The Role of Competition in Promoting Dynamic Markets and Economic Growth

Address by

William J. Kolasky¹
Deputy Assistant Attorney General
Antitrust Division
U.S. Department of Justice

Before the

TokyoAmerica Center
Tokyo, Japan

November 12, 2002
I. Introduction

Good afternoon. This is my first trip to Japan, and I am delighted both to visit your beautiful country and to have an opportunity to speak with you today about my favorite topic: competition. I should make clear at the outset that I am an unabashed advocate for competition. I believe, as do my colleagues at the Justice Department and the Federal Trade Commission, that sound competition policy and strong competition law enforcement are critical to the efficient operation of free markets and to economic growth.

All of us are aware of the difficult decade Japan has just lived through. At the beginning of the 1990's, the entire world marveled at the Japanese economy. When my predecessors came to Japan in the late 1980s, it was both to learn how you had done it and to push you to open up your markets to American companies. And, then, the bubble burst. Today, a decade later, the picture looks very different. Michael Porter, with two Japanese co-authors, for example, published a book just last year provocatively entitled, “Can Japan Compete?”

In the United States, we have just had not one, but two bubbles burst. First, the dot.com bubble; then the telecom bubble. We must now work hard to ensure that we don’t experience the same economic growth pattern that Japan has seen over the last decade.

I know there is incredible pressure on the Japanese government and on Japanese business to improve your economic performance. You certainly do not need yet another American coming over here to lecture you on the need to restructure your economy or on how to do it. And given the problems that we ourselves face, especially in the area of corporate governance, it would be not only arrogant, but also presumptuous, for me to try to do that.

What I want to do today is instead to talk about competition policy more generally and about the critical role it plays in promoting economic growth. This, of course, is hardly an
original thought. Michael Porter, among others, has long taught that strong domestic rivalry is a key element of international competitiveness and economic progress.\textsuperscript{3} In the first part of my speech, I will review very briefly why competition is so important.

In the second part of my speech, I will turn to a subject that has received less attention, but that is even more important — namely, how do we design a competition policy that will promote economic growth. In many parts of the world, including much of Asia, and perhaps sometimes even in Japan, competition law is seen more in terms of fair trade than of consumer welfare. In these countries, competition law is used more to protect small competitors and maintain a fragmented market structure rather than to promote efficiency. This view of competition law was once also common in the United States, as recently as a quarter century ago. Pursuit of those types of antitrust policies contributed, we ultimately concluded, to the stagflation we experienced during the 1970s. This led us to adopt a new vision of competition, one that defines competition, not in terms of the number of competitors, but as a process that is designed to promote consumer welfare and economic progress by assuring that goods and services are produced and delivered in the most efficient manner possible. As one of our senior economists likes to say, “efficiency is the goal; competition is the process.” We believe that this shift in antitrust policy helped stimulate the surge in productivity and innovation we have enjoyed in the United States over the last twenty years.

In the third part of my remarks, I will discuss how a competition policy that pursues consumer welfare as its only objective should be designed, and will offer a set of guiding principles for that purpose.
I will close by reviewing some concrete steps Japan might take to incorporate these principles into its enforcement of the Anti-Monopoly Act (“AMA”).

II. How Competition Promotes Dynamic Markets

Competition has a positive impact, not only on the well being of consumers, but also on a country’s economy as a whole. Competition bolsters the productivity and international competitiveness of the business sector and promotes dynamic markets and economic growth.

I know I do not need to persuade an audience as sophisticated as this of the virtues of competition. Michael Porter, who has studied the Japanese economy for years, has shown that the Japanese industries that are most competitive internationally are those in which domestic rivalry is strongest. During our bilateral yesterday, Commission Shibata of the JFTC shared with me a recent study by our National Bureau of Economic Research showing how deregulation contributed to the growth of the British economy over the last twenty years. In the United States, we have found that deregulation has reduced prices by as much as 30-75 percent in many key sectors as it forced those industries to restructure in order to become more efficient.

Let me review very briefly some of the principal benefits of competition.

The most obvious benefit of competition is that it results in goods and services being provided to consumers at competitive prices. But what people often forget is that producers are also consumers. They must buy raw materials and energy to produce their products, telecommunications services to communicate with their suppliers and customers, computer equipment to keep track of their inventories, construction services to build their plants and warehouses, and so forth. To the extent that prices for these goods and services are higher than those of their foreign competitors because of a lack of competition in those markets, firms will
be less competitive and will suffer in the marketplace.

A second benefit of competition is its effect on efficiency and productivity. Companies that are faced with vigorous competition are continually pressed to become more efficient and more productive. They know that their competitors are constantly seeking ways to reduce costs, in order to increase profits or gain a competitive advantage. With that constant pressure, firms know that if they do not keep pace in making efficiency and productivity improvements, they may well see their market position shrink, if not evaporate completely. It is exactly this process of fierce competition between rivals that leads firms to strive to offer higher quality goods, better services and lower prices.

A third benefit of competition is its positive effects on innovation. In today’s technology-driven world, innovation is crucial to success. Innovation leads to new products and new production technologies. It allows new firms to enter into markets dominated by incumbents, and is critical for incumbent firms who want to continue their previous market successes and stimulate consumer demand for new products. Competition drives innovation. Without competition, there would be little pressure to introduce new products or new production methods. Without this pressure, an economy will lag behind others as a center of innovation and will lose international competitiveness.

A fourth benefit of competition is that it fosters restructuring in sectors that have lost competitiveness. It is difficult for governments to determine which sectors of the economy need to be restructured, which firms in those sectors should remain or should cease to exist, and when it is best to engage in such restructuring. Governments are subject to political constraints and pressures, which more often than not lead to sub-optimal decisions. The competitive process, on
the other hand, is unbiased. It forces decisions to be based on market factors, such as demand, product uses, costs, technologies, rather than the incomplete information in the possession of government bureaucrats. The competition for capital and other resources by firms throughout the economy leads to money and resources flowing away from weak, uncompetitive sectors and firms and towards the strongest, most competitive sectors, and to the strongest and most competitive firms within those sectors. In these ways, the very operation of the competitive process makes decisions on restructuring clear, and leads to the strongest and most competitive economy possible.

III. The Need for Economically Sound Competition Law and Enforcement Policy

I hope I have made my point — competition acts in many ways to promote a dynamic economy, and is therefore essential to economic growth. So, the next question is: “How does a nation best encourage and protect the competitive process?” I believe that the most fundamental requirement is a commitment by government to allow competition, rather than bureaucratic intervention, to determine market outcomes. This means reducing regulation of the economy, both public and private, to the minimum necessary to achieve legitimate social goals, while ensuring that the competitive process is not distorted. To prevent the competitive process from being undermined, the enactment of an economically sound competition law and the establishment of a competition agency with the powers and resources to effectively enforce that competition law are imperative.

It must always be remembered, however, that competition law itself requires government intervention in the workings of the market in order to ensure that the activities of market participants do not undermine or distort the competitive process. And, unfortunately,
enforcement of a competition law can have negative consequences on competition and on the economy as a whole if the law restricts too broad a range of conduct, if it is too inflexible to changing markets, or if its enforcement is not based on sound economic analysis. Let me give you just two examples of how misguided competition policy can have harmful effects on an economy.

The first is in the area of merger enforcement. Mergers can, of course, harm the competitive process where, for example, a merger between competing firms eliminates competition between the parties and provides the merged firm with the power to raise price or exclude competition. At the same time, mergers can also increase competition and benefit consumers by creating efficiencies that could not be effectively realized without the merger. If a competition agency blocks a merger because it creates a more efficient firm that may be able to out-compete its rivals, the economy will suffer.

A second example relates to enforcement against low pricing practices. One of the fundamental benefits of competition is that it forces companies to compete vigorously in terms of price and quality. Although there are limited cases where low pricing can harm competition — primarily where a firm with market power tries to drive all of its competitors out of the market through sales below cost so that it can act like a monopolist and raise prices to recoup its earlier losses (a practice known as predatory pricing) — for the most part, vigorous price competition is good for consumers and helps business consumers compete more effectively through lower input costs. Competition agencies should be extremely reticent about challenging low pricing behavior, especially where engaged in by firms with no prospect for exercising monopoly power.
To avoid these pitfalls, the first thing we need to do is to agree on the objectives of competition law and on our definition of competition. As I said at the beginning of my talk, misguided competition policy, designed to maintain fragmented markets or protect small business, retards growth and undermines faith in free markets. In the United States, we believe that the sole objective of competition policy is consumer welfare. This means, to repeat one of my favorite sayings, that “efficiency is the goal, competition is the process.” Consistent with this objective, we define competition not in terms of the number of firms in a market, but as “the process by which market forces operate freely to assure that society’s resources are employed as efficiently as possible to maximize total economic welfare.” Applying this definition, we should not challenge conduct or agreements under the antitrust laws unless we are confident, weighing their potential anticompetitive effects against any potential efficiencies, that they will leave consumers substantially worse off by restricting output, raising prices, or retarding innovation.

IV. Basic Principles of Sound Competition Policy

Once we agree on the objectives of our antitrust laws and on our definition of competition, it is relatively easy to develop a set of guiding principles to follow in implementing those laws.

1. Make Anti-Cartel Enforcement Our Number One Priority

Detection and prosecution of hard-core cartels should be the top enforcement priority of every competition authority. Cartels — whether in the form of price fixing, output restrictions, bid rigging or market division — raise prices and restrict supply, harm consumers, and act as a drag on the entire economy. A recent OECD study on international cartels determined that the
amount of commerce affected by 16 large cartel cases exceeded $55 billion world-wide. The survey showed that price-increases caused by cartels are often very large, in some cases as much as 50% or more.

The large potential harm, combined with the huge potential gains to cartel participants and the difficulties of detection, require tough measures in order to deter cartels from being formed. That is why in the United States we treat cartels as criminal enterprises, pure and simple, and prosecute both the companies and the individuals who perpetrate them. Over the last ten years the Antitrust Division has successfully prosecuted more than 300 companies and almost 300 individuals for engaging in illegal cartel activities. Over that period, corporations have been fined a total of more than $2.1 billion and 120 corporate executives have been sentenced to actual imprisonment for their criminal behavior.

We believe there are four important elements to any effective anti-cartel program. The first is a per se rule against hard-core cartels that does not require the agency to prove harm to competition and does not allow parties to claim an efficiency justification. The second is fines for the companies involved that are large enough to have a strong deterrent effect. Given the difficulty of detecting cartels, the maximum monetary penalties we impose in the United States are now five times the amount of damage done. The third is criminal sanctions against the individuals involved, both to deter such conduct and to provide an incentive to cooperate with our investigations in exchange for immunity or a lighter sentence. The fourth is an effective leniency program, to give companies the same incentive to turn themselves in before their co-conspirators do.
2. **Protect Competition, Not Competitors**

Our second principle is that competition laws protect competition, not individual competitors. Competition agencies should not be in the business of picking winners or protecting losers, or of seeking to ensure that existing competitors survive. Thurman Arnold, one of the most famous leaders of the Antitrust Division, pointed out some sixty years ago that “[the antitrust laws] recognize that competition means someone may go bankrupt. They do not contemplate a game in which everyone who plays can win.” We should not block efficient transactions or conduct just because they will make life harder for rivals. Making life harder for rivals will generally force them to work even harder to keep up, multiplying the benefits to consumers.

3. **Recognize The Central Role Of Efficiencies in Antitrust Analysis**

The third principle is a close corollary of the second: efficiencies should play a central role in our analysis of allegedly anticompetitive conduct. As the June 1994 OECD Interim Report on Convergence in Competition Policies states: "[T]he basic objective of competition policy is to protect and preserve competition as the most appropriate means of ensuring the efficient allocation of resources, and thus efficient market outcomes, in free market economies.” We should never use the antitrust laws to restrain efficient conduct or transactions.

4. **Develop a Strong Analytical Framework for Evaluating Agreements and Other Conduct**

The fourth principle is that we need administrable standards to assure that our laws do not unduly interfere with the competition we are trying to protect. We all know that legal institutions are not omniscient and that some error is inevitable. We also all know that fact finding in competition cases is costly and that those costs can deter efficient conduct. Finally,
we all know that there is a trade-off between cost and the risk of error — a system that strives to eliminate all error would almost certainly be too costly to administer.

As we design the analytical frameworks and decision rules we will use to apply our competition laws, and especially as we try to incorporate the best economic learning into our decision-making, it is also important to remember that while technical economic discussion helps inform antitrust laws, those laws cannot precisely replicate the economists’ views. Unlike economics, law is an administrative system. Rules that embody every economic complexity and qualification may well prove counter-productive by, for example, discouraging legitimate price competition.

5. **Base Decisions on Sound Economics and Hard Evidence**

The fifth principle grows out of the need to prevent competition enforcement from becoming politicized. As an economy grows, and the stakes become ever larger, firms are naturally driven to seek protection and help from their governments. They can be expected to try to use the competition law as a weapon against their competitors. The best thing competition agencies can do to prevent competition enforcement decisions from becoming politicized is to make sure our decisions are soundly grounded in economic theory and fully supported by the empirical and factual evidence. We must also ensure that our decision-making is transparent and fair, and that parties and complainants have an opportunity to provide their perspective before a final enforcement decision is reached.
6. **Realize That Our Predictive Capabilities Are Limited**

Sixth, competition officials, like doctors, should take a sort of Hippocratic oath: before intervening, we should be confident that our actions do not cause harm. Competition authorities should be law enforcers, not industrial policy makers who try to move industries in a certain direction or dictate particular market results. Dictating industrial policy is not the proper role of a competition authority for a very good reason: the long-term (and, in some industries, even the short-term) predictive powers of competition enforcers are limited. Over the course of my twenty-five-year career as an antitrust lawyer, I have been amazed over and over again at how markets evolve — often in ways that even the most sophisticated of industry participants were unable to anticipate. In the United States, we have much more faith in the self-correcting nature of markets than we do in our own ability to predict their future course.

7. **Impose No Unnecessary Bureaucratic Roadblocks**

The seventh principle is that we should work hard to ensure that the competition laws do not themselves become bureaucratic roadblocks to efficient transactions. A vigorous, competitive, free-market economy produces a whole host of agreements and transactions every day. The vast majority are pro-competitive or, at worst, competitively neutral. We enforcement authorities should therefore continually take stock of our procedures to be sure that only those transactions that raise legitimate competitive concerns are delayed and that we are stopping only those that are truly anticompetitive.

8. **Be Flexible and Forward Looking**

Finally, competition agencies should be as flexible and dynamic as the industries with which they deal. We must make sure that competition law adapts to changes in technology and
in the economy. In particular, we should recognize that in our new, knowledge-based economy, competition in some markets is driven more by innovation than price. New-economy industries frequently require very large and risky upfront investments that will not be made without the promise of a substantial return. Too much government interference will frustrate innovation and discourage efficient practices to the detriment of consumers worldwide. On the other hand, a totally hands-off approach could lead to high prices and frustrate the emergence of potentially superior technologies — also to the detriment of consumers. We need, therefore, to constantly be studying the dynamics of these markets and incorporating new learning about those dynamics into our enforcement decisions.

V. Recommendations for Japan

Based on the principles I enumerated, I would like to take this opportunity to suggest — respectfully and with humility — some steps Japan might take to incorporate these principles even more fully into its competition policy regime:

1. **Show Unambiguous Government Support for Competition Principles**

   In order for the Japan Fair Trade Commission to be effective, it must have the full and unambiguous support of the Japanese Government. Mixed messages from the government — giving lip-service to the principles of competition while at the same time supporting *dango* or giving administrative guidance that is inconsistent with antimonopoly law or policy — only confuses the public and the business community and undermines support for the JFTC. It is also important that the public have confidence that the JFTC will be able to perform its mission in an independent manner, free of political or bureaucratic influence. For that reason, the proposals to change the status of the JFTC to that of an independent agency under the Cabinet are appropriate.
and I hope they will come to fruition in the coming Diet session.

2. **Strengthen Economic Analysis in AMA enforcement**

   Competition law is an economics-based discipline. As I have discussed, it is very important for a competition agency to perform a careful economic analysis of the procompetitive and anticompetitive aspects of particular conduct before determining whether to challenge or approve that conduct. A broad range of economic issues may need to be analyzed in such matters as merger reviews, monopolization cases, intellectual property licensing restrictions and even in collaborative ventures between competitors. The Antitrust Division has 55 Ph.D economists on our staff, who are thoroughly integrated into the work of our agency. By contrast, the JFTC counts very few graduate-level economists within its ranks. In order for the JFTC to ensure that it is taking necessary enforcement actions against anticompetitive activities, and to ensure that it not taking misguided action against conduct that is on balance procompetitive or competitively neutral, it would be very helpful if the JFTC increased the number of graduate level economists on its staff.

3. **Provide the JFTC with Necessary Tools for Effective Enforcement of AMA**

   Antimonopoly Act violations are often difficult to uncover, since the activities are often undertaken in secret. Competition agencies must have effective enforcement tools at their disposal if they are going to be able to do their jobs and if they are going to be able to keep ahead of the increasing sophistication of firms engaging in anticompetitive practices. In particular, I think it is important that the JFTC have the most modern investigation and enforcement powers available to the competition authorities in other major countries. Such powers should include the authority to reduce or eliminate surcharges for firms that come forward voluntarily, criminal
investigation authority for cases that are likely to be prosecuted criminally, and strong penalties for persons and enterprises that fail to comply with JFTC investigation orders or otherwise interfere with JFTC investigations.

4. **Impose Stronger Deterrent Measures Against Hard Core AMA Violations**

As I discussed earlier, cartels can do significant damage to consumers and to the economy. The potential profits from cartels are a strong inducement for firms to engage in this illegal behavior, especially since it is very difficult for competition authorities to uncover secret cartel agreements. For these reasons, penalties against firms must be very substantial if enterprises are to be deterred from engaging in unlawful cartels. Although the AMA provides for both administrative surcharges and criminal penalties, the potential penalties are still too modest to have a genuine deterrent effect and fall far short of the sanctions faced by cartel participants in the United States and other major jurisdictions such as the EU and Canada. To remedy this situation, surcharge levels should be raised significantly. In addition, criminal charges should be brought much more frequently than is currently the case. The current practice of JFTC criminal accusations once every two or three years is unlikely to be predictable enough to contribute to the deterrence of these otherwise very profitable, and very harmful practices.

VI. **Conclusion**

In conclusion, competition policy plays a key role in fostering dynamic markets and in stimulating economic growth. The international competitiveness of industries depends on access to inexpensive inputs, improvements in efficiency and productivity, and innovation, all of which competition promotes. A well-constructed competition law, backed up by a competition enforcement agency with strong powers, an economically sound enforcement policy, and a
commitment to follow the principles I enumerated earlier, is therefore absolutely critical in order for free markets to deliver the economic growth they promise. I am hopeful and optimistic that Japan will continue to make the changes in its competitive environment and in its Antimonopoly regime needed to bring the benefits of competition to Japanese consumers and the Japanese economy.

Before I close let me say a word about the close cooperation that exists between the U.S. antitrust agencies and the JFTC and Ministry of Justice. We have worked very closely together with both the JFTC and the Ministry of Justice in prosecuting some of the largest multinational cartels in history, cartels that cost consumers in the United States and Japan, and in many other countries, billions and billions of dollars. We have also worked very closely with the JFTC in founding the new International Competition Network, which provides a vehicle for competition authorities around the world to work together both to enforce their competition laws more effectively and to build stronger competition cultures in their regions. We have just completed our most successful bilateral ever, and we fully expect our working relationship will grow even closer in future years.

Thank you. I would be happy to take your questions.
ENDNOTES

1. Deputy Assistant Attorney General for International Enforcement, Antitrust Division, U.S. Department of Justice. These remarks reflect my personal views and not necessarily those of the Department. I want to thank Stu Chemtob for his contributions to this paper and, of course, my assistance Gloria Jenkins. Any mistakes are, of course, my own.


4. Id.


