Competition is all
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There is more to making markets work than laisser faire

QUESTIONS surrounding competition policy tend to divide economists—and not necessarily along party lines, so to speak. Mainstream pro-market economists agree almost to a man that competition is an indispensable spur to efficiency and innovation, and hence to higher living standards and faster economic growth. There is far less agreement over the character and extent of the government intervention that is required to make sure competition thrives. Recall, for instance, how the Microsoft anti-trust case divided the economics profession between those who thought that vigorous enforcement action was called for and those who felt that Microsoft’s dominance of its markets could and should be left to correct itself.

In the annual public lecture of Britain’s Royal Economic Society, John Vickers, a distinguished scholar and chairman of Britain’s Office of Fair Trading (OFT), points out that this tension in economics goes back a long way*. Just compare, he says, two of the best-known quotations from Adam Smith:

It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own interest.

People of the same trade seldom meet together, even for merriment or diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.

The point of the first quotation is to say that self-interest, unco-ordinated except by the invisible hand (that is, by competition), promotes the public good. The second says, in contrast, that producers set out to subvert competition unless they are somehow prevented from doing so. So the first remark is broadly sympathetic to the principle of laisser faire, whereas the second apparently takes an opposite view. But Mr Vickers explains that Smith’s comments must be seen as complementary rather than contradictory. Questions about the desirability of competition, especially those bearing on how best to arrange incentives so that welfare is improved, must be kept separate from questions about the inevitability of competition. “There is no inconsistency in regarding competition as beneficial but vulnerable to being undermined—for example, by cartel activity.”

Mr Vickers argues that the right way to think about competition policy is to see it as a form of regulation expressly intended to bring out the best of laisser faire. To the extent that competition policy succeeds, other forms of economic regulation will then become less necessary. Thus, judicious use of one kind of economic regulation—competition policy—can hope to lower the aggregate burden of all kinds taken together.
Seen this way, competition policy extends far beyond antitrust as traditionally defined. Notably, Mr Vickers regards reform of Europe's common agricultural policy as a species of (long-awaited) competition policy. Cartel-busting, though, remains a central concern. And in this area Mr Vickers reports that efforts in Europe have been stepped up. Britain, in particular, he says, has learned from America's experience. America relies heavily on combining leniency for those who first come forward with information and severity against hard-core offenders. Promising partial or total immunity to whistle-blowers transforms the incentives facing cartel members, making their conspiracies against the public far less stable, even before the trustbusters turn their gaze upon them. The British authorities have adopted this strategic use of leniency.

Mr Vickers also argues that broad-based deregulation should often be regarded as a primary tool of competition policy—not a view that the OFT or similar agencies have always eagerly espoused. Much of the public may be sceptical too, often regarding efforts to replace direct control with competition as a cause of subsequent grief. Excellent reading on this is a new paper by Alfred Kahn, doyen of America's regulation economists†. In a study jointly published by the American Enterprise Institute and the Brookings Institution, Mr Kahn assaults the widely held view that America's deregulation of airlines and telecoms has been a terrible failure—and the main cause of the financial disasters lately visited upon those industries.

**Cartels and corporate supergrasses**

Not so, as Mr Kahn's methodical analysis makes plain. Deregulation of the airline industry has been, he says, "a nearly unqualified success, despite the industry's unusual vulnerability to recessions, acts of terrorism and war." The benefits to consumers have been estimated at in excess of $20 billion a year, mainly in the form of lower fares and huge increases in the availability of fast one-stop services between hundreds of cities. Consumers do complain that standards of service have fallen. So they have—because passengers are unwilling to pay for them. Through competition, the market has discovered that consumers prefer cheap tickets to frills. Such discoveries are the whole point.

American telecoms deregulation is a more complicated tale, but here, too, Mr Kahn draws attention to several large and clear benefits: much cheaper rates for long-distance calling; vastly cheaper cellular and other wireless services; and, in both cases, correspondingly huge increases in usage.

Reluctant as consumers may be to believe it, competition is far and away their best friend in economic policy. The first question to ask of any existing microeconomic policy, or of any proposed new one, is simply whether it promotes competition. Depressingly often, despite the efforts of policy-oriented economists such as Mr Vickers and Mr Kahn, the answer is still no.

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* "Competition Economics". The speech can be downloaded from www.oft.gov.uk/News/Speeches+and+articles/2003/index

†"Lessons from Deregulation: Telecommunications and Airlines After the Crunch". Published by the AEI-Brookings Joint Centre for Regulatory Research. The paper can be downloaded from www.aei-brookings.org/publications/abstract.php?pid=400

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