, an evaluation program might seek to assess the quality of the competition agency’s internal operations – the mix of managerial methods and organizational choices that determine how the agency allocates and applies its resources.

Are antitrust performance indicators measuring antitrust policy performance or are they simply reflecting the heterogeneous views of businesses? There appear to be fundamental differences between businessmen’s understanding of competition policy performance across countries. We speculate that this may be due to the different perception of the most immediate competitive "threats" affecting each
focus on achieving optimal market outcomes, the conventional assessment actually lacks of proper metrics to explain when such outcomes have been attained.

Alternatively, these measures emphasize performance indicators of *competition agencies* (Kovacic, 2006). These indirect performance standards evaluate the transparency of the executing agency; and their degree of independence (financially, operational and otherwise) from central governments. However, focusing on the expediency of the agency is a second’s best metrics that does not examine the central problem of meaningful competition metrics: whether competition is actually enhanced or diminished as a result of direct policy interventions deciding on the competitive nature of businesses’ strategies.

Not surprisingly “competition policy leaders have not been able to explain with hard data the benefits of competition.” (IDB, 2014: 6) The very US Federal Trade Commission, which epitomizes the model of antitrust policy enforcement, noted the problem of ‘direct measurement’ of welfare effects following policy intervention, (and only in merger cases, because in horizontal cases, these effects are simply “assumed”) indicating that “determining the optimal mix of cases to use as a benchmark for the actual mix of cases is likely to be somewhat subjective” (FTC, 2009:20). In fact, the subtle language used by the FTC denotes an intention to elude the impossibility of identifying competition metrics. This language turns into overt concealment of the issue when she advocates her own “intellectual leadership” as proxy for approaching cases “when direct measurement is not feasible”.23

This problem is directly related to the cognitive dissonance of the competition theory. The misguided approach into theoretical problems that have little connection to real market undertakings has caused antitrust policy to lack objective performance indicators. In short, the policy is geared towards analyzing the normative impact of blackboard, idealized markets, rather than analyzing the causal effects of policy interventions upon real business conduct.

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23 If the leadership is not obvious, the FTC recommends looking at “the outcome of enforcement actions”; “the direct impact, deterrent effect, and precedential value of these actions”; “the guidance and transparency provided by the FTC to businesses and consumers”; or “the burdens the FTC places on industry”. It is really hard to fathom a more subjective proxy for performance measurement than the very opinion of the agency on its own record; not to mention the conceited reference to “intellectual leadership”.

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3. Legal uncertainty as by-product of antitrust policy tinkering.

A second result arising from antitrust policy’s lack of institutional assessment of markets is the subordinate place the policy gives to legal certainty. The literature has emphasized this problem repeatedly (Bork, 1980; Sowell, 1980; Rockefeller, 2009; De Leon, 2009) yet, the majority of competition scholars simply choose to play it down or simply ignore it altogether (Kovacic, 2005; Kovacic and Shapiro, 2000; Fox and Gal, 2014). For example, Kovacic (2005: 5) indicates “in the sciences, an indispensable element of the process of experimentation is the systematic evaluation of the experiment’s results. So it should be with experimentation in antitrust policy.”

The idea that “experimenting” (i.e. tinkering) with the market exchanges provides a kernel of the logic behind antitrust intervention. Using law as an “experimentation tool” naturally undermines the “stability” of the rule of law system, upon which economic development rest. Thus, antitrust theory euphemistically substituted the “rule of reason” for the rule of law. Yet, the historical development of the rule of reason in the US antitrust policy shows that there is little “reason” behind the rule, if one considers that predictability disappears altogether from the picture. The dithering jurisprudence and giving rise to changing to a succession of antitrust legal theories gives ample evidence of the changing assessment of social welfare, which is alien to a system based on the rule of law.

24 Speaking on the future of U.S. antitrust, Kovacic and Shapiro (2000) indicated: “For the future, two related challenges confront the 1990s approach to antitrust enforcement, capable as it is of generating various results. One is for economists and attorneys to devise analytical techniques that accurately identify complex business practices as being pro-competitive or anti-competitive. The second is to adapt such techniques to formulate rules that are suited to the capabilities of enforcement agencies and courts and give the business community a stable and predictable base for designing business plans.”

25 It is worth examining further Kovacic’s claim of antitrust being “scientific”: “The process of formulating antitrust policy frequently requires public antitrust authorities to make difficult judgments amid uncertainty about the competitive significance of various forms of business conduct. The formulation of policy amid uncertainty gives a substantial experimental element to government enforcement. Individual enforcement decisions can be viewed as experiments in which public authorities test the efficacy of different hypotheses about the competitive significance of business behavior. Without experiments that sometimes intervene too much or sometimes intervene too little, it would be impossible for enforcement authorities to determine the correct mix of policies. (…) The importance of uncertainty and the experimental quality of antitrust policy is apparent in several dimensions of government decision-making. Competition authorities sometimes are called upon to diagnose the competitive significance of dominant firm conduct. Claims of unlawful exclusion often require the competition agency to choose between competing explanations that posit efficiency and naked exclusion as rationales for the challenged behavior. A decision to prosecute or not to prosecute may depend upon debatable interpretations of observed behavior.” Kovacic makes a superficial argument in favor of the “scientific” foundations of antitrust, because it takes for granted the epistemological foundations of the methodology supporting such “science.” After all, alchemists, too, used experimentation as their main research tool but hardly could be branded as “scientists.”
The broad language of the Sherman Act (1890), which chastised “every contract in restraint of trade,” marked the ambiguous enforcement of the rule of reason from the very onset. Clearly, such expression could not be construed literally, and called for further casuistic revision of their welfare restrictive effects in order to distinguish between collaboration that suppressed rivalry and cooperation that promoted growth. Some of the early cases already confronted this problem, eventually leading to the “ancillary restraints” doctrine. This doctrine, which at first seemed to give flexibility to the rigid word of the law, eventually was expanded to a broad array of forms of business collaboration, becoming the hallmark of antitrust policy, which would later be extended to monopolization and merger control legal doctrines in the 1930s and 1950s respectively.

In Europe, a similar phenomenon followed after the adoption of the foundational competition law provisions of the Treaty of Rome, whereby a broad prohibition was followed by a casuistic clearance procedure that eventually proved unmanageable, leading to rather uncertain categories of white, black and grey “acceptable” behavior. The Treaty of Rome of 1957, which established the European Common Market, established a broad legal prohibition encompassing “all agreements between undertakings, decision by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market” (Article 85(1)). The drafters of the Treaty, perhaps inspired by the U.S. enforcement experience implementing the ancillary restraints doctrine, also incorporated article 85(3) which declared inapplicable Art. 85(1) on those agreements otherwise violating the latter article provided such agreements meet two positive conditions and two negative conditions. The two positive conditions are that such agreements operate to help "to improve the production or distribution of goods or promote technical or economic progress" and to reserve to consumers "a fair share of the resulting profit." The two negative conditions are that no restrictions should be allowed if they are not "indispensable to the achievement of these objectives" or “afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.” Soon it became obvious that even a system that allowed for individual authorizations based on a “statutory” rule of reason would be unmanageable, and that it needed to develop a more effective clearance procedure allowing those agreements that contributed with the economic welfare of the Common Market. The system of individual

26 For example, the Court, in United States v. Trans-Missouri Freight Association (166 U.S. 290 [1897]) recognized that prohibiting all agreements which curbed commercial freedom could imperil beneficial forms of cooperation, such as partnerships. In United States v. Addyston Pipe&Steel Co. (85 Fed. 271 [6th Cir. 1898], aff’d, 175 U.S. 211 [1899]), the court distinguished between “naked” trade restraints, where direct rivals simply agreed to restrict output and raise price, and reasonable “ancillary” restraints, which encumbered the participants only as much as needed to expand output or to introduce a product that no single participant could offer.
authorizations established in 1957 started being effectively implemented in 1962, but soon called for revision through a system of block exemptions that was eventually approved in 1965. The OECD (2005: 11) noted the problem arising from administering this system: “When the system was implemented in 1962, the Commission received over 35,000 notifications requesting exemption or negative clearance. Case-by-case response proved impossible; general rules were obviously needed instead. The block exemption regulation of 1965 responded to the overload.” Eventually, “block exemptions” also proved too broad, thereby forcing the Commission to implement a system of “white, black and grey” lists, qualifying types of behavior within each “block”. This system, however, is still perceived “too legalistic” and devoid of connection with the underlying economics of the ideal competition system (Sendra, 1992: 389)

The casuistic approach of antitrust policy led to changes in the understanding of the law, as successive economic theories gave new (hypothetical) interpretations to inter-firm collaboration. Economics grew influential to the point of capturing the interpretation of the law. Kovacic and Shapiro (2000: 58) acknowledge this phenomenon: “The consciously evolutionary quality of the U.S. antitrust statutes, with their implicit recognition of the need to adjust doctrine over time in light of experience and new learning, gives economists considerable power to influence competition law and policy.” However, contrary to the opinion of those who believe economics has given certainty to the understanding of the law, it actually has subjected the latter to the consecutive changes occurred in the theory of the firm. This impacted the law by making policy decision making erratic, wavering and unstable. In the light of this, it is forceful to conclude that “reason” is what is entirely absent of the ratio decidendi behind policymaking in this area.

Naturally, legal uncertainty such as that described above runs counter to the essence of a system governed by the rule of law. Under this legal principle law should govern a nation and not arbitrary decisions by individual government officials. According to the Organization for Economic Co-operation and Development (OECD) the concept of the rule of law "first and foremost seeks to emphasize the necessity of establishing a rule-based society in the interest of legal certainty and predictability." (Maxeiner, 2008)

However, the logic behind the rule of reason typical of antitrust policy is inspired on utilitarian goals: it searches to achieve Consumer Welfare or another consequential “social” goal perceived to be morally superior to the pursuit of legal certainty. Lack of focus on the rulemaking process, to be concerned on the outcome of market (hypothesized) interaction leads to any party to advance positions that will depend, not

Kovacic (2005: 8) acknowledges this: “Economics is a dynamic discipline. The history of industrial organization economics has featured considerable change and refinement in the understanding of commercial phenomena. As economic learning has changed, so too have changed many antitrust legal doctrines that are informed by economic insights. Empirical research, including the analysis of past antitrust cases, has supplied a major impetus for the development of new industrial organization ideas and an important stimulus for alterations in antitrust doctrine and enforcement policy.”

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on facts, but on economic hypotheses about future imagined (blackboard) situations. As Sowell (1980: 203) colorfully puts it, “[t]here is usually nothing in antitrust cases comparable to finding someone standing over the corpse with a smoking pistol in his hand. Objective statistical data abounds, but its interpretation depends crucially on the definitions and theories used to infer the nature of the prospective process which left behind that particular residue of retrospective numbers.”

In short, the previous assessment shows that institutions such as contracts, rules, customs, standards, collective behavior, and the like, are misconstrued by antitrust policy analysis; therefore, they are simply ignored. This is the result of Robinson’s silence about institutions, which she simply opted to assume as “givens”, thereby “filling” this institutional gap with the normative tenets of her theory, which, in her words, emphasized the “imperfection” over “competition.” (Robinson, 1951: viii)

These arrangements, which under the tenets of Robinson’s Imperfect Competition theory appear as suspicious attempts to divert short-run (perfect) competition into monopolistic maneuverings, acquire a totally different outlook when they are perceived under an alternative long-run institutional building assessment. In a long-run perspective, overcoming inter-temporal uncertainty is a clear reason justifying these business arrangements. In this assessment, they enable some businesses to compete, even though if they naturally do at the expense of excluding infinite hypothetical competitors that would otherwise be under perfect competition; exclusion that is carried out through contracts and other similar arrangements usually falling under the purview of competition statutes. In the words of Macneil (1980: 4-10) contracts are “the projection of exchange into the future.”

In short, the institutional neglect of the policy deprived the enforcers of clear guidelines about what they should construe as anticompetitive; instead, it filled the policy with legal doctrines promoting ad-hoc analysis that could never satisfy the requirements of legal certainty.

4. Antitrust legal formalism over economic substance.

The cognitive dissonance of competition theory towards institutions not only misconstrues market functioning, but also directs the analysis away from institutions that are essential to understand competition dynamics, particularly in developing countries.

Consider the case of the “shadow economy” which, according to recent estimates (Schneider, 2014), reaches a hefty 41.1% of the GDP in Latin America and the Caribbean.28 Antitrust policy scholars adopt a peculiar bias against the “shadow

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28 According to Vuletin (2008) “the size of the informal economy in the early 2000s is found to vary considerably—from a low of around 15 percent of measured GDP for The Bahamas to a high of over 70 percent of measured GDP for Paraguay. The relative contribution of each underlying factor to the overall
economy;” this is the result of Robinson’s reluctance to integrate the law and economics of her imperfect competition model into a unified analysis; instead, the opted for isolating them by idealizing the latter into the mould of perfect competition, and simply ignoring (i.e. postulating) the former. In Robinson’s approach, laws, contracts, rules, standards, customs and social conventions are just “givens” that have no other role in her analysis but to “justify” the existence of monopolistic restraints. How these institutions emerge, or whether they have universal impact or just under certain circumstances or groups, becomes completely irrelevant for the sake of her analysis. She simply adopted a legalistic assessment over market institutions that neglected those that emerged beyond the realm of formal legality.

Accordingly, antitrust advocates adopted an antagonistic view against informal businesses, which they perceive as a source of “unfair competition” against “formal” businesses (i.e. incumbent firms). This peculiar analysis, which among antitrust advocates ranges from mistrust to outright hostility, is the by-product of the policy’s cognitive dissonance towards institutions. The response of antitrust scholars, guided by a positivistic legal (i.e. formalistic) approach, is to chastise shadow economy activities as “illegal”29 which in fact is to state the obvious, namely, that these activities are outside of the law. Yet, formal illegality does not make them economically irrelevant, as policymakers in developing countries well know.

Furthermore, by condemning almost half of the economic activity of a standard Latin American economy to be on the sidelines of competition analysis, antitrust scholars simply ignore the very significant effects that informality has upon “formal” market incumbents in terms of entry barriers in labor-intensive industries. For example, informal firms are more likely to compete effectively with established businesses in the retail and services industries, albeit in commerce of products of low added value. Similarly, they are

size of the informal economy is also estimated for each country. For some countries like Antigua and Barbuda, Barbados and Trinidad and Tobago, the key element is the tax burden. For other countries, like St. Vincent and the Grenadines, St. Lucia and Belize, the importance of the agriculture sector appears to be decisive, with around 75 percent of exports concentrated in agriculture and food products. For others like Paraguay and the Dominican Republic, labor rigidities are some of the most important factors, with minimum wages representing 170 percent and 90 percent, respectively, of the corresponding GDP per capita."

29 Actually, the condescendence of the competition literature goes further than that, by comparing the “informal economy” to the “mafia.” A report from the OECD (2009:14) states: “Nearly all the countries reported that, in principle, their competition laws applied to economic activity carried out by the informal sector. However there are significant issues in applying competition law to the informal sector. Informal firms tend to be small and highly mobile. There may be difficulty in serving legal notices. Even when prosecuted, these firms are less likely to have significant assets to pay any penalty and, in any case, may simply start up a new business elsewhere. In some countries organised crime is a component of the informal sector. Some competition authorities consider it too dangerous for their staff to prosecute anti-competitive behaviour by the mafia.” Perhaps with the exception of the smallness, one has to wonder why the description just made could not equally apply to financial scandals featured by Enron, Lehman Brothers, Barings Bank and a long list of “formal” and hitherto very respectable businesses.
also less likely to do so in industries dominated by higher sunk costs, i.e. construction; medical services; food distribution; and the like.

The incapacity of antitrust analysis to deal with the shadow economy cripples the antitrust assessment of industrial concentration, by overestimating the level of concentration accruing from only counting businesses in the formal economy, under the Hirschman Herfindalh methodology. But the analytical flaws of the antitrust analysis do not end here; other areas show a similar cognitive dissonance. Consider a keystone concept of antitrust policy analysis such market definition. In the logic of the Imperfect Competition model this step is essential to establish the significance of market power, i.e. the “source” of monopolistic restraints. Market size begins on the assumption that “perfectly” homogeneous products (commodities) establish the boundaries between “markets”. Yet, homogeneity is conceptually possible only if one assumes institutions entirely absent from the model: it is by doing away with them that one can possibly think of products that are exactly identical in production costs; delivery; inputs; service; and other qualities. On the other hand, any differentiating attribute resulting from institutions communicating knowledge unevenly among market agents would forcefully lead to market differentiation.

On another sphere, the cognitive dissonance of the antitrust analysis alienates antitrust policy by ruling out any consideration over the actual reality of developing countries, which is dominated by a large presence of the shadow economy. Antitrust policy, far from addressing the problem of small and medium firms who cannot overcome the transaction costs imposed by the legality prevailing in these countries chooses to ignore it.

5. Conclusion: An old policy, a new rhetoric.

The quest for the soul of Competition Policy has been disappointing. Like Janus, the Roman god of beginnings and future, the policy has two faces looking at opposite directions: One face, that of antitrust enforcement embodies a contrived view of markets that patronizes them and favors policy interventions in cases that are not theoretically warranted; this has resulted in increased competition barriers to the extent that it undermines the rule of law and increases unpredictability among entrepreneurs.

The opposite face is one of competition advocacy, which has steadily emerged to fill the gap left by antitrust enforcement’s incapability to perform consistently. This understanding of competition policy, far from novel, replicates the same sort of policy intervention conducted by Common Law courts against economic privileges laid down by the Sovereign: they are aimed at emphasizing the elimination of exogenous legal barriers that create obstacles upon new entrants into the market. Yet, it has another, fresh component, that is, the promotion of endogenous capabilities to do innovation. This element is more subtle and requires a policy combination of public and private support
aimed at identifying potential opportunities for firms; help them commercialize their intellectual assets (i.e. intellectual property); and build an innovation ecosystem through stirring collaboration between the academia, business community, the government, and venture capital sources.

Clearly, antitrust enforcement has severe inner flaws that undermine its legitimacy; it makes no use to blame on others for their alleged “lack of understanding”; their “hidden interests;” or the “country’s institutional incapacity” to enforce these provisions effectively. The IDB (2014: 6) indicates that competition agencies are unable to “educate consumers on the benefits of competition policies” thus presupposing that consumers would be better off if they were literate on Industrial Organization matters. This assumption is a derivative of a methodological error that assumes external observers to be better informed or better intentioned than market agents themselves. No explanation is given to why we should assume that antitrust scholars actually have deciphered what competition is like better than businesses whose main daily activity – one should assume - is to compete, in order to survive.

Moreover, the claim attesting the experimentation nature of the policy as advantageous appears unconvincing particularly in the light of a sheer absence of policy metrics that could otherwise make the policy accountable. If there are no metrics capable of measuring whether policy interventions are actually successful, how can anyone say that “experimentation” or tinkering with market outcomes will do any good at all? Only indirect measures, such as counting the number of cases brought, seem to count; but then again, these metrics only seem to reinforce the self-indulgency of those who advocate antitrust enforcement at any cost.

Not surprisingly, meager results attained by antitrust enforcement in Latin America have driven competition agencies into the bandwagon of economic policymaking. They have made progress to the extent that they intuitively have step out of the conventional script of antitrust enforcement, and have undertaken positive steps to conduct more competition advocacy activities. Yet, there is a long way to go, if one considers the scant resources devoted to this activity by competition agencies worldwide.

Disappointment in the policy is the consequence of the failed expectations raised by the naïve normative proposal implicit in the tenets of the Imperfect Competition theory.

On the face of it, Consumer Welfare appears akin to good market functioning: in this situation, social resources are directed to those who value them the most. In closer inspection, however, such efficiency is nothing but one (extreme) case of social resource allocation that only applies to the very unlikely case of instantaneous, fully-informed, short run allocation that exists under conditions of perfect competition (infinite information; timeless exchanges; absolute product homogeneity; countless sellers and buyers). This situation, seeking mathematical elegance of equilibrium modeling, rejects
long run planning among firms; hence, entrepreneurial innovation strategies, to develop capabilities and seek market leadership.

Indeed, the problem with Consumer Welfare (and other alternative short run goals) is not only one of methodological rarity, but a less studied one: that it leads policy interventions to awkwardly play the fiddle of redistributive socialist policies, albeit in a pro-market rhetoric. Indeed, Robinson’s Essay on Marxian Economics published less than a decade after her Theory of Imperfect Competition declared: “Recent developments in academic theory have led (academic economists) to a position which in some respects resembles the position of Mark far more closely than the position of their own intellectual forebears. The modern theory of imperfect competition, although formally quite different from Marx’s theory of exploitation, has a close affinity with it.” (Robinson, 1942: 4) Very few antitrust scholars, driven by their excitement about attacking what they perceive to be anticompetitive restraints, realize how close they align ranks to those who actually declare themselves to be enemies of the market.

In this light, antitrust scholars have entertained a superficial, idealized discussion over the normative goals that should inform competition policy, whether economic efficiency or some other social welfare value. In this subjective choice of goals, they adopt a condescending view towards developing countries, whenever these countries enforce policies that the former perceive to be away from their normative “Nirvana”.

It is not surprising that competition policy goals have remained restricted to these parameters; after all, this discussion reflects the same short-term parameters of the conventional market analysis inherited from Robinson’s Imperfect Competition theory that has nourished the antitrust debate. Yet, these are short-term competing goals that conceal a broader discussion between short-term goals and long run ones.

A more meaningful discussion on the goals of competition policy should differentiate between equilibrium short-run analysis and long-run disequilibrium analysis. This discussion would differentiate between a policy that would privilege resource allocation through intervention over market dynamics, on the one hand; and a policy that would privilege long run innovation, which directs the attention of policymakers into eliminating legal barriers to potential entrants, even at the expense of tolerating temporal “monopoly rents.”

There is no question that such a policy would fulfill the conditions one would expect on pro-market policymaking, that is, predictability, accountability and consistency. Predictability would follow because it would direct the attention of competition agencies into barriers to competition that create obstacles to potential market entrants, that are not based on their differentiated commercial risk, market facilities or technical reasons.

Accountability would follow, because unlike the imprecision of current antitrust measurement proxies, such as the Global Competitiveness Report, focusing the attention
on legal barriers is easy to identify and measure, as witnessed through the emergence of numerous international indicators of institutional transparency, as seen above.

Finally, consistency would follow, because a policy focus on legal barriers would exclusively examine the impact that such rules create by discriminating businesses according to their long run technical standards, not to their particular position in the market at one moment in time. Ultimately it entails recognition that competition is about Uber’s mobile technology undermining the power of taxi driver guilds and associations, rather than assuming certain market structures to be off-limits, and intervening guided by delusional “optimal” scenarios that only make sense in the blackboards.

Twenty-five years after the inception of modern competition policy in Latin America, and in other developing countries, experience shows that the quest for economic competition demands above all unraveling the ideological confusion that pervades legal reform in developing countries, which has led them to blend government interventionism under a pro-market rhetoric.


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