THE CAUSES OF COMPETITION AGENCY INEFFECTIVENESS IN DEVELOPING COUNTRIES

A.E. RODRIGUEZ* AND ASHOK MENON**

I
INTRODUCTION

Examining the administrative and operational difficulties as well as the successes and failures of developing country competition law enforcement activities can help policymakers address the numerous difficulties accompanying the implementation of competition policies.[1] As Umut Aydin and Tim Büthe explain in the introductory article of this symposium, there are a variety of criteria that should be taken into account when assessing performance, and those criteria vary across countries depending on the overall goals of the agencies themselves.[2] Nonetheless, it is a task that is evidently necessary given the variation in performance across the world's competition policy enforcement agencies, as the statistical appendix to this article demonstrates. To this end, this symposium has brought together an impressive array of interdisciplinary experts, practitioners, and scholars—all charged with critically appraising the successes and shortcomings of competition policy programs worldwide. By assembling both the "lessons learned" as well as derivative recommendations or remedies that address shortcomings, it is expected that policymakers and practitioners can

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This article is also available online at http://lcp.law.duke.edu/.

*Associate Professor, College of Business, University of New Haven.

** Principal Associate, Nathan Associates. We thank Lesley DeNardis, Brian Marks, Glenn McGee, Ignacio De Leon, Jerome Reichman, and Maarten Van Oostrom for helpful comments and suggestions. We also gratefully acknowledge the contributions and assistance of Tim Büthe, Umut Aydin, Erik Wibbels, our anonymous reviewers, and the other participants of the Success and Limits of Competition Law & Policy in Developing Countries, a workshop held at the Keenan Institute, Duke University, May 2015.

1. *See, e.g.*, YANG-CHING CHAO, GEE SAN, CHANGFA LO & JIMING HO, INTERNATIONAL AND COMPARATIVE COMPETITION LAW AND POLICIES (2001); COMPETITION LAW AND DEVELOPMENT (D. Daniel Sokol et al. eds., 2013); COMPETITION LAW AND POLICY IN LATIN AMERICA (Eleanor M. Fox & D. Daniel Sokol eds., 2009); COMPETITION POLICY AND REGIONAL INTEGRATION IN DEVELOPING COUNTRIES (Josef Drexl et al. eds., 2012); IGNACIO DE LEON, AN INSTITUTIONAL ASSESSMENT OF ANTITRUST POLICY (2009); IGNACIO DE LEON, LATIN AMERICAN COMPETITION LAW AND POLICY (2001); DAVID J. GERBER, GLOBAL COMPETITION 205–269 (2010).

2. Competition Law & Policy in Developing Countries: Explaining Variations in Outcomes; Exploring Possibilities and Limits, May 4 for a workshop on Competition Law and Policy in Developing Countries, The Kenan Institute for Ethics at Duke University.

develop and deploy improved competition policy mechanisms to assist in the broader objective of enhancing developing nations' economic growth.

This institutional engineering task is a challenging undertaking. The competition law enforcement apparatus can be exceedingly well-positioned to curtail the abuses of naked horizontal cartels. And at that simple task agencies do a decent job, despite being bedeviled by procedural difficulties and methodological limitations.[3] But they don't succeed often because the naked, horizontal cartels at which they aim rarely exist.

This point hinges on recognizing a distinction between private, "naked," cartels and cartels that succeed by their proximity to and close historical association with the state—publicly sanctioned cartels, for lack of a better term. In this view, the latter—the tacitly or explicitly state-sanctioned cartels—are the norm in developing economies. The presence of these cartels, their interlinkages with the state, and the strength of the association are a product of a nation's development. These state-sponsored cartels, also recognizable as combines, groups, or associations, are market participants that emerged historically to reduce transactions costs in response to artifacts and problems of development.[4] By contrast, naked private cartels emerge infrequently, unlikely to exist in pure form because they are unsustainable.[5]

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3. For instance, the effective prosecution of cartels requires "hot" or "hard" evidence. *See infra* text accompanying note 12. These include a written agreement among firms, a credible statement by a participant, an internal memorandum written to report a meeting with competitors in which an agreement was reached, notes of telephone conversations with competitors or a statement by a person who was approached by the cartel to join it—or any such artifact that implicates a participant or potential cartel participant in an illegal agreement. But it is rare to find written agreements setting out the terms, conditions and details of a collusive agreement. Moreover, written agreements are not necessary given the strength of the tacit agreements forged by participants. The recurring nature of transactions and interactions between and among group members ensures the stability of the association. And the norms and informal ties that bind interest group participants are sufficiently strong to ensure the required cartel discipline. Setting aside the question of whether hot documents exist, agencies are still handicapped by their ability to reach them. Antitrust enforcement has the ability to subpoena documents and individuals, the authority to conduct unannounced inspections known as "dawn-raids," and the right to enter into leniency agreements with cartel participants. However, their deployment effectiveness varies across jurisdictions. In practical terms, agencies have limited or circumscribed capabilities to the extent they exist at all. *See generally* A.E. RODRIGUEZ & ASHOK MENON, THE LIMITS OF COMPETITION POLICY (2010).

4. *See* Mauro F. Guillen, *Business Groups in Emerging Economies: A Resource-Based View*, 43 ACAD. MGMT J. 362, 363 (2000) ("Groups step in where the market does not work or is not allowed to work by institutionalizing and alternative allocation mechanism so that production can take place."); Elinor Ostrom, *Collective Action and the Evolution of Social Norms*, 14 J. ECON. PERSP. 137, 138 (2000) ("Extensive fieldwork has by now established that individuals in all walks of life and all parts of the world voluntarily organize themselves so as to gain the benefits from trade, to provide mutual protection against risk, and to create and enforce the rules that protect natural resources.").

5. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW, 285–291 (4th ed. 1992); George J. Stigler, *A Theory of Oligopoly*, 72 J. POL. ECON. 44, 44 (1964) (pointing out that it may be difficult for firms to reach a consensus even with few firms competing in a market; and any consensus achieved may be upset by cheating). Indeed, the desire to curtail the pervasive and insidious relationship between the private sector and the state, which results in preferential treatment or protection, is the whole reason for antitrust's emphasis on competition advocacy. On the elements and outlook on domestic and

Competition policy's remit is broad. It reaches beyond challenging narrow horizontal collaborations among competitors. It brings to bear the full array of antitrust proscriptions against a wide range of business practices ranging from vertical practices, abuse of dominant positions, commonplace horizontal practices, to full-fledged merger reviews.

As a practical and operational matter, the metrics and procedures on which antitrust enforcement relies are inherently imperfect and may expose it to two kinds of decisionmaking errors. First, there is the possibility of prosecuting a pro-competitive or competitively innocuous market practice. Or, second, it can overlook a patently anti-competitive one. Conventional antirust doctrine holds that there is little chance of error in prosecuting a naked cartel because naked cartels convey few pro-competitive benefits.[6] On the other hand, as the agency seeks to target violations other than horizontal cartels, the possibility of unintentionally damaging pro-competitive behavior increases, and, as a result, the associated likelihood of error increases as well.

Thus, the core enforcement tool of the agency's tool kit, its most-effective, unambiguous and well-understood competition policy principle—the prohibition of per-se anti-competitive horizontal agreements orchestrated by private cartels —is a finely honed weapon aimed at an either scarce or inconsequential problem in most developing economies. In pursuing more ambiguous business practices, false-positives are inevitable because distinguishing pro-competitive conduct from unambiguously harmful conduct is an inherently difficult task.[7]

This article advances the following proposition: the level of antitrust enforcement activity in developing economies should be markedly lower than its level in developed ones. The reasoning turns on the following claims: particular

international competition advocacy, see INT'L COMPETITION NETWORK, ADVOCACY WORKING GRP., "ADVOCACY AND COMPETITION POLICY" REPORT (2002), http://www.internationalcompetitionnetwork.org/working-groups/current/advocacy.aspx [https://perma.cc/8LHS-4BYK]; R. Shyam Khemani & John Clark, *Competition Advocacy*, *in* A FRAMEWORK FOR THE DESIGN AND IMPLEMENTATION OF COMPETITION LAW AND POLICY (R. Shyam Khemani & Andre Barsony eds., 1998), http://documents.worldbank.org/curated/en/1998/11/438795/framework-design-implementation-competition-law-policy [https://perma.cc/BMP8-A6UG]; Timothy J. Muris, Creating a Culture of Competition: The Essential Role of Competition Advocacy, REMARKS BEFORE THE ICN PANEL ON COMPETITION ADVOCACY AND ANTITRUST AUTHORITIES (Sept. 28, 2002), https://www.ftc.gov/public-statements/2002/09/creating-culture-competition-essential-role-competition-advocacy [https://perma.cc/CN4Q-WBRK]. For recent critical commentary on competition advocacy, see Maurice E. Stucke, *Better Competition Advocacy*, 82 ST. JOHN'S L. REV. 951 (2008).

6. RICHARD A. POSNER, ANTITRUST LAW ix (2d ed. 2001). *See also* C. Frederick Beckner & Steven C. Salop, *Decision Theory and Antitrust Rules*, 67 ANTITRUST L.J. 41, 70–73 (1999) (outlining the full scope of this traditional perspective); Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 3 (1984); David S. Evans & Jorge A. Padilla, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 U. CHI. L. REV. 1, 37 (2005).

7. *See* Easterbrook, *supra* note 6, at 39 ("Antitrust is an imperfect tool for the regulation of competition. Imperfect because we rarely know the right amount of competition there should be, because neither judges nor juries are particularly good at handling complex economic arguments, and because many plaintiffs are interested in restraining rather than promoting competition.").

conditions of developing economies make the likelihood of antitrust enforcement error greater; and collaboration among firms is an endogenous, pervasive, necessary and often pro-competitive practice that emerged in response to the historical presence of high transaction costs endemic to developing areas. The scant presence of private cartels relative to all commercial entities suggests a low prevalence or base-rate. A failure to account for the presence of a low base rate event enhances the likelihood of error in forensic outcomes, specifically, a greater realization of false positives.[8] Sensitivity to the high cost associated with possible prosecutorial overreach suggests that competition policy, in its operation, should tread lightly and operate under a presumption of error.

In this narrative, trade associations, family-owned, or ethnic, industrial, and corporate groups, or any other variant of "self-regulating" entities found in developing economies are an organizational alternative to reduced, inadequate, or limited administrative guidance by the state. They exist due to limited access to capital and managerial talent, as well as political and socio-economic transaction costs unlikely to be significant in successful market economies.[9] These entities help coordinate decisions and efforts among association members. They therefore reduce transaction costs and create value for their members and others.

The presence of these interest groups conveys both benefits and costs to the economy and its development. As a result, the targeting of seemingly (and possibly) anti-competitive business practices without a recognition of the countervailing pro-competitive benefits results in enforcement errors that are much more damaging than the enforcement errors in developed economies. In sum, the prospective social costs of enforcement actions appear substantially greater than the benefits. This would suggest a more muted role for competition policy as a development instrument, to the extent that the error–cost tradeoff should inform the emphasis or aggressiveness of antitrust enforcement.

This hypothesis is illustrated and examined in the article. Part II describes and explains the source of the uncertainty that begets antitrust enforcement errors in developing economies. Part III describes the relevance and comparatively greater influence of business groups, industry, and regional associations, among others, which constitute private social networks that convey pro-competitive benefits. Part IV provides an accounting of the particularities of developing economies, and specifically the characteristics that handicap competition policy

8. Daniel Kahneman & Amos Tversky, *Evidential Impact of Base Rates*, *in* JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 153–160 (R. Kahnemen, P. Slovic & A. Tversky eds., 1982).

9. Guillen, *supra* note 4. *See also* Janet T. Landa, *A Theory of the Ethnically Homogenous Middleman Group: An Institutional Alternative to Contract Law*, 10 J. LEGAL STUD. 349, 356 (1981) (describing how tightly knit social relationships can substitute for law); Barak D. Richman, *Norms and Law: Putting the Horse Before the Cart*, 62 DUKE L.J. 739, 766 (2012) (arguing that "legal and legal-like processes must be viewed within the underlying social and economic context in which they appear"); AVNER GREIF & GUIDO TABELLINI, THE CLAN AND THE CORPORATION: SUSTAINING COOPERATION IN CHINA AND EUROPE 1, 6–7 (Sept. 26, 2015) (highlighting the similarities between Chinese clans and European clans and their importance in cooperative interactions), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2565120 [https://perma.cc/2KG6-TGC8].

practice in its orthodox deployment. Part V explains the impact of enforcement actions on the relative costs of colluding privately versus seeking state-sanctioned protections. Part VI offers some concluding comments.

A few caveats are necessary; as is a careful delineation of the scope of the commentary. This article does not seek to add to the copious scholarship on informal norms, private enforcement mechanisms, or private orderings—terms often used interchangeably. The article provides an overview of the extent to which the pro-competitive benefits of the social capital present among members of close-knit groups should be accounted for in the administration of the competition laws in developing economies. And last, although it draws from the work of commentators who question antitrust enforcement's general effectiveness, this article's analysis of antitrust policy is focused exclusively on its incantation in developing economies.[10]

It follows, as a matter of policy, that antitrust in developing economies—if it's to be had at all—should be relegated to its core function: the curtailment of horizontal price-fixing.[11] The current observed ineffectiveness of competition policy enforcement in developing countries rests to a great extent on the massive enforcement agenda with which the enforcement agencies are saddled, the multiple and often contradictory policy goals, and the unattainable expectations heaped on competition policy. Competition policy agencies in developing countries should, at least in the short-term, focus on horizontal practices; all other

10. Abel Mateus, *Competition and Development*, *in* COMPETITION LAW AND DEVELOPMENT, *supra* note 1, at 115 ("Even among developed countries and even within the organization for Economic Cooperation and Development (OECD), enforcement of antitrust has encountered major obstacles."); David Teece, *Favoring Dynamic Over Static Competition: Implications for Antitrust Policy and Policy*, *in* COMPETITION POLICY AND PATENT LAW UNDER UNCERTAINTY 203, 205 (Geoffrey Manne & Joshua Wright eds., 2011) (setting as the motivation for his study "the lack of compelling evidence indicating that antitrust is not aiding consumers"); R.W. Crandall & Clifford Winston, *Does Antitrust Policy Improve Consumer Welfare? Assessing the Evidence*, 17 J. ECON. PERSPS. 3, 4 (2003) (finding "little empirical evidence that past interventions have provided much direct benefit to consumers"); Paul E. Godek, *A Chicago-school approach to antitrust for developing economies*, 43 ANTITRUST BULL. 261, 262 (1998) ("For developing countries, in particular for those post-communist countries attempting to create the basic core of capitalism, antitrust may be an unnecessary and potentially harmful encumbrance. That is, since there is no free lunch it might be better for those countries to skip this particular meal.").

11. The adoption of antitrust laws in developing countries may not have been a result of any endogenous political process. Rather commonly, embracing antitrust was instrumental, a quid pro quo that allowed admittance into a particular multilateral institution, or an element of the conditionality tied to financial assistance. In numerous instances, the lack of antitrust legislation and policy often precluded trade with a developed country or trade bloc. Such pressures, more often than not, compelled nations to act and adopt competition legislation to comply with treaty obligations: this is not an endogenous process in the conventional sense. *See* Dina Waked, *Competition Law in the Developing World: The Why and How of Adoption and Its Implications for International Competition Law*, 1 GLOB. COMPETITION REV. 69, 69 (2008) ("The motives to adopt these laws have varied. In some instances, rules have been adopted over the course of many years in response to local pressures, in order to mend behaviours imposing social costs on societies. In other instances, rules have been recommended as tools to achieve development. In yet other circumstances, they were imposed through treaties and international pressure. Most developing countries either adopted competition rules in response to recommendations of international institutions or because of various obliging treaties they signed.").

activities can be too costly, expensive, and counterproductive for competition agencies in developing countries to implement effectively.

II
THE SOURCE OF ERRORS

The difficulties involved in proving the illegal nature of cartels and other anti-competitive agreements among firms are well known. Antitrust authorities can only prosecute the makers of collusive agreements if there is hard evidence of violations of the proscribed conduct.[12] This high threshold makes collusion very difficult to combat. But proceeding with less than conclusive evidence may ultimately lead to mistakenly taking action against practices that only seem anti-competitive but in reality are not collusive.

Investigating and prosecuting is costly. But investigations and false prosecutions also create unintentional social costs by "chilling competitive behavior," and instill reluctance to take risks and innovate practices for fear of running afoul of the competition agency.[13] Such litigation risk, or simply the fear of attracting unwanted regulatory attention, could even dissuade firms from deploying practices that might be only remotely similar to the scrutinized practice for fear of it being confounded. In fact, as a result of the potentially significant unfavorable impact on net welfare, several scholars have noted that it might be optimal for society to tolerate some degree of seemingly anti-competitive behavior among firms or—equivalently—that enforcement err on the side of caution and restraint.[14]

12. *See* Geoffrey A. Manne & Marcellus Williamson, *Hot Documents vs. Cold Economics: The Use and Misuse of Business Documents in Antitrust Enforcement and Adjudication*, 47 ARIZ. L. REV. 609, 610 (warning against using documentary proxies for economic relevance) (2005); Organization for Economic Cooperation & Development, *Prosecuting Cartels Without Direct Evidence of Agreement*, 9 OECD J. COMPETITION L. & POL'Y 49, 53 (2007) ("It can be difficult to convince courts to accept circumstantial evidence in cartel cases, especially where the potential liability for having violated the anti-cartel provisions of the competition law is high."); Darren S. Tucker & Kevin L. Yingling, *Too Hot to Handle: Internal Party Documents in Whole Foods and Other Modern Merger Challenges*, ANTITRUST SOURCE, Oct. 2007, http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Oct07_Tucker10_18f.authcheckdam.pdf [https://perma.cc/N9XR-K63B].

13. Ken Heyer, *A World of Uncertainty: Economics and the Globalization of Antitrust*, 72 ANTITRUST L.J. 375, 375 (2005) ("Despite the veneer of certainty suggested by the scientific method of economics, there continues to be a large degree of potential error in antitrust enforcement, and such errors may result in substantial economic costs.").

14. *See, e.g.*, David Besanko & Daniel F. Spulber, *Antitrust Enforcement Under Asymmetric Information*, 99 ECON. J. 408, 408 (1989) (showing "that asymmetric information can be a significant factor in the decision to tolerate some degree of collusion even though price fixing is illegal per se"); Stephen Martin, *Competition Policy, Collusion and Tacit Collusion*, 24 INT'L J. INDUS. ORG. 1299, 1299 (2006) (finding that when communication is not too costly, explicit collusion may be more profitable as it has the potential to reduce the incentives to defect); Saïd Souam, *Optimal Antitrust Policy Under Different Regimes of Fines*, 19 INT'L J. INDUS. ORG. 1, 1 (2001) (comparing the efficiency of two different regimes of fines against cartels when antitrust authorities have limited resource). *See also* F.M. SCHERER, COMPETITION POLICIES FOR AN INTEGRATED WORLD ECONOMY, 43–46 (1994) ("There are several reasons why individual nations might permit or even encourage cartels and other horizontal agreements

The arguments favoring tolerance of some potentially anti-competitive activity, under certain conditions, typically call attention to the costs of errors brought about by the mistaken prosecution of cartels or seemingly anti-competitive practices. In antitrust practice, both false positives and false negatives are inevitable, given the inherent difficulty of distinguishing efficient, pro-competitive business conduct from anti-competitive behavior.[15]

To determine pro-competitive and anti-competitive behavior, a Competition Policy Authority requires accurate metrics. For example, the fundamental premise in efficiency-based antitrust practice holds that any observed persistent and significant departures between observed prices and marginal costs are indications of anti-competitive pricing.[16] If such a difference is present, it raises a presumption of illegality.[17] But marginal costs are fiendishly difficult to measure. And the price–marginal cost gap reflects various attributes specific to the time and place that the transaction for a particular good or service takes place. These imprecise metrics can lead to sources of errors and both false positives and false negatives and impact a pro-competitive business environment.

Errors may result from a misunderstanding of the nature of price–marginal cost gaps. Any product or service can be viewed as a bundle of attributes. Upon close examination one can quickly discern those from which a product or service is made. But the numerous intangibles that were required to secure the product at the particular location and time are not visible to casual inspection. Thus, a

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with an impact on international trade."); Geoffrey A. Manne & Joshua D. Wright, *Google and the Limits of the Market: the Case Against the Antitrust Case Against Google*, 34 HARV. J.L. & PUB. POL'Y. 171, 173 (2011) (applying antitrust laws to innovative companies in dynamic markets has always been a perilous proposition, and despite significant advances in economics and jurisprudence, it remains so); J. Gregory Sidak & David J. Teece, *Dynamic Competition and Antitrust Law*, 5 J. COMPETITION L. & ECON. 581, 631 (2009) ("If nothing else, a wider appreciation of the importance of dynamic competition for innovation and consumer welfare may temper the hubris that the uninformed sometimes bring to antitrust analysis.").

15. *See* Easterbrook, *supra* note 6.

16. *See* MASSIMO MOTTA, COMPETITION POLICY THEORY AND PRACTICE 41–42 (2004) (stating that since the lowest possible price a firm can profitably charge is the price which equals the marginal cost of production, market power is usually defined as the difference between the prices charged by a firm and its marginal costs of production); Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1, 1 (1969) (The Nirvana Fallacy contains three elements. First, ignore the costs of corrective economic policy interventions by government but account for costs on consumers and on the economy. Numerous empirical attempts to appraise the costs of monopoly prices on the U.S. economy and elsewhere have not been very persuasive suggesting that the costs of enforcement far outweigh the losses. Second, the antitrust model is driven by efficiency considerations and disregards the true tastes and preferences of consumers in developing economies who possibly rank, given the disparity in wealth, equity considerations higher than they do economic efficiency considerations (getting prices right). Third, antitrust analysts often assume that markets in developing countries are perfectible. This perfection is unattainable. Markets are what they are in effect as a response to any number of institutional, normative, historical considerations.).

17. The determination of the critical significance of the price–cost gap is context dependent to some extent. Moreover, its interpretation may vary across jurisdictions. The threshold might be different depending on the industry and the particular competition problem being scrutinized. MOTTA, *supra* note 16, at 41.

customer purchasing a banana in downtown New Haven pays a price that covers the elusive costs of getting the banana to the supermarket.

But the transaction reflects still more. The true value of the banana also contains the value of embedded knowledge of international and domestic logistics, marketing relationships, climate and weather characteristics, exclusionary distributional arrangements, highly specialized and transaction-specific shipping and other transport equipment, tropical farming expertise, financial management, accounting, and many other aspects of specialized knowledge, including an understanding of the prevailing mores, relationships, and customary business practices.

When one thinks of products and services in these terms, transactions take on a different meaning. In developing economies, where markets may be less developed or thinner, the attributes that are embodied in products are necessarily distinctive. In fact, the price–cost gaps arise to some extent because of the returns that accrue to these attributes that exist *because* of the lack of fully competitive markets. The attributes contributing to the value of a product will differ in that some will reflect characteristics of the particular social and economic context and circumstance.

These attributes are sundry. They may include: varying returns to quality differentials; transactional, currency and financial risk; scarcity; safety and security premiums; costs of doing business, such as bribes or assurances; and generalized costs, such as taxes, surcharges, or location. Equivalently, disparities between international and domestic prices for a particular good or service may constitute a price differential attributable to transaction costs of trading internationally such as freight, custom charges, or duties; and relatedly, premiums reflecting context-related transactions costs.[18]

Price asymmetries and price–marginal cost gaps may also reflect distinct commercial practices involving differentiated products. These divergences may be due to unobserved differences in costs such as opportunity costs, quality, risks, varying levels (and associated costs) of opportunism, and the number of ancillary products or services. Or the price difference may be due to one of the many attributes that naturally combine to provide value—and often individualized

18. *See, e.g.*, Benjamin Klein & John Shepard Wiley Jr., *Competitive Price Discrimination as an Antitrust Justification for Intellectual Property Refusals to Deal*, 70 ANTITRUST L.J. 599, 602 (2003) ("In virtually all real-world markets competitive firms produce goods and services that are unique in some dimension. As a result, each firm faces less than a perfectly elastic demand. Real-world competitive firms, therefore, price above marginal cost and may find it profitable to price discriminate."); A.E. Rodriguez & Jeffrey I. Rosenbaum, *Is the Exercise of Market Power by Distributors in Newly Liberalized Economies Preventing Trade Gains? An Empirical Inquiry*, 22 WORLD COMPETITION 65, 73 (1999) (finding no support for an inference of supra-competitive returns in distribution services in Latin America). *See also* POOJA POKHREL ET AL., PRICE VARIATIONS IN MOZAMBIQUE 1–2 (2015) (finding that existing market price variations between locales in Mozambique and South Africa are attributable to red-tape, poor infrastructure, costly warehousing and inventory facilities, and state-sanctioned protectionist policies in the case of sugar); Malcolm B. Coate & A.E. Rodriguez, *Pitfalls in Merger Analysis: The Dirty Dozen*, 30 U.N.M.L. REV. 227, 230–34 (2000) (listing documented instances of errors in merger analysis).

value—to the consumer in a particular setting. These individualized attributes constitute tangible features as well as intangible ones, such as the extent and nature of the ongoing and recurring business relationship between a customer and supplier. Commercial trading arrangements in developing economies may reflect long-standing trading relationships among parties typical of smaller, less complex economies.

Parties to a transaction often rely on personalized exchanges to facilitate trade. They benefit from the presence of reputational capital and other informal mechanisms. The price differential charged by a seller may reflect some particular feature of the business relationship in the cost of the commodity. Embedded in the transaction price, for instance, may be an implicit financing charge or, perhaps, an adjustment for an exclusionary agreement. Or there may be a commitment by the seller to absorb some of the downside risk—a promise to "take care of the buyer" when prices decline. In other words, transactions are likely to incorporate relationship-specific circumstances derived from the nature of personal transactions.[19]

Industries that require considerable up-front investment are another context in which prices will not necessarily equal marginal cost. Many "new economy" markets, including software, video games, mobile telecommunications, as well as many "old economy" markets, such as pharmaceuticals, reflect this feature of high fixed costs and modest incremental costs.[20] As a result, these industries have a built-in difference between prices and marginal cost. Therefore, approaching perceived competition problems in these markets—to the extent that they exist in developing countries—based on the conventional understanding of price–marginal cost gaps is theoretically inappropriate and may lead an investigator to mistakenly infer the presence of anti-competitive behavior.[21]

These examples show that the presence of price–marginal cost gaps in developing economies is not necessarily evidence of influence over market conditions—like a finding of market power would require. Rather, observed price differentials may instead be a *response* to market conditions.

19. This is the key tenet in Transaction Cost Economics; non-standard agreements reflect the reduced the cost of transacting, accounting especially for the anticipated costs of opportunism derived from relationship-specific investments. As such, their presence reduces the cost of conducting economic activity. *See* OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 15 (1985).

20. *See* Richard A. Posner, *Antitrust in the New Economy*, 65 ANTITRUST L.J. 925, 926 (2001) (characterizing new economy as follows: "by falling average costs (on a product, not firm, basis) over a broad range of output, modest capital requirements relative to what is available for new enterprises from the modern capital market, very high rates of innovation, quick and frequent entry and exit, and economies of scale in consumption (also known as "network externalities"), the realization of which may require either monopoly or interfirm cooperation in standards setting"); Robert W. Hahn, *A Primer on Competition Policy and the New Economy* (AEI-Brookings Center for Reg. Stud., Working Paper No. 01-03, Feb. 2001) ("The basic conundrum that antitrust authorities face is that scale economics in production and consumption provide an economic justification for having a single firm dominate a market.").

21. *See* Demsetz, *supra* note 16.

The lack or poor quality of data in many developing economies also raises problems that can lead to errors. In antitrust investigations, applicable metrics must frequently be constructed with poor-quality data—assuming there is any relevant data to be had at all.[22] The data required to construct market shares, prices, measures of cost, concentration, potential entrants, and barriers to entry have to reflect the particular antitrust markets under consideration.[23] Antitrust investigations must define the particular product and geographic markets in which the parties to a transaction compete. Institutional statistics assembled by national statistics agencies under common industry standard codifications were not assembled for purposes of antitrust investigations.[24] They are, for the most part, useless for antitrust practice.

Errors may also arise in the gathering of testimony. Agencies often refer to testimony from customers, industry participants, and third parties.[25] For instance, the construction of antitrust product and geographic markets involves asking market participants a series of hypotheticals.[26] Similarly, the appraisal of the conditions of entry into the constructed product and geographic markets relies on hypotheticals and assessments of likelihoods.[27] Hypotheticals are also used when devising a "theory of competition" that seemingly reflects the behavior of participants in the market being examined.[28] There may be doubts regarding the honesty or objectivity of witnesses. There may also be doubts because even honest and unbiased witnesses may be mistaken in their perception. The end result is that the entire investigative process is fraught with uncertainties.

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22. Data is required for the various antitrust constructs used in enforcement practice, such as product and geographic market definitions required to establish an actionable antitrust market. Antitrust markets constitute all reasonable substitutes—across product and geographic space—to the particular product being examined. For example, it entails determining if the sole manufacturer of cellophane directly competes with producers of saran wrap, wax paper, or aluminum foil. If it is determined that these are reasonable substitutes, the antitrust "product" market may be defined as one that includes all these products. *See* ERNEST GELLHORN & WILLIAM E. KOVACIC, ANTITRUST LAW & ECONOMICS 98–109 (4th ed. 1994) (detailing how rare it is for the data assembled by government statistical agencies match a product or geographic market under antitrust scrutiny).

23. *See, e.g.*, GUIDELINES, *infra* note 25, at 8; MALCOLM B. COATE & A.E. RODRIGUEZ, THE ECONOMIC ANALYSIS OF MERGER 5 (1997); ERNEST GELLHORN & WILLIAM E. KOVACIC, ANTITRUST LAW & ECONOMICS 117 (4th ed. 1994).

24. Gregory J. Worden, *The Divergence of SIC Industries for Antitrust Markets: Some Evidence from Price-Fixing Cases*, 28 ECON. LETTERS 193, 193 (1988) (explaining how SIC four-digit industries often are far broader in product and/or geographic scope than antitrust markets and that the divergence between the two is greater than suggested in the literature).

25. *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES 4–6 (2010) [hereinafter GUIDELINES], https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf [https://perma.cc/7KN6-6N6U] ("The Agencies consider many sources of evidence in their merger analysis. The most common sources of reasonably available and reliable evidence are the merging parties, customers, other industry participants, and industry observers.").

26. *See id.* at 7–15 (defining the market for purposes of applying the horizontal merger guidelines).

27. *See id.* at 27–31 (examining entry or adjustments to pre-existing plans induced by mergers).

28. *Id.* ("In assessing whether entry will be timely, likely, and sufficient, the Agencies recognize that precise and detailed information may be difficult or impossible to obtain.").

Thus, theoretical imprecision in the conceptualization of the price–marginal cost gap, the uncertainty associated with development of routine, conventional antitrust constructs—product and geographic markets, entry, competitive effects—required to examine each particular violation, the uncertainty of witness testimony, and data imprecisions and unavailability all exist in the formulation of a possible antitrust inquiry. Each of these elements compounds the overall uncertainty confronting an antitrust decisionmaker appraising whether a particular practice warrants investigation. And each element increases the chance of making an incorrect decision.

The error costs of antitrust prosecutions in developing economies are no less damaging than those inflicted on developed economies. But the errors of prosecution are also comparatively more likely and possibly more consequential than in developed economies.

III
THE COSTS OF ERRORS VARY WITH THE CONTEXT

Keiretsu-like business conglomerates, groups, associations, or business clusters have a comparatively greater influence in developing economies than they do in developed countries.[29] In developing economies these interest groups simultaneously impart pro-competitive benefits as well as anti-competitive effects. Since Macaulay, it has been recognized that some measure of assurance and predictability can be supplied to markets via informal means.[30] Small, stable social networks provide the necessary context for the reliance on informal social

29. Keiretsu is a Japanese term ascribed to a business group with interlocking business relationships. More generally, business groups are entities that control and coordinate two or more distinct legal companies through commonly held ownership stakes, often complemented by social and familial ties. Thus, our discussion encompasses, inter alia, Korean Chaebols, the Indian business houses, Turkish family holdings, and Latin American and Spanish Grupos. Paul Sheard, *Keiretsu, Competition, and Market Access*, *in* GLOBAL COMPETITION POLICY 502 (Edward M. Graham & J. David Richardson eds., 1997) (detailing how Keiretsu represent efficient forms of economic organization, conditioned by historical circumstance, and adapted to Japan's unique business and market environment). *See also* Mark Granovetter, *Coase Revisited: Business Groups in the Modern Economy*, 4 INDUS. & CORP. CHANGE 93, 93 (1995); Nathaniel H. Leff, *Industrial Organization and Entrepreneurship in the Developing Countries: The Economic Groups*, 26 ECON. DEV. CULTURAL CHANGE 661, 663 (1978) (arguing that networks in which participants are "linked by relations of interpersonal trust, on the basis of similar, personal, ethnic, or communal background have emerged in response to institutional failures"). Although business groups exist in both developed and developing markets, business groups constitute the dominant organizational form in developing economies. *See* Tarun Khanna & Krishna Palepu, *Why Focused Strategies May Be Wrong For Emerging Markets*, 75 HARV. BUS. REV. 41, 41 (1997) ("[H]ighly diversified business groups can be particularly well suited to the institutional context in most developing economies. From the Chaebols in Korea, to the Business Houses of India, to the Grupos of Latin America, conglomerates can add value by imitating the functions of several institutions that are present only in advanced economies. Successful groups effectively mediate between their member companies and the rest of the economy."); Tarun Khanna & Jan Rivkin, *Estimating the Performance Effects of Business Groups in Emerging Markets*, 22 STRATEGIC MGMT. J. 45, 45 (2001) (explaining a striking feature of most emerging economies: the prominent role played by business groups).

30. *See* Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 55–67 (1963) (outlining this theory of informal regulation for the first time).

relations and norms, and informal sanctions to negotiate and enforce agreements.[31] These collaborations could be traditional "middleman" ethnic or tribal associations. Or, and often with some overlap, the collaborations can be regional groups and even political, party-affiliated groups. Their prosperity is attributable to commercial networks and informal, often highly efficient capital and managerial markets based on common ties and the group's reserve of social capital.[32] Taking antitrust action against the business practices of these groups is likely to inflict damage on total social welfare because of the difficulty of distinguishing the pro-competitive effects of business practices from the anti-competitive ones.

But the presence of collaborative and self-interested groups is not necessarily always pro-competitive. To the contrary—the trust and group cohesiveness that once imparted pro-competitive benefits, thereby facilitating economic development, could end up reducing or impeding it. Economic exchange sustained largely by personal relationships of trust and reciprocity can impede the development of a functioning impersonal market economy if no interaction outside the group is possible. If exchanges are limited to reciprocal ones, the number of prospective partners is limited and the search costs for finding a partner will be high.[33] These limitations do not create the political and economic institutions that foster cooperative activity in impersonal exchange settings.

But a theoretical understanding of the possibility of a group's negative impact is immaterial for enforcement purposes. The net competitive value of the various groups may still be unclear to the competition agency, and thus the uncertainty and possibility of error remains.

31. *See* DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 61–73 (1990) (detailing how these arrangements sanction individual actions by rewarding or punishing alternative courses of behavior). *See also* Avner Grief, *Commitment, Coercion and Markets: The Nature and Dynamics of Institutions Supporting Exchange*, *in* HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 727 (C. Menard & M. Shirley eds., 2005); Benjamin Klein, *Self-Enforcing Contracts*, 141 J. INST. & THEORETICAL ECON. 594, 594–600 (1985).

32. Philip Keefer & Stephen Knack, *Social Capital, Social Norms, and the New Institutional Economics*, *in* HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 727 (C. Menard & M. Shirley eds., 2005); *see generally* Mike Wright, Igor Filatotchev, Robert E. Hoskisson & Mike W. Peng, *Strategy Research in Emerging Economies*, 42 J. MGMT, STUD. 1 (2005) (commenting on the different roles of social capital and networks in facilitating entry into emerging versus developed economies by emerging economy firms); William Wan, Robert E. Hoskisson, Jeremy C. Short & Daphne W. Yiu, *Resource-Based Theory and Corporate Diversification: Accomplishments and Opportunities*, 37 J. MGMT. 1335, 1359 (2011) (explaining how, in emerging and transitioning economies, non-market capital (e.g., political capital or social capital) is likely a more important means for firm diversification and growth than is market capital (e.g., brand awareness)).

33. *See* Robert Cooter & Janet T. Landa, *Personal vs. Impersonal Trade: The Size of Trading Groups and Contract Law*, 4 INT'L REV. L. & ECON. 15, 15 (1984); Rachel E. Kranton, *Reciprocal Exchange: A Self-Sustaining System*, 86 AM. ECON. REV. 830, 830 (1996) (examining the persistence of reciprocal exchange by formalizing the interaction between self-enforcing exchange agreements and monetary market exchange).

Even if properly deployed, the enforcement of competition law promises to fall short because it effectively reaches only private antitrust practices.[34] Very few countries have antitrust laws that provide the ability to prosecute commercial activities of the state; even fewer have the political will to do so.[35] Few private groups, understood to be those that operate independently of the state, exist in developing economies.[36] Interest groups everywhere typically and routinely avail,

34. Few competition authorities are capable of enjoining anti-competitive practices of other state institutions; indeed, in some instances they are proscribed from doing so. More generally, there are other limitations and impediments afflicting the effectiveness of antitrust. These include, inter alia: weak judicial institutions; corruption; limited experience with antitrust law and practice across key elements of society, including the judiciary, academia, and the press; the proliferation of goals other than economic efficiency; and manpower shortages. *See generally* RODRIGUEZ & MENON, *supra* note 3. In addition, there is evidence to suggest that the objectives of efficiency-based competition programs in transition and developing economics are poorly understood. A.E. Rodriguez & Lesley DeNardis, *Assessing Competition Policy Performance Metrics: Concerns About Cross-Country Generalisability*, 7 INDIAN J. ECON. & BUS. 95, 95–100 (2008).

35. UNITED NATIONS CONF. ON TRADE & DEV., APPLICATIONS OF COMPETITION LAW: EXEMPTIONS AND EXCEPTIONS 11 (2002) ("A survey of selected countries indicates that most competition laws either exempt specific sectors and/or types of economic activity, and/or have provisions for the granting of such exemptions in given situations. It is worth observing that there generally tend to be fewer exemptions in countries which have recently adopted competition laws (mainly developing and transition market economies) as compared with more industrialized nations. However, this could be reflective of the fact that in many of the less developed countries, effective implementation of competition law has yet to take place. And various businesses are likely to be still unaware of the potential impact that competition law can have on their economic activities, and lobbying for exclusions from the application of competition law may yet take place. Indeed, casual observation suggests that in more advanced industrial countries, exemptions granted from competition law have generally tended to evolve and expand over time because of specific issues and cases confronted in the application of the law, and the resulting lobbying by business."), http://unctad.org/en/Docs/ditcclpmisc25_en.pdf [https://perma.cc/5XXR-V7VD]; Ulf Böge, State imposed Restrictions of Competition and Competition Advocacy, ABA Spring Meeting, at 4 (Washington D.C., 29, March 2006) ("The regulated conduct defense, or in other words the precedence of anti-competitive regulation over competition law, exists in several jurisdictions. One example is the United States with a body of law known as the state action doctrine: If a US state or local government enacts legislation that eliminates competition, federal competition law may be displaced in certain circumstances."); Roger Alan Boner, *Antitrust and State Action in Transition Economies*, 43 ANTITRUST BULL. 71, 72 (1998) ("Because antitrust policy is often explained in terms of consumer welfare and other measures of economic efficiency, one might expect that the actions of state agencies and officials would have a prominent role in antitrust enforcement. Yet in most countries, quite the opposite is true. Antitrust enforcement in developed countries tends to focus upon the actions of private parties, and antitrust enforcement against the state is either absent or, more often, carefully confined.").

36. Leidy & Hoekman, *infra* note 37 (discussing direct and indirect influences that labor and industry lobbies can have on government policies related to free trade, especially in the context of protection from foreign competition). *See also* John H. Coatsworth, *Obstacles to Economic Growth in Nineteenth Century Mexico*, 83 AM. HIST. REV. 80, 94 (1978) ("The interventionist and pervasive arbitrary nature of the institutional environment forced every enterprise, urban or rural, to operate in a highly politicized manner, using kinship networks, political influence, and family prestige to gain privileged access to subsidized credit, to aid various stratagems for recruiting labor, to collect debts or enforce contracts, to evade taxes or circumvent the courts, and to defend or assert titles to land. Success or failure in the economic arena always depended on the relationship of the producer with political authorities—local officials for arranging matters close at hand, the central government of the colony for sympathetic interpretations of the law and intervention at the local level when conditions required it.") Coatsworth's is a generalized observation, despite being lifted from nineteenth-century Mexico. It would

or seek to avail, themselves of protection and advantage by state fiat; it is unlikely that any successful economic venture in developing countries succeeds without the tacit or explicit assistance of the state.[37] And it is precisely this proximity to state munificence that enables interest groups to effectively side-step or neutralize the competition agency's prosecutorial efforts.

Barak Richman persuasively argues that in developing economies with underdeveloped legal systems, private orderings of cartels effectively replace weak formal legal systems of contract enforcement.[38] Cartel-sponsored private orderings mobilize an affiliated group of merchants in a manner that ensures contractual agreements among cartel members.[39] Thus, the presence of cartels guarantees competition-enhancing contractual transactions. Simultaneously, as cartels are wont to do, they also restrict competition. Richman writes about the tension that exists as a result of this dual function whereby the well-understood harms of groups as a restraint on competition compete with the underappreciated benefit of groups as a pro-competitive solution to legal failures.[40] Richman insightfully conjoins his argument with the rich history of the economic success of the traditional "middleman" groups in developing economies.[41] Middleman

apply across all developing economies with expected variations attributable to differences in the idiosyncratic development of formal and informal constraints; Group pervasiveness is, of course, additionally inferred from: recognizing the various documented linkages that exist of collaboration among and between groups, *supra* note 29; *infra* note 38; from the solicitation of preferential treatment arising from the ease with which tariffs and non-tariff barriers are erected, *supra* note 35; and the persistent calls for increased and enhanced competition advocacy, *supra* note 5.

37. For a survey of commentary on domestic gains as a result of tariff and non-tariff barriers, see Arye Hillman, *International Trade Policy: Departure from Free Trade*, *in* READINGS IN PUBLIC CHOICE AND CONSTITUTIONAL POLITICAL ECONOMY 129 (Charles K. Rowley & Friedrich Schneider eds., 2008). For specific commentary on gains from non-tariff barriers derived from anti-dumping and environmental protocols, see, respectively Michael P. Leidy & Bernard J. Hoekman, *Spurious Injury as Indirect Rent-Seeking: Free Trade Under the Prospect of Protection*, 3 ECON. & POL. 111 (1991) (explaining how, under well-established injury criteria for protection, import-competing producers have an incentive, either collectively or individually, to feign injury) and C. Ford Runge, *Trade Protectionism and Environmental Regulations: The New Nontariff Barriers*, 11 NW. J. INT'L L. & BUS. 47, 47 (1990) (reviewing economic and legal aspects of the growing role of environmental, health, and safety regulations operating as disguised barriers to trade). *See also* Mario Daniele Amore & Morten Bennedsen, *The Value of Local Political Connections in a Low-Corruption Environment*, 110 J. FIN. ECON. 387 (2013) (finding positive value in family connections with local politicians in Denmark, a country with strong political institutions); Paul Brockman, Oliver M. Rui & Huan Zou, *Institutions and the Performance of Politically Connected M&As*, 44 J. INT'L BUS. STUD., 833 (2013) (documenting relationships between political connections and corporate investments); Pramuan Bunkanwanicha, & Yupana Wiwattanakantang, *Big Business Owners in Politics*, 22 REV. FIN. STUD. 22, 2133 (2009) (documenting the positive value of political connections in Thailand); Charles Calomiris, Raymond Fisman & Yongxiang Wang, *Profiting from Government Stakes in a Command Economy: Evidence from Chinese Asset Sales*, 96 J. FIN. ECON. 399, 399 (2010) (documenting the value of political connections in China); Raymond Fisman, *Estimating the Value of Political Connections*, 91 AM. ECON. REV. 1095 (2001) (documenting the positive value of political connections in Indonesia).

38. *See* Barak D. Richman, *Contracts and Cartels: Reconciling Competition and Development Policy*, *in* COMPETITION LAW AND DEVELOPMENT, *supra* note 1, at 155.

39. *Id.* at 165; NORTH, *supra* note 31, at 34, 55.

40. Richman, *supra* note 38.

41. IMMIGRATION AND ENTREPRENEURSHIP: CULTURE, CAPITAL, AND ETHNIC NETWORKS (Ivan

groups are mostly ethnic emigres who marshal social capital into successful commercial ventures—often operating amidst and overcoming unwelcome environments from the domestic ethnic majority.[42]

Also, the groups that emerged to facilitate negotiations and transactions with the state, including unions, political parties, military cliques, business associations, and regional concerns, simultaneously confer both benefits and costs to competition. These groups are not necessarily cartels in the traditional economic sense, but are interest groups that effectively reduce the transaction costs of managing the state including, among other attributes, the effective disciplining of group members.[43]

Having structured the analysis in terms of the tradeoffs between pro-competitive benefits and anti-competitive effects, the task remains to appraise the difficulties confronting the administration of competition law when the dual characteristics of a particular cartel or interest group are known to authorities. In plainer words, it is important to establish the conditions under which the competition authority should exercise prosecutorial discretion or restraint in deference to a broader social objective.

This is not merely a conceptual exercise. Ulrike Schaede documents how Japanese trade associations have replaced waning state influence and assumed important regulatory functions of their own.[44] Indeed, economic policy was

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Light & Parminder Bachu eds., 1993); DAVID S. LANDES, THE WEALTH AND POVERTY OF NATIONS (1998); THOMAS SOWELL, MIGRATIONS AND CULTURE: A WORLD VIEW 477 (1996); THOMAS SOWELL, RACE AND CULTURE: A WORLD VIEW (1994); Lan Cao, *The Ethnic Question in Law and Development*, 102 MICH. L. REV. 1044, 1046, 1054–65 (2004) ("market-dominant minorities are classic middleman minorities whose prosperity attributable to business networks and informal but efficient capital markets based on common ethnic ties and the group's reserve of social capital"); Robert Cooter & Janet T. Landa, *Personal and Impersonal Trade: The Size of Trading Groups and Contract Law*, 4 INT'L REV. L. & ECON. 15 (1984); Stephen Knack & Philip Keefer, *Does Social Capital Have an Economic Payoff? A Cross-Country Investigation*, 112 Q.J. ECON. 1251 (1997).

42. SOWELL, RACE AND CULTURE, *supra* note 41, at 2, 11, 12, 47; Kevin Davis, et. al., *Ethnically Homogeneous Commercial Elites in Developing Countries*, 32 LAW & POL'Y INT'L BUS. 331, 335 (2001) (asserting that deficiencies in formal institutions are not the sole, and may not even be the primary, reason why economically dominant ethnic minorities have been and will continue to be observed in developing countries).

43. NORTH, *supra* note 31, at 55; Landa, *supra* note 9, at 354–55; James E. Rauch, *Business and Social Networks in International Trade*, 39 J. ECON. LITERATURE 1177, 1180 (2001).

44. ULRICKE SCHAEDE, COOPERATIVE CAPITALISM: SELF-REGULATION, TRADE ASSOCIATIONS, AND THE ANTIMONOPOLY LAW IN JAPAN 1 (2000) ("Deregulation will not necessarily lead to increased competition across all Japanese industries. Rather, as Japan's postwar industrial policy regime crumbles and the regulating ministries become less potent, many industries rely more than ever on the practice of 'self-regulation'—using trade associations to enforce trade rules and market controls. . . . As a result of self-regulation, many markets will remain as restricted as they are today, but this restriction will be based more on trade practices established by trade associations and less on government intervention in the marketplace."); MARK TILTON, RESTRAINED TRADE: CARTELS IN JAPAN'S BASIC MATERIALS INDUSTRIES 22 (1996) ("The institutions that carry out the cartels are usually trade associations, organizations of firms for the purpose of furthering the members' collective interests. They may be either industry-specific or peak associations, combining businesses from any industries.").

discussed, formed, and implemented largely through informal mechanisms involving trade associations of particular industries.[45]

> The implementing agents were more frequently cartels, facilitated by MITI but directly enforced by the trade associations. These cartels were sometimes legal, formally approved by MITI or the Fair Trade Commission. At other times, the cartels were largely informal, created through consultation between industry and MITI, sometimes with the understanding of the Fair Trade Commission, sometimes without. On rare occasions, the Fair Trade Commission would object to a cartel's formation or attack an existing one.
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> . . . .
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> Disagreements led to fierce and bitter battles among the players in a given industrial field, but they rarely took their grievances public and even less frequently to the courts.[46]

Thus, the social arrangements that emerge over time, which act as built-in stabilizers convey both pro-competitive as well as anti-competitive efforts.[47]

The next part explains the relevance and importance of the informal norms, customs and practices characterizing close-knit communities in developing economies, and discusses their response to liberalization-driven changes.

IV
TRANSACTION COSTS AND THE FORMATION OF CARTELS AND CARTEL-LIKE STRUCTURES

Deregulation, privatization, trade reform, and other liberalization initiatives create both gains and losses. Policies that reduce domestic barriers to trade, thereby stimulating imports and entry, create competition between imports and domestic production. This competition has distributive consequences that provide incentives for interests—firms, employees, and domestic suppliers—to seek protection from imports.

The benefits of increased competition from imports are typically distributed broadly among consumers. The costs—on the other hand—are concentrated among import-competing industries. To illustrate, consider the following archetypal example: a hypothetical agricultural products firm in a small economy is anticipating a liberalization that will reduce historical barriers to entry that have heretofore successfully kept out competing products. Competing products are selling at a considerable discount in international markets and would effectively eviscerate the local producer if the current tariffs are eliminated. The local product manufacturer boasts a 300-gallon reactor or some comparable capability for the production of agricultural products, perfectly suitable—and

45. Frank Upham, *Mythmaking in the Rule of Law Orthodoxy*, *in* PROMOTING THE RULE OF LAW ABROAD: IN SEARCH OF KNOWLEDGE 75 (Thomas Carothers ed., 2006).

46. *Id.* at 95.

47. *But see* Sheard, *supra* note 29, at 541 ("Despite the frequent use of terms such as 'cartel-like' and 'collusive' to describe them, keiretsu are not anti-competitive and have nothing to do with price-fixing.").

efficient—given the size of the existing, pre-liberalization, local market. The international competitor, on the other hand, has a 1500-gallon reactor—adequately sized to efficiently service his larger market, which spans several countries. The competitor also enjoys complementary managerial expertise built over several years of competing internationally, as well as economies of scale that enable him to provide product at prices considerably lower than those of the local producer—even when shipping from abroad. In fact, thanks to the enhanced volume gained from entering the newly liberalized countries, the international competitor can provide even greater price benefits to his new consumers. And although the domestic producer could conceivably embrace the liberalization and quickly move to replace the suddenly inefficient reactor or manufacturing facility with a 1500-gallon one, it is unrealistic and unlikely.[48] Credit market constraints and domestic labor market rigidities, both features of underdevelopment, are likely to act as barriers to entry, expansion, and innovation. Credit constraints may limit the ability of domestic firms to finance the fixed costs required to enter new markets or introduce adequately competitive production technologies. Similarly, labor market rigidities will curtail the firm's ability to redirect resources to a new production line. The fate of the domestic producer, along with the associated jobs, is sealed.

This is a well-trod narrative: the liberalization process is better in the long run because, in addition to the fact that consumers benefit from the lower prices, any previously poorly utilized resources can be reallocated to better uses.[49] In this narrative, the domestic firm is impelled to take action. It acts not only to protect its rents, but also because it is incapable of effectively adapting to the new competitive regime and is existentially threatened by the prospective change.

More realistically, in most instances of reform or transitioning, competing interests take competing positions on the direction of change.[50] But even within

48. The original insight is from Gordon Tullock, *The Transitional Gains Trap*, 6 BELL J. ECON. & MGMT. SCI. 671, 673 (1975) (arguing that the initial benefits of government largesse are quickly capitalized and often sold to others at rent-inflated capital values. Those who purchase the asset only earn a normal return on their investments. If the privilege should ever be withdrawn, the later entrants would incur a capital loss. To avoid such an outcome, the holders of the rent-generating assets will lobby aggressively against any such removal of benefits or privileges). *See also* Dani Rodrik, *Policy Uncertainty and Private Investment in Developing Countries*, 36 J. DEV. ECON. 229, 230 (1991) (capital investment is partially irreversible in that there are sunk costs of entry and exit when physical capital is committed or moved from one sector to another).

49. *See, e.g.*, Niraj Dawar & Tony Frost, *Competing With Giants: Survival Strategies for Local Companies in Emerging Markets*, HARV. BUS. REV., Mar.–Apr. 1999, at 119, 126; Kenneth Kletzer & Pranab Bardham, *Credit Markets and Patterns of International Trade*, 27 J. DEV. ECON. 57, 75–76 (1987) (showing that countries with a relatively well-developed financial sector have a comparative advantage in industries and sectors that rely on external finance); Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Schleifer, *The Economic Consequences of Legal Origins*, 46 J. ECON. LITERATURE 285, 307, 321 (2008) (financially underdeveloped countries typically have higher regulatory barriers to entry); James Levinsohn, *Testing the Imports-as-Market Discipline Hypothesis*, 35 J. INT'L ECON. 1, 1–9 (1993).

50. The impact of political instability and uncertainty on investment and firm decisionmaking is well established. *See, e.g.*, Alberto Alesina & Roberto Perotti, *Income Distribution, Political Instability, and Investment*, 40 EUR. ECON. REV. 1203 (1996); Nick Bloom, Stephen Bond & John Van Reenen,

this more complex frame the political economy landscape hardly changes. Firms in a sector that has already committed to a particular technology and governance structure have invested in resources, capital, and organizational capabilities that are likely to be specific to the status quo.[51] As a result, their value declines if the status quo changes; this is the case of the hypothetical domestic producer previously described. By contrast, any sector that has embraced flexible practices, or is better capable of weathering change, as well as the increased competition promised by the change in status quo, is less likely to be hindered by sunk costs. Thus, with no vested interest in the status quo, the innovative firm is less likely to oppose change and more likely to favor it.

The presence of non-trivial, sunk resources among import-competing industries—those which may result in a significant loss of rents—provides a potent incentive to seek protection. The import-competing industry generally has more to lose than the export industry has to gain, so the incentives for protection can be stronger than the pro-liberalization forces.[52]

Firms and workers concentrated in import-competing industries are likely to oppose liberalization in order to prevent rent erosion. However, their recent efforts have been less a response to the elimination of tariffs, given the decline in international trade and diminishing relevance of tariffs.[53] Tariffs have been

Uncertainty and Investment Dynamics, 74 REV. ECON. STUD. 391, 391 (2007); Yi Feng, *Political Freedom, Political Instability, and Policy Uncertainty: A Study of Political Institutions and Private Investment in Developing Countries*, 45 INT'L STUD. Q. 271, 271–72 (2001); Witold J. Henisz, *The Institutional Environment for Infrastructure Investment*, 11 INDUS. & CORP. CHANGE 355 (2002); Rodrik, *supra* note 48; Jakob Svensson, *Investment, Property Rights and Political Instability: Theory and Evidence*, INST. OF INT'L ECON. STUD. 1, 2–5 (1994); Kyle Handley & Nuno Limao, *Trade and Investment Under Policy Uncertainty: Theory and Firm Evidence* (Nat'l Bureau of Econ. Research, Working Paper No. 17790, 2012); Scott R. Baker, Nicholas Bloom & Steven J. Davis, *Measuring Economic Policy Uncertainty* (Nat'l Bureau of Econ. Research, Working Paper No. 21633, 2015).

51. *See* Rodrik, *supra* note 48.

52. The idea of economic losers rebuffing (economically) efficient change to preserve rents has a long history in economics and especially in explaining why free trade is not adopted. Raquel Fernandez & Dani Rodrik, *Resistance to Reform—Status Quo Bias in the Presence of Individual Specific Uncertainty*, 81 AM. ECON. REV. 1146 (1991) (showing how uncertainty about the incidence of benefits and costs prevents reform from taking place); Thomas J. Holmes & James A. Schmitz, Jr., *Resistance to New Technology and Trade Between Areas*, 19 FED. RES. BANK MINNEAPOLIS Q. REV. 2 (1995); Sanjay Jain & Sarun W. Mukand, *Redistributive Promises and the Adoption of Economic Reform*, 93 AM. ECON. REV. 256, 257 (2003) ("reforms may still not be enacted. Under individual specific uncertainty about the outcome of reform, the incumbent fears not only that it will turn out to be a loser, but that the new government will be drawn from the ranks of the winners, with no incentive no make compensatory transfers."); Raghuram G. Rajan, *Rent Preservation and the Persistence of Underdevelopment*, 1 AM. ECON. J. MACROECONOMICS 178 (2009) (proposing a model where initial inequalities in endowments divides voters into constituencies with competing interests in different reforms potentially lead to reform paralysis as each constituency protects their own rents). For more detail, including their own contribution regarding how the fear of losing political power influences policy, see Daron Acemoglu, Simon Johnson & James Robinson, *Institutions as a Fundamental Cause of Long-Run Growth*, *in* HANDBOOK OF ECONOMIC GROWTH 385–472 (Phillippe Aghion & Steven N. Durlauf eds., 2005).

53. The most recent data suggests that trade is not only not keeping up with global output growth but has started to decline. The OECD reported in late May 2015 that total merchandise exports and imports, in current U.S. dollars, for the G7 countries and the major emerging economies (Brazil, Russia,

progressively declining and are at historical lows, especially in free-trade areas such as ASEAN, SADC, and others.[54] Instead, those seeking protection turn to standards or quality regulations, local content requirements, government procurement regulations, and other non-tariff barriers.[55]

Increasing non-tariff barriers threaten to reverse trade liberalization—or compromise its impact.[56] This is because they stand to obtain concentrated, immediate, and visible benefits from policy reversals. On the other side of the political ledger, the primary beneficiaries of trade reforms may be unable to adequately articulate the promised gains of the reforms. Moreover, reform supporters may be economically, geographically, and temporally widely

India, Indonesia, China and South Africa) fell by 7.1% and 9.5%, respectively, in the first quarter of 2015 relative to the previous quarter. Bernard Hoekman, *Trade and Growth—End of an Era?*, *in* THE GLOBAL TRADE SLOWDOWN: A NEW NORMAL? 3, 4 (Bernard Hoekman ed., 2015). Hoekman's work contains a discussion of possible explanations for the slowdown in global trade. Chapters 15 and 17 are especially relevant, where contributors appraise the likely influence of domestic protectionism in the reduction of trade. Simon J. Evenett & Johannes Fritz, *Crisis-Era Trade Distortions Cut LDC Export Growth by 5.5% per Annum*, *in* THE GLOBAL TRADE SLOWDOWN: A NEW NORMAL? 267 (Bernard Hoekman ed., 2015); Simon J. Evenett & Johannes Fritz, *'Peak Trade' in the Steel Sector*, *in* THE GLOBAL TRADE SLOWDOWN: A NEW NORMAL? 303 (Bernard Hoekman ed., 2015). The United States has many free trade agreements in place, many with developing economies. Practically all explicitly seek reductions or the elimination altogether of tariffs. *Free Trade Agreements*, OFFICE U.S. TRADE REP., https://ustr.gov/trade-agreements/free-trade-agreements [https://perma.cc/LQZ4-7TN4]. For successful instances of tariff reduction, see SOUTH AFRICAN DEVELOPMENT COMMUNITY, http://www.sadc.int/about-sadc/integration-milestones/free-trade-area/ [https://perma.cc/8EZE-VXG9] (noting that 85% of intra-regional trade amongst the partner states attained zero duty by 2008); *More Import Duties Reduced to 0% under ASEAN Free Trade Agreement*, FED'N MALAY. MANUFACTURERS http://www.fmm.org.my/International_Trade-@-_More_Import_Duties_Reduced_to_0-p_under_ASEAN_Free_Trade_Agreement_%28ITP-s-11-s-2009%29.aspx [https://perma.cc/U4XM-A97J] (hailing the achievement of 0% import duties).

54. *See, e.g.*, Tim Büthe, *The Politics of Market Competition: Trade and Antitrust in a Global Economy*, *in* THE OXFORD HANDBOOK OF THE POLITICAL ECONOMY OF INTERNATIONAL TRADE 213 (Lisa L. Martin ed., 2015). There is theoretical and empirical evidence that argues that trade policy agreements themselves are endogenous; that is to say, they occur, or are accepted as a result, in response to a nation's internal political conditions. *See* Emily Blanchard & Xenia Matschke, *U.S. Multinationals and Preferential Market Access* 1, 1 (Research Papers in Econ. No. 8/10, 2010), http://hdl.handle.net/10419/88669 [https://perma.cc/JL5D-P3JM] (finding that to the extent that governments tailor their commercial policies in response to the interests of constituent industries, differences in the pattern of firm operations across the globe may be reenacted in trade policy).

55. Leidy & Hoekman, *supra* note 37, at 113 ("The idea is that under existing protection or under the prospect of protection resources will be diverted from the production of goods and services to directly unproductive lobbying activity. This either enhances the likelihood of protection, or influences the distribution of intervention-generated revenues among competing interests."); MEHTA, ET. AL., *infra* note 89, at 9–11 ("Market-oriented regulatory reforms, especially competition and regulatory laws, are often viewed with apprehension by most constituencies in developing countries. Even those who are expected to benefit from open markets and competition, in particular consumers and new businesses created after deregulation of previously reserved markets, are reluctant towards reforms due to misinformation or ignorance.").

56. MEHTA, ET. AL., *infra* note 89, at 8 ("Market-oriented regulatory reforms, especially competition and regulatory laws, are often viewed with apprehension by most constituencies in developing countries. Even those who are expected to benefit from open markets and competition, in particular consumers and new businesses created after deregulation of previously reserved markets, are reluctant towards reforms due to misinformation or ignorance.").

dispersed and consequently face severe transaction costs in cooperating to defend their interests.[57]

In most countries, affected parties, including companies, unions, and industries, can seek protection and relief from injury due to imports and other competitive threats in any number of ways. For example, domestic interests can prevent rent erosion by availing themselves of antidumping protocols and other safeguards to have duties placed on imports sold at "less than fair value."[58] They can also solicit preferential treatment from their government via advantageous access to foreign exchange, tax relief, differential pricing schemes, regulatory barriers, subsidies, quotas, and other similar mechanisms.[59] Affected parties may also lobby for domestic currency devaluations, an alternative that would make imports more expensive relative to domestic products.[60]

Many nations presently undergoing reforms have benefited from the presence of historical groups formed along ethnic, regional, filial, tribal, political or economic lines. This collaboration among interwoven sets of keiretsu-like business groups and related institutions is a practice that some scholars refer to as "crony capitalism" or, perhaps more elegantly, as "relationship capitalism."[61] Chinese migrants settling in foreign countries developed and relied on the practice of guanxi, or networks of specially developed relationships. Guanxi has provided a traditional means of managing transactional opportunism thereby reducing search and transaction costs and reduced environmental uncertainty. The practice of guanxi involves drawing on interpersonal, reciprocal relationships

57. *See* John Constantelos, *The Europeanization of Interest Group Politics in Italy: Business Associations in Rome and the Regions*, 11 J. EUR. PUB. POL'Y 1020, 1021 (2004) ("Research shows that state and non-state actors use a variety of subnational, national, and supranational channels to influence EU policy and that multi-level policy networks are developing."); William Easterly & Ross Levine, *Africa's Growth Tragedy: Policies and Ethnic Divisions*, 112 Q.J. ECON. 1203, 1205 (1997) (" . . . cross-country differences in ethnic diversity explain a substantial part of the cross-country differences in public policies, political instability, and other economic factors associated with long-run growth").

58. *See supra* note 50.

59. Doug Bandow, *The First World's Misbegotten Legacy to the Third World*, *in* THE REVOLUTION IN DEVELOPMENT ECONOMICS 213 (James A. Dorn, Steve H. Hanke & Alan A. Walters eds., 1998) ("Intervention took many forms: restrictive licensing of businesses, such as cotton ginneries; tight import regulations; and state monopolies in state exports. The best known export controls involved cocoa, but trade in cotton, palm oil and groundnuts was similarly controlled. Agricultural marketing boards, which invariably offered farmers below market prices for their crops, were a related Western creation. These disruptive measures, which benefited powerful interest groups while impoverishing the great mass of people, were part of the administrative apparatus handed to incoming governments upon independence.").

60. CARLOS D. RAMIREZ, THE POLITICAL ECONOMY OF CURRENCY MANIPULATION BASHING, DEP'T OF ECON., GEORGE MASON UNIVERSITY 1, 4 (2012) (finding that PAC money from groups that supported the enactment of the September 2010 law [for the United States] is by far the most important determinant of China (currency manipulation) bashing).

61. *See* RAGHURAM G. RAJAN & LUIGI ZINGALES, SAVING CAPITALISM FOR THE CAPITALISTS 247–51 (2003); Petruzzella, *infra* note 76, at 3.

either through directly known parties, or indirectly known third parties. The objective of the practice is to minimize business risk.[62]

Extant groups originally may have formed to marshal scarce capital, to overcome the scarcity in administrative and managerial talent and rely on tribal, filial, ethnic, and other similar ties to ensure reputation and minimize the principal–agent problems that bedevil economies in transition.[63] The groups forged the social bonds that constitute the foundation of reciprocity and trust. Economic transactions like exchange and investment require parties to build up trust and other social norms over time, especially in the absence of functioning bodies of contract law and systems of property rights.[64] Trust can be seen as an informal institution based on the prevailing systems of beliefs about the behaviors of others. Trust and other informal institutions lower transactions costs, thereby facilitating exchange and mutual trade.[65] When trust and trustworthiness stem from confidence in community sanctions of norms, principal and agent relations are enforceable without resorting to legal rules and litigation.

Many factors influence the success of group economies. Ethnic economies rise in response to self-imposed boundaries or in response to obvert or subjective constraints established by the dominant societal groups.[66] Among the middleman groups, these constraints compel cooperation, solidarity and the forging of social capital within the group.[67] These group traits and practices enabling trust and

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62. Antony Drew & Anton Kriz, *An Institutional Analysis of Chinese Business Relationships*, 3 INT'L J. VALUE CHAIN MGMT. 356, 367 (2009) ("Responses from all locations indicate that the nature and practice of guanxi is still very malleable and that despite the presence of formal politico-legal institutions, most agreed that they would use guanxi as a source of competitive advantage, particularly in times of scarce resources.").

63. *See e.g.*, Thomas K. Cheng, *How Culture May Change Assumptions in Antitrust Policy*, *in* THE GLOBAL LIMITS OF COMPETITION LAW 205, 205 (D. Daniel Sokol & Ioannis Lianos eds., 2012) (analyzing the effects between culture and antitrust policy); Jong Ki Lee, *Promoting Convergence of Competition Policies in Northeast Asia: Culture-Competition Correlation and Its Implication*, *in* THE GLOBAL LIMITS OF COMPETITION LAW 221 (D. Daniel Sokol & Ioannis Lianos eds., 2012) (discussing the cultural interplay with anti-trust in Northeast Asia); Julian Pena, *The Limits of Competition Law in Latin America*, *in* THE GLOBAL LIMITS OF COMPETITION LAW 236 (D. Daniel Sokol & Ioannis Lianos eds., 2012) (analyzing cultural implications in Latin America); Dwight H. Perkins, *Law, Family Ties, and the East Asian Way of Doing Business*, *in* CULTURE MATTERS: HOW VALUES SHAPE HUMAN PROGRESS 232, 232 (Lawrence E. Harrison & Samuel P. Huntington eds., 2000).

64. ROBERT C. ELLICSKON, ORDER WITHOUT LAW 167 (1991) ("members of a close-knit group develop and maintain norms whose content serves to maximize the aggregate welfare that members obtain in their workaday affairs with one another."); NORTH, *supra* note 31, at 36; Cao, *supra* note 41, at 1059 ("In numerous and diverse countries, these minorities establish an ethnic community by relying on group cohesiveness and homogenous networks to benefit group members.").

65. Arthur Denzau & Douglass North, *Shared Mental Models: Ideologies and Institutions*, 47 KYKLOS 3, 20 (1994).

66. Davis, et. al., *supra* note 42, at 344 ("There are at least two reasons why [invidious discrimination may have contributed to East Indians and other groups' success]. First, discrimination might tend to increase a group's endowment of 'social capital.' Second, if a group faces discrimination – lowering the returns it can expect to earn from one class of activities – the members will find it advantageous to participate in activities in which they face less discrimination.").

67. *Id.* at 345 ("The best-known way in which social capital enhances group wealth is by reducing

cooperation rest on "multiplex networks and norms of reciprocity."[68] These economic institutions facilitate commercial transactions by reducing uncertainty and risk in markets. Groups with a social-capital base of networks, norms, and social trust that facilitate coordination and cooperation for mutual benefit are particularly poised to produce economic capital.

These and other groups assisted the government in administering the former state-led economy by implementing policies, minimizing negotiation, and supplying the necessary group discipline.[69] Firms assembled into collaborative interest groups to overcome limitations in transportation, labor markets, communications, and credit.[70]

Yet, once formed, the same governance structures erect barriers to entry and other mechanisms designed to ensure the preservation of the group's rents largely at the expense of causing higher prices and productive inefficiencies that directly impact consumers.[71]

The emergence of industrial and regional groups—often family-owned—is a direct consequence of the institutions that existed historically. Yet, these institutions persist today. Douglass North observes that informal constraints and norms provide "continuity so that the informal solution to exchange problems in the past carries over into the present and makes those informal constraints important sources of continuity in long-run societal change."[72]

But available commentary ignores the political dimensions of the state's agents. The commentary therefore lacks a clear understanding of the potential pitfalls agencies embrace when challenging non-tariff barriers, especially those sanctioned by other arms of the government, and when failing to account for the beneficial effects of the economic groups. The next part turns to that concern.

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the costs of contracting with in the group. There are a number of forms of social capital that might produce this effect. . . . By providing channels for the transmission of information about past conduct, social networks make it relatively inexpensive for members of the network to screen potential trading partners and to ensure the enforcement of social sanctions for past misconduct. . . . [C]ultural and linguistic factors may make it relatively easy for members of the same ethnic group to assess one another's trustworthiness and to achieve mutual understanding. Finally, trading partners selected from within the same ethnic group may, on average, be more trustworthy than outsiders if group norms discourage opportunistic behavior within the group.").

68. VICTOR NEE & SONJA OPPER, ECONOMIC INSTITUTIONS FROM NETWORKS 1 (Sept. 9, 2014), http://www.economyandsociety.org/wp-content/uploads/2013/07/wp71_NeeOpper_Institutions fromNetworks.pdf [https://perma.cc/M8KW-39GA]. *See also* NORTH, *supra* note 31, at 40.

69. Davis, et. al., *supra* note 42, at 349 ("[T]he regulatory environment is extremely complex in many developing countries. Large, established firms may have an advantage in negotiating thickets of regulation because of their experience and because they can spread the fixed costs of establishing and maintaining political contacts over larger streams of revenue.").

70. Khanna & Palepu, *supra* note 29, at 41 ("Successful groups effectively mediate between their member companies and the rest of the economy.").

71. Davis, et. al., *supra* note 42, at 348 ("If, for some reason, the producers who initially achieve high levels of output are concentrated in one particular ethnic group, the presence of increasing returns to scale will lead to the perpetuation and even enhancement of the group's dominance.").

72. NORTH, *supra* note 31, at 37. *See also* NEE & OPPER, *supra* note 68, at 12.

V
THE COMPETITION POLICY DILEMMA

What is the dilemma? If the competition agency successfully prosecutes the anti-competitive practices of the merchant groups, it is likely to unintentionally destroy or impair a storied and rich source of pro-competitive benefits. There is more. Again, if the competition agency successfully prosecutes the business group practices, it sows the seeds of its own ineffectiveness in the long run. In response to the prosecution, groups are likely to turn to the state and solicit preferential treatment or seek official or implicit immunity from antitrust processes.[73] This would substitute non-tariff barriers and other instances of protectionism for private anti-competitive practices. Given the ease with which protectionist measures are made available, no interest group would seek to create a naked cartel to begin with. Thus, antitrust policy promises the prosecution of private sector activities that hardly exist.

Commentators, including erstwhile avid proponents and supporters of competition policy in transition economies have acknowledged the limited impact enforcement agencies have had. Ignacio De Leon recently stated:

> [T]he empirical evidence gathered after two decades of inception in developing countries shows that competition policy implementation is far from being successful in many developing countries. Some competition authorities appear to be making progress in defining a sound policy agenda and displaying a strong commitment towards the development of a level playing field; whereas others, after a promising start, seem to have faded into oblivion or struggling their way through.[74]

And former President of the Portuguese Competition Authority Abel Mateus stated:

> The following factors restrict the effectiveness of a competition enforcement regime: (1) vested interests that dominate economic policy making, either through legal means (party financing, lobbying, influence in the nomination of the government, senior officials, or the council of the national competition authority (NCA) or illegal means (corruption, abuse of public service power, or cronyism); (2) inefficient public administration and regulatory systems that limit the capacity and effectiveness of public

73. UNITED NATIONS CONF. ON TRADE & DEV., *supra* note 35, at 11 (". . . various businesses are likely to be still unaware of the potential impact that competition law can have on their economic activities, and lobbying for exclusions from the application of competition law may yet take place. Indeed, casual observation suggests that in more advanced industrial countries, exemptions granted from competition law have generally tended to evolve and expand over time because of specific issues and cases confronted in the application of the law, and the resulting lobbying by business.").

74. Ignacio De Leon, *What are the Relevant Features for Assessing Economic Competition in Developing Countries?* 1 (Nov. 1, 2012), http://ssrn.com/abstract=2169905 [https://perma.cc/2BSH-JSMP]. De Leon's soul-searching is telling because he is among the most influential practitioners and commentators in the field of international competition policy; he is not only an experienced antitrust practitioner himself—having led the Venezuelan Competition agency in its early days—but as an independent consultant De Leon has actively provided training and support for countless competition agencies around the world, ranging from Kazakhstan to the Dominican Republic. Importantly, his extensive writings and commentary on the topic alone distinguishes him as an important voice in these debates.

> bodies, including the NCA; and (3) inefficient judicial systems that preclude the sanctioning of violation of the competition law.[75]

Giovanni Petruzzella, head of the Italian competition authority, characterizes the presence and influence of these business conglomerates in Italy and describes a general difficulty:

> The target of this current of thought is crony capitalism, which in Italy is called relationship capitalism. The latter is based on the interweaving of few big economic powers, on their relationships with the political and administrative powers, on the research of "situational rents". Crony capitalism is based on privileges, rather than on merits; it worsens inequalities, it makes society closed, static, not very much open to competition and innovation. Likewise, it sacrifices individuals' ambition of being able to improve their social position exclusively owing to their merits. Therefore, it prejudices the particular form of equality which is equality of opportunities. These tendencies, in Countries such as Italy, have favored the expansion of an unproductive and inefficient public expenditure, as regards some of its components, aimed at satisfying particularistic interests of lobbies and of rent seekers. Also this has contributed in creating the enormous public debt which constitutes a big obstacle for economic growth and an unfair burden on the new generations.[76]

And from the World Bank's Competition Policy Team: Anti-cartel enforcement continues to be a challenge in developing countries where government policies still facilitate the creation and sustainability of cartel behavior among firms.[77]

The World Bank commentators diagnose the problem as an operational one, arguing that the implementation and enforcement practices have been ineffective. And they recommend doubling-down on deterrence practices, removing exemptions, improving and enhancing investigating powers, and other direct enforcement tools.[78]

These recommendations are misguided and shortsighted. But they are entirely reasonable if it is assumed that the challenged narrow practices serve only the private interests of the business or interest group—and have only anti-competitive consequences. The implicit frame guiding the prosecutorial effort is that the social, political, and economic context in which the enforcement machinery is introduced resembles the one prevalent in western economies.

Interest groups choose whether to obtain anti-competitive rents from cartelization, seek favors from the state, or, more likely, both. Interest groups will choose the combination of private collusion and government protection that

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75. Abel Mateus, *supra* note 10, at 115–16.

76. Giovanni Petruzzella, Presentation of the Competition Authority's Annual Report, 1 IT. ANTITRUST REV., no. 2, 2014, at 1, 3.

77. *See* GRACIELA MIRALLES-MURCIEGO, CARTEL EXEMPTIONS IN DEVELOPING COUNTRIES: RECENT WORK FROM THE WORLD BANK GROUP (Sept. 2, 2013), https://www.competitionpolicyinternational.com/assets/Uploads/CartelSeptember2.pdf [https://perma.cc/QD3U-VMKF]. *See also* EUGENIO RIVERA & CLAUDIA SCHATAN, LOS MERCADOS EN EL ISTMO CENTROAMERICANO Y MEXICO, QUE HA PASADO CON LA COMPETENCIA? (2006).

78. *See* MIRALLES-MURCIEGO, *supra* note 77. *See also* Martha Licetti-Martinez, *Combining Cartels in Developing Countries: Implementation Challenges on the Ground*, COMPETITION POL'Y INT'L (Sept. 27, 2013), http://ssrn.com/abstract=2345402 [https://perma.cc/QD3U-VMKF].

maximizes their narrow expected benefits derived from the state's involvement. Rent-maximizing interest groups will devote resources to cartelization and government influence based on the relative costs of the two activities.

The level of benefits obtained by the interest group increases in both the amounts of rent-seeking and cartelization efforts the group undertakes. For any given budget or level of resources, the group prefers more benefit to less. Thus, a group will choose its level of activity devoted to cartelization and lobbying at the point at which their incremental costs approximate their benefits.

If an antitrust agency is established and actively and credibly sets out to enforce proscribed practices, the unit price of cartelization efforts rises. Obviously, economies of scale and scope in political influence may cause different firms to face different relative prices for particular resources. However, as the costs of cartelization rise relative to rent-seeking, at the margin the interest group will seek more rent through government protection and this correspondingly reduces their efforts toward private cartelization.

Thus, the establishment of an antitrust regime may, in response to this demand, cause an increase in the availability of other forms of government protection. If the activities of an antitrust agency only make it more difficult to cartelize privately, the special-interest group is worse off than it was before. It will reduce its private collaboration efforts, but will shift resources into monopolization gained through government protection.

VI

THE TYRANNY OF BEST PRACTICES AND OTHER CONCLUDING COMMENTS

The underwhelming performance of the highly heralded competition policy programs in developing countries may be a result of the perplexing deployment of programs that are best at focusing on violations of narrow horizontal proscriptions—that is, violations by naked, private cartels. In developing economies this is a target that is hardly ever present. However, if antitrust is to ascend in influence over time, it should nonetheless, tenaciously continue to focus solely on horizontal, per se proscriptions. Deployed in its full majesty, antitrust can be counterproductive and impair growth.

The model that has been adopted by many economies alongside pro-market liberalization and reform is a program based on the economic efficiency, consumer-welfare maximizing approach common to western economies.[79] This "best practices" approach may recognize—and expect—that powerful industry

79. INT'L COMPETITION NETWORK, REPORT ON THE OBJECTIVES OF UNILATERAL CONDUCT LAWS, ASSESSMENT OF DOMINANCE/SUBSTANTIAL MARKET POWER, AND STATE-CREATED MONOPOLIES 5 (2007) ("Two of these nine objectives – the promotion of consumer welfare and the maximization of efficiency – were identified by the vast majority of ICN member respondents."); Dina I. Waked, *Antitrust Goals in Developing Countries: Policy Alternatives and Normative Choices*, 38 SEATTLE U.L. REV. 945, 952 (2015) ("A consumer welfare standard to guide antitrust policy defines the mainstream today. It is the most widespread welfare criterion pronounced in developed countries' antitrust laws and case law, and it is also the standard most widely replicated by developing countries.").

groups, which stand in opposition to reform, do so out of a natural desire to protect their historical monopoly rents. But it fails to recognize that these groups also constitute surviving institutional organizations capable of overcoming historical resource limits and institutional constraints. These are entities that convey substantive, and often pro-competitive, benefits to the proper functioning and stability of the state.

The competition agencies' conventional analytical tool box is incapable of understanding the role and relevance of the array of historical transactions costs and other difficulties that led to the formation of groups. And it is hard-pressed to appraise their value, let alone the tradeoffs incurred in the removal of anti-competitive costs against the historical pro-competitive benefits.

The dual contribution imparted by interest groups and the ability and ease of substitution between private cartels and state-backed protective measures suggest the following hypothesis: the equilibrium level of antitrust enforcement in developing economies is likely to be much more modest than those in developed economies. Relatedly, the equilibrium level of antitrust enforcement is likely lower in nations where the influence of immigrant, political, regional, or ethnic group-controlled businesses looms large.

Yet to the extent that this understanding of the dual nature of groups is disregarded and their relevance ignored, then, by extension, one would expect to find an observed increase over time in non-tariff barriers, protective regulations, and other similar protectionist measures or outright exemptions from the antitrust laws as interest groups lobby successfully to obtain preferential treatment to counter the pressures of competition and competition agency enforcement actions. Two more outcomes would also be expected. First: antitrust is likely to turn—over time—to targeting the vulnerable, the politically unprotected, and the economically unimportant—the local hot-dog vendor.[80] And second: the competition agency will be deliberately underfunded to curtail its reach.[81]

80. R.A. EPSTEIN, SIMPLE RULES FOR A COMPLEX WORLD 126 (1995) ("[I]t should never be assumed that any ideal antitrust policy will survive unscathed the hurly-burly pressures of a political environment, in which the incentives for individual actors often cut at cross-purposes with the one sensible objective of an antitrust law. Quite simply, it is too easy in a political setting to forge an antitrust law that is more intent on protecting the position of marginal competitors than on ensuring the preservation of open markets."). In an instance of the "hot-dog vendor effect" the antitrust agency of Panama—known as the CliCac (Comision de Libre Competencia y Asuntos del Consumidor; Free trade and Consumer Affairs Commission)—once came down harshly against the Panama City association of private high schools citing the practice of compelling students to buy uniforms from the same retail outlet as an anti-competitive practice; the agency investigated but ultimately brought no charges. *See* Acalorada discusión entre CLICAC y representantes de colegios privados, EL PANAMA AMERICA (Oct. 22, 1999) http://portal.critica.com.pa/archivo/102899/nac6.html [https://perma.cc/E8J9-LCZJ].

81. *See* Mateus, *supra* note 10, at 136 (finding that "countries around the world, including a substantial number of developed countries, have not provided, have not provide enough resources for their national competition authorities to fulfill their basic duties").

Still, despite the limited numbers of prospective targets, prohibitions on price-fixing activities enforced on a per se standard should constitute the core antitrust policy of a program in its early stages. Remedies should not vindicate underperforming existing competition policy programs. Reforms that would convert the enforcement agencies into useful policy tools of economic growth would effectively render the result a competition policy unrecognizable to anyone familiar with its inception elsewhere in the developed world.

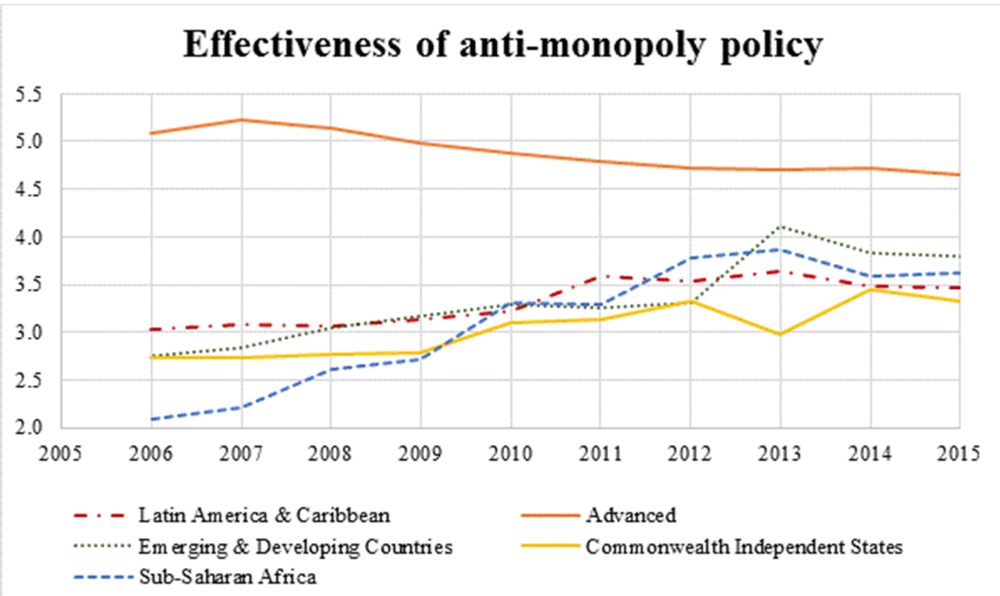
Similarly, a focus on fostering trade and entrepreneurship by eliminating regulatory barriers, what is known in the trade as competition advocacy, is a toothless endeavor. Agencies have little popular and political support or even appeal for speaking out against non-tariff barriers. These activities are better discharged by independent think tanks, academics, and pro-market private interest groups.

APPENDIX

COMPETITION POLICY PERFORMANCE

The Anti-monopoly performance index published by the World Economic Forum's Global Competitiveness Report (GCR) is a widely cited performance metric. The latest compilation provides a visual representation of agency performance across regional groupings over the last decade.[82] The GCR surveys businessmen to rate the effectiveness of the antitrust policy in their particular country, asking them to rate "antimonopoly" policy on a Likert scale; where 1 represents an antimonopoly policy that "does not promote competition" to a 7, where antimonopoly policy "effectively promotes competition."[83] The memberships of the groupings in the chart are assembled by the GCR.

Figure 1



The observed time trend suggests improvement across all groups and considerable improvement in the performance of the agencies in sub-Saharan Africa. This article attempts to explain this gap. And the initial visual examination of the data is consistent with our argument: that the equilibrium level of antitrust will be lower in developing economies. However, it is difficult

82. *See* WORLD ECON. F., THE GLOBAL COMPETITIVENESS REPORT 2014–2015 (2014), http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2014-15.pdf [https://perma.cc/V35A-CUU4].

83. *Id.* at 468.

to be certain based on this data alone.

The practice of using perception-based surveys either individually or as an input into a composite measure, has raised concerns.[84] Among these are questions about the basic validity of the surveys, inter-rater reliability and sensitivity to external biases as well as to the inferences drawn.[85] Concerns have been raised as to raters' understanding of antitrust and especially the goals of antitrust because antitrust is a novelty in many developing countries.[86] Concerns have been raised about raters' susceptibility to cognitive biases, such as halo and devil effects, vividness, and recency.[87]

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84. *See* CHRISTINE ARNDT & CHARLES OMAN, USES AND ABUSES OF GOVERNMENT INDICATORS, (2006), http://www.la.utexas.edu/users/chenry/polec/2006/oecd/AE795835C8392A811 1572211048C64BBAF3DA2573E.pdf [https://perma.cc/X42A-NWXQ]; DANI RODRIK, GETTING INSTITUTIONS RIGHT 6 (2004) ("The manner in which institutional quality is measured in the empirical literature that is discussed above leaves a lot of questions unanswered."), http://drodrik.scholar.harvard.edu/files/dani-rodrik/files/getting-institutions-right.pdf [https://perma.cc/XX2C-FGD5]; STEVEN VAN DE WALLE, MEASURING BUREAUCRATIC QUALITY IN GOVERNANCE INDICATORS 7 (2005) ("The World Bank Governance indicators dataset is one of the most complete datasets to assess the quality of governance. Many of its composing indicators, however, are of a subjective nature, and therefore do not necessarily present us with a correct picture."), http://pmranet.org/conferences/USC2005/USC2005papers/pmra.vandewalle.2005.pdf; Stephen Knack, *The Worldwide Governance Indicators: Six, One, or None?*, 46 J. DEV. STUD. 350, 351 (2010) ("There is little if any evidence on the concept validity of the six WGI indexes."); Marcus J. Kurtz & Andrew Schrank, *Growth and Governance: Models, Measures, and Mechanisms*, 69 J. POL. 538, 538 (2007) ("Our results suggest that the dominant measures of governance are problematic, suffering from perceptual biases, adverse selection in sampling, and conceptual conflation with economic policy choices."); Marcus J. Kurtz & Andrew Schrank, *Growth and Governance: a Defense*, 69 J. POL. 563, 565 (2007) ("We maintain that perception-based indicators of governance in general, and the KKM indicator of GE in particular, are overly dependent on the impressions of businesspeople."); Laura Langbein & M.A. Thomas, WHAT DO THE WORLDWIDE GOVERNANCE INDICATORS MEASURE? (2006), http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.590.3190&rep=rep1&type=pdf [https://perma.cc/3U2M-D9AQ]; Stephen Knack, *Measuring Corruption in Eastern Europe and Central Asia: A Critique of the Cross-Country Indicators* (World Bank Pol'y Res. Working Paper No. 3968, 2006), http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-3968 [https://perma.cc/9CWM-3AA9].

85. ARNDT & OMAN, *supra* note 84; RODRICK, *supra* note 84, VAN DE WALLE, *supra* note 84; Knack, *supra* note 84; Kurtz & Schrank, *Models, Measures, and Mechanisms*, *supra* note 84; Kurtz & Schrank, *Defense*, *supra* note 84; Langbein & Thomas, *supra* note 84.

86. For example, some developing world GCR survey businessmen respondents feel that competition in the form of foreign direct investment or foreign entry often arrives relying on below-cost pricing. A variant of the oft-discussed "Wal-Mart effect," this practice is routinely labeled, pejoratively, as predatory pricing. It is believed that the new competitor is pricing its products below cost in a calculated effort to take market share, drive local firms out of business, or both. A "challenge" by the anti-monopoly office would therefore elicit "good marks" by someone holding that view. Others, more comfortable with the conventional view of predatory practices, will recognize the agency's action as political and protectionist—and would assign a "negative mark" to the agency's performance.

87. Individuals are likely to recall recent newspaper headlines or prior mental schemas to aid or assist decisionmaking. News coverage likely reflects the media's tendency to call attention to unusual or infrequent events. Thus, if survey respondents are asked to appraise the performance of the competition office, they may assess the parallels or similarities between the competition agency and a particular government agency (not necessarily the competition agency) caught up in a recent corruption scandal, for example. Or they may recall headlines in the local news media recounting a recent or ongoing EU or American antitrust investigation and combine it with their understanding of what "competition policy" or "protecting competition" entails. Perception of the "facts" is often distorted by the most available,

Individual agency performance scores are routinely compared to average regional scores[88] or income groupings. But such comparisons make no sense statistically. Implicit in the construction and usage of these indexes as performance yardsticks is a perception that the difference between 2 and 3 means the same thing as the difference between 5 and 6. They also assume that a rating of 3 means the same thing to different raters and to raters in different countries. They also imply that the competition programs are similar across nations and are therefore commensurable.

This is not necessarily the case. Some agencies benefit from more experienced staff at different stages of its development, or a considerably different budget. The nature of the interaction between the different agency leadership and staff and its domestic constituencies vary: some operate in a hostile environment; others in one less so. Some competition programs have narrow policy objectives. Others have many policy outcomes that may matter much more, reflecting dimensions of governance such as a government's commitment to: growth and democracy as a political objective; fostering conditions for successful entrepreneurship; enlarging the pool of managerial talent; addressing abject poverty; eliminating or reducing discrimination in all forms; and redressing inequality.[89] The assessment score of the performance of an agency acting on the basis of violations of efficiency considerations cannot be the same assessment when an agency is challenging a practice aimed at reducing racial inequality. Thus, although it is not clear how one can establish fair comparisons across agencies when the policy outcomes vary, it is clear that the task is an impossible one via GCR-style surveys.

There are statistical pitfalls as well. The GCR scores are ordinal categories of performance—a ranking from 1 to 7. But the numbers are simple descriptors or labels of a particular category that is often arbitrary and subjective in its

most recent or most vivid information. This piggy-backing on our innate "pattern-matching" processes is an example of the "availability" heuristic. The problem arises when our use of the heuristic results in a biased appraisal of the agency's actual performance. If the resulting association is a positive one, it is considered a halo effect, in which the agency benefits from good press or good recall of a noteworthy case. Conversely, a negative association such as inferring or presuming that agency officials are corrupt only because corruption is endemic in the other administrative agencies of the government is a bias of obvious negative effects, a devil effect.

88. *See, e.g.*, Figure 1.

89. INT'L COMPETITION NETWORK, *supra* note 79 ("Respondents identified ten different objectives of unilateral conduct laws, regulations, and policies, with all but one member agency identifying more than one objective as relevant to their unilateral conduct regimes. As detailed in Annex A to the Report, these objectives (listed in order of the number of times cited by respondents) include: ensuring an effective competitive process; promoting consumer welfare; maximizing efficiency; ensuring economic freedom; ensuring a level playing field for small and medium size enterprises; promoting fairness and equality; promoting consumer choice; achieving market integration; facilitating privatization and market liberalization; and promoting competitiveness in international markets."). PRADEEP S. MEHTA, ET. AL, POLITICS TRUMPS ECONOMICS – LESSONS AND EXPERIENCES ON COMPETITION AND REGULATORY REGIMES FROM DEVELOPING COUNTRIES (2007). *See also* De Leon, *supra* note 74, at 23; RODRIGUEZ & MENON, *supra* note 3, at 84.

construction. Aside from revealing a natural order to the ranking, the labels do not represent values.

Consider the following example by way of explanation. Suppose that instead of a numeric scale, the scale was from A to G, where A is considered the best performer. How would one find the average of the following ascribed scores: {A, A, C, D, E, A, G, B}? It is impossible. Suppose that the scale were not a 7-category scale A to G but rather, a 3-category scale A to C. The scores would be then be: {A, A, C, C, C, A, C, B}. One would still be unable to find the average. But one would also obtain entirely different performance outcomes. For example, the fourth nation in the ordering would be ranked below the third nation in the 7-category scale; but they would be equally ranked in the 3-category scale.

In addition, setting aside the difficulties with ordinal categories, an understanding of the variation in agency performance matters. Without knowledge of the distribution of the scores it is impossible to determine whether differences in performance between an agency and the regional or income-group average are meaningful. Statistical significance is the coin of the realm when appraising the meaningfulness of differences.