Competition Policy vs Regulation in the Context of Law and Economics

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Structure

- Context of Law and Economics
- Review competition policy and regulation as an public policy instrument
- Analyze reasons for state regulation
- The relationship between competition policy and regulation, types of competition and types of regulation
- EU Competition law
- Competition policy in a globalized economy
- Trade policy and competition policy
- Barriers to a market entry
- Analyze market entry regulation via licensing
- Analyze the regulation practices in different countries
- Some conclusions on market entry regulation.
What is Law and Economics?
What is the economic analysis of law?

- Classical definition of a law: a law is an obligation backed by a state sanction.
- Problem: How will a sanction affect behavior?
- Economics provide a scientific theory to predict the effects of legal sanctions on behavior.
- To economists sanctions look like prices and people respond to these sanctions much as they respond to prices.

Law and Economics

- Economics provides also a useful normative standard for evaluating law and policy.
- Laws are instruments for achieving important social goals.
- Lawmakers must have a method of evaluating laws’ effects on important social values.
Law and Economics (2)

- Economics predicts the effects of policies on efficiency.
- Efficiency is relevant for policymaking, because it is always better to achieve any given policy at lower cost than at higher cost.
- Besides efficiency, economics predicts the effects of policies on another important value: distribution.

Why should lawyers study economics and economists study law?

- Laws are incentives (not just justice) for changing behavior (implicit price) and instruments for policy objectives (efficiency and distribution). Economics provides scientific theory of behavior.
- Economic analysis often takes for granted such legal institutions as property and contract.
- Understanding law and economics together, models will become closer to reality.
Competition

- Competition in the market means that market participants as customers have the choice between different suppliers and as suppliers the choice between different customers.
- The essence of competition is rivalry (Stigler, 1957) Rivalry on one side of the market means freedom of choice on the other side.
- Competition may be regarded as an instrument which simultaneously creates freedom and checks power, that is market power.

Competition policy and regulation (by Kirchner)- non-competing or competing institutional devices?

- 1. Competition in markets for goods and services gives rise to positive economic and social welfare effects. It is an important factor for the organization of society as based on individual freedom.
- 2. Competition exclusively left to market forces may be endangered by activities aimed at creating or strengthening market power (restrictive business practice)
Competition policy and regulation (2)

3. Competition policy aims to protect freedom of competition by defining and enforcing measures preventing restraints of competition.

4. Markets in which competition would not produce the positive welfare effects industry should be regulated.

Issues addressed by competition policy

1. Market power
   - Monopoly and cartel power - the use of market power to increase prices, or of predatory pricing by a firm to reduce competition by another firm.
   - Preventative actions – intervention to prevent the formation of monopolies, controls on acquisitions, mergers, and foreign ownership, guaranteeing market share for new operators, breaking up existing monopolists, etc.
Issues addressed by competition policy (2)

2. Resource allocation
- *Fair access* to all available resources for production; constraining access creates barriers to entry for new producers.
- *Exclusive dealing* – where suppliers prevent a purchaser from dealing with their competitors.
- *Labour constraints* – where labour supply is constrained by trade union agreements.

Issues addressed by competition policy (3)

3. Consumer protection
- *Collusive agreements* – arrangements between firms to fix prices or control supply.
- *Resale price maintenance* - where suppliers or wholesalers set minimum retail prices.
- *Quality controls* – where minimum standards for products are assumed to exist.
- *Consumer information* – the provision of accurate information, including fair labelling.
Issues addressed by competition policy (4)

- 4. **Impacts of government**
- *Competitive neutrality* – in which government enterprises operate under the same conditions as private firms.
- *Legislative efficiency* – enacted to ensure that the costs of compliance to regulation are minimized.
- *Tax distortion* – minimizing the effects of cost or price distortions from taxation that make an industry less competitive on a global market.

Issues addressed by competition policy (5)

- 5. **Microeconomic reform**
- *Government policy* enacted to affect performance in particular industry sectors to lower costs.
Competition policy

- Can be defined as a public policy instrument to prevent constraints on competition.
- The goal of competition policy is to keep markets free from restrictive practices.
- Competition policy as such cannot create competition. It can only prevent or limit the effects of certain activities restricting freedom of competition.

Regulation is being used in the following senses (Baldwin et al. 1999)

- As a specific set of commands – where regulation involves the promulgation of a binding set of rules to be applied by a body devoted to this purpose. An example would be the health and safety at work legislation.
- As deliberate state influence – where regulation has a more broad sense and covers all state actions designed to influence industrial or social behavior. Thus, command-based regimes would come within this usage but so also would a range of other modes of influence – for instance those based on the use of economic incentives (e.g. taxes or subsidies); contractual powers; development of resources; franchises; the supply of information or other techniques.
- As all forms of social control or influence – where all mechanisms affecting behavior – whether these be state-derived or from other sources (e.g. markets) – are deemed regulatory. Within this usage of the term ‘regulation’ is there no requirement that the regulatory effects of a mechanism are deliberate or designed rather than merely incidental to other objectives.
Regulation as Policy Instrument

- Economic regulation – intervenes directly in enterprise and market decisions such as pricing, competition, market entry and exit.
- Social regulation – protects values such as health, safety, environment and social cohesion.
- Administrative regulation - concerns government formalities and paperwork.

Regulatory instruments and forms

- By Ogus (2002) regulation is divided into economic - monopolies, inadequate or asymmetrical information, externalities and coordination problems and non-economic – distributional justice and paternalism.
- By Hetrog (1999) economic regulation consists of two types of regulations: structural and conduct.
Reasons for Regulation

- Monopolies and natural monopolies
- Externalities
- Asymmetric information problems
- Continuity and availability of service
- Anti-competitive behavior
- Public goods and moral hazard
- Unequal bargaining power
- Distributional justice and social policy
- Rationalization and coordination
- Planning

Market failures

- Market failure is said to exist in those circumstances where the normal operation of the market does not deliver the best attainable outcome, hence, a better outcome can be attained by some form of public intervention.
- Market failure occurs when the allocation of resources becomes distorted and inefficient, or where the market outcome generates a socially undesirable impact.
Regulation (NIE approach)

- *Positive theory of regulation* – explains why and how existing regulatory structures have been developed and how the existing regulatory instruments work in practice.
- *Normative theory of regulation* – discusses the justification of regulation and/or the merits of competing regulatory regimes and/or the rationale of a choice between regulation and application of competition law.

Monopoly and market power

- Various forms of monopolies; natural monopoly
- Usually, the price is too high and the quantity supplied is too low from the viewpoint of efficiency.
- Correcting the shortcomings of monopoly: to replace monopoly with competition where it's possible or regulate the price charged by the monopolist (what about quality?)
Sometimes the benefits and costs of an exchange may spill over onto other parties than those explicitly engaged in the exchange.

The externality-generator produces too much output and too much harm because there is a difference between private and social marginal costs.

The key to achieving the social optimum where there are externalities is to induce private – maximizers to restrict their output to the socially optimal level.
Negative externalities

Positive externalities: health services market as an example
Public goods – two main characteristics

- **Non-rivalrous consumption**: consumption of a public good by one person does not leave less for any other consumer;
- **Non-excludability**: the costs of excluding nonpaying beneficiaries, who consume the good, are so high that no private profit-maximizing firm is willing to supply the good.

Public goods

- Free-rider problem: they hope to benefit at no cost to themselves from the payment of others.
- Government may undertake to subsidize the private provision of the public good, either directly or indirectly through the taxation.
- Also government may undertake to provide the public good itself and pay the costs of providing the service through the revenues raised by compulsory taxation.
Information asymmetries

- Sometimes an imbalance of information between parties to exchange is so severe that exchange is impeded.
- If sellers know more about the quality of goods than do buyers, then information is distributed asymmetrically in the market.
- Information voluntary exchange: a warranty to guarantee the quality of a product and also quality standards.
- Government intervention in the market can correct the information asymmetries: reducing costs of transaction.

Anti-competitive practices

- Collusion, formation of cartels
- Product bundling and tying
- Refusal to deal
- Exclusive dealing
- Bid rigging
- Dividing territories
- Conscious parallelism
- Price fixing
- Predatory pricing
- Misuse of patents and copyrights
The relationship between competition policy and regulation

- The goals to be attained by both institutional devices are overlapping but not identical.
- Some scholars focus on the efficiency goal in competition policy case, but often this goal is combined with consumer protection goal.
- In the case of regulation most authors stress the efficiency goal.

Competition policy and regulation

- Competition policy and regulation are alternatives, but complementary institutional devices.
- Rivalry between competition policy and regulation shows up in certain phases during the deregulation of an industry or the transformation of former state monopolies into competitive markets.
- In practice: as one between competition authorities and sector-specific regulators.
Types of Competition and Types of Regulation

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<tr>
<th>Type of competition</th>
<th>Types of regulation</th>
<th>Regulatory authority</th>
<th>Examples</th>
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<tbody>
<tr>
<td>1. Deregulated</td>
<td>Self-regulating markets</td>
<td>No regulation (retreat of the state)</td>
<td>Moving from certification to liability laws in order to protect consumers</td>
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<td>2. Regulated</td>
<td>Regulation-of-competition</td>
<td>National competition authorities</td>
<td>Prevention of concentration through the regulation of mergers, cross-ownership, etc.</td>
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<tr>
<td>3. Regulated</td>
<td>Regulation-for-competition</td>
<td>Sector-specific authorities and national competition authorities</td>
<td>Interconnection regimes in telecommunications, unbundling the network</td>
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<tr>
<td>4. Meta-regulated</td>
<td>Enforced self-regulation of competition rules</td>
<td>Sector-specific authorities and national competition authorities</td>
<td>Institutionalization of internal mechanisms of self-regulation that correspond with the legal requirements of competition law in general and the regulatory regime in particular.</td>
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European Community competition law (CL)

- Is one of the areas of authority of the EU.
- CL, (or antitrust in the United States), regulates the exercise of market power by large companies, governments or other economic entities.
- In the case of EU, it is an important part of ensuring the completion of the internal market, meaning the free flow of people, goods, services and capital in Europe.
Four main areas in Competition Policy (CL) include:

1. Cartels, or control of collusion and other anticompetitive practices which has an effect on the EU (Article 81 of Treaty of the European Community (TEC)).
2. Monopolies, or preventing the abuse of firms’ dominant market positions (Article 82 TEC).
3. Mergers, control of proposed mergers, acquisitions and joint ventures involving companies which have a certain, defined amount of turnover in the EU/EEA. Governed by the Council Regulation 139/2004 EC (the Mergers Regulation).
4. State aid, control of direct and indirect aid given by EU Member States to companies. Covered under Article 87 EC.

Competition policy in globalized economy

- From extraterritorial application to harmonization.
- As trade barriers set up by states are being removed in the course of liberalization, private companies are becoming more exposed to foreign competition.
- The competition of competition legislations.
Trade policy and competition policy: conflict vs mutual support

- Trade liberalization policy is aimed at achieving equal market access by all firms.
- Competition policy is aimed at preventing anti-competitive action within the domestic market.
- Problems: countries depart from efficiency motives in setting trade and competition policies; jurisdictions of the policies may overlap.

Barriers to a Market Entry

- In economics and in the theory of competition and regulation, *barriers to entry* are obstacles in the path of a firm which wants to enter a given market. Some of those barriers are following:
  1. Investment, especially in industries with economies of scale and/or natural monopolies.
  2. Government regulations may make entry more difficult or impossible (requirements for licenses and permits).
3. **Predatory pricing** – the practice of a dominant firm selling at loss to make competition more difficult for new firms who cannot suffer such losses, as a large dominant firm with large lines of credit or cash reserves can. It is illegal in most places, however it is difficult to prove.

4. **Intellectual property** – patents give a firm the sole legal right to produce a product for a given period of time. Patents are intended to encourage invention and technological progress by offering this financial incentive.

5. **Economy of scale** – large, experienced firms can generally produce goods at lower costs than small inexperienced firms. Cost advantages can sometimes be quickly reversed by advances in technology.
Purpose of Establishing Rules

- **Generic Policy**
  - Indirect information provision
  - registration
  - certification
  - licensing

- **Perceived Problems**
  - Information asymmetries
  - Negative externalities
  - Bureaucratic supply failure

Action Permits and Licenses as State Barriers

- To guarantee the certain minimal standards for quality of the goods and services
- to avoid social and ecological risks.
Objectives for the Establishment of Action Permits and Licenses

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<tr>
<th>Social Goal</th>
<th>Economic Goal</th>
<th>Administrative Goal</th>
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<tr>
<td>• Consumer protection and to guarantee the safety</td>
<td>• Market regulation</td>
<td>• Protection of the state interests</td>
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<td>• Reducing the risks</td>
<td>• To guarantee the workable and active competition</td>
<td>• The fiscal objective – to guarantee the tax proceeds</td>
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<td>• Environment protection</td>
<td>• Fixing the contract responsibilities</td>
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<td>• To guarantee the general safety</td>
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The Practices of Regulation

- Regulation varies widely around the world.
- Heavier regulation of business activity generally brings bad outcomes, while clearly defined and well-protected property rights enhance prosperity.
1. Market entry regulation (*Doing business in 2007*)

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Some conclusions

- Regulating the market entry will correct the competition in the certain market, but also reduces the choices for consumers.
- Heavier regulation of business activities generally brings bad outcomes, while clearly defined and well-protected property rights enhance prosperity.
References