

Antitrust policy versus the rule of law

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“[t]he sole consistency that I can find is that in [antitrust] litigation under § 7, the Government always wins.”

Judge Stewart, United States v. Von’s Grocery Store, 384 U.S. 270, 301 (1966)

Introduction

In 1978, Judge Robert Bork published a book that would have a profound influence over the course of antitrust enforcement in the ensuing decade: “The Antitrust Paradox”. This book criticized the state of U.S. antitrust policy in the 1970s. The “paradox”, in Bork’s view, lie in the inner contradiction of the policy: while it formally sought to promote market competition its practical effects actually led to stifle it.¹

Bork argued that both the original intent of antitrust laws required that consumer welfare and the protection of competition rather than competitors be the only goals of antitrust law. Thus, while it was appropriate to prohibit cartels that fix prices and divide markets and mergers that create monopolies, allegedly exclusionary practices such as vertical agreements and price discrimination did not harm consumers and should not be

¹ In his words, “Because antitrust’s basic premises are mutually incompatible, and because some of them are incorrect, the law has been producing increasing bizarre results. Certain of its doctrines preserve competition, while others suppress it, resulting in a policy at war with itself.” (p. 7)

prohibited. The paradox of antitrust enforcement was that legal intervention artificially raised prices by protecting inefficient competitors from competition. Bork emphasized that the pursuit of policy goals different from economic efficiency diverted antitrust policy from its original intent, and eroded the predictability of the system, to the detriment of market agents.

However, although Bork (p. 405) advocated the pursuit of consumer welfare as the only goal giving legal certainty to antitrust enforcement (for which proper balance between resource allocation and productive efficiency was necessary),² he did not explain the connection between antitrust law making and the emergence of such legal stability, or how such balance would be attained in practice.

Bork's discussion highlights a feature that often has been acknowledged in legal reform initiatives, yet never resolved: the alignment of the policy goals to the needs of a rule of law system, featured by legal certainty.

Clearly, stable law and institutions facilitate economic development.³ However, is economic efficiency compatible with the pursuit of the rule of law? This question is important, in light of the modern legal reform efforts that advocate a "second generation" of institutional reforms in developing countries supported on the rule of law, and oriented towards attaining economic efficiency.⁴

Antitrust policy is merely one example of the sort of policy advocated by those who also proclaim the need of enforcing the rule of law. The purpose of this paper is to highlight the contradiction between the pursuit of a stable rule of law and the enforcement of antitrust policy, as a policy that seeks to promote economic efficiency. We examine the

2 "The only goal that should guide interpretation of the antitrust laws is the welfare of consumers. Departures from that standard destroy the consistency and predictability of the law; run counter to the legislative intent, as that intent is conventionally derive; and damage the integrity of the judicial process by involving the courts in grossly political choices for which neither the statutes nor any other acceptable source provide any guidance." (Bork, p. 405)

3 Tamanaha (2009) provides a complete and update review of the literature of studies which show a correlation between "the rule of law" and a host of development indicators.

4 M. Naim (1999). Also, the editorial of a well-known magazine put it: 'Economists became fascinated by the rule of law after the crumbling of the "Washington Consensus". This consensus, which was economic orthodoxy in the 1980s, held that the best way for countries to grow was to "get the policies right" – on, for example, budgets and exchange rates. But the Asian crisis of 1997-98 shook economists' confidence that they knew which policies were, in fact, right. This drove them to re-examine what had gone wrong. The answer, they concluded, was the institutional setting of policymaking, especially the rule of law. If the rules of the game were a mess, they reasoned, no amount of tinkering with macroeconomic policy would produce the desired results.' (The Economist, 2008)

case of antitrust enforcement in Latin America to show the underlying contradictions of those advocating institutional reforms through a subset of policies that actually undermine market interaction.

Antitrust policy and the neglect of the rule of law

The rule of law requires a high degree of predictability and strict limits on the discretion of authorities; therefore the form of economic policies is crucial for their effectiveness. Economic policies should primarily seek to establish and apply the rules rather than to assess the economic merits of behavior in specific cases.

Rules enhance the chances of achieving an order in which individuals pursue and attain their goals because they reduce the spectrum of potential courses of action that would emerge in a situation of total uncertainty: '[I]n order to pursue goals and make plans it is necessary to have a system of property rights that is clearly defined and that each individual can count on into his foreseeable future. Any involuntary alteration of a given property rights structure will necessarily interfere [...]' (Cordato, 1992, p. 402) Individuals can plan their investments more easily if they know in advance the legal consequences of their actions; anticipation of costs and benefits will enable better economic planning of their activities. Therefore legal uncertainty — defined as a low probability of success in predicting what is allowed and what is not — can be a serious problem for efficiency in a market economy.

In light of our present discussion, the task is to determine whether antitrust policy can be enforced in a way that fulfils the aforementioned standard of predictability required under the rule of law, thereby becoming an institutional tool for the promotion of economic growth, or whether its inner functioning causes it to become a tool for enhancing unfettered government intervention and a source of rent seeking.

At a more general level, however, this paper is intended to show the limitations of conventional "Law and Economics" analysis advocated by the Chicago school of Law and Economics, which postulates economic efficiency as the hallmark of good rule making, yet it entirely leaves aside the negative impact of this pursuit on the rule of law.

The question of whether in the long run economic efficiency is by-product of rule making, or whether these goals are contradictory, not only affects the assessment of regulation and antitrust policy, but a broader perspective of legal development as a field.⁵

The impossibility of antitrust stable decision making

What is the rule of law? At a general level, policymakers associate the rule of law with the need for preserving stability in the rule making process. Arthur (2000) has summarized the institutional conditions necessary to achieve a stable rule of law in developing countries, as follows: (i) Provision of clear direction to facilitate voluntary compliance and effective enforcement; (ii) Prevention of arbitrary and retroactive imposition of liability; (iii) Enforcement of legal rules consistently with previous similar cases; (iv) Predictability; (v) Restriction of legal rules to specific issues, thereby avoiding broad or excessive regulation; and (vi) Confinement of legal rules to the institutional competence of the decision maker; in other words, the law must not place excessive knowledge constraints upon the enforcing authority in order to decide individual cases.

The concept of “rule of law” is elusive to conventional economic theory. This is no coincidence. Conventional analysis regards institutions as “exogenous givens”, which merely provide market exchanges a “passive” framework for interaction. In this notion, social rules are merely “static” rules that create alternative frameworks, which lead to alternative market outcomes.⁶ No attention is placed upon the way market interaction leads economic agents to choose alternative sets of rules, or the way by which these rules emerge, as a process of selection by market agents.

5 This school applies neoclassical economics analysis (in particular, price theory) to the law. As such, this approach embodies the following premises: a) individuals are rational maximizers of their satisfactions in their nonmarket as well as their market behaviour; b) individuals respond to price incentives in non market as well as market behaviour; and c) legal rules and legal outcomes can be assessed on the basis of their efficiency properties, along which comes the normative prescription that legal decision making should promote efficiency. (See Mercurio and Medema, 1997, p. 57)

6 Typically, this is the approach of “game theory”. To be true, game theory models also address “dynamic interactions” as a sequence of successive moves between strategic actors. Yet, a closer look into this approach clearly reveals that no “learning” between such agents occurs, and that both their final position in the game could be easily predicted given the initial set of constraints provided for by the analyst. As Foss (1998, p. 18) explains: “in much of game theory there is precisely the conflation between the objectively existing and subjectively perceived (reality)”, but that, “the co-ordination problem of course isn’t solved at all, merely side-stepped.” Therefore, these models are not endogenous, in the sense that they explain how agents “learn” new routines governing their exchanges, which eventually turn into a “rule of law”.

Due to their disengagement from the conventional methodology of economics, libertarians such as early focused their attention on the nature of rule making, hence on the substratum of the “rule of law”. Leoni (1961) and Hayek (1973) linked the concept to the “certainty of the law”, understood by reference to abstract rules, rather than “written law”. In their dynamic epistemology of markets, they clearly understood that certainty of the law did not blend with the rigidity of written law. Hence, it should be understood as a intuitive mechanism whereby judges select rules that would decide what conflicting expectations should be upheld and what should be disappointed.

Hayek (1973, p. 119) further identified rule selection as the natural mechanism for the adaptation of the rule of law under dynamic market processes, but he did not fully work out the essence of this mechanism. His explanation focused on a general level, underlining the way by which such decision making process, through intuition, would bring about an order which would be the result of “human action, but not of human design.”

Judicial intuition would enable judges to select what rules should prevail. Hayek thus identified intuition, rather than the wording of the law, as the mechanism of the decision machinery process that brings about the certainty of law; thereby, makes the rule of law feasible: “If often his ‘intuition’ rather than the ratiocination will lead him to the right solution, this does not mean that the decisive factors in determining the result are emotional rather than rational, any more than in the case of the scientist who also is normally led intuitively to the right hypothesis which he can only afterwards try to test. Like most of other intellectual tasks, that of the judge is not one of logical deduction from a limited number of premises, but one of testing hypotheses at which he has arrived by processes only in part conscious.” (p. 120)

Hayek assumes, of course, that such hypotheses are supported on “hard evidence” or “empirical facts” whose existence no one disputes. Objective data furnishes the analyst’s hypotheses linking perceived empirical phenomena. A homicide, for instance, requires prior verification of the existence of a corpse, and a killing tool, before linking these facts to a suspected person, and a motive for the killing. Through their intuition and logic, judges identify the best rule linking otherwise isolated facts. Judges apply a principle of “reasonableness” to make sense of the World through their common sense. Insofar the causality giving sense to common sense explanations about the World, one could say, at least in a narrow sense, that such evidence is perceived “objectively”, in the sense of being appraised and understood in a similar way by a social group. This is so, because we all share the same logical principles about the way reality unfolds. Also, institutions play a key role in this understanding; hence, judges cannot ignore their influence in the meaning they attach to events that otherwise would appear to be unconnected.

Yet, in contrast with the common sense of judges, which rests on their own previous experience of how the World works, economic “common sense” is not established

“objectively”, but they result from idealized assumptions about the World. Antitrust methodology does not rest on data which is understood and filtered through common sense but on “economic hypotheses”. These assumptions do not serve as logical tools linking isolated observed facts; instead, *they are intended to support the analyst’s predictions about idealized models of the World*. In other words, conventional economic analysis is intended to attain totally different goals from that of conventional judicial decision making; a fact which is easily overlooked by advocates of this policy.

By virtue of the idealistic models of market relations giving support to antitrust analysis, the analyst cannot avoid obtaining a distorted view of business relations, particularly their contribution to the social good. Business arrangements are perceived, under this dystopian view, as geared towards promoting “monopolistic conduct”. Set aside from the negative consequences of such an approach on the “justice” of such arrangements –which should be assessed in their merits, rather than by comparison to some abstract, utopian behavioral standard of “social welfare”, it is clear that antitrust analysis promotes unchecked discretion in the hands of decision makers. Antitrust analysis, concentrated on commanding “real life” business behavior along an idealized standard of social welfare, bears little connection with conventional judicial reasoning.

Conventional economic analysis and judicial decision making, therefore, are intended to serve different, even contradictory purposes: while the former is concerned with model predictions and idealized worlds of social resource allocation, the latter is interested in ascertaining the impact of real world institutions such as property or contractual rights as a *cause* of business strategies, regardless of their seeming restrictive nature.

Hence, in the latter case, businesses’ failure to align their conduct to predictable rules of social behavior constitutes the keystone of judicial analysis. These rules are construed on the basis of past behavior, which settled businesses’ expectation regarding their resource entitlements. These precedents serve an orientation purpose on judges in order to ascertain the rules that should establish what expectations are truly legitimate. Accordingly, the judge serves a connecting purpose between the rulings imposed upon past events and their applicability to present expectations. In the Common Law countries, the principle of *stare decisis*⁷ induces judges to obey the precedents established by prior

7 The U.S. Ninth Circuit Court of Appeals has stated: “Stare decisis is the policy of the court to stand by precedent; the term is but an abbreviation of stare decisis et quia non movere — “to stand by and adhere to decisions and not disturb what is settled.” Consider the word “decisis.” The word means, literally and legally, the decision. Nor is the doctrine stare dictis; it is not “to stand by or keep to what was said.” Nor is the doctrine stare rationibus decidendi — “to keep to the rationes decidendi of past cases.” Rather, under the doctrine of stare decisis a case is important only for what it decides — for the “what,” not for the “why,” and not for the “how.” Insofar as precedent is concerned, stare decisis is important only for the decision, for the detailed legal consequence following a detailed set of facts.” (*United States Internal Revenue Serv. v. Osborne (In re Osborne)*, 76 F.3d 306, 96-1 U.S. Tax Cas. (CCH) paragr. 50,185 (9th Cir. 1996)

decisions; in Civil Law countries, where judges' decisions are merely referential, this role is left to custom and legal hermeneutics.⁸ In both systems, the legal system is geared to provide businesses with useful information about the extent of their rights, which is what consolidates their market expectations.

Predictability is thus the very essence of a rule of law, because it is inextricably linked to the delivery of just rulings in the context of an evolutionary world, featured by changing expectations of what is fair and what it isn't. The capacity of business people to anticipate the rules governing their actions (by linking their expectations to that of whom they trade with) is the foundation of a rule of law system.

Legal predictability is ensured by judges' adherence to "reasonableness" in their legal interpretation of individual cases. Reasonableness is widely acknowledged in the legal principles applied in Continental Civil Law,⁹ as well as in Common Law Jurisdictions.¹⁰ This connecting principle, which clarifies businesses' expectations in the market, is supported by logic and common sense; they give judges a "picture" of what parties could reasonably expect under certain market situations. They may steadily evolve over time, but they are

8 The French jurist Rene David (1967, pp. 94-95, 96) notes that although the basis of any legal reasoning in Civil Law countries is represented by written law, "these documents are merely regarded as supporting materials." Thus, "against the opinion of certain authors, who see in them a normative system, we regard them as more or less precise legal frameworks whose real meaning will be furnished by the interpreter." Also, he states: "In all civil law countries the law seems to encompass the entire legal order... however, the reality behind this impression is very different and liable to surprise those who believe such opinion. The law embodies the skeleton of the legal order, but others are the factors that introduce life into this skeleton. The law is not exhausted in its written text; not even when it is subject to rigorous and comprehensive interpretative principles. In the view of jurists, legal codes are merely a starting point; not an end." Thus, legal hermeneutics (i.e., the art of interpreting legal texts and the methodology of interpretation and explanation) is a more important "source" of law, inasmuch it provides consistency and understanding to written law.

9 According to this principle, courts must support their decisions on both logical inference as well as empirical verification of the surrounding world. Couture (1990, pp. 22-23) states that such logical inference rests on "a priori, immutable truths, preceding all sensorial experience," whereas facts are contingent on time and space; thus judicial evaluation supported by reasonableness will be permanent and immutable in one sense while variable and contingent in another. Moreover, the empirical assessment of the judicial evaluation will depend on the temporal and spatial circumstances within which judges are situated. Thus, a valid decision requires evaluation of factual evidence taking into account the particular circumstances within which it takes place. In more general terms, the law refers to the "general principles of law", which provide courts with intuitive assessment of what societies usually regard as "fair" and "just". They represent a "common ground where superior values of Natural Law or of the political order converge with the assessment of particular problems, that which we brand as 'institutions'". They integrate both, "superior values and living experience, the combination of which constitutes the core foundation of the Law." (Eduardo Garcia de Enterrria, 1984, pp.64-65).

10 See Eisenberg, 1988.

stable enough to serve judges as a supporting tool, to guide their decisions about rights allocation.

By contrast, conventional economic analysis supporting antitrust policy undermines the rule of law because it is not aimed at developing a stable rule making through reference to previous rulings or hermeneutic logic. Instead, it is intended to predict market outcomes through the aid of contrived assumptions about market agents' rationality, linked together by tentative causal explanations (i.e., hypotheses) about their interaction. This exercise induces the analyst to frame her model assumptions to deliberately accommodate her forecast (i.e., hypothesis) about future market outcomes; notably, it drives her attention away from the reasons why market agents act the way they do. The role of hypotheses under this approach is merely one of logically connecting the analytical premises (i.e. assumptions) with the predictions about future market outcomes.

This method induces the analyst to misconstrue past business behavior. Since market predictions are built upon the logical deduction of predetermine idealized assumptions about human conduct, antitrust analysts fail to see *why* individuals actually behaved differently from the hypothesis postulated, and markets reached a sub-optimal allocation, different from the outcome that the analysis predicted from construed assumptions about individual rationality. Simply, the analysis states the obvious; that businesses behave differently from rational economic agents.

This would not be a problem, except for the fact that antitrust enforcement does not stop here. Instead, antitrust enforcers take this divergence to be a clear sign that government intervention is needed to put things in order. In other words, this way of approaching business conduct inevitably condemns it, to the extent the latter, in the eyes of antitrust analysis, appears to fail to replicate the analytical premises that antitrust decision makers have deliberately chosen to support their forecasts. No objective empirical evidence can challenge the assumptions of a model which is intended to predict future "social" outcomes (as opposed to *explaining past business conduct*), because "economic facts" are contingent to the particular hypothesis connecting such isolated events in a particular causal explanation; yet, as seen above, such hypotheses are merely logical extensions of deliberately chosen assumptions.

Therefore, once antitrust enforcers have come up with a given "theory" explaining business monopolistic intent, there is no way of beating such an opinion (i.e. hypothesis), except by postulating alternative assumptions about individual behavior, with a view of aligning the new (and more complex) hypothesis to the new predicted outcomes. By the same token, if the attention of the analyst is focused on explaining the ex post effects of a business arrangement that has already taken place, antitrust authorities simply take "predicted outcomes" of competitive equilibrium markets as their departure point of analysis, and then conclude that the failure of real markets to meet such standard is due

to the departure of business strategies from their idealized assumptions about rational conduct. Naturally, this leads into ad hoc, intuitive –indeed, meaningless, explanations about why flesh and bone entrepreneurs cannot behave like idealized rational decision makers.

To see the extent of this analytical flaw, it is necessary to examine more in detail how antitrust forecasts and business conduct diverge. Antitrust analysis endorses conventional economics’ objections against positive economic analysis being based upon “unrealistic assumptions”.¹¹ Let us focus our attention on this epistemological flaw.

The “wrong turn” that inaugurated Industrial Organization

For antitrust analysis, industrial organization models are mere representations of market outcomes, derived from the assumption that monopolists face negative sloped demand curves. This model, initially developed by Auguste Cournot (1838) was extended and broadened by Joan Robinson (1934). Robinson never explained *why*, in the absence of legal impediments, monopolists would be sheltered from outer competition; this she simply assumed it. Instead, her attention focused on connecting her forecasts about “socially inefficient” market allocations with her assumptions about market’s enclosure, never mind reality. Her answer was blaming “monopolistic firms” for conducting what appeared –in her view- to be manipulations and other contrivances such as product differentiation, price discrimination, advertising and reputation. Thus she sowed the seeds of modern antitrust analysis.¹²

In Robinson’s view, socially inefficient market outcomes would emerge from manipulations and other contrivances imposed by monopolistic firms, due to their *assumed* capacity to maintain demand negatively sloped, by keeping competitors at bay. Robinson viewed firms acting in isolation in the market; she contemplated no strategic interaction, except for reinforcing individual monopolistic behavior –as for instance, through oligopoly collaboration. Firms could successfully manipulate markets thanks to their unilateral capacity to dictate terms; later, this ability would be termed “market power”, under antitrust theory. Two decades after, Bain (1956) refined Robinson’s assumption by introducing the notion of “entry barriers”; these barriers “explained” why

11 Following the pioneering work of Friedman (1953), the weight of theory under neoclassical economic analysis rests in its capacity to forecast future outcomes, rather than its closeness to underlying analytical premises.

12 Although by the time Robinson postulated her “imperfect competition” theory antitrust policy had been already enforced in the United States since the enactment of the Sherman Act (1890), it is also true that until then, policy enforcement had been highly influenced by legal doctrines, and was even suspected by the economists’ profession. (See Kovacic and Shapiro, 2000). It is only after Robinson’s contribution that modern Industrial Organization emerged, in the work of Bain (1950) and other followers, whose work relied on Robinson’s view about imperfect competition.

monopolists could maintain competitors at bay. Soon, the field of Industrial Organization, featured by its search of “market concentration” and “monopolist behavior”, was underway.

At the bottom of antitrust analysis, therefore, lies Robinson’s premise. According to Loasby (1998, p. 3), Robinson deliberately decided to endorse such equilibrium view of markets, due to the influence of Arthur Pigou’s notion of “equilibrium firm”.¹³ Pigou, misunderstood Marshall’s notion of long run competitive equilibrium ([1890] 1949), in which he regarded increasing returns and perfect competition as “incompatible.” By doing so, he inaugurated the famous dispute about “costs” which dominated the 1920s.¹⁴

Clearly, Robinson’s hypothesis about markets did not attain “socially optimal” resource allocation was consistent with her assumption that markets, at some point, could attain “optimal equilibrium” presumably, if governments intervened to restore such equilibrium lost. Whether this assumption was utopian or unrealistic was beside the point: in order to make meaningful predictions, it was necessary to follow this logic. Rather than questioning whether the premises were “correct” or “accurate”, Robinson concentrated her attention on what sort of assumptions about individuals’ conduct were necessary to postulate in order to predict “inefficient market outcomes” which, after all, seemed to plague markets in the real world. Unknowingly, Robinson fell into the intellectual fallacy of

13 Pigou’s fundamental conceptual twist turned the Marshall’s “representative firm” into an “equilibrium firm,” that faces a known production function and equalizes marginal revenue, marginal cost and price. In this way, this “firm” would still remain as analytical tool, without representation in the real world. (Pigou, 1932 (1920), paragraph II.XI.3)

14 Piero Sraffa, professor of University of Cambridge, reaffirmed this mistake, by emphasizing the inconsistency between long term decreasing costs and the perfect competition model in his seminal 1925 essay “*Sulle relazioni fra costo e quantita prodota*” which would later be developed in his famous paper “*The laws of return under competitive conditions*,” a year later. Sraffa criticized Marshall’s distinction between increasing and decreasing returns, which he regarded as inconsistent notions. Like Pigou, Sraffa had a Walrasian equilibrium “reading” of Marshall’s work; evidently, that took him to the same conclusion. In his 1926 article, Sraffa insisted in this contradiction, but this time he proposed abandoning perfect competition as a reference viewpoint from which to appraise markets, and take monopoly instead as the analytical reference of markets. Sraffa thought that Marshall’s theoretical contradiction invalidated his “partial equilibrium” approach: “I am trying to find what are the assumptions implicit in Marshall’s theory; if Mr Robertson regards them as extremely unreal, I sympathise with him. We seem to be agreed that the theory cannot be interpreted in a way which makes it logically self-consistent and, at the same time, reconciles it with the facts it sets out to explain. Mr Robertson’s remedy is to discard mathematics, and he suggests that my remedy is to discard the facts; perhaps I ought to have explained that, in the circumstances, I think it is Marshall’s theory that should be discarded.” (Sraffa, 1930, p. 93) Bortis explains why Sraffa held this view: ‘Underlying all this, Sraffa pointed out, was a conceptual confusion: in classical political economy the “law” of decreasing returns was associated with [the conditions of production in agriculture] and with the problem of rent (theory of distribution), while the “law” of increasing returns was associated with the division of labor [and] general economic progress (theory of [industrial] production)’ (Bortis, 2000, pp. 14-15)

incommensurability (Fereyabend, 1970), whereby she conflated observed short run market output restrictions, and contrasted them with idealized, long-run productive efficiencies, yet to accrue. Loasby branded Robinson's mistake a "wrong turn", from inadvertently misconstruing Marshall's dynamic theory of the markets, in Walras' equilibrium framework.

Evidently, under Robinson's short-run equilibrium logic, every departure perceived today from long run competitive equilibrium was "inefficient", and could only be explained as intended towards imposing "monopolistic" conditions in the long run. Robinson was forced by the logic of her argument, to ignore the presence of competitors ready to snatch the monopolist's market share at the first sign of supracompetitive prices. She simply postulated that monopolists would impose their terms, and markets would work at sub-optimal level because no one else would be able to enter into the market. The explanation thus became the explanandum of her theory.

Robinson and her followers failed to see why, in order to understand how firms behave in the market the issue to be explained is why firms impose output restrictions today, in order to ensure productive investments needed to foster innovation and develop competitive advantages. In this dynamic synergy competition to outdo competitors arises. Yet, this is an explanation that can only be understood if we explicitly elude the trap of conflating the short run and the long run, which underlies in the competitive equilibrium perspective behind antitrust theory. To do so, it is necessary for us to reintroduce real time in economic analysis (Rizzo and O' Driscoll, 1985), and examine competitive behavior under dynamic, evolutionary perspective.

It is somewhat ironic that, notwithstanding Robinson's decisive role in providing modern antitrust with the theoretical support of economic science it needed to enable her independence from commercial law, years later she acknowledged her misled approach and declared: '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) 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.' (Robinson, 1960, p. viii) Unfortunately, Robinson's intellectual honesty was not enough to retrieve economic thinking about competition from the wrong path where she had it funneled to.

Marshall's theory of the market, abandoned by the generation of economists to which Robinson belonged, would allow us a proper reintroduction of these concepts into the analysis of industrial organization, through his well-known distinction between the short

and long run. Let us now see the impact of an alternative assessment of business conduct, under the light of Marshall's theory.

Elusive market size measurement

The inclusion of the long run evolution of markets into the analysis has implications which challenged received assumptions of the conventional economic analysis, such as the feasibility of market measurement. Advocates of the efficiency standard usually assume that economic data about past market conduct provides knowledge about future market trends.

This assumption is seen, for instance, in the idea behind market size, which is fundamental for antitrust analysis. Antitrust analysis postulates that markets have boundaries, where businesses can freely impose their monopolistic conditions provided that entry barriers are high enough.

Let us examine this belief, which supports the key premise of the Imperfect Competition theory, i.e., monopolists face a negatively sloped demand of their production.

Antitrust analysis rests on the assumption that it is possible to define such boundaries, through measurement of demand elasticities and cross-elasticities. In this assumption, empirical data provides a record of consumer preferences, and such preferences establish their degree of willingness to abstain from purchasing a good or service in the event of prices increasing above a certain threshold (usually 5%).

Antitrust agencies place their expectations in the improvements of data collection to complement price information about demand cross-elasticity. This information includes interviews of clients, corporate documents, trade publications, industry statistics, financial data and changes over time of output, prices and profitability ("time series analysis").

Yet, this data suffers from a fundamental flaw: it records past history about consumer preferences; it does not tell anything about future choices in the market, which may (and do) vary over time. Consumer preferences are never steady but permanently evolve, as consumers change their perception on the properties of alternative goods and services; these perceptions change due to several reasons: product testing; advertising; changes in the commercial reputation of the manufacturers or retailers; the experience of other consumers, and other similar ways.

Similarly, production costs in the industry decrease thanks to Marshall's external economies. As Young (1928, p. 527) put it: "Out beyond, in that obscurer field from which

it derives its external economies, changes of another order are occurring. New products are appearing, firms are assuming new tasks, and new industries are coming into being. In short, change in this external field is qualitative as well as quantitative. No analysis of the forces making for economic equilibrium, forces which we might say are tangential at any moment of time, will serve to illumine this field, for movements away from equilibrium, departures from previous trends, are characteristic of it.”

The focus of conventional economic analysis in the short run misleads the analyst about the likely long run market trends, defined by unknown changes in consumer preferences and external economies.

Furthermore, the pace of industrial change due to external economies in one industry varies according to the rate at which other industries grow; this trend, in turn, is contingent to the level or intensity of demand in the first industry. In his words: Young stated that “an increase in the supply of one commodity is an increase in the demand for other commodities, and it must be supposed that every increase in demand will evoke an increase in supply.” He concluded that forecasting the speed of industrial growth is impossible: “The rate at which any one industry grows is conditioned by the rate at which other industries grow, but since the elasticities of demand and of supply will differ for different products, some industries will grow faster than others.” (Young, p. 533)

Indeed, in some industries such as high-tech and telecommunications, the “long run” becomes “short run” in a very short span of time because consumer preferences and external economies evolve at a high speed. Hence, the analyst has no way of knowing whether consumer preferences revealed in past transactions actually conveys information about future market trends, particularly the speed of change. A new discovery, which appears to have a marginal relevance, may induce further changes in the industry that change its pace of innovation. Examples abound; consider, for instance, the impact of internet Voice IP protocols, which has lowered the cost of telecommunications, but also have prompted operators in this industry to develop new added value devices that ease portability, such as Blackberries.¹⁵

15 Young (p. 532) highlighted this point, which he raised to the status of “theorem”: “the division of labour depends in large part upon the division of labour.” By this he meant that “not only new or adventitious elements, coming in from the outside, but elements which are permanent characteristics of the ways in which goods are produced make continuously for change. Every important advance in the organisation of production, regardless of whether it is based upon anything which, in a narrow or technical sense, would be called a new “invention,” or involves a fresh application of the fruits of scientific progress to industry, alters the conditions of industrial activity and initiates responses elsewhere in the industrial structure which in turn have a further unsettling effect. Thus change becomes progressive and propagates itself in a cumulative way” (p. 532)

Demand and supply curves do not exist and cannot exist in real life in the static way antitrust analysis usually depicts them. The assumption that a homogeneous product is traded does not follow the notion that entrepreneurs are constantly striving to differentiate themselves in order to seek and seize increasing returns resulting from the division of labor.

The impossibility of assessing market size with exactitude undermines the capacity of antitrust enforcement to deliver a stable rule of law. Given that past economic data provides no reliable guidance about future consumer preferences, antitrust agencies are forced to impose their own subjective perceptions about price elasticity between goods. Under such conditions, it is impossible to know whether prices applied by a given firm suspected of acting as a monopolist is, in fact, above the “competitive level”. The analyst has no objective “competition price” available to use as reference for ascertaining whether the investigated firm enjoys “market power”. Lacking objective economic data in order to establish what the competitive price should be in a particular market, antitrust agencies are forced to assume that such market will shelter monopolistic contrivances if it fails to comply with the premises of competitive equilibrium markets. They always do.

Reliance on the abstract “prices-above-marginal (objective) costs” yardstick can easily lead the competition authority into a tautology: the observed price of product A is assumed to be above marginal costs, merely because no alternative product substitution exists between product A and other products B, C or D, leading to the conclusion that the investigated firm holds market power. In fact, the analysis should proceed the other way around: firms *always* impose prices above marginal costs, which is why no substitution takes place. Competitive prices, on the other hand, would enable such substitution to occur. The problem for the static analysis, however, is determining what price should be considered “competitive” in order to have a standpoint from which to conclude that product A has been priced above marginal costs. The only possibility is by postulating market power in the hands of the individual investigated firm.

Hence, any firm automatically will be suspect of antisocial, anticompetitive behavior when it has a competence that enables it to produce a good or service that is more reliable or has higher quality and hence, is worth 5 percent or more. (Hunt, 2000, p. 255)

In the absence of an objective assessment of the market competition authorities fill the gap with their own subjective opinion, which may or may not correspond to the perception of consumers. Antitrust agencies thus conflate consumer preferences with their own preferences.

A case in point is Colombia’s *P&G — Colgate Palmolive pre-merger filing case (2004)*. In this pre-merger filing by Procter & Gamble (P&G) before Colombia’s SIC relating to the acquisition of Colgate’s soap brand portfolio, the competition authority declined to

authorize the acquisition due to the SIC's perception that P&G's powder soap brands belonged to a different product market than industrial powder soap brands. In essence, the SIC's decision depended on its interpretation of "evidence" that poor Colombian households did not use laundry machines. In its interpretation of the evidence, the SIC failed to acknowledge that, while about 70 percent of Colombian households lack laundry machines, they nonetheless use the same powder soap, albeit in a bucket.

The decision turned on the analysis of the competitive effects of an undertaking involving the exchange of certain brands in the Fabric Home Care (FHC) industry between P&G and Colgate-Palmolive. The FHC industry is comprised of three distinct kinds of products used for laundry purposes, namely, powder, bar and liquid detergents, cleaners, and bleach.

The applicant claimed that the relevant antitrust market was comprised of all products used for laundry purposes, including powder, bar, and liquid detergents. The Colombian competition authority (SIC), on the other hand, identified powder soap used in laundry machines as the product market in this case; as a result, it concluded that P&G had a dominant position in the market. Yet, the data collected showed that all sorts of soaps, whether powder soaps or bar soaps, were perceived by consumers as possessing similar properties and functional purposes, i.e. washing laundry; in other words, they were considered substitutes for one another.

P&G argued that the SIC had misinterpreted the functionality of bar soap in assigning this product to an independent antitrust market. Furthermore, P&G contended that the SIC did not use accurate data to define the market. In Colombia, only 25.1 percent of households use laundry machines; yet the SIC contended that the correct figure was 62 percent of the market. The difference between the two estimates lies in the methodology used by each party. The SIC used data from one study in which researchers interviewed 900 people in four large cities (Bogotá, Medellín, Cali and Barranquilla); the petitioners used a statistical study that incorporated 24,090 interviews conducted all around Colombia.

Another case will further illustrate the problem of substitution in antitrust market analysis. In the controversial *Nabisco* case (1996) involving the merger of two producers of saltine crackers, Venezuela's Pro-Competencia adopted the questionable view that the relevant product market was limited to saltines rather than the broader market of snacks in general, as the merging firms argued. In the opinion of Pro-Competencia, the evidence showed that, unlike other snacks, consumers regarded saltines as a healthy food substitute for meals. The basis of this "evidence" was never revealed in the decision.

In a Venezuelan case involving advertising in the Caracas subway system —*K Exteriores Publicidad vs C.A. Metro de Caracas* (Caracas Metro case) (2001)— a complaint was filed against Sygnos y Gráficos Nomencladores Sygno, C.A., and C.A. Metro de Caracas, for

allegedly engaging in anti-competitive practices by imposing conditions on the sale of advertising spaces in Caracas subway cars, which became permanent barriers to entry in the relevant market (defined as the market for advertising in modular units in the cars of the subway system). Pro-Competencia ordered the termination of the practice. It also ordered that a public bid, public offer, or other mechanism be used to award the advertising space in the future.

In this case the definition of the relevant market may have been unduly narrow because of the existence of innumerable outlets for advertising spaces that compete with the spaces allocated in the subway system. In view of the amount of time spent in traffic jams in Caracas, it is reasonable to think that advertising space is much more effective above the surface than in the subway system. Pro-Competencia never documented the reasons why it had confined the market to the advertising spaces available in the subway system we can only suppose that its officers are active users of the system, unlike the majority of Caracas's commuters, who use ground transportation.

These cases show that, from a long run, dynamic perspective of markets, these should not be viewed as closed-ended boxes which the analyst can measure according to settled econometric standards. Due to their assumption that consumer preferences are stable, competition agencies are inclined to misconstrue product substitution in their assessment of market size.

The assumption of prices above marginal costs that underlies the analysis of monopolistic behavior can only take place in idealized static markets, where information is known by the analyst because he assumes to possess it in full. If he does not have it all, he assumes that it is due to someone else's fault; he does not consider the possibility that such acquisition is, simply, impossible, due to the very subjective nature of market information.

Led by the assumption that the antitrust analysis can operate because information is somewhere "out there" waiting to be seized and processed, antitrust scholars endeavors are then directed towards examining substitution possibilities among products *already existing* in the market.

The problem with this approach stems from an obvious fact: antitrust authorities cannot know whether observed prices are prices that exceed marginal costs, because market information is not static, but changes from one moment to the next. The antitrust analysis is only possible "on the blackboard", and rests on the assumption that production costs which are employed in economic analysis to draw these conclusions, are objective, and stable – that they are equally valuable to anyone; yet, in the business world, entrepreneurs make investment decisions or refrain from doing so based on their particular subjective costs, which cannot be translated to third parties.

In sum, fundamental problems arise from the nature of market size analysis, based on the examination of product substitution. Joan Robinson's Imperfect Competition model conceptualized firms enjoying monopoly power as monopolists of their own production; thus, facing negatively sloped demand curves. This assumption, coupled with the existence of "barriers to entry", postulated (as opposed to "explained") the capacity of monopolists to act unconcerned to their competitor's reaction, in the event of a price increase. Substitution possibilities were limited by steadiness of consumer preferences. Resting on these assumptions, competition analysis proceeded to define markets on the basis of product substitution possibilities. The analysis of substitution through the use of the mechanical evaluation of cross demand elasticity compares the prices of alternative products. In this view of markets, prices are mere snapshots of the preferences of consumers at a given point in time.

In sum, from the viewpoint of the legal process, this indeterminacy about the methodology to be employed in assessing market size leaves competition agencies with qualitative measurements about interchangeability based on the wavering opinion of focus groups, and sometimes nothing more than intuition, thus conflating the personal preferences of antitrust enforcing officials, with that of the markets'. In the absence of objective measurements, competition agencies are inclined to conflate their own perceptions about product interchangeability with the markets'.

Antitrust policy's misled understanding of productive efficiencies.

In addition to market measurement, the failure of antitrust policy to develop a stable rule of law is also evident in its assessment of productive efficiencies, which is the cornerstone of the policy's evaluation. It is important to note why productive efficiencies are important under antitrust analysis. Under antitrust policy, not every welfare losses are regarded a social loss subject to prosecution; merely welfare losses uncompensated by productive efficiencies. Antitrust case law has acknowledged that some degree of welfare losses due to output restrictions is necessary if consumers are to benefit from productive efficiencies resulting from rearranging productive factors. Hence, antitrust policy is not only concerned with the welfare loss resulting from sub-optimal allocation, but also with delivering consumers welfare gains resulting from such productive rearrangements.

The problem stems from the incapacity of the policy to do such balancing calculation in a steady, predictable way.

Guided by their conventional static approach to productive efficiencies, competition agencies fail to see the inherent compatibility between monopoly power and the production of long-run dynamic efficiencies. Rather than viewing them in the context of a

learning process that creates a positive spill-over (i.e. externalities) to other market participants, thereby reducing total costs in the industry, competition agencies are inclined to condemn such efficiencies as the very material instrument that enables a business to monopolize markets. For instance, seizing scale economies enables one firm, in extreme cases, to displace all other competitors from the market. Clearly, this sort of efficiency would lead to market monopolization.

Short-run productive efficiencies are more likely to be seized through improved management of the firm; under these conditions firms will use the best technology available and use existing resources most efficiently, thereby causing production levels to reach society's production frontier. Significant cost savings arises, however, due to innovation and learning accruing from Marshallian pecuniary external economies (Chandra, 2004). Under these conditions, businesses develop skills that enable society to move the production frontier outwards. These cost savings are not attainable through improvements in the management of existing resources, but rather through improvements and innovation in production processes that bring about entirely new resources and products. In Marshall's view, productive efficiencies are not related to the individual firm's cost function, but are industry-wide.

Competition analysis takes productive efficiencies verifiable in the short run to be the counterpart of output restrictions, while in fact such efficiencies could only be compatible with market foreclosure or output restrictions if we visualize them in the long run, as a mechanism that will create today the incentive for firms to invest in the production of future returns.

In other words, such efficiencies can only be understood in a dynamic, long-run sense, as by-product of Marshallian external economies, i.e. learning processes that enable firms to produce at increasingly lower costs. Therefore, the tendency of competition agencies is to consider any competitive advantage, such as economies of scale, as a source of monopoly behavior, rather than perceiving it as a source of long-run productive efficiencies. Robinson's "wrong turn", as discussed above, essentially led antitrust thinkers to believe that any exploitation of scale economies is bound to lead to monopoly power, because it did not consider the impact of Marshallian external economies on cost reductions. Again, these external economies develop only in the course of time, in the long run.

Under the conventional equilibrium view, all analysis of productive efficiencies remains confined to the evaluation of benefits that the analyst assumes will be obtained from an improved use of existing technology or surrounding economic circumstances, such as economies of scale. No consideration is given to new, unforeseen uses resulting from entrepreneurial discovery (i.e. innovation).

The failure of competition agencies to acknowledge the long-run nature of dynamic efficiency biases the whole exercise of antitrust analysis. Williamson (1968, p. 34), long ago noted the danger of antitrust analysis's imbalanced welfare calculation. He stated that 'if neither courts nor the enforcement agencies are sensitive to [including productive efficiency in the calculus] the system fails to meet a basic test of economic rationality. And without this the whole enforcement system lacks for defensible standards and becomes suspect.'

Williamson did not see that the ultimate reason why the antitrust enforcement system lacks for defensible standards rested on its failure to apprehend the essence of long run dynamic productive efficiencies that justify short run output restrictions. He mistakenly assumed that the system is marred simply by the pursuit of alternative goals different from consumer welfare, which call for different decisions about how to allocate *existing* social resources, rather than *producing* future ones. Williamson, Bork and the majority of scholars who criticized antitrust policy from this perspective, simply advocated following one social resource allocation criterion that, at face value, merely entailed a decision to favor consumer welfare, but like other alternative resource allocation criteria, always sacrificed at the expense of misconstruing markets' dynamics and the production of long run productive efficiencies through reaping pecuniary external economies.

Consider the standard approach followed by competition authorities, that is, the use of price theory in order to establish the net positive welfare effects of a business undertaking. The price theory test requires significant efficiencies that reduce a firm's costs so much that the firm's optimal price *actually* falls, even though the conduct demonstrates (or increases, in the case of mergers) a firm's monopoly power. Only then can consumers claim to have received some immediate benefit from the business undertaking, so that competition agencies can approve it. Evidently, such a situation is quite rare in practice, since the very existence of the short-run output restrictions embodied in business undertakings indicates that some degree of price increase is likely to follow. Therefore, the test becomes biased against due consideration of productive efficiencies, which always seem incapable of balancing, much less outweighing, output restrictions.

An improper antitrust analysis of dynamic efficiencies renders the analyst liable to overemphasize the significance of output restrictions by consistently finding the existence of "uncompensated" monopoly power. This perception is reinforced by the fact that the actual presence of measurable quantitative restrictions on output contrasts with the merely hypothetical, intuitive nature of short-term productive efficiencies. It is natural that the opinion of the competition authority is biased in favor of those elements that it can observe readily and directly. It is no wonder, then, that antitrust enforcement

overestimates the negative effects of short-run allocation over the positive effects of long-run dynamic efficiencies created by a transaction.¹⁶

Let us now see the practical implications of such misconstruction of markets, in the erratic case law of several Latin American jurisdictions.

The case of price fixing

Guided by the tenets of industrial organization theory, antitrust policy seldom, if ever, admits the possibility that simple (“naked”) price alignment can increase the welfare of consumers. These agreements are usually condemned as *per se* prohibited because of the emphasis placed by antitrust theory on the short-run effects of such conduct. Yet in a dynamic long-run perspective on economic welfare, it is possible for price alignment to positively impact consumer welfare.

Consider the case of several producers of a particular product for which demand begins to fall relative to productive capacity, with the result that the prices previously charged now exceed marginal costs. In these circumstances each entrepreneur is tempted to lower his price so as to divert trade from rivals and thereby ensure that his firm is working at full capacity. However, if this policy was followed by all, the outcome would be large excess supply. Each firm would fail to increase its own share of total sales, and would find that the increased output it had produced and hoped to sell at a price below its previous level could not in fact be sold at that price. It would have to put up with a larger stock or apply a further price cut. Prices would fall well below marginal costs, and entrepreneurs would sustain heavy losses, depending on the elasticity of demand for the product (in comparison with that of other competitors) and on how large the price cut was.

The competitive equilibrium model assumes that this fall stops at the point where prices equal marginal costs (i.e. perfect competition), but in the world of uncertainty in which entrepreneurs interact, this situation reinforces itself: in the absence of any communication between entrepreneurs, further price cuts will result in larger stocks and

¹⁶ In other jurisdictions, the same criticisms have been made about the way competition agencies conduct their analysis. For example, Korah (1994, pp. 56-57, 267-284) emphatically criticizes the European Commission’s reluctance to give ancillary restrictions a paramount role in competition analysis, thus overemphasizing the ‘ex post’ consequences of past restrictions rather than stepping on the toes of the parties involved in a transaction, whose ignorance about future market conditions causes them to negotiate some restrictions on competition ‘ex ante’, in order to induce them to trade at all. Similarly, Bork (1978) criticizes the U.S. competition agencies for overreaching by interpreting their mandate beyond what was in fact the ‘real intention’ of the framers of the Sherman Act (in Bork’s opinion), i.e. to make consumer welfare the goal of antitrust policy. These criticisms, however, fail to see that this problem is linked with the self-defeating nature of competition analysis, and see it as a failure of competition agencies to implement the competition agenda.

an inability to place products in the market even at the reduced price. Evidently, taken to the extreme, sheer uncertainty (i.e. no information exchanged between competitors) joined with price competition would result in a massive misallocation of social resources.

Moreover, prices depend on the fluctuations introduced by the very uncertain nature of business expectations about the way that a change in prices will be interpreted by other competitors in the market. One seller may wish to raise prices but be afraid to do so in case others do not raise their price as well, or he may not want to trigger a price war by lowering his prices first. Entrepreneurs thus develop certain codes to preempt destructive behavior. For instance, they are inclined to maintain their prices when capacity exceeds demand, in the expectation that their rivals will act likewise. Fear of retaliation is the main driver of such conduct.

This explains why in markets where homogeneous products are traded (i.e. sugar, cement, etc.), competitors tend to avoid price-based competition. Instead, they compete on intangible factors that are more difficult to replicate, such as service, delivery, etc. (as it were, “elasticity” of these attributes is lower). Price competition is effected, at any event, in the long run, and it is based upon long-run efficiency cost reductions. Thus, prices do not remain unchanged, but they yield to cost variations and changes in demand. The key factor guiding price competition is the competitive strategies followed by competitors in the long-run (e.g., development of superior capabilities). Meanwhile, in the short run, competition is based upon services, quality, and customer service.

Latin American antitrust policymaking, being driven by the Imperfect Competition model, assumes that the likelihood of anti-competitive restrictions is greater in industrial sectors where homogeneous products are traded, because the “real world” markets in these industries will clearly depart from the assumptions of the “ideal” equilibrium (perfect or workable) competition model. Any simultaneous price increase will inevitably be regarded with suspicion. As it happens, antitrust prosecution is more likely in these industries as compared to others, simply due to the influence of the Imperfect Competition model.

Under antitrust rules, however, what matters is short-term competition. The *Alcool Cartel* case (1999) is a case in point. In May of 1999, 181 alcohol producing firms established an association, the Brazilian Alcohol Exchange (“BBA”) that would sell under exclusivity agreements all the output of its members for three years. These firms together produced 85 percent of all the alcohol in the south, southeast, and central-west regions of Brazil, though individually they had under 3 percent of the national market. The BBA would complement the existence of another association, Brazilian Alcohol (“Brasil Álcool”), created to store its members’ excess capacity, which amounted to approximately 15 percent of their total output. The alleged motivation for the creation of these associations was a response to the deregulation of the sector, which drove prices below the average costs of production. This was supposedly a temporary crisis caused by excess capacity that

would be corrected in two or three years' time with the expansion of the consumption of alcohol. The SEAE determined that the parties were in fact forming a cartel.¹⁷

Under a dynamic market process perspective, however, this conclusion is unwarranted. In the absence of the associations, in the SEAE's view, the sector would have likely adjusted to reflect the different productivity levels of the firms. The least efficient would probably have left the market, and others would merge, but the sector as a whole would have survived. However, this is counterfactual, since it relies on mere speculation about what would have happened if circumstances would have been different. One could also hypothesize the an alternative outcome: that an industry wide downward spiral spurred by excess capacity could have caused prices to plummet below efficient levels, thereby inducing *everyone* out of the market, not merely the least efficient firm. By maintaining higher prices during a certain period, these associations prevented a collapse of the industry in times of unexpected shock. Moreover, provided that the alignment between member firms was temporary and confined to prices, there was no reason to believe that they would have restrained themselves from competing in other key areas of the alcohol business: distribution; marketing, better consumer service at stations; and many more. The question determining the existence competition (or lack thereof) was not whether price alignment existed but whether other potential entrants were significantly prevented from entering the market, or whether actual firms were impeded from offering other complementary services, during the time of the price agreement. These are the issues usually left aside by competition agencies, due to their analytical emphasis on price alignments.

Cases decided in other countries followed a similar rationale. In the Argentinean *Chamber of Construction* case (2003), the chamber was prosecuted and fined, despite their contention that "reasonable prices" had been agreed to in order to prevent a "price war." This argument seemed, to CNDC, entirely contrary to the rationale of antitrust policy. Under conventional antitrust principles, this is correct. However, the case might have taken on a different appearance if the CNDC had focused its attention of the absence of entry barriers, rather than on the agreement itself. If the CNDC had taken this approach, it could have determined whether, in the absence of entry barriers, such "reasonable prices" were in fact monopolistic. Under conditions conducive to market entry, in the

¹⁷ The SEAE's report indicated that the creation of the BBA had kept prices artificially high, and that when the government had stopped dictating the prices of alcohol in February of 1999, the market had immediately started reflecting the excess capacity through lower prices. Moreover, from February through May of 1999, prices had fallen 33.9 percent for the producer and 16.8 percent at fuel stations, while prices for gasoline had increased by 14.1 percent. The first increases in the prices for alcohol had only occurred in May, when the BBA began operating, and since that time they had increased by 216.5 percent for producers and 73.1 percent for the final consumer. The SEAE concluded that the existence of the BBA and *Brasil Álcool* facilitated coordination among the firms, restricting competition and ultimately harming consumers. These associations reduced the member firms' incentive to improve their production techniques, as any increase in price would necessarily benefit all the producers, regardless of how efficient they were.

event that prices were set above competitive levels it would be reasonable to think that new competitors would enter the market and impose discipline on the incumbents. Alas, the CNDC said nothing about entry barriers in its decision.

Two cases, *Venezuela's Pro-Competencia v. Cemex and others* (2003) and *Brazil's Sao Paulo — Rio de Janeiro Airline Cartel* case (2003), show how the short-run allocation notion of competition employed by antitrust authorities may impinge upon the functioning of industries where short-term price competition is irrelevant and firms compete instead based on intangible factors such as service and quality.

In the cement case, it would have been very hard for Pro-Competencia to admit that competition exists in this market *because* prices and market shares are stable. Of course, price competition would have been eliminated; but under a market process perspective, this is merely one—and probably the least important form of competition. Customer service and quality is possibly even more important as a competition driver; after all, trading of a homogeneous product, such as cement, forces traders to differentiate themselves in those intangible aspects of competition that cannot be easily replicated by competitors. Moreover, price competition almost entirely rests on the economies of scale that traders enjoy.

Thanks to price stability it is possible for firms to concentrate on building their long-term competitive advantages; this is what eventually makes them price leaders in their local markets. This reveals the wide gap existing between the way that businessmen interpret their own actions, which they view as pro-competitive in the long run, and the views of antitrust authorities, which highlight short-term resource allocation inefficiencies resulting from what they perceive to be explicit agreements to fix prices. Pro-Competencia disregarded the long-run dynamic efficiency justification behind the price leadership explanation, namely, that producers trading homogeneous products usually compete on intangible attributes which are more difficult for competitors to replicate: post-sale services, maintenance, prompt delivery, individualized attention, etc. Prices, on the other hand, are not the main competition drivers, because competitors can easily reproduce them. Price competition is over the long-run: dynamic efficiencies play a key part in the overall competitive process as cement producers closer to cement production plants will increasingly enjoy a competitive advantage. This is hardly an advantage that can easily be passed on to consumers in the short-run; however, this difficulty does not mean that long-run efficiencies do not exist.

Similarly, Brazil's SEAE attributed a uniform increase to the computerized system of the Airline Tariff Publishing Company (ATPCO). To reach this conclusion, it focused on proving price information exchanges in order to confirm the existence of collusion among airline carriers. However, the SEAE's emphasis on price information exchanges is pointless. Let us assume, for the sake of the argument that firms *did* collude to fix plane ticket prices. Would competition be impaired due to this?

In a wider theoretical perspective focused on the long run, fixing plane tickets would certainly have a minimal impact on the fate of competition of the industry. First, as in the cement industry, price competition is not the main driver of competition among airline carriers, albeit for different reasons. While in the cement sector, product homogeneity drives firms to differentiate them based on the provision of intangible services (e.g. attention to particular clients' needs, customer service, timing of delivery, etc.), in the airline industry, services are usually standardized, so airline carriers ordinarily compete in the pursuit of long-run efficient cost reductions; only exceptionally they do concentrate on price schedules. In the short run, however, competition is based upon services, quality, and customer attention: bigger and better-equipped hubs, availability of connecting flights, immediate and automatic dispatch of luggage, etc.

Competition, then, is about developing superior efficiency through better management of services, identifying particular client's needs, etc., while increasing the reach of connections through cooperation with other airlines (e.g., mile reward clubs and sharing international hubs). Pricing in local markets does not determine the competitive conditions of the whole industry, whereas better outreach and easier flight connections do.

In the airline industry, huge investments are needed to meet high fixed costs (e.g. sunken investment costs due to acquisition of an airline carrier fleet, payment for government permits, construction of maintenance facilities, etc.). Evidently, this requires any market participant to fix prices above marginal cost in the short run, so as to recoup them in the long run. Whether this is a permanent situation or just temporary does not depend on the inner intentions of the incumbent firms (who would not enjoy being a monopolist?) but on the existence of enough barriers imposed on potential competitors. If these barriers are government-created (e.g. entry licenses, route permits, etc.) then antitrust authorities should not pick up the wrong suspect, i.e. the private firm and if they are not, why blame the incumbent firms, rather than anyone else who is unwilling to take on the risk of investing in such a changing industry?

In support of this argument, one can easily see the huge positive social welfare impact created by the elimination of excessive government regulation in the airline industry. Deregulation of the domestic airline industry in the U.S. in the 1970s, led to the emergence of many more airline carriers than ever before; enabled better customer service through the development of efficient "transportation hubs"; and lowered airline fares significantly. (Viscusi, Kip, Vernon and Harrington, 2000 [1995], pp. 316, 575-76, 589-97)

Similarly, in the case *Pro-Competencia (ex officio) vs. Panamco de Venezuela S.A. (Panamco); Sociedad Productora de Refrescos y Sabores, S.A. (Sopresa) and Presamir, Presaragua y Presandes (Sopresa-Panamco)* (2003), soft drink bottlers Panamco de Venezuela S.A., Sopresa, and their subsidiaries, Presamir, Presaragua, and Presandes,

contended that their behavior was a classic example of competitive, rather than collusive, oligopoly. Dynamic game theoretical models of retaliation explain the evolution of some markets towards a quasi-standardization of commercial terms. Avoiding retaliation does not necessarily mean, as standard oligopoly models assume, that firms will not compete. Rather, they may avoid competition in certain areas of their business behavior, particularly prices, and concentrate on areas in which competition is harder to replicate, such as services and the promotion of intangible goodwill. The prosecuted firms alleged that commercial conditions negotiated with supermarkets and hypermarket chains had evolved over one hundred years towards standardization of commercial terms, yet competition remained in distribution chains and investments in advertising, placement of products on shelves, and promotions. As for prices, the industry had evolved from a monopolistic structure towards oligopoly.

However, Pro-Competencia disregarded these arguments and ordered the immediate suspension of joint and simultaneous identical discounts on carbonated drinks, as well as new, independent negotiations on the percentage of discounts and credit terms given to supermarkets, hypermarkets and other special customers who were part of the affected market. Panamco de Venezuela and Sopresa were fined in light of the extent of the restrictive practice and the harm caused to consumers.

No consideration was given to the likely dynamic efficiencies arising from standardization of commercial terms, reduction of transaction costs, and concentrating investments on the development of quasi-exclusive distribution chains. Instead, Pro-Competencia concentrated its attention on whether competing traders had given discounts simultaneously.

In the *Correo Argentino S.A. vs. Sociedad Anónima Organización Coordinadora Argentina (Postal Services case)* (2001), this approach led Argentina's competition body to disapprove a merger request application by the two largest postal services companies. In this case, the parties competed nationwide in several postal services, including basic letter delivery, telegraphic services, money transfers, business services, small package delivery, high security delivery, and international courier services. There were smaller competitors in some of these markets, but the merging firms had the largest and most comprehensive networks. They were the first and second choices for most consumers of these services. The Commission concluded that the increases in concentration in these markets were unacceptably high and that it was difficult to enter these markets, in part because of significant economies of scale.

The Commission attempted to estimate the costs to consumers that would result from the merger and concluded that they could range from 18 to 55 million USD per year. Postal services in Argentina were partially regulated, but the only services for which prices were set were letters, telegrams, and small money transfers. Section 16 of the competition law

provides that when a merger occurs in a regulated industry, the sector regulator must provide a report to the competition authority on the competitive effects of the transaction. In this case, the National Communications Commission provided such a report detailing the anti-competitive effects of the proposed transaction. The proposed merger was disapproved.

It is interesting to note that the Commission rejected the efficiency claims made by the parties, saying that their estimates were not quantified and were “too imprecise”. Instead, it took the conventional short-run antitrust approach, according to which economies of scale were the very source of monopoly profits that the merging parties were waiting to reap after closing the deal. Had the Commission taken a long-run perspective, it would have seen such economies of scale as the very reason to encourage the firms to merge and create a profitable postal business, which would have delivered added value to consumers in the form of a wider array of products, and possibly price discounts—provided, of course, that no entry barriers were imposed.

In the *Anheuser-Busch/Antartica* merger review case (1997), Brazil’s CADE applied a *potential competition* doctrine that raised a clear presumption against the transaction, as it assumed the increased concentration resulting from the merger to be anti-competitive. Under this theory, the acquisition of a leading firm might reduce competition by eliminating the acquiring firm’s impact on competition (*perceived* potential competition) or might reduce the prospect of future entry into the market (*actual* potential competition). Based on this theory, CADE blocked the intended joint ventures between Miller Brewing Company and Cervejaria Brahma (to produce Miller Genuine Draft in Brazil) and between Anheuser-Busch and Antartica (to increase the presence of Budweiser in the country) respectively.

In particular, CADE interpreted the association between Anheuser-Busch (a former potential competitor) and Antarctica (a leading Brazilian brewery) as raising anti-competitive concerns, because their agreement provided for discrimination clauses and market segments in which both companies were active. The structural interpretation of the competitive effects of the deal (that is, inquiring into the market shares that would result from the deal) totally ignored that the fact that market shares were notorious for shifting over time. For example, in the period from 1989 to 1995, Brahma’s market share declined from 50.3 percent to 46.6 percent; similarly, Antarctica’s market share had declined from 40.8 percent to 31.9 percent. Clearly there was a competitive threat to the leading firms from existing competitors. Nonetheless, CADE declined to give proper weight to this piece of evidence, which showed how companies were actively competing through development of capabilities and core efficiencies. Instead, it embraced the conventional short-run allocation view by applying a dubious potential competition doctrine.

In the proposed acquisition of *Digitel by Cantv* (2005), affecting the Venezuelan telecom industry,¹⁸ these flaws were visible in full.

On November 21, 2005, *Compañía Anónima Nacional Teléfonos de Venezuela* (CANTV), Venezuela's oldest telephone company, announced its intention to purchase *Corporación Digitel, C.A.*, for USD 450 million from Italy's Telecom Italia Mobile (TIM). The merger came about after significant changes had occurred in Venezuela's telecommunications market. These changes were triggered when *Movistar* (the leading Spanish telecom company) acquired *Telcel*, Venezuela's second-largest mobile phone company (the largest being Cantv's *Movilnet*). In order to counteract *Movistar's* deep pockets, Cantv offered to buy Digitel, the third-largest mobile operating company. In this way, Cantv expected to gain a competitive advantage over *Movistar* by acquiring Digitel's superior technology.

However, Pro-Competencia announced that they would not authorize the acquisition because it would lead to the creation of a duopoly in Venezuela. Like most antitrust decisions, on the surface, this decision seemed sensible enough. On closer examination, however, it was a deeply-flawed decision that may have harmed the very consumers it was meant to protect. The frustrated deal blocked Cantv, from adding some 1.3 million subscribers, raising its total to 4.3 million and surpassing *Telcel* (now *Movistar*), which had 3.7 million lines. It would have also strengthened *Movilnet's* competitive position against the onslaught that was expected when aggressive marketer *Telefónica de España* finalized its purchase of *Telcel*, by giving the former clear dynamic efficiencies in the form of economies of scale and scope for serving more customers. Digitel, meanwhile, saw its market share shrink from 12.7 percent to approximately 10.0 percent (representing just 1.0 million lines). Although this firm had the best technology of any of the companies, it did not have the deep pockets necessary to compete effectively in the ongoing clash of giants. Moreover, it was having financial difficulties and was in no position to make the capital investments needed to compete toe-to-toe with Cantv and *Movistar*.

In the *Nestle/Garoto* case (2002), CADE also found that no efficiencies would compensate for any price increases arising from the intended merger between the two firms. In no way did CADE explain how it reached such a conclusion: it simply reached this conclusion as a result of its perception that a 58 percent market share in the hands of the firm that would have resulted from the merger was intolerable.

Social welfare: the short run vs. the long run.

These cases show the divergence between prospective business strategies and antitrust static analysis of the market. Price competition is paramount in the context of a given set

18 <http://www.procompetencia.gov.ve/Opinion%20Publica%20Cantv-Digitel.htm>

of products among which consumers choose; this only occurs in short-run analysis, as the analysis typically begins by showing the number of competitors, level of production, etc., that would exist if the market were to reach its ideal competitive equilibrium and then pointing out why any other combination, involving a different point on a given demand curve, would harm the firm's profits position (Earl, 1995, p. 148). By implication, this logic induces the analyst to brand firms departing from such short-run equilibrium as anti-social or monopolistic, because *ex definition* deviation from equilibrium would harm the consumers, as it would reap part of their rent. In short, this approach would confront consumers' interest with the firm's, because competition agencies would only look into the short run welfare effects resulting from price manipulation.

By contrast, competition analysis that is focused on the long-run does not consider price competition to be an essential factor because prices are not even representative of *finished* products that would maximize consumer choices. In the long-run process view of competition, firms are more concerned with making achievements in quality and productivity, process innovations, marketing innovation, and product innovations, which would enable entrepreneurs to step into new markets before their competitors do. The significance of price competition will vary depending on the stage of development of the market. In early stages in a market life-cycle, buyers will be poorly informed about the point of having the product, and concerned about its reliability and whether it will become accepted as the industry standard. At this early stage, the power of brands is quite relevant, as compared to price discounts. Later on, when the product has become increasingly homogeneous and when information about its design and manufacturing has leaked out and become widely known, brand names may count for little as signals of quality and reliability, and price competition may become more attractive to consumers. (Earl, p. 149)

In short, the lack of understanding of long-run dynamic efficiencies usually distorts the competitive outlook of business undertakings in the eyes of competition authorities. Rather than looking at competition as a complex process that entails both cooperation and rivalry between competitors, they overstate the extent to which rivalry is necessary to a truly competitive market.

Seizure of increasing returns is another motivation for business conduct that is usually overlooked by competition authorities, due to their short-term, structural analytical bias towards market competition. In a dynamic, long-term perspective on competition, increasing returns are the very source of competition, as they provide the profit incentives that drive entrepreneurs to seek innovative organizational means and enter into a diverse array of institutional arrangements with other firms in order to seize those profits.

In the long run, returns of scale would eventually lead to fewer firms in the market, even a single firm in the industry, if there were no external economies enabling other firms to

learn and create their own increasing returns by spotting profit opportunities in undervalued market niches. However, this is not necessarily wrong or welfare diminishing. As Marshall ([1890] 1949) indicates, external economies are an essential source of knowledge that is at the disposal of potential entrants, thus ensuring that competition will be present. External economies enable new competition to enter the market. Young (1928) indicates that this source is also a powerful driver of competition within industries.

However, this is not an issue that antitrust agencies care much about. Due to their emphasis on price competition, they reach misguided conclusions about the current state of competition in Latin America. In their eyes, every form of arrangement appears as a contrived manipulation of markets to eliminate potential downstream or upstream competitors. Their conventional view usually conflates the natural growth of firms and healthy seizure of increasing returns with monopolization of the market. It is assumed that bigger firms will be better positioned to take hold of increasing returns, due to their increased financial might; not to their superior entrepreneurial skills to reap them.¹⁹

What they fail to see is that Latin American markets are usually small, with fewer firms in control of large chunks of the market due to causes that may not be associated with the monopolistic conduct of firms which, as explained here, but to the costs they must bear in order to do business in the market. By overcoming such costs, businesses can reduce prices and increase their array of products through investing on developing new ones.

The problem of antitrust analysis is that it rests upon a cogent notion of competition which takes as a fact that businesses' aim their actions at preventing others from doing something, rather than exploring new ways of satisfying consumers, in a legitimate attempt to increase profits. In other words, it is a policy that rests on the idealized assumption about the behavior of firms at competitive equilibrium, whose actions are taken to be normative guidelines of the real world competition, where firms constantly aim their actions at excluding others from the market.

¹⁹ The conventional perception fails to distinguish between the meaning of both increasing returns and returns of scale. Increasing returns depend entirely on the development of some market niche that is systematically under-valued — a discovery that will be dependent on the satisfaction of other consumer preferences, rather than on the firm's capacity to affect markets. Returns of scale, by contrast, refers to the individual capacity to obtain financial benefits from the size of the firm's operations. These benefits accrue from a less rapid increase in production costs relative to increases in output as the number of units produced rises. Thus, while increasing returns are associated to the supra competitive profits that an entrepreneur can expect from discovering a new market niche, returns of scale are associated to plant size. In other words, returns of scale are the likely consequence of the entrepreneur's discovery of a new, promising market niche; by contrast, increasing returns do not necessarily accrue if the entrepreneur develops a large plant size exploits in an industry growing old, where profits are being dissipated by the presence of many other competitors.

Antitrust Policy's "Perfect Justice" versus the rule of law

Antitrust policy suffers from a fundamental flaw: Legal proceedings require a positive determination of the existence of restrictive conduct, which entails an exploration of the intentions of the undertaking party. However, the identification of truly monopolistic undertakings for the purpose of imposing legal liability depends on futile objective appraisals of collected data that are meaningless for identifying the real purpose of entrepreneurial activity.

This is an epistemological flaw that affects the essence of antitrust analysis. The conventional analysis does not give the regulator any meaningful knowledge about the "causes" of entrepreneurial activity because it is simply not concerned with this problem, only with assessing the short-run economic welfare effects arising from the obvious fact, that entrepreneurs do not (and will never) be rational. It is no excuse to argue that such are merely "idealized premises" which make it possible to maintain the consistency of model predictions; the use of such premises to decide over property rights in the market should warn policymakers about the logical inconsistency behind their policies.

Clearly, the antitrust logic of bounded markets where firms exploit consumers through supra-competitive prices provides the analyst with the proper setting to visualize the "ideal" world of social welfare, where market power would be detected and tamed. Yet, in light of Marshalls' external economies and changing economic preferences, it is clear that such assumption is illusionary. Further, illusion turns into utopia, at the attempts of enforcing such assumptions are normative standards of the real world.

In practice, the analysis induces the analyst to abandon any serious effort to explain market causalities, in favor of postulating personal assumptions about how market outcomes would (and should) be. Personal utilitarian preferences about "economically efficient" social welfare thus replace a truthful analysis on the justice of the business conduct examined.

Naturally, in this perspective there is never enough data supporting a final conclusion about the welfare enhancing (or diminishing) effects of a given conduct, since such collected data merely conveys knowledge about businesses past conduct; never on their present expectations and rationale for restricting output or raising prices.

Epstein (1995, pp. 37-42) has branded this effort as a quest for *perfect justice*. As a goal of policymaking, perfect justice requires rooting out error in every case, regardless of the costs involved. Similarly, Sowell (1999, pp. 27-42) 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 equalize the condition of each individual with every other.

The costs of attaining *cosmic or perfect justice* in the market would make such efforts unfeasible because prosecuted firms would always be one step away from reaching the price/output relationship that is necessary to attain perfection (i.e. competitive equilibrium): by definition, such perfection is utopian. Furthermore, competition authorities can never know what market conditions are necessary for attaining optimal allocation, because such optimality is, in any event, related to future events (i.e. prospective dynamic efficiencies), that have not yet unfolded, therefore, they are not disclosed to the analyst *ex ante facto*.

Sowell notes the impossibility of attaining cosmic justice, on the grounds that it is impossible to devise an ideal standard of equality that would achieve perfection for every individual, given the costs involved in such efforts. In other words, this mindset is entirely utopian. In his words: 'with justice, as with equality, the question is not whether more is better, but whether it is better at all costs.'

This phenomenon affects the very essence of legal analysis of observed market phenomena. In the absence of any reference point for what is "good" or "bad" economic behavior (since such reference is contingent on a notion of *prospective* dynamic welfare which is unknowable at the time that competition agencies conduct their investigations), competition agencies are led into making ad-hoc interpretations of market phenomena that are not subject to judicial control.

Legal evidence in this field, in the absence of an outright confession, almost invariably rests on economic indicia, which is more proof that economic theory is, in the end, what organizes competition authorities' interpretations of market phenomena. As it happens, economic theory is far from settled in this field (as is the case in every field). Under modern economic theory, markets are examined through dynamic models which often justify the need to restrict rivalry at one level in order to induce further investments at another, even if that investment adopts the form of short-run savings. For example, a restriction may seek to avoid further losses in price wars in order to promote competition in the long run through diversified production. Therefore, any conclusion that, for instance, horizontal arrangements are *inherently* anti-competitive is certainly far-fetched and premature, because it is ultimately a product of the analyst's perspective, which may privilege short-run allocative efficiency or long-run dynamic efficiencies.

Unlike other areas of law, in antitrust proceedings, economic "facts" are understood within the context of the theory that gives them explanation; in other words, they are not objective, in the sense of being perceived by anyone in a similar way through sensory experience. On the contrary, their existence is contingent to the economic theory that provides their "meaning".

Hence, price increases, output reduction, exclusion of competing businesses through contractual means, and so on. These are all events whose objective appearance reveals nothing about the monopolistic intention of the actor who undertakes them. It may well be that the exclusion of a competing firm from the market is the very condition of another's success, for they are both competing for the same client: in it of itself this is not evidence of the first business's intent to engage in monopolistic conduct.

For example, a contractual device binding distributors to an exclusivity agreement by its own terms does not reveal the "purpose" of the entrepreneur, whether it is to increase or diminish social welfare. On its face it merely reveals a fact, to wit, the exclusion of a client's rival, or the preferential (even discriminatory) treatment given to a supplier firm over its rivals. Any further inquiry into the intentions underlying such arrangements would require a proper understanding of the motives that cause a supplier to request exclusivity from its dealers, yet these motives are not readily visible by simply looking into the structure of a contract.

The problem becomes even more complicated when we realize that anyone pretending to decide a case under this methodology has to consider all possible states of the world. To determine the economic consequences of their decisions, judges would need to know the structure of the demand curves for every imaginable circumstance. But are judges up to this task?

The task is impossible. As markets evolve, the structure of industry demand (and supply) becomes heterogeneous, meaning that not one, but several, simultaneous demand curves overlap and cross one another. Subjective costs determine these heterogeneous demand curves. Therefore judges cannot know how much each party would be willing to pay (or bribe) to obtain various outcomes. (Block, 1995, p. 87) Without knowing willingness-to-pay, judges may not reach the wealth-maximizing solution. In a criticism this author makes against the utility maximizing property rights theory postulated by Coase-Demsetz, he developed this argument further:

"[Coase-Demsetz theory] will not do. Allowing judges such wide discretion is highly problematic because this will render personal and property rights highly uncertain. Further, Coase is making the normative claim that under conditions of positive transactions costs whether (any crime) should be legal or not should depend on judicial determination as to the costs and benefits involved in a given specific instance. But the judges simply have no way of knowing which the worse harms are; therefore, any attempt on their part to interpersonally compare utilities in this way is ultimately arbitrary. Indeed,

to champion a philosophy of rights with such implications bespeaks a certain moral opacity.”²⁰

If judges are unreliable in this respect, giving them discretion to decide cases based upon costs and benefits will make property rights uncertain and erratic, thereby comprising the foundation of the market economy.

It is clear that the substantive question regarding predictability turns out to be whether welfare effects can actually be identified in similar cases in a similar manner, that is, whether antitrust policymaking can be done in a predictable manner.

If one takes the words of experienced antitrust scholars such as Kovacic and Shapiro (2000), there does not seem to be much room for optimism about achieving a predictable rule of law in this field. In their words:

‘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.’ (Kovacic, William and Carl Shapiro, 2000, p. 58)

However, even in the United States, after more than a century of antitrust enforcement, the Supreme Court’s position on the question of what sort of consumer welfare antitrust policy protects is “opaque”. (Rosch, 2006)

Clearly, there is a fundamental flaw in antitrust thinking. The system, as it is currently conceived, cannot deliver predictable and stable outcomes, such that the business community can enjoy a stable and predictable basis for designing business plans. In the light of the preceding considerations, it seems that a new paradigm of legal and economic analysis for dealing with trade restrictions is necessary.

It is not surprising that the pursuit of cosmic or perfect justice through antitrust rules usually leads competition authorities to engage in targeted social engineering, thereby achieving exactly the opposite of what competition policy is intended to do: allow markets themselves to decide social resource allocation. In the words of Sowell (1999, p. 40): ‘[t]hose pursuing the quest for cosmic justice have tended to assume that the consequences would be what they intended —which is to say, that the people subject to

²⁰ Block, 2000, p. 67. Block’s critique on the use of interpersonal comparison of utilities to impose moral and legal rules that undermine property rights can be traced back to Rothbard (1956).

government policies would be like pieces on a chessboard, who could be moved here and there to carry out a grand design, without concern for their own responses. But both the intended beneficiaries and those on whom the costs of those benefits would fall have often reacted in ways unexpected by those who have sought cosmic justice.’

Conclusion

Virtue is in the eye of the beholder. What advocates of the rule of law see as a flaw, antitrust advocates regard it as a virtue. One of the assets of antitrust policy, in the eyes of its advocates, lies in its flexibility and adaptability to changing economic circumstances. Assistant attorney Bingaman (1994) put it eloquently: “I acknowledge that the antitrust laws are flexible and that they are adaptable to changing circumstances. But this flexibility and adaptability are strong assets, rather than liabilities”. Kovacic (2005, p. 5) also refers sympathetically of antitrust policy’s “experimental” substance.²¹ Yet this “experimental” nature is precisely what differentiates a policy directed towards tinkering with the market from another truly supportive of a rule of law system. Like the Roman God Janus, who had two heads facing in opposite directions, it seems that antitrust advocates speak in one direction but actually act in the opposite direction.

Stability of rule making is not incidental to market functioning: on the contrary, it is an essential trait that enables its proper functioning. Only through stable rules will prices reflect the true intensity of individuals’ preferences, thereby facilitating the allocation of resources to their highest-valued uses (i.e. economic efficiency).

Ultimately, the difficulties of antitrust analysis stem from the inherent contradictions of the Imperfect Competition theory that it is based upon. Imperfect Competition failed to develop a theory of oligopolies that could shed some light on the reasons that firms conduct their business the way they do. In other words, the conventional oligopoly theory is a non-starter inasmuch as it assumes that firms act in isolation in the market, whereas the policy implications drawn from any oligopoly model are to be imposed in markets where various firms simultaneously coexist, compete and collaborate.

Conventional oligopoly theory dismisses such contradictions and assumes that a firm’s behavior is actually conditioned by its particular position in the market *alone*. Significantly,

21 In his words: ‘The process of formulating competition policy frequently requires public antitrust authorities to make difficult judgments amid uncertainty about the competitive significance of various forms of business conduct. Will a merger of two significant rivals retard or increase competition? Are the restrictions that limit the freedom of participants in a joint venture reasonably necessary to ensure the development of a new product? Are the business justifications offered to support a refusal to deal or an exclusive contract genuine or contrived? Decisions of these types can be difficult even in “routine” matters, and they can be especially challenging when rapid technological change, deregulation, or other dynamic forces complicate the analysis of competitive effects [...] The formulation of policy amid uncertainty gives a substantial experimental element to government enforcement.’

it does not consider the framework of expectations in which firms conduct their business, even under the very assumptions of implicit collaboration introduced by the oligopoly model. It is for this reason that Herbert Simon (1976, p. 140) referred to this model as ‘a permanent and ineradicable scandal of economic theory.’²²

Intuition should immediately tell us why, a policy supported on a complete disregard of the analysis of institutional development through expectations is utterly incapable of reinforcing the rule of law.

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22 Augustin Cournot (1838) presented a model of duopoly in which each party must form conjectures about the actions of the other party. Implicitly, this means that each player is forming conjectures about the conjectures of the other player, leading to an infinite regression paradox: I think that you think that I think. As Koppl and Rosser (2002, p. 339) rightly state, ‘The “reflexivity” of such situations defies logical closure. Self-reference leads to paradox, not always or inexorably, but easily and often. Cournot resolved the problem by having each simply assume that the other's behavior would not change. Such devices are common in economic theory and amount to arbitrary limits to the rationality of the agents, but they amount to bounds on the rationality of agents, as was noted by Herbert Simon (1976) in discussing the Cournot model.’

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