

# Chapter 1

## OBJECTIVES OF COMPETITION POLICY

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Broadly defined, competition in market-based economies refers to a situation in which firms or sellers independently strive for buyers' patronage in order to achieve a particular business objective, for example, profits, sales, or market share. Competition in this context is often equated with rivalry. Competitive rivalry may take place in terms of price, quantity, service, or combinations of these and other factors that customers may value.

### TENSIONS IN COMPETITION LAW AND POLICY

Competition forces firms to become efficient and to offer a greater choice of products and services at lower prices. In a competitive market economy, price (and profit) signals tend to be free of distortions and create incentives for firms to redeploy resources from lower- to higher-valued uses. Decentralized decisionmaking by firms promotes efficient allocation of society's scarce resources, increases consumer welfare, and gives rise to dynamic efficiency in the form of innovation, technological change, and progress in the economy as a whole.

However, firms also have incentives to acquire market power, that is, to obtain discretionary control over prices and other related factors determining business transactions. Such market power may be gained by limiting competition by erecting barriers to commerce, enter-

ing into collusive arrangements to restrict prices and output, and engaging in other anticompetitive business practices. These examples of imperfect competition are generally viewed as market failures that result in inefficient allocation of resources and adversely affect industry performance and economic welfare.

Such market failures enable sellers to deliberately reduce output so as to extract higher prices at the expense of consumers and society in general. Additionally, questions arise as to what constitutes equitable distribution of the gains from trade between sellers, or between producers and consumers.

A spectrum of views has been expressed in this regard. Broadly speaking, the two ends of the spectrum can be described in terms of economic and noneconomic—or efficiency and public interest—approaches to competition policy. At one end is the view that the sole purpose of competition policy is to maximize economic efficiency. Under this view there is no room for sociopolitical criteria such as fairness and equity in the administration of competition policy. Such criteria are viewed as ill-defined and loaded with subjective value judgments, and therefore not able to be applied in a consistent manner. The opposite view is that competition policy is based on multiple values that are neither easily quantifiable nor reduced to a single economic objective. These values reflect a soci-

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ety's wishes, culture, history, institutions, and perception of itself, which cannot and should not be ignored in competition law enforcement. Within the spectrum a range of views has been expressed on the relative weights to be attached to different factors.

In addition to these debates there is a certain tension between law and economics. Whatever the objectives of competition policy, there is still the issue of how they should be attained. There is an inherent tension between the need for a clear set of legal rules to foster certainty in the application of competition policy and the need to consider specific facts. While competition policy aims at correcting market failure arising from imperfect competition, precise legal rules cannot be formulated across all types of actual or potential anticompetitive situations. For example, an outright prohibition or a *per se* approach may well be adopted against price-fixing agreements, while a rule-of-reason approach that evaluates facts on a case-by-case basis is likely to be more appropriate in certain types of business practices such as exclusive dealing contracts.

Another source of tension is the priority attached to competition policy relative to the rank order assigned to other government policies. In most industrial countries competition legislation is a general law that applies to all economic activities and sectors unless specific exemptions are granted. Given the extensive interface competition policy has with other government policies, there are areas in which the respective objectives may be complementary such as in the case of initiatives directed at deregulation and privatization of state-owned corporations. However, in other areas such as trade, investment, and regional development policies conflicts may often arise. The extent of consistency, or its lack, in different government policy measures can support or thwart the objectives of competition policy.

## MAJOR OBJECTIVES OF COMPETITION POLICY

Canada and the United States enacted competition legislation toward the end of the last century (in 1889 and 1890, respectively). While many objectives have been ascribed to competition policy during the past hundred years, certain major themes stand out. The most common of the objectives cited is *the maintenance of the competitive process or of free competition*, or the protection or promotion of effective competition. These are seen as synonymous with striking down or preventing unreasonable restraints on competition. Associated objectives are *freedom of trade, freedom of choice, and access to markets*. In some countries, such as Germany, *freedom of individual action* is viewed as the economic equivalent of a democratic constitutional system. In France emphasis is placed on competition policy as a means of *securing economic freedom*, that is, freedom of competition.

Initially, the primary objective of maintenance and promotion of effective competition was to counter private restrictions on competition; hence competition laws in most countries continue to prohibit price-fixing agreements and abuse of dominant market position. However, during the past two decades or so, the role of competition policy has expanded significantly to *include lessening the adverse effects of government intervention in the marketplace*. For instance, in Italy competition law applies to both public and private firms; firms supplying public services or operating a monopolistic position are exempted from competition law only within the limits of the mission attributed to them. The provisions in Canada's Competition Act are similar.

Improving access and opening markets by reducing barriers to entry through deregulation, privatization, tariff reduction, or removal of quotas and licenses, and marketing board schemes are specifically highlighted as important objectives in the administration of competition policy in several industrial countries.

These actions do not necessarily imply that competition authorities have a direct mandate over commercial, regulatory, and privatization policies in these jurisdictions. However, through inter- and intragovernmental participation in the development of public policies and by making submissions and interventions in regulatory proceedings, competition authorities can wield influence favoring market-determined solutions.

In some countries competition authorities can analyze whether regulatory measures from the public sector will negatively affect competition and strive to have any measures that unreasonably limit competition amended or abolished. In Sweden the Competition Ombudsman may propose changes to existing regulations that would enhance the competitive environment. Other countries, however, do not believe that government encouragement of state monopolies, or "national champions," at the cost of reduced competition in domestic markets would enhance their competitiveness, performance, or welfare. They have found that such national champions and public utilities, shielded from the full effects of competition, respond insufficiently to their markets and that improvements in productivity are slow; there has been widespread recognition that there is more to competition than simply applying competition legislation, since liberalization, deregulation, and privatization have also acted as stimuli to markets.

Other commonly expressed objectives of competition policy are *prevention of abuse of economic power* and thus protection of consumers and of producers who want the freedom to act in a competitive manner; and *achievement of economic efficiency*, defined broadly so as to encourage allocative and dynamic efficiency through lowered production costs and technological change and innovation.

During the past two decades the focus has been on attaining economic efficiency, so as to maximize consumer welfare. For example, the

Antitrust Enforcement Guidelines for International Operations of the U.S. Department of Justice (1988) state that the purpose of antitrust laws is to establish broad principles of competition that are designed to preserve an unrestrained interaction of competitive forces that will yield the best allocation of resources, the lowest prices, and the highest quality products and services for consumers.

A major theme of competition legislation in the United States was once the explicit preference for pluralism in terms of the diffusion of economic power throughout the economy. Lawmakers viewed a concentration of economic power as a threat to dispersed decisionmaking, the foundation of democratic society. The argument was that large firms, with their aggregation of resources, resemble private governments not subject to external constraints or public accountability. This concern has also led to a tendency to protect small businesses, which is frequently in conflict with the objectives of maximizing economic efficiency and consumer welfare.

In various countries these objectives are juxtaposed without any particular ranking of priorities. Different views persist as to which objectives should receive greater emphasis, although increased emphasis on the efficiency objective is apparent in a number of jurisdictions.

In the United States, for example, the Supreme Court has since the mid-1970s consistently decided antitrust cases with the economic efficiency objective in mind. This has also been the thrust of the enforcement policies adopted by U.S. competition agencies during the past 25 years or so. France's administration of competition emphasizes innovation and the dynamic efficiency of firms. In Canada the preamble of the Competition Act states that its purpose is to maintain and encourage competition in order to promote efficiency. However, the importance that many of these countries attach to efficiency does not imply the exclusion of other objectives of competition policy.

### SUPPLEMENTARY OBJECTIVES OF COMPETITION POLICY

In response to sociopolitical concerns various objectives of competition policy other than economic efficiency and enhanced consumer welfare have been identified. These include *protecting small businesses, preserving the free enterprise system, and maintaining fairness and honesty*. Some objectives, such as *moderating or curbing inflation*, recur over time, on the grounds that price stabilization measures are less likely to succeed when monopolistic tendencies exist in an economy.

In addition, economists have argued that competition policy must recognize the effects that business practices such as mergers may have on employment, breakdown of communities and regional development through plant closures, reorganization of material sourcing, and production, distribution, and financing decisions. The issue of absentee ownership and the lack of local presence or commitment by “head office management” has also been raised.

The respective weights and priorities attached to these and other objectives of competition policy have remained largely ambiguous and hence are the subject of intense debate. The inherent conflicts between some of these objectives heightens the controversy. The only areas of consensus apparent across different jurisdictions are that:

- The objective of competition policy is to protect competition by striking down or preventing those private (and where possible, public) business restraints that adversely interfere with the competitive process.
- The competitive process should be protected not to maintain and promote competition for competition’s sake but to achieve other objectives.

Thereafter, consensus breaks down within and across countries. Although competition is recognized as the process that fosters effective use or efficient allocation of society’s resources, the supremacy of this objective has not been uni-

formly accepted. Moreover, there is disagreement over what constitutes private restraint to competition. The relative importance and balance between efficiency and the various other economic-social-political objectives that competition policy can advance remain to be identified.

### POSSIBLE CONFLICTS AMONG MULTIPLE OBJECTIVES

The multiple objectives of competition policy are not necessarily the product of a well-defined, consistent set of principles. While the essential core of competition legislation has remained intact—the maintenance or protection of competition through the prevention of private restraints on trade and abuses of economic power—the changing emphasis on various objectives and the pressure to increase the number of goals have been notable. Although these shifts support the proposition that competition policy can adapt to changing economic, social, and political conditions, these shifts also imply that competition policy may be the subject of *political compromise*.

Attempts to take into account multiple objectives in the administration of competition policy may give rise to conflicts and inconsistent results. For instance, protecting small businesses and maintaining employment could conflict with attaining economic efficiency. With the small business objective, competitors rather than competition may be protected. In addition, such concerns as community breakdown, fairness, equity, and pluralism cannot be quantified easily or even defined acceptably. Attempts to incorporate them could result in inconsistent application and interpretation of competition policy. Clear standards would be unlikely to emerge, thereby leading to uncertainty and distortions in the marketplace and the undermining of the competitive process.

However, it has been argued that the intent of competition policy encompasses more than allocative efficiency. Competition policy as

expressed in the laws enacted by representative governments aims to serve the broad *public interest* and thus includes sociopolitical goals. Although economic analysis provides valuable insights into business dynamics and the probable effects of a commercial practice in the marketplace, economics is not law. Moreover, there is intense debate among economists about what types of market structure and business environment are likely to yield the most efficient, dynamic, and innovative economy. Nor do economists agree on the assessment and distribution of the gains of economic efficiency. The debate, in part, centers on whether to maximize consumer welfare or total economic welfare.

The pursuit of economic efficiency may in some situations give rise to increased consumer and producer surplus as a result of higher levels of output at the same or lower prices. These circumstances may also yield higher profits for businesses. In such instances, the proponents of economic efficiency would not differ in their viewpoints. However, a conflict may arise if producer surplus increases at the expense of consumer surplus, even if the total surplus (economic welfare) of society as a whole rises. Generally, competition policy would assign greater importance to consumer surplus.

Notwithstanding disagreements among economists, it is widely acknowledged that the application of economic analysis imparts a greater degree of precision and predictability in the enforcement of competition policy. Economic tools can be used effectively to analyze noneconomic concerns, such as the *fairness or equity* implications of enforcement decisions, or to systematically assess the effects of different business practices and market structures. Competition policy incorporates both legal and economic principles, and both disciplines play mutually supporting roles.

However, if competition policy is to address the broad public interest, then what constitutes the public interest? Public interest is an elusive and amorphous concept. In many cases public

interest can be widely divided, and what might be considered clearly in the public interest by one party may be seen as less important by another. The complexity of the public interest approach to competition policy may thus produce significant tension between different stakeholders. Implementation of competition policy itself risks becoming captive to the political process if it attempts to serve different interest groups, which may not be conducive to maintaining or promoting effective competition. In other words, although the public interest approach to competition policy permits the consideration and balancing of different economic, social, and political objectives, the independence with which this policy can be administered can easily become constrained.

#### INSTRUMENTS OF COMPETITION POLICY

Competition policy embodies different kinds of instruments that are conventionally categorized as either structural or behavioral (conduct). The structural instruments relate primarily to mergers and monopolies or the dominance of a firm's market position. The conduct-oriented components relate to business behavior such as price-fixing and other collusive agreements, vertical restraints, and the abuse of dominant market position. While the structure and conduct instruments of competition policy tend to be applied separately, the relationship between market structure and business conduct is interactive.

Proponents of different views about the objectives of competition policy typically share common ground when it comes to cartel agreements. Such agreements are widely acknowledged as blatant attempts to replicate the monopolistic behavior of raising prices above competitive levels by reducing output. This conduct results in the misallocation of resources and a reduction in economic welfare. Most economists and practitioners of competition law strongly condemn price-fixing and similar forms of collusive arrangements, such as

bid-rigging. Against this backdrop of general consensus, however, different legal and economic standards have been adopted to attack price-fixing agreements in different jurisdictions. In Australia, the European Union, Germany, and the United States, for example, price-fixing is *per se* illegal and subject to criminal penalties. In Canada, although such agreements are treated as criminal acts, they must affect a substantial part of the market. In Spain, Sweden, and the United Kingdom, a *rule-of-reason* standard is applied to judge the legality of price-fixing agreements.

In other areas of business conduct, such as vertical restraints (resale price maintenance, tied selling, exclusive dealing, and geographic market restrictions) attention focuses primarily on the legal and economic standards to be applied to these practices. Economists of different persuasions generally would argue that the rule of reason should be applied to vertical restraints; the arguments for efficiency and the lessening of competition can be valid depending on specific situations. In this connection competition policy authorities may need to decide where the burden of proof should lie with regard to the adverse economic effects of vertical restraints—with the authorities or with the parties involved? A stringent policy might impose high opportunity costs in terms of dynamic efficiencies forgone. The basic objectives of competition policy should thus incorporate a balancing of these concerns.

Differences in approach toward vertical restraints may still persist, not so much because of differences in economic and legal standards as because of the philosophical underpinnings of competition policy objectives. As indicated earlier, jurisdictions such as France and Germany place particular emphasis on the freedom of economic action for individual market participants. In the European Union vertical restraints are generally seen as conflicting with the basic policy objective of market integration.

Regarding the structural provisions of competition policy, the presence of monopoly or dom-

inant firm position in markets is not *per se* illegal in Western industrial countries. However, recognizing that such market structure characteristics may give rise to abuse of economic power, specific types of conduct are subject to investigation and remedy. Included would be practices such as predatory pricing, preemption of scarce raw materials or distribution channels, and the acquisition of customers or suppliers in ways that prevent or eliminate entry by a competitor. These and other practices need to be examined on a case-by-case basis as they could be part of a legitimate business strategy designed to gain competitive advantage rather than to restrict competition. There may be a thin line between the use and abuse of economic power, and a firm's monopoly or dominant market position may indeed reflect superior competitive performance.

The most significant disagreements on the objectives and instruments of competition policy arise in the treatment of mergers. A wide variety of motives may underlie the corporate decision to increase size through the acquisition of an existing business rather than by undertaking internal expansion and new investment. In the case of horizontal mergers, competition authorities are especially interested in two possible motives: the increase in market power or in economic efficiency, or both. Distinguishing between the two has been recognized as a complex task.

Essentially, two types of policy approaches have been used to control market power that may stem from horizontal mergers: the structural and the cost-benefit approaches. Though clear-cut distinctions cannot easily be made given the interaction between market structure and business conduct, the *structural approach* emphasizes a competition test that examines whether the increased levels of concentration resulting from a merger will likely give rise to the substantial lessening of competition. This approach implies that anticompetitive business practices by large firms can be avoided by preserving an unconcentrated environment through

the prevention of mergers beyond a particular market share or size threshold.

The *cost-benefit approach* is basically neutral in that it starts out with no general stance with respect to mergers among relatively large firms. The actual or possible exercise of postmerger market power is evaluated on a case-by-case basis, taking into account such considerations as efficiencies and other benefits that may arise from the mergers. This is not to say that structural considerations are irrelevant to this policy approach. However, concentration or market share data, along with information on other economic factors such as barriers to entry and foreign competition, may be used to establish whether, after a merger, firms are likely to be in a position to lessen or prevent competition substantially through discretionary control over market prices, output, and related factors. In other words, this approach focuses more on the actual or possible market behavior of merging firms than on the market dominance the merger may bring about.

The other dimensions of merger policy are the extent to which specific transactions are to be evaluated in terms of economic efficiency, public interest and benefit, or some combination. Viewed in this manner, there is a connection between the policy approach and the substantive criteria applied in assessing mergers that bears directly on the objectives of competition policy. A structural (concentration-market share) approach would foster pluralism and diffusion of economic power. However, while this approach might protect competition, it could do so at the expense of economic efficiency. The behavioral-economic efficiency combination might have the opposite effects.

Among industrial economies, Canada probably places the greatest emphasis on economic efficiency and the least on concentration or market share of firms. What is evaluated and considered important is the postmerger conduct of firms and their ability to exercise market power by raising and maintaining prices. Mergers that, while perhaps lessening competition substan-

tially, are expected to realize offsetting gains in efficiency are specifically exempted in the legislation on mergers.

In Australia until recently, a structural criterion prohibited mergers that may lead to market dominance unless authorization was received on the basis of a public interest-benefit analysis. The United States employs specific concentration-market share indices to screen mergers, but the review process places significant emphasis on predictions of postmerger exercise of market power by the merged firm and its rivals, as well as on the efficiency-enhancing aspects of the merger.

In summary, the range of differing viewpoints on the objectives of competition policy tends to be reflected also in the instruments, criteria, and legal and economic standards applied in administering competition policy. These standards have clearly evolved in different ways within countries. The economic efficiency criterion tends to be unidimensional whereas the public interest criterion is multidimensional, with efficiency being only one of many factors to be considered. The issue of implementing competition policy is the differing weights to be assigned to different factors.

#### **INTERFACE BETWEEN COMPETITION POLICY AND OTHER PUBLIC POLICIES**

Competition legislation is usually a law of general application: it applies to all sectors of economic activity unless special exemptions are provided. Given this wide purview, there are complex interrelationships between competition policy and other public economic policies. Although the nature of this interface is largely determined by country-specific factors, the list of public policies that influence the state of competition policy prevailing in an economy tends to be quite lengthy. This factor has a direct bearing on the extent to which competition policy objectives can be pursued without being constrained by or conflicting with other public policy objectives. The central issue is the priority

attached to competition policy objectives in the overall framework of government policies.

An assessment of the impact of various public policies on competition is beyond the scope of this volume. However, a list of microindustrial government policies that can support or adversely impinge on the application of competition policy would include:

- Trade policy, including tariffs, quotas, subsidies, antidumping actions, domestic content regulations, and export restraints.
- Industrial policy.
- Regional development policy.
- Intellectual property policy.
- Privatization and regulatory reforms.
- Science and technology policy.
- Investment and tax policies.
- Licenses for trades and professions.

In addition, various sector-specific policies in environment, health care, telecommunications, cultural industries, financial markets, and agricultural support schemes tend to have measures more likely to restrict than to promote the objectives of competition policy. The formulation and implementation of these and other policies need to be tuned to take into account competition principles. Consistency in government decisionmaking can be ensured in this manner and distortions in the marketplace avoided. Indeed, the case can be made that competition policy should be viewed as the fourth cornerstone of government economic framework policies along with monetary, fiscal, and trade policies.

#### **THE OBJECTIVES OF COMPETITION POLICY AND THE ROLE OF COMPETITION POLICY AUTHORITIES**

Administration of competition policy is more reactive than proactive. Competition authorities, for the most part, respond to market developments such as mergers or price-fixing agreements to protect the competitive process. Public perception of competition agencies tends to be that they are law enforcement bodies. Even within gov-

ernment the input of competition authorities in the formulation of economic or sectoral policies has historically been limited. In a few jurisdictions competition agencies are empowered to intervene in regulatory and trade-related matters.

To achieve the major objectives of competition policy, competition authorities need to consider augmenting and altering their role in the economy. A proactive stance should be adopted to promote competition by attacking not only infringements of the law but also institutional arrangements and public policies that interfere with the appropriate functioning of markets. Through analysis of market conditions that adversely affect economic performance and adoption of solutions that violate free market principles the least, the role of competition as an instrument of overall government policy would be strengthened.

#### **CONCLUSION**

This overview of the different objectives of competition policy indicates that in most jurisdictions the basic objectives are to maintain and encourage competition in order to promote efficient use of resources while protecting the freedom of economic action of various market participants. Competition policy generally has been viewed as a way of achieving or preserving a number of other objectives as well: pluralism, decentralization of economic decisionmaking, prevention of abuses of economic power, promotion of small business, fairness and equity, and other sociopolitical values. These supplementary objectives tend to vary across jurisdictions and over time, reflecting the changing nature and adaptability of competition policy as it seeks to address current concerns of society while remaining steadfast to the basic objectives.

The inclusion of multiple objectives, however, increases the risk of conflicts and inconsistent application of competition policy. The interests of different stakeholders may constrain the inde-

pendence of competition policy authorities, lead to political intervention and compromise, and erode one of the major benefits of the competitive process, namely, economic efficiency. In most cases the conflicts between economic efficiency and other policy objectives either are insignificant or can be balanced. Nevertheless, the rank and weights attached to the multiple objectives of competition policy remain largely ambiguous and need to be defined. This is necessary to ensure both business certainty and public accountability. The views articulated in this and subsequent chapters of this volume suggest that the administration and enforcement of competition law and

policy should assign the greatest importance to fostering economic efficiency and consumer welfare.

Another issue is the relationship between competition and other government framework policies. These other policies tend to inject market distortions that impede the competitive process. Therefore, competition policy authorities need to be involved proactively in government policy formulation to ensure that markets remain open, free, flexible, and adaptable. Competition policy should be considered the fourth cornerstone of government framework policies along with monetary, fiscal, and trade policies.