COMPETITION REGULATION OR MARKET? OR: THE THREE EXCESSIVE DEMANDS

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Abstract

Competition regulation has always been discussed controversially within the libertarian community. On the one hand, markets must be free, but on the other, there seems to be a demand for rules within this freedom. The following will show that the rules we regard as competition regulation today are not up to protecting or supporting the market in its diversity. On the contrary: Competition regulation disables the market. It will be shown that competition regulations are based on three excessive demands: first, expectations concerning markets (or rather: concerning the idea of competition), second, the excessive demand on economic theory and third, an overstrain of the regulators' epistemic capabilities.

Text

Competition regulation has always been discussed controversially within a liberal framework. On the one hand, the market must be free, but on the other, there seems to be a demand for rules within this freedom. The following will show that the rules we regard as competition regulation today are not up to protecting or supporting the market in its diversity. On the contrary: Competition regulation disables the market.

The problems associated with competition regulation can easily be ascribed to three excessive demands on the issue: Competition regulation firstly overtaxes the market per se, secondly, it overstrains economic theory, and it thirdly expects too much of the regulators, personally and institutionally. Excessive demands in the above sense meaning that competition regulation generally presupposes or expects too much and has a far too high opinion of itself. Thus the liberal scepticism this kind of government

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intervention is met by. The three problematic issues shall be presented in the following.

1. Excessive demands on the market

The object of competition regulation is competition – and not the market. Specialist literature, like Neef 2008, Zäch 2005, or Motta 2004, bears witness to this declared definition. Both terms are often nonchalantly used as synonyms, or at least not as opposites. But the market is different from competition. Competition, according to common understanding, is a condition; namely the condition of competing buyers and suppliers who challenge themselves and each other in order to be better, more reasonably priced, or both.[1] The market, on the other side, is a process with the possibility of many conditions. Among these conditions, competition is certainly one, but the market also allows voluntary co-operations, monopoles,[2] or even collapses. In addition, there is market conditions not categorized under any term; monopolistic competition, cooperative associations, or surrogate competition, for example.

It is quasi inherent to the market-as-process term that no condition is static, and therefore no condition can be guaranteed or even preferred. As long as market entry is not legally or improperly prevented, all conditions are perfect. What begins as a monopoly today may (depending on the behaviour of the other market participants) be subject to competition tomorrow – or not on the market anymore at all, because buyers are finding substitutes or are simply not interested in the product. “Free market”, in this sense, is not a condition of the most intense competition possible, but the freedom of the players in the market to adapt. Such adaptations in the dynamic relationships of the players amongst themselves are the necessary requirement for markets to function and to produce good results. Markets are therefore also described as learning processes or discovery procedures (see particularly Kirzner 1996 and secondary Mises 1949 and 1927).

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[1] Of course, this is not the only definition of competition, but it is this definition that the theory of competition regulation is based on. Alternatively, competition can be understood as a process of discovery and freedom of action, by not consciously taking place between competitors, but arising from (largely unforeseeable) technological innovations and entrepreneurial initiative.

[2] In the free market, monopolies are extremely unstable conditions. Should a monopolist misuse his position under market conditions, he will not be able to hold it for long (in comparison to legally protected state monopolies).

It is even possible that competition in general is the natural condition of the free market. But one cannot deduce therefrom that a particular competition at a particular time is the natural or much less the ideal condition for a particular market – nor that this condition is ex ante identifiable. If markets are learning or discovery processes, their ideal condition is not known to them, which means that this supposed ideal condition is also not known to the market players. This axiomatically implies that the ideal condition of a market can again not be known to regulation or the regulators. Could this condition be known ex ante, there would be no need for a market, and the achievement of any conditions could more efficiently be left to central planning.

In sum, competition regulation overtaxes the market, because it presupposes that somebody – the regulator, at any rate – knows more than the market itself – thus making the market obsolete as an instrument.

But competition regulation is also overtaxing itself. Its commonly stated goals are the increase of consumer welfare, the increase of social welfare, and the increase of competition efficiency (paradigmatic in Motta 2004, 17ff.).

Competition regulation thus demands of itself not only to know more than the market, but also to know more than those players who have decided not to participate in a particular market. This decision takes place in the form of the consumption of substitutes or in non-consumption. Markets disclose information about the preferences and actions of market players – but when several players are not participating in a particular market, this information is missing, because it is perhaps non-existent. Regardless of this, competition regulation expects knowledge about the non-existent from the regulator.

What is more: Under the maxim of social welfare, competition regulation has to develop, anticipate, and judge common social conditions. At this point, there is another overstrain: The welfare of the buyers quite often stands in direct contradiction with social welfare in general. In a capitalistic system, one can moreover assume that a large number of the buyers are also owners of the enterprises that cause alleged declines in competition. And not to forget the fact that the state assumes the right to induce distortions of competition in the name of social welfare.

In other words: Competition regulation also makes excessive demands on itself, because it not only has to take care of competition, but also of social and individual welfare, which themselves are to be judged outside of the categories of competition – and therefore out of the reach of competition regulation. Competition regulation strives to strengthen competition in areas where competition is potentially not a desired condition.

2. Overstrain of economic theory[3]

The fact that competition regulation is putting such excessive demands on itself indicates that it not only focuses on the wrong aspects, but also has problems in its basic theoretical structure.
Competition regulation has its basis in welfare economics, which is oriented towards a pareto criterion: An optimum is reached when no individual can be benefitted without adversely affecting another (e.g. Reetz 2005). Although obvious, even this principle is repeatedly contestable; it is firstly static, secondly atomistic, it thirdly assumes a constant marginal rate of (factor)substitution (also intertemporal), and, finally, also the same marginal productivity of all factors (also intertemporal).

The ideal of completely atomistic competition, like the theorem of constant factor substitution (principle of homogeneity), are part of the micro-economic theory of market equilibrium. More precisely, it encompasses those preconditions that allow the development of a single balance in the market (Arrow and Hahn 1971). As well-known as both assumptions are, their application is limited to the introductory theory of economics; few economists would accept the effectiveness of these assumptions uncritically in real economy. Financial markets, which display higher efficiency, more closely approach these assumptions than real markets. But this has to do with the fact that actions in the financial markets are based on mathematical models, which themselves require those two initial values. In other words: Financial markets are autopoietic systems based on these principles (Brodbeck 1991).

For the real markets, however, these assumptions fall short. First, there will be transaction costs to enter into competitive, commercial, or legal relationships, but also to terminate any such. Second, there will be further costs when production factors are exchanged. The respective costs will have a less potent effect if

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[3] This chapter corresponds with the argumentation of Schneider 2013a (Copyright held by sic!).

they can be redistributed to a larger structure; the larger the basis of cost allocation, the smaller the average cost rate. In other words: Large enterprises can better distribute these additional costs to their structures, and by means of this absorption they more closely approach the principle of homogeneity. Small and medium-sized enterprises (SME) cannot manage the same. This makes it quite clear that each regulation which does not consider the costs of transaction or assumes them equal to zero is simultaneously causing a structural distortion of the market in favor of some players (see Williamson 1979 and Amstutz and Reinert 2004).

The hypothesis of atomistic competition is based on the fact that market players carry neither transaction nor substitution costs. But these costs actually emerge, and for the sake of minimizing them, market players – suppliers and buyers – can unite in corporations, for instance in the form of buying cooperatives, sales groups, vertical structures, etc. In order to approach the principle of homogeneity and thereby enjoy the advantages of economic cost reductions (which will be manifested in lower prices), the market players selectively give up atomistic competition without abandoning it altogether as an option. Competition is an institution that allows collaboration and disciplines it by making it unilaterally callable at any time.

It can therefore be established that the market understanding hidden behind competition regulation neither corresponds with sophisticated economics, nor is it adapted to real economy. Just as there will be transaction costs (which are assumed to equal zero), the cooperation between competitors (suppliers and buyers) can lead to the reduction of market prices, because general expenses (especially transaction costs) are spread to structures that absorb these costs and consequently lower them. Competition regulation, by contrast, takes the view that in a world without transaction costs, every co-operation benefits insiders in comparison to outsiders. But this is the wrong conclusion, based on the wrong assumptions.

Finally: Even if the theoretical models consulted were to be „consistent“, they are still being reduced in an undue manner, by monitoring competition merely on the basis of prices (and in fewer cases on the basis of quantity), while the different facets of competition altogether as well as their mutual complementation and their effects remain theoretically and practically disregarded. There is competition between prices, locations, qualities, levels of

service, brands, and competition within brands, between risks, information and its assessors.

3. Excessive demands on competition regulators

Regulators – as institutions and individuals – regulate markets: They intervene in markets and thus influence market conditions as well as market results. In the course of this, we can safely assume that they are governed by the above mentioned goals.

It is the goals themselves that lay the foundation for the excess demands on the regulator. Not only does the regulator have to make use of models that do not do justice (as mentioned above) to market reality, but tasks are imposed on him, which are epistemically impossible for him to master. This is revealed in at least three contexts.

First: The regulator must decide on the cases he has to or wishes to pursue, i.e., from a variety of potential cases, he selects several, which he will then subject to his analysis and intervention. These cases may be brought to his attention from the outside, but the regulator must also act on his own initiative. Of course, there will be enough relevant information in reality, and on grounds of institutional economics alone, a regulator will endeavor to spot as many indications as possible. This, however, requires that the regulator either knows the conditions of all possible markets, or that he is in a position to analyze all markets and to recognize their respective conditions. Even if one can generously concede the former, the latter is more difficult in a logical sense. In an epistemical sense, the regulator must closely approximate the market's state of knowledge in order to know the conditions of all markets, which means no less than that the regulator must asymptotically approximate the number of market players in his natural resources. If practice now argues that the regulator's focus is on the most important cases, this is an indirect admission that the regulator cannot achieve the goals imposed on him, because he does not increase social welfare as something aggregate, but rather the individual welfare of players in submarkets. Why should the market for hand cream be higher-ranking than the market for peanuts? It is in the implementation of competition regulation that competition authority is met with excessive demands.

Second: The challenge for the regulator is no less taxing if he focuses on one case alone. To know a market, its communication processes must be understood and shared in (in the sense of cost and benefits). From a third-party perspective, markets can be characterized, but hardly known or understood. As the regulator cannot participate in every market – this would distort the market he wishes to investigate – and in order to evade this problem, he turns to a methodological approach: phenotypic market analysis.
Different markets, each functioning differently and each by description a model in itself, are subsumed under even more abstract constructs. Similarities in structure and function have been postulated for the different already abstracted market descriptions. This makes it no longer necessary to understand the market for telephony as such, because, in the abstract, it can be treated and judged equally to the market for sprouts. Because the market models for telephony and for sprouts have the same structure, it is assumed that the markets will function alike in reality – and that their respective ideal conditions can be determined in this abstraction.

To further confirm this approach, competition authorities are resorting to gaining as much information as possible on the markets to be investigated – in fact, so much information that it not only makes subsumption under the abstract difficult in itself, but, secondly, information contradicting the subsumption is not sufficiently considered. This self-fulfilling logic even creates the epistemic illusion of having identified the right "market, of understanding it, being able to anticipate its ideal condition and initiate the necessary corrections. In reality though, this represents the transfer of a second-order model to a reality with doubtful empirical evidence. Martenet und Heinemann 2012 are a good example for this kind of excess demand. After initially admitting that the market is not an organizing principle (but rather the model of competition), they explicitly state that complete verification of an offense against competition as an organizing principle cannot be required from the regulator, but must take place with the necessary "souplesse".

The third problem of excessive demand on competition authority is of practical nature: It is interesting to observe that competition authority is committed to competition, because it brings to light alleged efficiencies – while, itself, it is equipped with absolute regional, quantity and price monopolies. Competition authorities are monopolists themselves. If it is true that players are only

efficient in competition, the deduction must be that competition authority is necessarily inefficient (see Schneider 2013b).

4. Solutions? Freedom!

Is there nothing to say in support of competition regulation from a liberal point of view then? There is at least much to say in favor of competition as a market condition among many. And it is beyond debate that competition will uncover efficiencies and have welfare-increasing effects. But if one keeps in mind that competition itself is the result of the monopolistic pursuits of market players, it becomes clear that competition is a market condition which can hardly be anticipated ex ante. Not even a market player can say when, under what conditions, and with what kind of effect competition will become established in a specific market – as little as he can speculate how consistent this condition will be.

Competition can be a strong – we generally assume: the strongest – organizing principle, if it is understood as a process of discovery and freedom of action, by not consciously taking place between competitors, but arising from (largely unforeseeable) technological innovations and entrepreneurial initiative.

Competition regulation presupposes too much market knowledge. So much knowledge, in fact, that it would no longer be rational to allow markets in spite of such comprehensive knowledge. Should the presupposed knowledge in fact exist, it would be better applied to centrally planned economy. But: That much knowledge does not exist – it is epistemically impossible.

Especially a liberal perspective will thus prefer a laissez-faire approach here. It is capitalistic institutions like freedom of trade, property guarantee, freedom of contract, and, ultimately, also integrity which must be guaranteed (by the state). The free market will itself generate results which are best possible under given circumstances–but never perfect, because the market is a learning process, and no learning process is initially or altogether free of friction.

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