THE VIRTUE OF AN IMPERFECT COMPETITION LAW

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The Virtue of an Imperfect Competition Law

By Paolo Buccirossi

Imperfect competition is not necessarily a curse. It evokes an environment in which firms compete on multiple dimensions to satisfy heterogeneous consumer preferences. This can create a tension between competing social goals. Inevitably, we must decide which of these goals should guide competition law. In making this decision, we must accept that it is impossible to reconcile these goals or to rank them in an order that applies to everyone, at all times. Thus, the choice of which objective to pursue is a moral choice. However, we can still give competition law a specific goal, since other policies may pursue other goals. The objective of competition law should be selected by considering the main characteristics of competition law rules. These rules are stable, technical, and their violation carries severe penalties. I argue that the value that best fits these characteristics is a narrow notion of total welfare.

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"Imperfect" is an adjective loaded with a negative sentiment: something undesirable as opposed to what is perfect. At first glance, this is also true when "imperfect" is associated with "competition." The ideal market is one in which competition is perfect, since this would lead to an outcome that guarantees the maximization of social welfare. Departing from this setting would imply a waste of resources. Yet, Joan Robinson in her *Imperfect Competition* explains that competition is imperfect because consumers have "a number of good reasons for preferring one seller to another."[2] This leads to a situation where "rival producers compete against each other in quality, in facilities, and in advertisement, as well as in price."[3] So, how can an imperfectly competitive market be undesirable if it emerges from decisions that consumers make for *good* reasons? And do we really dislike markets where firms compete in quality, facilities, and advertisement? These questions have obvious answers if we recognize that "imperfect competition" only indicates an environment in which competition is more nuanced, as it has many dimensions, and is therefore richer. This does not contradict the statement that perfect competition, in a static setting, achieves an optimal allocation of resources, defined as allocative efficiency. It only implies that there are other ways of describing a socially desirable market outcome that are based on and relate to other values. We can refer to other notions of efficiency, such as productive efficiency or dynamic efficiency, or consider values that are not normally put in terms of efficiency, such as fairness, liberty, equality, etc.

This richness poses a question that has been debated for decades and has recently returned to the forefront.[4] What is the goal that competition law should pursue? This is not (only) a philosophical question, as it has implications on the interpretation of the prescriptive rules that make up competition law, the boundaries of the prohibitions and the tools that can be used to distinguish between legal and illegal conducts.[5] Since leading scholars have participated in the debate, my attempt to contribute to it is probably presumptuous. However, i think that some crucial aspects have been overlooked. Therefore, I will try to fill in some gaps and, hopefully, give the debate a new perspective.

The first point to make is that the various goals that can be pursued are irreconcilable with each other. If this were not true, the whole debate would be futile because there would be only one goal that sums up all the others. I find ridiculous those bold and oversimplifying statements (typically made by politicians) that claim that competition guarantees that consumers will get the best quality at the lowest price. Unfortunately, this is untrue: some modes of competition will induce firms to provide a better "quality," others will force them to charge a lower price. Most of the time, we cannot attain both and so we have to decide which is the outcome we like best.

The second observation is that an order of these goals that is generally valid does not exist. Indeed, if such an order existed then the debate would only last because some of us are blind or ignorant, in that we do not see or understand that one of them is more important or valuable than the others. I assume this is not the case.

These two preliminary statements form what I consider to be one of the impossibility theorems of the twentieth century. I would name it after one of the most prominent political philosophers of the last century, Isaiah Berlin, and so I refer to it as Berlin's "impossibility theorem." Berlin states that: "The world that we encounter in ordinary experience is one in which we are faced with choices between ends equally ultimate, and claims equally absolute, the realization of some of which must inevitably involve the sacrifice of others."[6] In another passage he observes: "To assume that all values can be graded on one scale, so that it is a mere matter of inspection to determine the highest, seems to me to falsify our knowledge that men are free agents, to represent moral decision as an operation which a slide rule could, in principle, perform."[7] Thus, Berlin's impossibility theorem states that: "It is impossible to completely reconcile values or to rank them according to an order that is valid to anyone at any time." I call this statement a "theorem" because I believe that its validity or truthfulness should be accepted as we do for a mathematical theorem.

2 Robinson Joan, Imperfect Competition, 1933, St. Martin Press, 2nd ed. 1966, p. 89.

3 *Ibidem* p. 90.

4 The literature on this topic is indeed so wide that it is impossible to provide a comprehensive list of references. Limiting it to some recent contributions I can refer to Baker Jonathan B. and Steven C. Salop, "Antitrust, Competition Policy and Inequality," 2015, 104 Georgetown law Journal, 1; Crane Daniel, "Antitrust and Wealth Inequality," 2016, Cornell L. Rev. 101, no. 5, 1171; Hovenkamp, Herbert J., "Antitrust Policy and Inequality of Wealth," 2017, CPI Antitrust Chronicle, October, 1; Lina Khan & Sandeep Vaheesan, "Market Power and Inequality: The Antitrust Counterrevolution and Its Discontents," 2017, 11 Harv. L. & Pol'y Rev. 235; Lianos Ioannis, "The Poverty of Competition Law - The Long Story," 2018, CLES Research Paper Series 2/2018, Available at SSRN: https://ssrn.com/abstract=3160054; Ducci Francesco & Michael Trebilcock, "The Revival of Fairness Discourse in Competition Policy," 2019, The Antitrust Bulletin, 64(1), 79; Ezrachi,et al., "The Effects of Competition Law on Inequality – Incidental By-Product or a Path for Societal Change?," 2021, CCLP(L)55 Working Paper, Available at SSRN: https://ssrn.com/abstract=3870375.

5 The question concerns other aspects of competition law enforcement and in particular the decision about the agencies' priorities, provided that not all potential infringements can be prosecuted, due to resource limitations. However, in my discussion I will only consider how the goal of competition law can affect the interpretation of its rules and therefore the distinction between illegal and legal conducts.

6 Isaiah Berlin, "Two Concepts of Liberty" in Four Essays On Liberty, 1969 Oxford: Oxford University Press, p. 168.

7 *Ibidem* p. 171.

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Choosing between goals that inevitably conflict with each other and that cannot be ordered on a scale is a moral decision. Interestingly, Robinson devotes a chapter in her book to discussing the welfare effects of price discrimination. That chapter is entitled "The moral of price discrimination." And indeed, she does not provide any conclusions about whether price discrimination is desirable or not, but only points out the welfare conflicts that this practice inevitably entails. Robinson also shows that even if we consider the narrow value of consumers' welfare a conflict exists, so that the choice depends on whether we value the well-being of some consumers more than that of others.

Berlin's impossibility theorem may be perceived as the tombstone of the debate: if we cannot summarize all goals into one, or grade them, there is no point in discussing which goal should competition law pursue, as this is a moral decision that people, as free agents, must make. However, although I believe this conclusion to be correct, it actually opens up other questions for scholars or pundits to address. Well, Heisenberg's uncertainty principle did not end physics, mathematicians still work on their theories despite Gödel's incompleteness theorems, and economists and political scientists do discuss about electoral systems even if Arrow's impossibility theorem applies. We just have to take the impossibility as a truth and move on.

The first step we can take, now that we are aware of the impossibility, is to consider that competition law is not the only government intervention that can influence how market competition unfolds. Although this is obvious, we tend to forget it and try to identify the virtue or virtues of competition that we think are the most desirable and attribute to competition law the role of defending them, as if competition law were the only available instrument or the one that has to be tasked with the responsibility of protecting what we deem the best property or feature of a competitive market. There is no reason to do so. Competition law may have an objective that conflicts with that of another intervention on competition, and the latter, on the basis of a moral or political decision, may trump the former. Perhaps a useful way to clarify this point is as follows: competition is "imperfect," but so is competition policy, where this expression refers to the existence of a broad set of interventions that affect market competition and includes competition law as one of them. Imperfect competition policy simply means a rich, multidimensional, human endeavor to shape the way firms compete.

Having an imperfect competition policy (in the sense we are using this expression) is something of a relief: even if we assign a goal to competition law that is not the most valuable (according to our moral decision) or that conflicts with other ends that we believe are worth pursuing, this is not a problem, since other components of the competition policy will play their role. Berlin's impossibility theorem lightens the baggage we carry on our journey, so that we are nimbler in the next steps.

A different way to approach the question of what goal we want to assign to competition law might be: what is the objective that best suits competition law, given its characteristics? I must admit that, in theory, this is not the most rational way to proceed. A better, or more consequential, approach would be to identify an objective to be attributed to a specific intervention or set of rules and then design the rules and the institutional set-up so that they are fit for purpose. But competition law has its own legacy. Indeed, in many jurisdictions competition law provisions are very old and limited corrections have been made since they were enacted. Similarly, the institutions that preside over their enforcement show surprising stability. Thus, I will consider this stability as the first prominent feature that we consider when selecting the goal of competition law.

A second feature is that, although the prescriptive content of competition law provisions is very vague (this is a reason for their longevity), their violation carries very severe consequences: criminal sanctions in some cases, penalties that have a criminal nature in others, treble damages in some jurisdictions.

A third important feature is that competition law has a technical content.[8] At least in recent decades, it has been suggested that a particular technical expertise, i.e. economics, is necessary (and sufficient) for the identification of which conducts infringe competition law. This is an objective orientation that is evidenced by the institutional decision (adopted in many jurisdictions) to entrust competition law enforcement to specialized independent agencies that are not subject to political control.

Certainly, there are other relevant elements that characterize competition law, but I will stop here. Thus, competition law rules are stable, technical and their violation carries severe penalties.

Now we can ask: what goal justifies or is most compatible with rules that have these characteristics? I think that the objective that is justified or more compatible with these features is one that most (if not all) people agree or do not have reasons to disagree about and that this agreement or lack of disagreement is not (or is less) based on values that may change over time.

8 See Crane Daniel, "Technocracy and Antitrust," 2008, 86 Tex. L. Rev, 1159.

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Now we can proceed with the analysis and reflect on the following three additional questions: 1) what is the *object* of competition law, that is, what is the human sphere or institution with which competition law is intended to interfere? 2) What virtues can this institution generate? 3) Do any of these virtues have the characteristic of involving less disagreement and being more time invariant?

Competition law provides (some of) the main and essential rules of one of the most important social institutions: Markets. I use here the capital "m" for a reason. While markets differ greatly depending on the product being traded and have changed enormously over time, the function they perform is the same and has not changed over time. This function is to allow sellers and buyers to trade. Hence, I use "Markets" to identify a single yet fragmented and dispersed institution that performs this function. To be sure, there are other institutions that serve a similar function, in that they provide access to goods and services. For instance, in most countries (probably all) people obtained their Covid-19 vaccine not in a market but through the public health system (even though the latter purchased vaccines in a market). Thus, I do not include in Markets all institutions that enable the provision of goods and services. Markets form a dispersed institution that enables the *trade* of goods and services.

The function of Markets can also be described as that of selecting the transactions that occur and, in so doing, selecting the sellers who can sell and the buyers who can buy. The flipside of the coin is that Markets prevent some potential sellers from selling and some potential buyers from buying. In short, Markets select (meaning that they include and exclude) buyers, sellers, and transactions. Competition law consists of a set of rules whose purpose is to prevent market participants from engaging in behavior that renders Markets incapable of "properly" performing this important selection function.

To be more specific, we need to understand that the selection of transactions (and the parties to them) is important to society for two main reasons. First, because of its direct effect on what products are exchanged and between whom at a given time. Second, because the way this institution performs its selection function influences market participants' incentives and their future position. Buyers and sellers try to anticipate how Markets will act in the future, also by observing their current behavior, and make decisions that they believe will improve their probability of being selected. In addition, the feasibility of future transactions depends on the transactions that are selected today. For instance, a famer will not be able to sell her crop tomorrow, if she is not allowed to buy seeds today. Hence, Markets influence the investments that are made and ultimately the set of transactions that will be possible in the future.

Thus, we may want to set rules that prevent market participants from engaging in conducts that are likely to affect Markets in such a way that their influence on current and future transactions is undesirable.

We can now address the second question: what virtues can Markets (the selection process) generate? Well, there are many. Markets can generate efficiency, fairness, equality and so on. There are many ways in which we can determine whether we prefer a certain set of transactions (now and in the future) to another. We may prefer transaction set A to transaction set B, because in a world in which the transactions in A occur production is more efficient, or because wealth is more equally distributed or because people enjoy more freedom, or simply because that world is more beautiful. If the Berlin theorem holds, it is impossible to reconcile or order all of these virtues. Thus, if we want to identify any of them as the proper goal of competition law (and accept the method I propose) we must answer the third question: is there a virtue that the process of transaction selection can achieve that we think is stable over time and generates less or no disagreement? I maintain that such a virtue exists, and it is the maximization of a narrow notion of total welfare. Let me clarify and demonstrate my claim.

Total welfare is the sum of the individual welfare enjoyed by all persons belonging to a society. This welfare can come from many activities. Reading a book might be a source of welfare. However, I will restrict my attention to the act of trading. Buyers and sellers obtain a benefit from trading. If I buy a book, I get a benefit even if I do not read it. So, let us focus on the welfare generated by economic transactions, that is the first reason why the notion of welfare I am using is narrow.

This welfare is typically described as the sum of consumer's and producer's surplus, where the consumer's surplus is the difference between the price a consumer would be willing to pay to obtain a product and the price that she has to pay, and the producer's surplus is the difference between the price that a firm obtains and the one that it would be willing to accept to sell the product. While this description is technically correct, it can be misleading. A better way to name the two components is buyer's surplus and seller's surplus, as this avoids the confusion that many people make between consumer surplus and the end consumers welfare. One should always remember that in most transactions the buyer is not an end consumer but a firm, or the government or other organizations. Moreover, there is no need to define the two components and then sum them up, because when we do that the price that is paid cancels out. Hence, the total welfare of a transaction is just the difference between the maximum price the buyer would be willing to pay and the minimum price the seller would be willing to accept. We also refer to this as "gain from trade."

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One of the advantages of this measure is that it is expressed in monetary terms. Therefore, the total welfare of a set of transaction is just the sum of welfares generated by each transaction in the set. However, this notion of total welfare is narrow for another reason. It considers only the welfare of the parties to the transaction and ignores any benefit or cost that others may enjoy or bear. These are externalities because the parties to the transaction do not consider them in deciding whether they want to trade or not. In conclusion the notion of total welfare I use is narrow in two ways: it only concerns welfare from trade, and it excludes externalities. This is what I have in mind even if, from now on, I will not specify these two restrictions.

Total welfare is a value. We can say that we prefer a certain set of transaction over another because the total welfare generated by the former is greater than that of the latter. My claim is that this value is more stable over time and does not generate disagreement. Why? The reason is that total welfare is built on individual preferences. These preferences may change over time, but this does not affect the validity of total welfare, as this metric, by definition, will reflect these changes. Similarly, preferences over economic goods may differ among individuals, but this does not undermine the possibility of computing a measure of welfare that includes all of these divergent preferences. Thus, people have no reasons to disagree on this measure of welfare. The latter point is delicate, and I want to avoid any misunderstanding. Thus, let me make my position crystal clear.

Suppose that there are two set of transactions, A and B. What I maintain is that if one were asked to rank these two set of transaction in terms of total welfare, everyone would come up with the same ranking. This ranking implies no judgement, since it is totally based on judgements made by the parties to the transactions included in A and B. The second point I make is that all people agree that total welfare represents something good, so that the higher the better. What I am not saying is that everybody must prefer A to B if total welfare is higher in the former. A person may have other reasons for preferring B to A, notwithstanding the lower level of total welfare. For instance, she might believe that the distribution of wealth is fairer or more just in B.

Now, are there other economic values that share the same properties of total welfare applied to Markets? I do not think so; at least not among those that are typically used to identify the goals of competition law. Take, for example, consumer welfare (i.e. buyer surplus). Even if an objective ranking is feasible, people will not agree on that higher consumer welfare is better than lower consumer welfare. Or take equality, we can objectively measure how far a certain income distribution deviates from a perfectly even distribution, yet people will disagree about which is more desirable. Or think about fairness. Even if we all agreed that more fairness is better than less fairness, there is no objective way to measure the degree of fairness, and we will probably disagree on how to rank two different situations with respect to fairness.

My conclusion is that (narrow) total welfare generated by institution that presides the trade of economic goods and services is the ultimate goal that should guide the interpretation and the enforcement of the rules that form competition law. This is the objective that best fits the main features of these rules. Indeed, they are severe, because the institution they regulate has an extraordinary importance in our societies; they are stable and technical because the goal they pursue is one that does not change over time and because it does not generate disagreement.

Some will certainly disagree with my analysis, and I reserve the right to change my mind if the reasons for this disagreement are meritorious. In closing, however, let me clarify what my argument is not asserting, so that any criticism is not directed at the wrong target.

I am not arguing that competition law is incapable of contributing to the achievement of other goals. On the contrary, I believe that competition law enforcement has redistributive effects that improve equality, that competition law removes barriers that would otherwise limit freedom, and that it leads to outcomes that most people would consider fairer. However, this does not affect my conclusion. Sooner or later these values will clash with that of total welfare. My point is that when that happens total welfare should prevail in the interpretation of competition law.

I do not argue that total welfare should trump other values in any policy decision, for the simple reason that I do not think that competition law should always trump other laws or policies. In fact, when total welfare, liberty, equality, fairness, and other value conflict with each other a moral decision must be made. This decision requires a political mandate that most competition agencies lack; a political decision that, in our societies, cannot be subtracted to a democratic process. Thus, my claim is not disproved by evidence that shows that inequality is a serious problem and that the way competition law is enforced is to some extent responsible for this inequality. My position is that assigning competition law the goal of solving this problem is not the right response. It is more appropriate to limit the unintended negative effects of a properly enforced competition law through the prioritization of other policies that are specifically meant to cure the problem of inequality.

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Finally, I do not argue that the interpretation and the enforcement of competition law involves no human judgement or that this role could be assigned to an algorithm or a "slide rule." Our understanding of how firms' behavior can alter the functioning of Markets and affect total welfare is still "imperfect." Thus, my argument is not contradicted by the observation that the actual competition law enforcement has failed to achieve the total welfare objective to the extent it has not prevented the formation of inefficient market power. This means only that the theory we use to distinguish between legal and illegal conduct can (and should) be improved and that much human judgement is needed to achieve these improvements. This is what makes this subject so fascinating to me.

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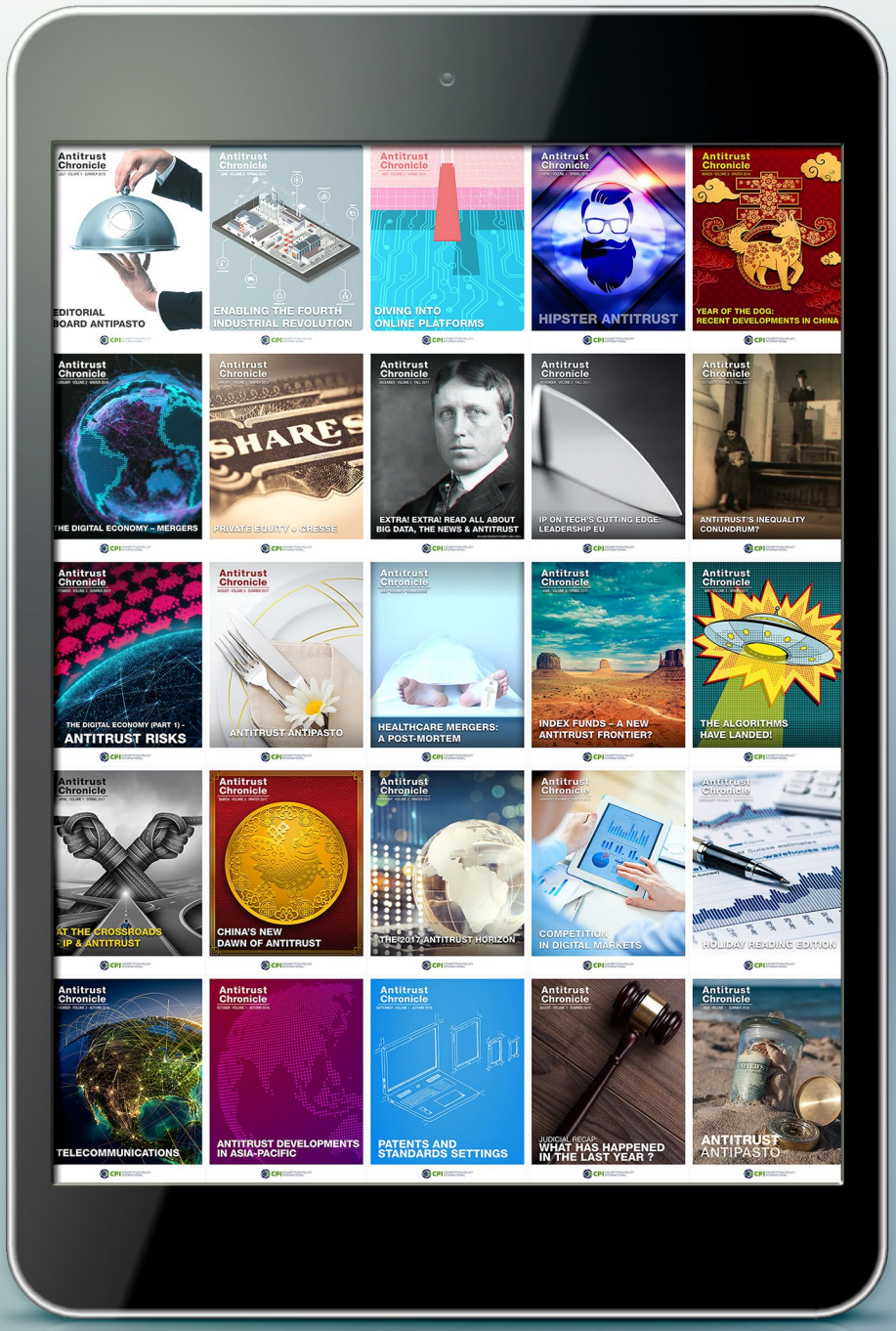
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