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Antitrust Enforcement Information and Incentive Problems

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The Norwegian Competition Act was enacted by the Norwegian Parliament 11 June 1993, and entered into force on 1 January 1994.

The statutory purpose of the Competition Act is stipulated in Section 1-1 – as to "ensure efficient use of society's resources by promoting workable competition". Over the last 10 years, Sweden, Finland and Denmark have enacted similar competition laws, with similar statutory purposes or intentions. This focus on efficiency contrasts sharply with the multitude of policy intentions of the previous Norwegian Price Regulation Act, which sought i.e. to promote full employment, income distribution as well as price stability – in addition to policing anti-competitive conduct.

The selection of economic efficiency as the statutory purpose, means that the intention as well as the effect of this new generation of Nordic Competition Laws can be measured by using economic analysis. The Norwegian, Swedish and Finnish Competition laws are all based on the prohibition principle, under which price cartels, market sharing cartels, retail price maintenance, and bid rigging are flatly outlawed in the statutes themselves. In addition, various provisions exist to deter other forms of anti-competitive conduct and, in Sweden and Norway, also anti-competitive mergers. In essence, these three laws conform to the basic principles of EU and US antitrust regulations, even if the methods of legal design vary in each jurisdiction. Denmark had adopted a less bold approach, under which only retail price maintenance has so far been flatly outlawed, while (other forms of) anti-competitive conduct requires intervention from the competition authority to be prohibited. But recently a new law has been put forward to bring also Danish competition law into line with the EU system.

The basic legal design is certainly important, and the Swedish, Norwegian and Finnish designs are more in tune with economic theory than e.g. the previous Danish law. However, for the purpose of this article, it is important to stress that all laws –

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regardless of their basic design – require concerted efforts by the Competition Authorities to be consistently applied. These agencies, sometimes in co-operation with Ministries and courts, posess important enforcement powers, and the *discretionary use* of this power determines the fate of the regulated firms. Under the Norwegian law, several important discretionary decisions are left to the Competition Authority:

- The detection of illegal cartels requires a *decision to report* the alleged illegal activity to the criminal prosecution authorities;
- it is possible to apply for a *dispensation* from the general cartel bans, provided that certain statutory requirements are met; and
- anti-competitive conduct not outlawed in the law itself, as well as anti-competitive mergers, can still be deemed illegal if the Competition Authority makes a *decision to intervene* against them.

While the first decision is principally an enforcement decision that could theoretically be left to the police, the second and third forms of decisions are policy decisions that require professional analysis to determine whether a certain form of action promotes the statutory purpose of economic efficiency. In turn, this means that decisions by the Competition Authorities can be analyzed and criticized by economists on purely professional grounds. Such professional supervision comes in addition to judicial review of decisions by administrative agencies.

The legal doctrine of judicial review comprise such standard elements as the determination of the correct application of the law, the correct establishment of the facts, as well as procedural guarantees to ensure due process and prevent abuse of administrative power. However, an economist seeking to test the efforts of the Competition Authorities could more or less ignore the key legal elements, and focus solely on the facts and effects, when deciding whether an individual decision is likely to promote or retard economic efficiency. Professional criticism and discussion of the actions of Competition Authorities have been long existing in the US, but only recently on the rise in Europe.

In my view, increased professional focus on the efforts of the enforcement agencies will only enhance the quality of competition policy. However, when analysing competition policy, the institutional elements of enforcement can not be ignored. Competition policy is not automatic, and the enforcement efforts do not constitute a black box which will produce only decisions that enhance efficiency. Competition officials need externally collected information in order to fullfil their mandate, and during the information collection process, business firms will seek to influence the contents of the information as well as the incentives of the competition officials in their own favour.

In this article, the intention is to give a closer description of some of the techniques available to analyze the enforcement process itself, i.e. in addition to general economic theory about markets and competition. The institutional theories highlighted here are important from a law and economics prospective, since their application does not depend on the existence of perfect markets, but rather on the legal rules assigning monopoly powers – i.e. exclusive jurisdiction – to Competition Authorities.

However, before turning to examine institutional economic theories, the article takes a look at the chief legal standards that direct the legislative process and enforce-

ment. It will be demonstrated that while these standards form important ground rules, that guide and construe legislative action, it is impossible to anticipate the need for future enforcement efforts exhaustively. This is because the "veil of ignorance" as well as capacity constraints are present at the rule-making stage.

The overall aim of this article is to outline a comprehensive law-and-economics approach that makes use of insight from both fields, and to provide a law-and-economics took kit for analysis of competition enforcement as a separate sphere of inquiry. This paper draws more heavily on general economic theories of regulation than on the specific economic theory of industrial organization. This is consistent with the aim of the current study, which is to make an explanatory inquiry into the enforcement process.

The law-and-economic approach aims to merge legal and economic insight. Economics is, of course, an international science. Each positive law jurisdiction, on the other hand, is *sui generis*. However, lawyers also aim to compare legal systems and facilitate cross-national exchange on legal problems and experiences. Nordic lawyers – bureaucrats, scholars and practitioners – have e.g. over the years developed close common ties that allow them to communicate professionally with ease.

The Legality Principle

An important part of the basic concept of Rule of Law in all Western democracies is that public agencies cannot intervene in the private sphere without legal authority. In Scandinavian law, this tenet is known as the Legality Principle. The description of this basic principle in the legal literature varies form one country to another. But whatever its manifestation, the common denominator is that the executive branch of government is not free to intrude in the private sphere at will. The legal authority to intervene must be vested in pre-existing legal rules. This requires the legislature to pass on the need for public regulatory intervention in the first place. The Legality Principle can therefore be seen as a logical upshot of the Separation of Powers Doctrine that lies at the heart of the constitutional make-up of modern political democracies. The content of the law is supposed to be predetermined in scope and purpose and it is for the Parliament to enact legislation. The Legality Principle is an important safeguard even if, as under the parliamentary form of government, the executive is legally and politically subordinated to the legislature. While not constitutionally on par with the legislative branch, the executive retains a considerable operational advantage since the administration commands the operational resources. Legislatures do not consist of specialists, but of a large number of elected members. Even if more cumbersome to operate they are more democratic.

However, to reconcile the concerns for democratic control with operational needs, the executive branch will normally be empowered not only to apply public law rules in individual cases, but also to exercise rule-making power on a subordinated level, as the rule-making power is delegated in part from the legislature.[1] Still, by requiring the

1. See op.cit pp. 146-148 cf. ch. 10. For the authoritative Norwegian treatise on delegation of parliamentary authority, see Opsahl, Delegasjon av Stortingets myndighet, 1965.

legislature to pass – at the minimum – on the issue of what rule-making authority to delegate, means retaining some overall parliamentary control. Moreover, the requirement that the legislature gets involved at some point reinforces the protection of individual rights, political control and public interest, and ensures public overview over the regulation process.[2] These are considerations traditionally highlighted in the legal literature.

Recent contributions in the law-and-economics field have reinforced this traditional view, but with additional reasons: Broader participation means government that is better informed. Noting first that the existence of hierarchical organizations could be understood as a result of efficient gains in communication in small elites over larger groups, Kenneth J. Arrow also notes the limits to such advantages:

> *"As a final observation, I note that we do observe fairly large legislative bodies. These corresponds to the implication in the above discussion that there is a good deal of information available to the agents not part of the elite. A garbled version may be communicated, not repeatedly but only once or twice, from a larger number of agents. This information may be useful, depending on circumstances, as a check or veto. The actual leadership is still taken by an elite group, but it is subject to the need for ratification by a larger group. If the elite dispose of only a relatively narrow range of information, then at least some safeguard is provided by the need for ratification or choice among a restricted range of alternatives by a larger group, such as a legislative body or an electorate."*[3]

Whatever the economic implications – and on this basic constitutional level traditional legal research dominates – the Legality Principle is a synthesis of the Separation of Powers and Rule of Law requirements where the principal aim is to contrain executive action. However, these constraints vanish as soon as the legislature establishes direct or indirect (by authorizing enabling rules) legal authority for an executive agency to intrude. This observation is well suited as a baseline for the analysis below – for two distinct reasons. On the one hand, to make sense of enforcement policy issues, it is necessary to make the enabling legal instruments the object of scrutiny. On the other hand, the underlying rationale for the Legality Principle does not extend very far to guide the details of the enforcement effort – i.e. operational issues – since the various needs will only subsequently present themselves to the enforcement agency. The Legality Principle is grounded in considerations separate from the need for effective enforcement.

The Law-Making Process

The law as such is neither devoted to economic efficiency nor operational effectiveness per se, but to these policy concerns as well as a host of other issues – depending on the design of the regulation at issue. It is desirable to pay a brief visit to the general mechanism for handling of enforcement concerns at the law-making stage, and to take a look at later interpretations issues. The present account is merely on the highlights of the lawmaking process. For the constitutional details, reference is given to the legal literature.[4]

2. See Eckhoff, forvaltningsrett, 1992, esp. pp. 146-148.
3. Arrow, Scale Returns in Communcation and Elite Control of Organizations, 1991 p. 6.

At the pre-enactment stage, the prospective rule-maker will pay particular attention to the means by which she may clarify her intentions as to how the rules should subsequently be applied. These are, first, the *text* of the regulation – i.e. of *substantive rules* as well as the *regulatory intent*, and second the *record* of the legislative process that will accompany the text which, upon enactment, translates into legal arguments in the form of *legislative history*.

Taken together, substantive rules and intent clauses, as well as statements on the legislative record, provide the legislator with a tool kit to help her guide the application of the statute at the post-enactment stage.[5] By combining these tools the rule-maker may design the overall scope and content of the law not only to fulfil the requirements of the Legality Principle, but also to guide enforcement efforts – in sum, what is in Anglo-American law often referred to as what actions will be within the law (*ultra vires*). How the various legislative tools will be used in the instant case, is largely a function of what information constraints fence the legislator in:

This substance-intention slide represents the first axis in a matrix that grants the rule-maker both latitude to set her priorities, and to guide enforcement efforts. The second axis reflects the degree of precise knowledge about the conduct to be regulated that is present at the time of enactment. All pre-enactment considerations must necessarily take place behind the "veil of ignorance" concerning future needs, but the degree of uncertainty varies from one regulated sphere to another. If the conduct to be regulated consists of patterns of behaviour that have already been observed and are well known, specific substantive provisions can be drafted to reach such conduct directly. But if only the general policy aims of the regulation are certain but not what form of conduct it will be necessary to reach, the rule-maker will often rationally prefer an intent clause as the principal policy tool. A clear statement of intent can then be used together with broadly phrased rules intended to be more narrowly applied by the courts than the wording itself suggest because of the constraining influence of a said intent. Or a clear statement of intent may lead legislation that is otherwise enabling – i.e. which sets out the intention and main rules but leaving to the executive branch to make individual decisions and promulgate subordinate regulations as the policy is implemented.[6] In sum, by operating the substance-purpose axis like a slide-ruler according to the degree of precise knowledge about the need for regulation (and providing further clarification on the record), the rule-maker should be able to tailor any regulation

4. For a comprehensive account of the law-making process in U.S. constitutional saw, see Tribe, American Constitutional Law, 1988, chs. 4 & 5 For an analysis of Norwegian constitutional law, see Johs Andenæs, Statsforfatningen i Norge, 1990, esp. §§ 29-31. For a general discussioin of law-and-economics and contemporary Norwegian legal method placed within the context of Scandinavian Legal Realism, see Stray Ryssdal, Economic Analysis of Law & Scandinavian Legal Realism, 1992. A general tendency among the Legal Realists is to put heavy emphasis on statutory purpose when public law regulations are later applied.
5. See, e.g., Eckhoff, Rettskildelære, 1987, chs. 2-4 for legal method on how information encased in the text, legislative history and regulatory intent guide subsequent legal interpretation.
6. The regulatory purpose will under this option also constrain the public agency's subsequent implementation decisions – individual decisions, as well as the framing of subordinate rules, see Eckhoff, Forvaltningsrett, 1992, pp. 160-155 on the need to consult regulatory purpose & pp. 258-267 on forbidden purposes. For a law-and-economics inquiry into the rational use of statutory purpose, see Rodriguez, Statutory Interpretation and Political Advantage, 1992.

to the perceived needs. By inference, the optimal form of regulation would consist of *both* precise ground rules and a clear regulatory purpose.[7] But it follows from the discussion above that the practical need for a statutory purpose to aid later construction diminishes with more precise knowledge about the conduct to be reached.[8]

However, this picture of the rule-maker as a rational designer of optimal regulations, who determines a regulation according to available information, is a stylized image. Additional considerations come to play in the real world. First, there is no single policy-maker, but a host of individuals, public servants, cabinet ministers and elected parliamentarians who take part in the preparation of new legislation. The notion of "statutory purpose" is therefore largely a fiction. This, however, need not be a serious drawback. If a statement on the purpose of a proposed regulation is prominently displayed in the text or on the record, and all participants known that this statement will be used to guide interpretation later, they will either have to object on the record, or accept that their silence is taken as consent to such alter use of the intent statement – i.e. as a guideline for interpretation issues and choice of executive action.

On the other hand, a second and more real drawback is that legislative capacity is itself a scarce resource.[9] Legislators must pass on a huge number of issues, and there is little time. Drafting legislation is also a painstaking, technical enterprise which requires special skills. Moreover, absolute clarity is not always desirable even when possible, since clarity also illuminates the risk of failure.[10] Legislators often rationally prefer to assign the blame for ill-devised policies to enforcement agencies and keep the praise for themselves; opting for vague and open-ended language that others have to apply is a way to preserve both options. Finally, the price of political agreement may be compromise – often on a less precise statute but one that a majority of the delegates can accept. Even if delegates belonging to the same political party may overcome some of these constraints by sharing tasks and responsibilities, not all difficulties can be resolved that way. And in any event, sharing means trading influence for a more satisfying work situation; all such tradeoffs serve to underscore the existence of information vacuums at the enactment state that can be exploited by industry or enforcers later.

In sum, legislators' failure to be omniscient and omnipresent provides opportunities for

7. For an example of drafting aimed at providing both a clear provision on statutory purpose and clear ground rules, see the Norwegian Competition Policy Committee's report, NOU 1991:27 at chs. 8, 12 & 15. Clarity was necessary on both scores since competition rules are both intrusive vs. the business sector, and since the committee suggested that the competition agency be granted discretion to make exemptions and intervene on a case-by-base basis.
8. An obvious example of the latter kind of rules is tax rules, where the degree of accuracy must be very high in order to facilitate private enterprise, see, e.g. for comments from the committee for experts on the Norwegian tax reform of 1989-1990, NOU 1989:14 which lists on p. 17 economic efficiency, fair sharing, simplification, and stability over time as the rationale for change. Such intentions were not, however, elevated to the text of the tax code. It would not be difficult to point to situations where considerations of e.g. justice and simplicity diverge. But this is not a great problem for later construction efforts since the tax code is in itself very detailed – requiring small assistance from an intent clause.
9. See e.g. Easterbrook, Some Tasks in Understanding Law through the Lens of Public Choice, 1992, suggesting that time restriction could be the real scarcity constraints in the political process – much like resource constraints influence the behaviour of markets.
10. See Rodriguez, Statutory Interpretation and Political Advantage, 1992, pp. 218-220.

distortion of the law-making process for private and politically unrepresentative purpose. First, agenda control in the legislature becomes crucially important; the agenda controllers – the leadership of the assembly, committee chairmen and key staffers – can influence the process by assigning discussion time and staff resources to the tasks that they find most important, or more sinister, not assigning resources to handle issues they rather saw passing unopposed or being buried. Second, and more important in parliamentary government systems where the executive has a stronger real than nominal influence, political and bureaucratic agents of the administrative branch can adopt similar tactics to promote their own causes rather than attend to the legislature's expressed concern. Take e.g. strategies like stalling requests for action or information, burying answers deep inside related issues, showering the legislature with voluminous proposals in order to have 99% adopted unopposed due to exhaustion etc. etc. Such phenomena are facts of life in most countries where the executive is charged not only with the implementation of adopted legislation, but also with the preparation of new legislative action reform. By taking care to hide and exploit proprietary information, non-elected agents may design their own mandate. Moreover, it is important to note that such processes may not be due to ill will, but simply due to capacity restraints that leaves neither the non-elected agents nor the elected parliamentarians with any alternative. Overloaded legislatures regularly request public agencies to "write their own check", since the parliamentarians have to devote their own effort to more important issues.

But whatever the reasons may be, the important point for the present discussion is that enforcement issues may not be dealt with according to the idealized standards of informed legislation at the law-making stage. Details of enforcement policy are often regarded as minor issues politically, while they will in reality often determine the actual execution of a chosen policy. On the one hand, this makes the ideal image of rule-making as a fully deliberate process highly stylized, while, on the other hand, it is likely that enforcement concerns are anticipated by the potential enforcers at the pre-enactment stage.

So far, the message has been that statutes cannot be designed in such a way that full compliance can be assumed by Competition Agencies. Before turning to institutional economics, it is, however, desirable to take issue with the status of economics as the guiding light for competition policy.

The status of economic analysis

Assuming that economic analysis is fundamental to competition policy, the state of economics becomes critical. Economists are the priests of competition policy. Today, there is general agreement that economics qualifies as the most theoretically developed among the social sciences, but it is still not an exact discipline in the scientific sense. One important source of errors is that the development of economics is characterized by changing opinions and scholars. A second source of errors may be that new knowledge threatens established knowledge. George J. Stigler emphasized in his Nobel lecture that knowledge is a form of capital, and that the value of this capital shall inevitably decrease as new knowledge supersedes accepted wisdom. A third source of errors may be more pertinent to the present state of competition analysis, and lies at the other extreme of the spectrum: The efforts and advances in New Industrial Economics rely heavily on game

theory where each model is so specific that it is currently difficult to see how this insight can be generalized in such a way that Competition Authorities or business firms can anticipate the direction of enforcement efforts. Game theory does not provide a general theory of competition, but represents a highly advanced tool with great explanatory power as long as the individual specifications are correct – a pre-condition rarely met in the real world. Economist John Burton has therefore drawn the following resigned conclusion about New Industrial Economics and competition policy:

> *"It is unfortunately necessary to move towards adapting the "negative" stance taken earlier towards standard neo-classical models of perfect competition and monopoly. This reviewer advises that the legal profession should be extremely pessimistic as to the positive role that the New Industrial Economics can as yet adopt in informing competition policy matters.*
>
> *(...)*
>
> *My main conclusion is unfortunately a rather negative one. Contemporary economic thinking about competition cannot supply either competition policy or competition lawyers with consensus view or a map for a way forward in these difficult matters.*
>
> *It was US President Hoover who was once led to request wearily – and no doubt lawyers would second this sentiment – "please find me a one-armed economist so we will not always hear: on the other hand ...". A resurrected Hoover would perhaps be even more way of economists, finding a cacophony of competing views from conflicting schools of thought with which to contend.*
>
> *We should also remember, however, that progress in the world of ideas, no less than in the world of business, depends upon competitive rivalry. This process at least allows us over time gradually to weed out erroneous theories, and to move towards more adequate perspectives. Taking the long view, economists over this century have positively clarified their understanding of the competitive process in the market arena; and the resulting agenda for competition is certainly different than it was a half-century ago."*[11]

However, even if economics does not provide the final answer to all competition policy puzzles, the alternative would certainly be more precarious: The alternative consists of more or less well-reasoned guesswork based on ad hoc and intuitive observations by the decision maker, her view of the evidence, and her guesses as to the effects of a particular enforcement effort. The real challenge is not to ignore economic analysis, but to make it as complete as possible. While the general theoretical insight into markets and micro economics has been stressed repeatedly in professional and political circles over the last ten years, the institutional economic element has so far not been adequately incorporated.

Capture Theories

Antitrust enforcement has been subjected to economic analyses of three ultimately related but still different strands. These are analyses of the demand and supply for specialized

11. See Burton, Competition over Competition Analysis: A Guide to some Contemporary Economics Disputes, 1994, p. 19 and 20-21

labour resources, information and public privilege.

The first kind of analyses is often referred to as *capture theories.* The term is used to denote the special ties between an agency's employees and its outside constituents. The essence of capture theory is to identify rational motives for public regulators to conform to, or at least be influenced by, the outside interests of the regulated industry. In its crudest, tabloid and "bribery-like" form, the hypothesis about capture is fundamentally flawed. Even if individual cases of corruption will always occur, the rational public servant knows that giving in to outside pressure means that her own career prospects will be impaired by her own tarnished reputation. Why should a private boss trust her, when her agency employer obviously cannot?

However, more refined capture theories with better explanatory potential exist – as e.g. that public servants' "on the job training" and inside knowledge represents a scarce resource that will capture a premium in the labour market for professional expertise. Upon observing that a regulating agency commands such a specialized resource – knowledge – Posner makes the following point:

> *"Under this view, the hiring of the agency's employees by the regulated industry carries no implication of a reward for past favors, and the relatively low wages paid by the agency carry no implication that its employees are substandard."*[12]

However, whatever the cause, the fact remains that enforcement agencies stand the risk of being impoverished if regulated industries constantly hire away key personnel. In addition, some form of "capture" is possible also when no change of career takes place, as when industry representatives and agency officials get together socially, and the officials let themselves be pampered (lavish entertainment, lucrative speech assignments etc.), or have their egos catered to and reinforced in other ways. Anecdotal evidence from the field of espionage demonstrates how even the mere fostering of feelings of community , attention and care can contribute to form bonds that may later be exploited for private profit, but with great social harm.

On a general level of analysis, recent research has been critical of the notion that public agents are only interested in promoting their narrow self-interest. Rational behaviour may be directed at the betterment of others – as e.g. displayed by dedicated public servants. However, if enforcement activity is unauthorized by the legislature, such altruistic efforts still lack the required stamp of approval – good intentions notwithstanding.[13] Capture and excessive zeal represent similar deviations form the basic ideals of democratic government.

In sum, capture theories – by the stress placed on individual rationality and the regulation context – often point in the right direction, but are insufficient to serve as an exclusive intake to the understanding of enforcement efforts, and to design wise enforcement policy normatively.

12. See Posner, Economic Analysis of Law, 1986, pp. 575-576.
13. See, e.g., Levine & Forrence, Regulatory Capture, Public Interest , and the Public Agenda: Toward a synthesis, 1990 for a general analysis that also points to the various constraints represented by both formal and informal controls.

Information asymmetries

Economists and competition authorities cannot conduct case analyses without external in-put. They need a basis of factual information to work from, and such information has to be collected. However, a number of problems arise in evaluating external information.

Lack of accurate evidence – the risk of drawing inferences

An external observer can only observe what is objectively manifested evidence. However, such evidence normally has to be collected from the regulated business firms themselves. This means that business firms risking adverse regulation have an important incentive to present the information about their situation to the Competition Authorities in such a way that the harmful effects from this information are minimalized. The theory of rent-seeking has often been applied to the interaction between regulated firms and regulating authorities, and is discussed further in the next sub-section. However, asymmetries may also be discussed in a principal – agent model.

Jan Erik Askildsen has used this approach. He emphasizes two kinds of problems. Firstly, since welfare theory is normally used to analyze the effects of monopolies, the theory itself provides monopolies with incentives to inflate its costs and hide its profits. Secondly, since the statutory purpose of economic efficiency also embraces the purpose of dynamic efficiency, a monopolist will often be able to explain high costs through the need for investments in expensive technology while the real reason for inefficient production may be x-inefficiency. The Competition Authorities will often lack information to contradict the firm's claims. There is no infallible solution to this problem, because all government efforts to reduce monopoly profits create incentives for the monopoly to reduce its efficiency.

Firstly, information could be presented in a biased way. The monopoly surplus could, e.g. be transferred in the form of contracts, arrangements, expense-coverage e.a. from the firm to the owners rather than as accounted profits. Secondly, the monopoly surplus may rather be transferred to management and other employees, in the form of high salaries and similar work benefits. The latter effect is especially likely if the owners are less than vigorous in their supervision of the enterprise, as in the case of the traditional publicly owned monopolies. At any rate, the incentives to improve the efficiency of production does not operate with the same intensity when a business firm is unchallenged by competition, and the policy problem is that the Competition Authorities are unable to access the information required to determine if there is a monopoly profit in the first place. Askildsen suggests that alternative governance techniques requiring the monopolist to reveal her preferences, i.e. by having to choose from a menu of contract terms and price alternatives, can be preferable to an attempt to regulate prices directly. However, if the monopolist acts rationally, only a short term improvement is to be expected from such a policy shift. As soon as the new governance technique is understood, monopolists will engage in strategic behaviour versus the Competition Authorities, and try to avoid revealing its preferences by choosing "second best" options precluding government insight.

The general problem is that private sector firms may constantly seek to bias the presentation of the information in order to obtain whatever dispensations, clearances and administrative decisions that suit their commercial interests. For the Competition

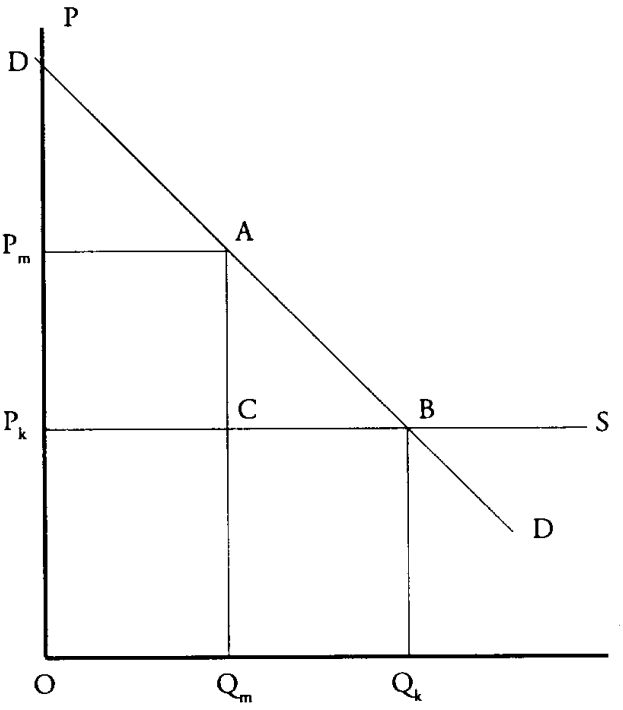
Authorities it is difficult to ignore claims for high costs. A number of industries are dependent on high qualified labour requiring high wages, costly technology and expensive investments simply to meet the business challenges of tomorrow. Misguided competition policy efforts to regulate prices or limit contractual freedom could actually damage these firms' ability to compete, and as such run counter to the statutory purpose of the Competition Act.

Rent seeking

The theory of rent-seeking is by now firmly accepted by economists. The fundamental economic problem is that rent-seeking leads to inefficiency, because private actors will expend real resources in their attempts to influence government agencies to obtain pure transfers. Rent-seeking is fundamentally different from business firms' efforts to achieve temporary monopoly profits from innovation, cost-efficiency and better satisfaction of consumer demands. The latter efforts create temporary monopoly rents, but the resources consumed benefit the economy as a whole, unlike the resources consumed by rent-seeking. Rent-seeking is a general phenomenon, covering i.a. interest groups' incentives to achieve transfers and monopoly protection of their businesses, as well as individual actors' interests in obtaining favourable administrative decisions. The baseline for rent-seeking is that governments exercise a monopoly on the use of legislation and legal force in their territories. By influencing a government agency to obtain a favourable administrative decision, the business firm therefore ipso facto benefits from this legally protected monopoly.

The incentives to obtain rent-seeking in a classic monopoly situation can be analyzed using Figure 1. Under competition, quantity

Figure 1.



Qk will be supplied at the price Pk. The consumers' surplus consists of the triangle DBPk. Assuming that the firm obtains a monopoly rent, two effects are realized: Firstly, the business firm obtains a transfer from consumers equalling PmACPk – i.e. the classic monopoly rent. Secondly, the triangle ABC shall not be produced; it vanishes from economy and is normally referred to as the deadweight cost of monopoly. This is the classic explanation of allocative efficiency under monopoly versus under competition.

Under rent-seeking, further improvements of the analysis is effected. If PmACPk is a transfer obtainable through government intervention, business firms will rationally invest an amount equalling the risk adjusted profit to obtain the transfer. The monopoly deadweight cost is no longer limited to the ABC triangle, but embraces the whole trapez PmABPk. The theory of rent-seeking provides entrepreneurs with incentives to

obtain special protection under the Competition Act. William J. Baumol and Janusz A. Ordover summarize the issue in the following terms:

> *"Entrepreneurship, in our view, is an input, whose supply and allocation, like those of other inputs, is determined in part by economic circumstances. If we define entrepreneurs as the individuals who are prepared to depart from the conventional modes of economic operation in the pursuit of wealth, power and prestige, then one can expect them to follow the line of least resistance in pursuit of these goals. Entrepreneurs presumably being no more or less dedicated to morality than are lawyers, landlords, doctors or professors, there will be at least a number among them who are prepared to be flexible to their choice of economic activity, preferring a line of endeavour that contributes to productivity only if it happens to be the most promising way toward the acquisition of wealth and the entrepreneur's other personal objectives.*
>
> *Along these lines, Schumpeter himself listed the formation of monopoly as among the sorts of (organizational) innovation an entrepreneur will sometimes seek to undertake (...).*
>
> *It should now be clear how antitrust fits into this story. To be extent that it prevents or impedes monopolization or reduces its profitability, it can discourage entrepreneurs from embarking on such ventures and cause them to reallocate their talents and efforts into production-enhancing innovation. On the other hand, to the extent that antitrust activity is carried out in ways that facilitate rent seeking [by awarding rents justified for 'dynamic' reasons], it can redirect entrepreneurship the other way, at the expense of productivity growth. Thus, facilitation of rent seeking would appear to have a double cost on society, one static and one dynamic."*[14]

Conclusion

That economic theory should guide competition policy is today well established, and the present article merely seeks to extend this approach to the enforcement level.

Capture theories, theories of rent-seeking and information constraints hold an important message for the exercise of competition policy. If the Competition Authorities' decisions are unlikely to reflect true information about the regulated firms' position, and if regulated industries spend real resources to influence Competition Authorities selectively in their favour, restraint on the part of the Competition Authorities seems called for.

Most important is to avoid the pitfall of favouring certain firms over their competitors through administrative enforcement decisions. Competition policy is less exposed to rent seeking and strategic behaviour if the Competition Authority formulates as general enforcement guidelines as possible, and later stick to these guidelines in individual cases.

14. See Baumol & Ordover, Antitrust: Source of Static and Dynamic Inefficiencies?, 1991, p. 90-91.

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