

Competition, Welfare, and Competition Policy

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Competition Applauded

Harold Demsetz, *Economic, Legal, and Political Dimension of Competition*, 1982.

Competition occupies so important a position in economics that it is difficult to image economics as a social discipline without it. Stripped of competition, economics would consist largely of the maximizing calculus of an isolated Robinson Crusoe economy. Few economists complete a major work without referring to competition, and the classical economists found in competition a source of regularity and scientific propositions.

Joseph Stiglitz, “The Meaning of Competition in Economic Analysis,” 1992.

At least since Adam Smith, competition has played a central role in economics. It is because of competition that individuals and firms, pursuing their own self-interest, are led to, as if by an invisible hand, to do what is the common good. Yet, while almost all economists applaud competition, the concept of competition has many different meanings. And while economists today share an enthusiasm for competition, this enthusiasm is not shared so universally among either businessmen or the public at large.

Two Conventional Beliefs about Competition

1. Orthodox Economists: “Invisible Hand” Thesis

Stage 1: Adam Smith’s **Invisible Hand**

Stage 2: Perfect Competition and Fundamental Theorems on Welfare Economics

Austrian Criticism: Friedrich von Hayek

Stage 3: Baumol’s Spectrum

[T]he standard analysis [of industrial organization] leaves us with the impression that there is a rough continuum, in terms of desirability of industry performance, ranging from unregulated pure monopoly as the pessimal arrangement to perfect competition as the ideal, with relative efficiency in resource allocation increasing monotonically as the number of firms expands.

2. Public at Large: Competition as a Necessary Evil

Confucian Maxim: To go beyond is as wrong as to fall short.

Excessive Competition; Destructive Competition

Yukichi Fukuzawa, Autobiography (1899)

I was reading Chamber's book on economics. When I spoke of the book to a certain high official in the treasury bureau one day, he became much interested and wanted me to show him the translation. ... I began translating it ... when I came upon the word "competition" for which there was no equivalent in Japanese, and I was obliged to use an invention of my own, *kyoso*, literally, "race-fight."

When the official saw my translation, he appeared much impressed. Then he said suddenly, "Here is the word, 'fight.' What does it mean? It is such an unpeaceful word."

"That is nothing new," I replied. "That is exactly what all Japanese merchants are doing. For instance, if one merchant begins to sell things cheap, his neighbor will try to sell them even cheaper. Or if one merchant improves his merchandise to attract more buyers, another will try to take the trade from him by offering goods of still better quality. Thus all merchants 'race and fight' and this is the way money values are fixed. This process is termed *kyoso* in the science of economics."

"I understand. But don't you think there is too much effort in Western affairs?"

"It isn't too much effort. It is the fundamentals of the world of commerce."

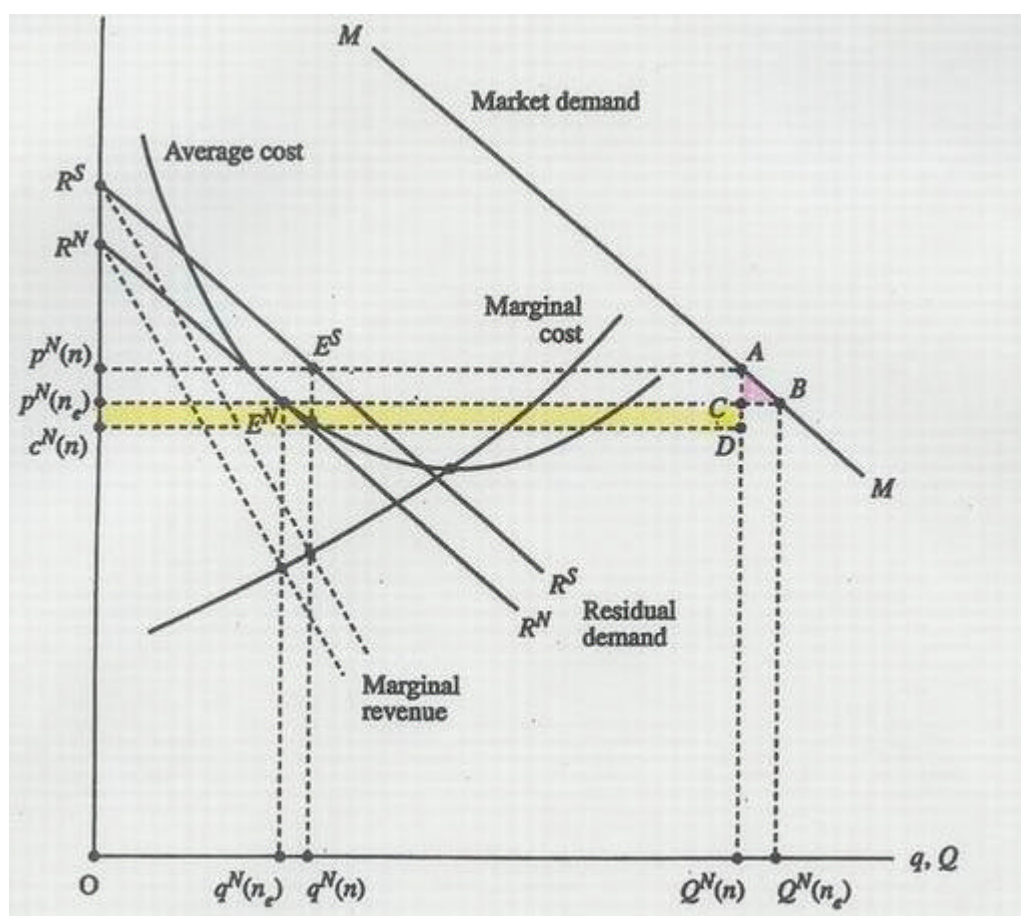
"Yes, perhaps," went on the official. "I understand the idea, but that word, 'fight' is not conducive to peace. I could not take the paper with that word the chancellor."

“Excessive Competition” Vindicated

Mankiw, N. G. and M. D. Whinston: “Free Entry and Social Inefficiency,” *Rand Journal of Economics*, Vol. 17, 1986.

Suzumura, K. and K. Kiyono: “Entry Barriers and Economic Welfare,” *Review of Economic Studies*, Vol.54, 1987.

Kotaro Suzumura, *Competition, Commitment and Welfare*, Oxford University Press, 1995.



Main Messages from Excess Entry Thesis

Vilfredo Pareto (1894/1927.p.379)

A protectionist measure provides large benefits to a small number of people, and causes a very great number of Consumers a slight loss. This circumstance makes it easier to put a protectionist measure into practice.

John Panzer (1980)

[R]egulation by enlightened, but not omnipotent, regulators could in principle achieve greater efficiency than deregulation.

Avinash Dixit (1984)

Vested interests want protection, and relaxation of anti-trust activity, for their own selfish reasons. They will be eager to seize upon any theoretical arguments that advance such policies in the general interest. Distortion and misuse of the arguments is likely, and may result in the emergence of policies that cause aggregate welfare loss while providing private gains to powerful special groups.

Consequentialism; Non-Consequentialism; Welfarism

Mechanism ---> Consequences ---> Welfare

Consequentialism: Judging the Goodness of Mechanisms in Terms of the Goodness of Consequences

Welfarism: Judging the Goodness of Mechanisms in Terms of the Goodness of Welfare Consequences

Welfarism is a special case of **Consequentialism**, and **Utilitarianism** is a further special case of **Welfarism**.

Non-Consequentialism does not necessarily neglect consequences in general and welfare consequences in particular. It just goes beyond consequences pure and simple and takes such non-consequentialist features of economic mechanisms as (1) **Procedural Fairness**; (2) **Richness of Opportunities**; and (3) **Liberty and Rights** into considerations along with consequences.

Criticisms against Welfarism

John Rawls, *A Theory of Justice*, 1971.

Amartya Sen, *Commodities and Capabilities*, 1985.

Ronald Dworkin, *Sovereign Virtue*, 2000.

John Hicks's Manifest

John Hicks, *Essays in World Economics*, 1959.

Why is it ... that anti-monopoly legislation (and litigation) get so little help, as they evidently do, from the textbook [economic] theory? Surely the answer is that the main issues of principle --- security on the one hand, freedom and equity on the other, the issues that lawyers, and law-makers, can understand --- have got left right out. The liberal, or non-interference, principles of the classical ... economics were not, in the first place, economic principles; they were an application to economics of principles that were thought to apply over a much wider field. ... As the nineteenth century wore on, the increasing specialization of economics led to an increasing emphasis on the economic argument. ... What I do question is whether we are justified in forgetting, as completely as most of us have done, the other side of the argument. ... What I do maintain is that the liberal goods are goods; that they are values which, however, must be weighed up against other values.

“Procedural Fairness” of Free Competition

Milton Friedman, *Capitalism and Freedom*, 1962.

No one who buys bread knows whether the wheat from which it is made was grown by a Communist or a Republican, by a constitutionist or a Facist, or, for that matter, by a Negro or a white. This illustrates how an impersonal market separates economic activities from political views and protects men from being discriminated against in their economic activities for reasons that are irrelevant to their productivity -- whether these reasons are associated with their views or their color.

[T]here is an economic incentive in a free market to separate economic efficiency from other characteristics of the individual. A businessman or an entrepreneur who expresses preferences in his business activities that are not related to productive efficiency is at a disadvantage compared to other individuals who do not. Such an individual is in effect imposing higher costs on himself than are other individuals who do not have such preferences. Hence, in a free market they will tend to drive him out.

Procedural Fairness versus Consequential Fairness

Consequential Values vis-à-vis Procedural Values

In examining the social value of competition, we should strike a balance between procedural considerations and consequential considerations. People seem prepared to make the following reasoning. Let x and y be the consequences of mechanisms m^1 and m^2 , respectively. In Mr. A's judgments, having x through m^1 is better than having y through m^2 , but Ms. B may judge otherwise.

There may be some people who say that it is better to obtain whatever commodity bundle through the free market mechanism than to be assigned another commodity bundle by the central planning board, even though the latter bundle may contain more of all commodities than the former. There may be some other people who ask for more bread, more wine and more whatnot, irrespective of how they are made available. In the former case, the resource allocation mechanisms are given the lexicographic priority over the consequences which emerge from them; in the latter case, the consequences are given the lexicographic priority over the mechanisms. It is more realistic to think, however, that people care not only about mechanisms, but also about their consequences, and they are prepared to strike a balance between them.

Major Tasks of Competition Policy

1. Private Sphere and Public Sphere

Private Sphere: Areas of economic activities over which private agents are free to compete with each other for the promotion of their own private objectives

Public Sphere: Areas of economic activities over which the government is within its jurisdiction to take public action by itself, or regulate the actions of private agents in accordance with some public objectives

Boundary Line: Natural Monopoly; Regulation and Deregulation

Drawing the boundary line between these spheres cannot be done once and for all. Depending on the state of technology, the boundary line must be subject to incessant review and redesign. To wit, there are many cases of regulatory reform in Japan and elsewhere, which transformed the traditional state monopoly of, say, telecommunications industry into the mixture of privatized competitive segments and regulated segments with residual natural monopoly elements. With the further development of technology, even those segments remaining under regulation are subject to further transfer to the competitive segments.

2. Design and Implementation of Fair Market Game

Suppose that a proper boundary line between the private sphere and the public sphere could be somehow drawn. Even then, the government cannot be indifferent to what private agents would do within their respective private spheres.

Isaiah Berlin: Men are largely interdependent, and no man's activity is so completely private as never to obstruct the lives of others in any way. 'Freedom for the pike is death for the minnows'; the liberty of some must depend on the restraint of others.

Thus, the government has the major task of designing a **fair market game**, which private agents are entitled to play, and see to it that private agents would faithfully observe their **obligation of fair play**. In order to enforce this obligation, the government officials in charge of competition policy must constantly monitor the play of the market game and, if need be, rectify the infringement on the fair play of the game. To cope with this major task efficiently and effectively, the competition policy authorities must legislate the competition laws, monitor and, if need be, enforce the fair play of the competitive game.

3. Friedman's "Procedural Fairness" Revisited

In passing, the procedural fairness of free market transactions may be under threat by the rapidly developing device of electric money. Recall that the Friedmanian protection of individuals from being discriminated against for reasons unrelated to productivities is closely connected with the so-called "anonymity of money". It is because no one can be traced back, after the completion of his/her market transactions, to his/her personal identity that he/she is warranted to be free from being discriminated against in the competitive market mechanism. Electric money, which is expected to be effective against such unlawful acts as money laundering and fraudulent product quality, may undermine one of the important procedural merits of the competitive market mechanism.

In order to maintain the procedural fairness of the competitive market mechanism in the face of otherwise beneficial development of technology, those who are in charge of designing the fair market game may have to confront a novel and difficult task, which may well be a totally different ball game for them to play.

4. Coordination of Domestic Market Games

Three Remarks on International Harmonization

(1) There are not many countries which have competition laws rooted deeply in the spontaneous evolution of domestic rules and conventions. Japan has the second longest history in the world of competition law and competition policy, but the **original antimonopoly law** was transplanted from the American soil during the post World War II occupation period as a part of the economic democratization of Japan. Several rounds of revisions took place after the end of the occupation period so as to strike a balance between the transplanted rules and the indigenous sense of “fairness” in competition. Nevertheless, the formal structure of Japan’s antimonopoly law is not that different from the US prototype and, for that matter, from the EU model. The difference, if any, lies mostly in the methods of administrative implementation, and there seem to be rooms for harmonization of domestic competition policies in this arena.

(2) International harmonization of domestic rules and policies requires that the domestic rules of the game prevailing in country A must be made in basic harmony with those prevailing in country B. However, it has no root in the two basic principles of the GATT/WTO regime, viz. the **principle of most favoured nation treatment**, and the **principle of national treatment**. The former requires the member countries to accord the most favourable tariff and regulatory treatment, given to the product of any one of the trading partners, to all other member countries at the time of import or export of like products; the latter requires member countries not to accord any discriminatory treatment between imports and like domestic products. To the extent that the same domestic rules and conventions are applied without discrimination to domestic and foreign agents, as well as to domestic and foreign products, there is no infringement on the two basic principles of the GATT/WTO regime.

(3) Why don't we retain the domestic rules and conventions and leave things to be settled by international competition among alternative economic systems? What is wrong with the following conventional wisdom?: "When in Rome, do as the Romans do."

The answer depends on the type of harmonization we choose for deliberation. It is surely unrealistic to require the **convergence of domestic rules and conventions** of other countries to those prevailing in the hegemonic country. However, this is more a straw man model of harmonization, the sole role of which is to be ridiculed about, than a real model to be seriously discussed about. More sensible approach is the coordination of domestic rules and conventions of the GATT/WTO member countries through a cleverly designed **interface mechanism**, which allows idiosyncratic domestic rules and conventions to function together harmoniously. As computers of the different make are able to collaborate harmoniously if only they are coordinated through a cleverly designed interface mechanism, domestic rules and conventions of the different countries can also collaborate at least in principle.

This may be easier said than done, but there are much room for facilitating collaboration among different economic systems through the harmonization along this line.