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SYMPOSIUM ARTICLES[†]

A PROPOSAL FOR A NEW COMPETITION POLICY IN LATIN AMERICA

*Ignacio De León**

I. WHY DO WE NEED A NEW POLICY FOR THE PROMOTION OF COMPETITION IN LATIN AMERICA?

Antitrust policy is currently being acknowledged as the optimal policy of the "second generation" of institutional reforms for developing competition in Latin America. However, those who support the policy take this claim too lightly. Little discussion has taken place on the goals that the policy should seek in the region, and indeed, on the convenience of the policy itself.

Specifically, the discussion about the goals of antitrust normally spins around the optimal resource allocation that its enforcement should accomplish. Some authors think that economic efficiency (most often, in the sense of Pareto) is the "right" goal to accomplish; thus antitrust policy should protect consumer welfare above all.¹ In essence, these scholars would advocate a kind of competition policy that forbids cartels and horizontal restraints, whereas they would propose a more lenient attitude towards other market restrictions. Others think that antitrust policy conveys a political appraisal and therefore, active prosecution should be taken in favor of small and medium firms competing in the market regardless of their

[†] These articles are based on presentations at the Second Annual Latin American Competition and Trade Round Table at the University of Miami Law School at Coral Gables.

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1. See, e.g., ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY OF WAR WITH ITSELF* 82-89 (1978).

efficiency. The focus of enforcement should therefore be on the "market structures" that limit competition, most often found in concentrated markets, as well as in those markets featured by the presence of "dominant" firms.

However, regardless of the particular social welfare goal sought, these appraisals suffer from the same shortcoming: they all measure the success of the policy in terms of its capacity to achieve a desired market allocation. Consequently, they do not question whether such resource allocation is identifiable by antitrust authorities, or indeed, whether it is desirable at all. This Article contends that it is futile to identify "predetermined" market outcomes as a basis for designing regulatory policies such as antitrust. Markets evolve according to ends that are not sought by anyone; therefore, they cannot be construed according to the particular goals shared by some authority. It does not matter whether such authority represents some political will embodied in a particular "social welfare goal" such as Pareto efficiency or any other. Markets do not fulfill anybody's aims, as they integrate the desires and needs of a plurality of individuals, each seeking their own ends and goals.

In fact, the important question is whether seeking a particular goal hampers the process that characterizes market functioning. This Article explores the reasons why conventional regulation focused on a variant of social resource allocation such as antitrust policy is unfit to address the dynamics of market functioning.

To understand these issues, this Article examines the conventional setting where ideas about markets and firms flourished, giving antitrust law and policy its theoretical foundations. Antitrust principles emerged out of a self-contained idea of markets where the social observer has all the relevant information necessary to achieve "social optimum." Next, it emphasizes the epistemological flaws of this perspective, by underlining the subjective and evolutionary essence of entrepreneurial knowledge about markets. These shortcomings pave the way for formulating an alternative perspective of markets grounded on evolution and change. Using this perspective, it then examines market arrangements currently regarded as "restrictive," particularly in the wake of the experience of Latin America's recent institutional reforms (*apertura*). Last, it identifies a set of guidelines to consider in drafting an alternative

competition policy for the region, based on the protection of individual rights and institutional transparency.

II. THE ROLE OF PARADIGMS IN SOCIAL SCIENCE: THE EPISTEMOLOGICAL LIMITATIONS OF ANTITRUST THEORY

It is important to realize that in social sciences the search for scientific truth is not impartial, but conventional. Alfred Eichner explains that "scientific truth" in social sciences (i.e., economics) is determined by the particular "epistemology" chosen, which is comprised by a particular set of conventions telling how to seize "knowledge"—what is "true" and what is "false."² As Thomas Kuhn argues, the search for "scientific truth" is not an impartial quest for ascertaining "objective truth."³ Rather, the scientific community behaves as "a political community seeking to impose order."⁴ Antitrust law and policy is rooted in the "neo-classical" economic paradigm that has dominated the landscape of economic theory since the formalist revolution of the 1930s.⁵ This conventional appraisal, which may well be called "mainstream," depicts firms and markets as separate and closed-ended entities unconnected with each other. This revolution in economic theory led economists to change their prior appraisal of markets and firms, and to visualize them henceforth through mathematical models of equilibrium.⁶

In this conventional view, markets are seen as conveying the forces of demand and supply. These forces eventually converge into a point of static equilibrium, where market allocation is optimal, and markets rest at perfect competition. Other markets may not be in equilibrium, but they are examined in reference to it, as being closer or more distant from this "ideal" state. Therefore, they are visualized as self-contained entities,

2. Alfred S. Eichner, *Why Economics is Not Yet a Science*, in *WHY ECONOMICS IS NOT YET A SCIENCE* 205, 206 (Alfred S. Eichner ed., 1983).

3. THOMAS S. KUHN, *THE STRUCTURE OF SCIENTIFIC REVOLUTIONS* (2d ed. 1970).

4. MARTIN LOUGHLIN, *PUBLIC LAW AND POLITICAL THEORY* 32 (1992).

5. See Peter J. Boettke, *Where Did Economics Go Wrong? Equilibrium as a Flight from Reality*, 11 *CRITICAL REV.* 11, 16 (1997).

6. For information about the formalist revolution of neo-classical thinking and its effects on economic theory, see FRANK M. MACHOVEC, *PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMICS* 161 (1995). See also Boettke, *supra* note 5, at 17.

where forces are examined through the eyes of an omniscient social observer who knows all the relevant information and the social goals to be achieved.

The use of equilibrium as a heuristic tool of analysis has numerous caveats which cast doubt on its usefulness as an instrument for understanding how markets function properly. Unfortunately, these limitations have often been left aside by scholars, who have shown an immoderate tendency for avoiding questioning mainstream economic analysis at its very heart. Perhaps the most important of these shortcomings is the lack of realism that equilibrium introduces into economic analysis. This lack of realism is not addressed by the conventional positive method, which is more interested in predicting unknown future market outcomes than explaining past economic causalities. It should be remembered that Milton Friedman's analysis disregarded the truth of the assumptions upon which a given theory is grounded as a basis for ascertaining scientific truth in social sciences in general, and in economics in particular.⁷ Hence, a theory is useful, and its conclusions accurate, as long as it is capable of giving better predictions as evidenced through empirical evidence.⁸

Unfortunately, *this particular way of approaching market causalities* does not consider that human beings do not behave according to regular patterns. As Isaiah Berlin stressed, human beings (whose interaction constitutes the subject matter of the social sciences) are self-interpreting creatures: "Men's beliefs in the sphere of conduct are part of their conception of themselves and others as human beings; and this conception in its turn, whether conscious or not, is intrinsic to their picture of the world."⁹ Hence, their appraisal of reality tends to be biased by their particular beliefs and thoughts. For the same

7. Friedman argues that it is irrelevant whether the assumptions of positive models are real or fictitious; what is relevant is that they can provide us with proper predictions of what would happen in reality if other conditions remained constant. The purpose of positive models is not to depict reality as it is, but to create a tool to understand how individuals behave "as if" certain forces are guiding their action. In other words, they are nothing but models, which were never intended to become normative references for measuring reality. See MILTON FRIEDMAN, *The Methodology of Positive Economics*, in *ESSAYS IN POSITIVE ECONOMICS* 3, 40-41 (1953).

8. See *id.*

9. Isaiah Berlin, *Does Political Theory Still Exist?*, in *PHILOSOPHY, POLITICS AND SOCIETY* 1, 13 (Peter Laslett & W. G. Runciman eds., 1962).

reason, it is impossible to know exactly when in the evolutionary process of reality the analyst should focus his attention in an attempt to draw meaningful conclusions from empirical evidence gathered from such reality.¹⁰

Markets are comprised by the interaction of people; thus, their substratum is provided by the thoughts and beliefs (i.e., knowledge) of such people, rather than by empirical objective data (i.e., information). Therefore, any analysis of such processes must be suited to this particular setting, which is far from objective, static or predictable.

Examining markets through "equilibrium" (or in terms of how distant reality is from it) is insufficient to understand their nature. To ensure the validity of the knowledge gained through a given theory, it is necessary that the latter retains at least one connection with observable reality. Unfortunately, due to the equilibrium perspective, conventional mainstream theories about markets and competition disregard this essential condition.

In his pioneering work *Information and Investment*, G. B. Richardson touches upon this essential limitation.¹¹ Richard-

10. In the words of Lachmann:

[H]ow can a system of pure logic, like that of the logic of choice [characterizing market phenomena], provide factual knowledge? The answer follows from the essence of my thesis: the distinction between logic and factual knowledge is justified in the realm of nature, where no meaning is directly accessible to us, and in which care must thus constantly be taken to distinguish between our concepts and reality. In the realm of human action it is different. Here such a distinction seems unjustified. On the one hand we are unable to verify or falsify our schemes of thought as hypotheses by predicting concrete events. Scientific tests are not available to us since they require a complete description of that concrete "starting position" in which the test is to take place. Every human action, however, depends on the state of knowledge of the actors. A verification test therefore would require an exhaustive description of the state of knowledge of all actors, also according to the mode of distribution—an obvious impossibility. Otherwise, however, the starting position is not exactly defined, and no real test is possible.

In economics this means that every concrete transaction depends, among other things, on the expectations of the participants. To test an economic theory *in concreto*, we must, then, be able, at the point of time of theory formulation, to predict the expectations of economic agents at the (future) point of time of the verification test.

Ludwig M. Lachmann, *The Significance of the Austrian School of Economics in the History of Ideas*, in CAPITAL, EXPECTATIONS, AND THE MARKET PROCESS: ESSAYS ON THE THEORY OF THE MARKET ECONOMY 45, 57-58 (Walter E. Grinder ed., 1977).

11. G. B. RICHARDSON, INFORMATION AND INVESTMENT: A STUDY IN THE WORK-

son emphasizes how the premises which prevail under equilibrium are indeed inconsistent with the conditions that should prevail in order to reach such a state.¹² The models simply assume that equilibrium is "there," already achieved within the model by perfectly informed entrepreneurs.¹³ It does not tell how imperfectly informed entrepreneurs conduct themselves in order to gather such information, thus pushing the economic system into a position of equilibrium.¹⁴

Indeed, markets evolve, since knowledge held by its participants changes; they are not predictable settings that a social observer can direct towards definite ends. For this reason, viewing reality as existing in equilibrium diverts the attention of the analyst from the very problem faced by society, which is after all *the* essential trait of reality, namely, what individuals do to achieve equilibrium. As Richardson argues:

[B]y neglecting the whole problem of information, the perfect competition model condemns itself not only to unrealism but to inadequacy even as a hypothetical system. It is no defense to appeal, moreover, to the analogy of mechanical statics which, though neglecting friction, can still identify the equilibrium position of a system of forces, for we cannot demonstrate that economic systems have such positions of rest without reference to expectations and information which could not be presumed to be available in the absence of restraints.¹⁵

By examining reality under the lens of an equilibrium analysis, mainstream theories inevitably avoid the problem of how individuals reach equilibrium, which is simply assumed.

As a result, mainstream scholars developed competing hypotheses about why markets have shifted away from equilibrium. Markets were not in equilibrium because they were "concentrated," because entrepreneurs "created" entry barriers to other entrepreneurs, had "monopolistic" intentions, and the like. Consequently, the explanation (i.e., why observed markets were not in equilibrium) was regarded to be the explanation of

ING OF THE COMPETITIVE ECONOMY (1960).

12. *Id.* at 1, 4.

13. *See id.* at 4.

14. *See id.* at Preface.

15. *Id.* at 69.

the causalities itself.

No one explained market causalities or how individuals interacted in their real transactions. Not surprisingly, under conventional economic appraisal "[t]here is not one model, not one argument in economic theory, which—when taking into account entrepreneurship, innovations, and chance—would relate structure to performance and anti-competitive conduct, and which, in particular, would suggest viewing with suspicion even a persistent positive correlation between 'profits' and concentration."¹⁶ It is clear that there is no such thing as a unique economic theory explaining what conduct is anticompetitive and why, because of this "shrill cacophony of divergent opinion[s]."¹⁷

More importantly, in the realm of antitrust theory, equilibrium misleads the social observer into making normative conclusions about the way in which markets *should be* organized. Achieving equilibrium thus became crucial to the normative appraisal of the notion of market competition. If the appropriate conditions of equilibrium hold (i.e., perfect information, decentralized markets, many buyers and sellers) the market mechanism yields the best possible welfare results. As Boettke explains, this created the setting for the "market failure" logic, because "[u]nless the strict conditions required for general competitive equilibrium were met, the economic theorist could not, with any confidence, make pronouncements about the efficiency of market allocations. In fact, she could be confident that the market would yield suboptimal results that demanded corrective government action."¹⁸

In light of these limitations, one wonders whether the conventional equilibrium heuristics are capable of delivering meaningful explanations about the way markets function, and about their by-products: competition, innovation, entrepreneurship, and so on. Perhaps, as Stigler contends: "The limitations of [mainstream economics] in dealing with conditions of persistent and imperfectly predicted change will not be removed

16. Reuven Brenner, *Market Power: Innovations and Anti-trust*, in *THE LAW AND ECONOMICS OF COMPETITION POLICY* 179, 196 (Frank Mathewson et al. eds., 1990).

17. WALTER ADAMS & JAMES W. BROCK, *ANTITRUST ECONOMICS ON TRIAL: A DIALOGUE ON THE NEW LAISSEZ-FAIRE* xi (1991).

18. Boettke, *supra* note 5, at 20.

until economics possesses a developed theory of change."¹⁹

Such a theory of change has begun to emerge in the writings of an increasing group of economists and social scientists that belong to an emerging trend of scholars who are more interested in the effects of disequilibrium, evolution and change on the creation of social rules, institutions and organizations.²⁰ Such a scientific project involves several explanations on the behavior of firms, currently known as "market process" theories.²¹ These theories are based upon the evolutionary, post-Marshallian and Austrian schools of economic theory in the field of industrial organization, market theory, and the theory of the firm.²²

In the context of market analysis, which is the key to formulating an alternative competition policy to conventional antitrust policy, they consider firms as evolving entities of unpredictable boundaries, which enter into cooperation arrangements with other firms to achieve productive purposes.²³ Individuals act on their expectations, which can be either reinforced or eroded by the prevailing institutional (formal and informal) setting. Hence, entrepreneurs will seek to develop means to reinforce these expectations. They may observe what patterns characterize business relationships in a given market; they may develop contractual bonds with other entrepreneurs, or simply acquire stock for ensuring a relationship with suppliers or distributors firms regarded as "strategic." They may develop a reputation, which reinforces a pattern of behavior from clients and customers, etc.

These links are important because they will provide the necessary assurance that productive investments can be undertaken without a significant degree of loss. Investment decisions made today determine the level of future production outputs. From the perspective of the social observer these business

19. George J. Stigler, *Competition*, in 1 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 531, 535 (John Eatwell et al. eds., 1987).

20. For a summary of the literature on evolutionary economics, post-Marshallian and Austrian schools of economics, see Nicolai J. Foss, *Austrian and Post-Marshallian Economics: The Bridging Work of George Richardson*, in ECONOMIC ORGANIZATION, CAPABILITIES AND CO-ORDINATION: ESSAYS IN HONOUR OF G. B. RICHARDSON 138 (Nicolai J. Foss & Brian J. Loasby eds., 1998).

21. See *id.* at 140, 143-44.

22. See *id.* at 143-44.

23. See *id.* at 151.

decisions may be "right" or "wrong," but at the micro level entrepreneurs can reduce the likelihood of errors by constraining the expected behavior and independence of action of other entrepreneurs. Obviously, in the conventional framework of equilibrium, this conduct always appears as departing from "equilibrium," or as keeping markets away from it. However, under an alternative perspective characterized by evolving relationships and an uncertain future, they may represent the only way out of sheer uncertainty. Thus, they may be crucial for producing investments.

Joseph Schumpeter clearly saw this problem in the analysis of regulators toward markets:

First, since we are dealing with a process whose every element takes considerable time in revealing its true features and ultimate effects, there is no point in appraising the performance of that process *ex visu* of a given point of time; we must judge its performance over time, as it unfolds through decades or centuries

Second, since we are dealing with an organic process, analysis of what happens in any particular part of it—say, in an individual concern or industry—may indeed clarify details of mechanism but is inconclusive beyond that. Every piece of business strategy acquires its true significance only against the background of that process and within the situation created by it. It must be seen in its role in the perennial gale of creative destruction; it cannot be understood irrespective of it or, in fact, on the hypothesis that there is a perennial lull.²⁴

For this reason:

[Antitrust] economists who, *ex visu* of a point of time, look for example at the behavior of an oligopolist industry . . . and observe the well-known moves and countermoves within it that seem to aim at nothing but high prices and restrictions of output are making precisely that hypothesis. They accept the data of the momentary situation as if there were no past or future to it and think that they have understood what there is to understand if they interpret the behavior of those firms by means of the principle of maximizing profits with reference to those data. The usual theorist's paper and the

24. JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 83-84 (3d ed. 1950).

usual government commission's report practically never try to see that behavior, on the one hand, as a result of a piece of past history and, on the other hand, as an attempt to deal with a situation that is sure to change presently—as an attempt by those firms to keep on their feet, on ground that is slipping away from under them. In other words, *the problem that is usually being visualized is how capitalism administers existing structures, whereas the relevant problem is how it creates and destroys them. As long as this is not recognized, the investigator does a meaningless job. As soon as it is recognized, his outlook on capitalist practice and its social results changes considerably.*²⁵

Schumpeter concludes:

In analyzing such [restrictive] business strategy *ex visu* of a given point of time, the investigating economist or government agent sees price policies that seem to him predatory and restrictions of output that seem to him synonymous with loss of opportunities to produce. He does not see that restrictions of this type are, in the conditions of the perennial gale, incidents, often unavoidable incidents, of a long-run process of expansion which they protect rather than impede. There is no more of paradox in this than there is in saying that motor-cars are traveling faster than they otherwise would *because* they are provided with brakes.²⁶

Under a perspective of markets subject not to certain structures, but to an evolutionary process, it is easier to give a different normative explanation of market arrangements such as vertical restraints, horizontal agreements, and mergers, otherwise condemned under antitrust theory. This provides an alternative appraisal of those institutional arrangements entered into by Latin entrepreneurs in the context of *apertura*,²⁷ and casts doubts on the convenience of enforcing conventional antitrust law upon them. Let us now turn to this point.

25. *Id.* at 84 (emphasis added).

26. *Id.* at 88.

27. See Henry Gómez, *The Globalization of Business in Latin America*, 39 INT'L EXECUTIVE 225, 228-29 (1997).

III. TOWARDS A NEW NORMATIVE PERSPECTIVE OF MARKET "RESTRICTIVE" BUSINESS PRACTICES

Contrary to the omniscience that mainstream economic analysis assumes among market participants, the fact remains that participants lack information about the future conditions that could influence their economic behavior. Instead, their activity is constantly pervaded by a "fog of ignorance," subjecting them to speculate about how the future will affect them. At most, they are guided by former experience, from which they learn to grasp likely trends or to identify possible future outcomes, but in making their plans they will never know for sure. Therefore, they will always face sheer uncertainty about the future. Individually considered, each entrepreneur ignores the actions of his peers; therefore, his actions cannot be more than a mere tentative inquiry into an uncertain future. In the light of this subjective reality based on conjectures, entrepreneurs are forced to seek and ensure information enough to encourage them to make investments *today* related to *future* production outputs, notwithstanding that knowledge is never fully unfolded and therefore, uncertainty will stubbornly reappear.²⁸

In particular, firms are constantly forced to weigh the level

28. Perhaps the best example of the "genuine" uncertainty surrounding those decisions taken on the basis of mere expectations was given by Keynes in his famous "Beauty Contest" example. The speculative essence of the decisions market participants adopt in their transaction is similar to that of a beauty contest whose winner is chosen according to the reciprocal expectations of the deciding judges. Under Keynes' example, each judge casts his vote according to what he regards other members of the jury will decide, but since none of the judges possess certainty as to the decision of the rest, because the latter will be based on subjective expectations, not on objective fact, their decision will inevitably be based on sheer or genuine uncertainty. See JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY* 156 (1965). In the event of sheer uncertainty, any decision to stop guessing is either arbitrarily chosen by a superior authority, or decided by convention among market participants. As O'Driscoll and Rizzo argue: "[T]here is in principle no limit to the height of the levels of guessing and counter-guessing. There is no *logically sufficient* reason to stop at any given point; all such stopping is, to a large extent, arbitrary or dervied [sic] from a convention." GERALD P. O'DRISCOLL, JR. & MARIO J. RIZZO, *THE ECONOMICS OF TIME AND IGNORANCE* 73 (1985). In the case of market transactions, these conventions sometimes adopt the form of explicit co-operation through manifold arrangements, or by tacit understanding whereby one firm appraises those elements giving shape to her expectations about other firms: reputation, former business behavior, and so on. We shall return to this question more extensively below.

of inputs they must invest today to reach an expected level of future aggregate demand. A problem arises, however, because any determination about future levels of aggregate demand will necessarily be speculative: nobody can foresee the future with certainty. Yet, firm managers cannot avoid deciding the amount of investments they must undertake today to satisfy their predicted level of future aggregate demand.²⁹ This trial-and-error process constantly forces them to experiment with different investment alternatives; obviously, these decisions are never similar to one another since particular circumstances of time and place change. Entrepreneurship demands that attention be paid to new opportunities. Entrepreneurs must be "alert," in Kirznerian terms.³⁰ Such new circumstances will "tell" them that certain techniques will prevail or that other techniques will replace them, or that consumers will change their preferences or that they will keep them.³¹ In sum, new circumstances will present entrepreneurs with the dilemma of raising (or lowering) their levels of investment to meet future demands.

Therefore, entrepreneurs cooperate to reduce the waste resulting from mistakes they could make due to false or incomplete information. To do so, they enter into a trial-and-error process enabling them to "discover" which of their initial expectations are worth holding onto, as they correspond their actions to the facts that actually emerged as time passes and the future unfolds. It is convenient to distinguish here between the expectations related to future facts that could emerge from natural events and the expectations pertaining to future facts which will result from human action. It is possible to ascertain the frequency of the former by determining their actuarial probabilities; entrepreneurs resort to insurance in order to cover their activities from such risks. In the case of future circumstances associated with expected human action, however, things are not so simple. It is not possible to subject the behavior of human beings to any regularities or predictable pattern, for they constantly rearrange and redefine their goals and objectives as new information emerges, leading them in turn to reconsider their actions at each point in time.³²

29. See RICHARDSON, *supra* note 11, at 29-46.

30. ISRAEL M. KIRZNER, *COMPETITION AND ENTREPRENEURSHIP* 146 (1973).

31. See *id.*

32. For this reason, it is not possible to cover the risks of these possible facts

Entrepreneurs build up mutual expectations through certain arrangements aimed at providing assurances about their future actions.³³ For example, they rely on their own past trading experience; alternatively, they base their judgment on the reputation of a given entrepreneur, (thus reflecting the trading experience of other entrepreneurs).³⁴ Finally, they may resort to contractual means to ensure a willingness to comply with the expectations raised. If contracts are unavailable for some reason, then parties align their conduct to that of other entrepreneurs on the basis of what they expect from them, and so on.³⁵ These arrangements, as well as many others, although less reliable than contracting insurance, nevertheless provide entrepreneurs with sufficient certainty to encourage them to make investments today which will affect future production levels. Obviously, all these techniques limit the possibilities for entrepreneurs to take alternative—"independent"—paths, but the limitation introduced is not the result of attempts to monopolize markets, but rather to coordinate activities in such a way as to forestall future losses due to possible errors in forecasting.

Indeed, as Richardson argues, entrepreneurs negotiate different arrangements to reduce their uncertainty and make more accurate forecasts depending on whether the activities they undertake are competitive or complementary.³⁶ In the case of competitive activities, the increase in the level of investment made by one firm negatively affects the rest, since the resulting increase in its future output will likely reduce the possibilities of other firms to increase production.³⁷ Here Richardson compares these investments to a particular kind of lottery, from which firms will reap benefits if the total level of present investment does not exceed the total amount of future demand, but from which they will bear losses if they exceed such amount.³⁸ How can entrepreneurs ensure that they will invest an optimal (ceiling) amount today? In the case of com-

with insurance. See generally FRANK H. KNIGHT, *RISK, UNCERTAINTY AND PROFIT* (1964).

33. See RICHARDSON, *supra* note 11, at 51-53.

34. See *id.* at 53.

35. See *id.* at 52.

36. *Id.* at 50-51.

37. See *id.* at 49.

38. *Id.* at 50.

plementary investments, a similar uncertainty arises. Indeed, in this case, the investments made by one firm making complementary investments to another will encourage the latter to invest only if the first commits itself to a minimum level of investment. How is it possible to ensure those firms will stick to the expectations they raise in others that invest such a minimum?

The answer is that entrepreneurs sometimes must limit their own independence in order to create reliable institutional settings. This will create a climate of supportive self-reinforcing mutual expectations, inducing firms to make adequate present investments. This is not to say that limiting the independence of entrepreneurs necessarily limits their freedom to trade. Freedom would be possible if entrepreneurs had feasible alternative courses of action; yet this is not the case. Entrepreneurs have no real choice in deciding whether they should align their own conduct to that of the rest; it is the only way they have to determine whether they should or should not invest. This conclusion by no means implies that rivalry ("dynamic competition") is excluded altogether, since in the end the future is unknown. The inevitable emergence of unseen new opportunities will create gaps of knowledge which more aggressive and alert entrepreneurs will seize, inducing the rest to follow. Parallel conduct, for example, provides entrepreneurs with some degree of expectation about the future conduct of others, but it does not imply that they should be limited to such conduct if circumstances change or new opportunities arise. A similar caveat applies to the rest of these techniques.

In the long run, output-restricting policies of firms are less important, because innovation will render them obsolete and acquire a stabilizing role. Restricting output (which leads to economic profit) can be a way of compensating for uninsurable risk. Insurance is normally included in costs, but allowances for uninsurable risks are not, thus making prices appear to be above costs. Some firms will fail to avoid the uninsurable risk, and will incur losses, while others will achieve profits. Horizontal agreements and parallel conducts may be useful tools to "homogenize" the global amount of investment required to provide optimal supply in a given industry. Also, business reputation may be regarded as "intangible capital" upon which firms project their expectations to warrant their business in relatively short-term exchanges. Finally, distribution or supply

agreements, joint ventures, mergers and vertical integration may be adequate means to ensure the stability of complementary activities in the long run.

Again, Richardson has examined the array of arrangements that entrepreneurs negotiate to deal with sheer uncertainty.³⁹ He classifies organizations on different levels. On one level, there is "a trading relationship between two or more parties which is stable enough to make demand expectations more reliable, and thereby to facilitate production planning."⁴⁰ This is the simplest form of inter-firm cooperation. In this case, the relationship "may acquire its stability merely from goodwill or from more formal arrangements such as long-term contracts or shareholding."⁴¹ The selection of any of these arrangements is a matter of qualitative rather than quantitative coordination. The habit of working with models which assume a fixed list of goods may be responsible for the lack of consideration of qualitative coordination and for encouraging us to think merely "in terms of the balancing of quantities of inputs and outputs."⁴²

Second, one firm may subcontract another by outsourcing. This modality is becoming quite popular for cooperation between firms located in different countries.⁴³ Subcontracting does not in itself imply much cooperation, and may be the result of competitive bidding. Stability arises from the fact that subcontractors assume the risks inherent to their narrow specialization in skills and equipment, and from the fact that it permits continued cooperation between those concerned with the development of specifications, processes and designs.

Third, firms may cooperate and rely on each other for manufacturing or marketing. These relationships may entail complex patterns of coordinated activity, ranging from quantities demanded (promoting quantitative adjustment of supply to demand), to qualitative standards involving processes or products.

Finally, there are "co-operative arrangements specifically

39. G. B. Richardson, *The Organization of Industry*, 82 ECON. J. 883-896 (1972).

40. *Id.* at 884-885.

41. *Id.* at 885.

42. *Id.*

43. *See id.*

contrived to pool or transfer technology."⁴⁴ These agreements are commonly based on the licensing or pooling of patents, but they provide for the provision or exchange of knowhow through the transfer of knowhow, personnel, drawings and tools. They are normally associated "with price agreements, market sharing and the like."⁴⁵

The particular shape given to these organizations results from the conditions imposed on them by the market in which entrepreneurs operate. The "inner intentions" of entrepreneurs to engage in unfair restrictive trade practices is not an explanation that could deal satisfactorily with the presence of the vast array of conducts and arrangements. Rather, the choice of these arrangements depends on the level of information they are supposed to convey, which is contingent upon the perception that each entrepreneur holds of those others with whom he deals (trusts) and with the complexity of the productive processes involved in the particular activity. In other words, organizational choice is constrained by the length of the relationship (as new circumstances emerge) and complexity of knowledge (as knowledge of other realities encourages the revision of initial plans). Information costs in this subjective sense are therefore essential in shaping the particular organization sought by entrepreneurs. The optimum size of a firm will be determined not so much by the scale of economies associated with any particular operation, but by the number of complementary operations requiring planned coordination. The length of time required for productive purposes and the complexity of production are ultimately responsible for the size and shape of inter-firm cooperation.

IV. THE EFFECTS OF *APERTURA* IN THE RESTRUCTURING OF LATIN AMERICAN MARKET INSTITUTIONS

Following these ideas, it is possible to characterize those arrangements entered into by Latin American firms in the context of *apertura* as efficient means of dealing with the characteristic institutional uncertainty and the unenforceability of the rule of law pervading the region.⁴⁶

44. *Id.* at 886.

45. *Id.*

46. See Gómez, *supra* note 27, at 228-29.

For more than a decade now, the region has undergone economic and trade reform, commonly known as *apertura* ("opening").⁴⁷ The new development strategy, implemented in the mid-1980s, was justified by the need to foster modern economies in the region. Latin American governments were thereby induced to adopt, some more reluctantly than others, pro-market measures that were unthinkable in the past such as: inflation control, trade and foreign exchange liberalization, lifting of regulatory measures, price controls, and elimination of restrictions on foreign investments (to name a few). Today the first generation of macroeconomic restructuring, consisting of trade reform, correcting fiscal imbalances, privatizing state assets, and implementing sound monetary policies has been achieved in many Latin countries.⁴⁸ Above all, *apertura* is a process of institutional reform.⁴⁹

In the context of such reform, entrepreneurs sought new business opportunities in the region. In this respect, the INTERMAN Management Innovation Programme has identified several features that summarize many of these new and innovative forms of doing business in Latin America.⁵⁰ These features have evolved out of the institutional uncertainties surrounding business activity in the region, which in part arise from problems created by the lack of infrastructure for trade in Latin America.⁵¹ In particular, the lack of global channels,

47. See *id.* at 229.

48. See *id.* at 226-27.

49. Gómez explains the implications of this policy turnaround:

Latin America's economic and commercial reform, a common strategy known as *apertura*, has been applied by countries throughout the region but in varying degrees of depth, with Chile performing the two roles of pioneer and champion

. . . .

The most striking effect of deploying the *apertura* strategy lies in commercial and exchange policy. Import duties were cut dramatically, from an average of 50 percent *ad valorem* to 15 percent in only five years. Most notably, these cuts were applied unilaterally, with no demands for reciprocity, wiping out as well, a wide array of non-tariff barriers. Exchange controls long in use were scrapped or pared to curb capital outflows.

Id. at 228-29. A summary of the measures comprising the "second generation of reforms" is found in MOISÉS NAÍM, *LATIN AMERICA'S JOURNEY TO THE MARKET: FROM MACROECONOMIC SHOCKS TO INSTITUTIONAL THERAPY* 1-7 (1995).

50. See Gómez, *supra* note 27, at 226.

51. See *id.*

favorable logistics, and information technology has forced firms to seek ways to overcome these constraints. Gómez comments: "In Latin America, securing adequate distribution for consumer products can represent a challenging management task; logistics represents more of a barrier than a driving force; and information technology, including communications, has only recently begun to contribute to internationalizing the region's business."⁵²

Furthermore, the lack of certainty and reliable expectations about legal regulation has often made Latin American firms turn to alternative means of enhancing their expectations, rather than those conventionally acknowledged in business practice elsewhere. The problems of currency volatility and about-turns in economic policy experienced in the region have frequently caused havoc in the management of multinational firms. For these reasons, to offset the uncertainties of official decisions, firms in Latin America resort to a variety of devices to ensure their markets. For example, they use family ties in business, seek more flexible management, use informal links, and develop a managerial capacity for influencing official institutions to create more predictable and reliable government decisions.

Family links often provide a reliable source of mutual trust in business. As Dávila and Gómez Samper argued in their study conducted on Latin American management: "[the majority of] Latin American owned innovative firms are medium size (i.e., employ from 300 to 800 persons), are often family run, and have proven proactive vis-à-vis the region's economic, social, and political turbulence."⁵³

Making business relationships flexible, so as to "open" them to changing circumstances, has also proved to be efficient in this context. Gómez explains the conclusions of a study on highly successful Latin firms, which revealed a degree of informality in management styles in some Brazilian, Colombian and Venezuelan organizations which differed from the explanations formulated by conventional theories.⁵⁴ The informality is

52. *Id.* at 233-34.

53. Carlos Dávila & Henry Gómez Samper, *Innovative Management and Organizational Development in Latin America*, 36 INT'L EXECUTIVE 671, 675 (1994) [hereinafter Dávila & Samper].

54. Gómez, *supra* note 27, at 244.

related in these cases to “novel property and organizational structures, effective empowerment strategies, unconventional organizational missions, and deliberate efforts to build on culture-specific idiosyncrasies [sic].”⁵⁵

Using informal links has also become important in reducing uncertainty.

For some Latin American firms, making good use of the informal market became a way for building home market as well as export sales. *Canels*, for example, has become Mexico’s second largest chewing gum manufacturer by focusing its distribution effort largely on the informal sector. *Leonisa*, a Colombian lingerie manufacturer, came to dominate the market for its product line in nearby countries chiefly by building and carefully monitoring, in each country, its informal sector wholesale and retail network.⁵⁶

Moreover, “[l]eading firms have in some cases developed alliances with counterpart firms in neighbor[ing] countries as a way for breaking into each other’s market.”⁵⁷ For example, multinational companies frequently buy local firms with an established customer base.⁵⁸ Switzerland’s *Nestlé* acquired Venezuela’s *Savoy*, a large local firm with a good reputation in the Venezuelan confectionery market.⁵⁹ *Alpina*, a Colombian firm, initiated exports of its dairy products to Venezuela by reaching a mutual marketing agreement with *Plumrose*, a Venezuelan meat processor.⁶⁰ Commenting on this operation, Gómez contends that “[b]oth firms produce premium quality products, and both benefit from the agreement by relying on each other’s extensive retail distribution network, rendering channels more efficient by adding new and complementary lines.”⁶¹ Once established, they then expanded their operations in the new market. *Alpina* acquired a new plant after obtaining consumer acceptance. In another case, *Mavesa*, a Venezuelan food processor, and Colombia’s *Noel*, followed a similar start-up strategy.

55. *Id.*

56. *Id.* at 234.

57. *Id.* at 235.

58. *See id.* at 242.

59. *See Arcor: Receta Difícil*, AMÉRICA ECONOMÍA, Apr. 23, 1998, at 20.

60. *See* Gómez, *supra* note 27, at 235.

61. *Id.*

Another example of developing business links with local partners is *Sky Latin America LLC*, a regional satellite television enterprise based in Miami, which has developed joint ventures with firms like *Organizacoes Globo* of Brazil and *Grupo Televisa S.A.* of Mexico in order to gain a foothold in these two Latin countries.⁶² This has been taken as a first step towards the expansion within in the region with the aim that *Sky* will eventually outdo its competitor—and leader in the market—*Galaxy Latin America*. *Sky* has created independent operations in each country, leaving marketing and sales strategies to its local partners.⁶³

Proliferating mergers and joint ventures are not necessarily the result of a manifest (or implied) intention to monopolize regional or local markets. There are two reasonable explanations for such operations. First, there may well be a need to overcome the uncertainty of investing in the newly emerging markets of Latin America. This need may induce firms wishing to take advantage of the liberalization in the region to forge closer business ties with other firms, offering them tacit and subjective knowledge of the new market, which they would otherwise require years to develop. Second, these concentrations may occur because of the need to ensure sufficient economies of scale to make the investment profitable. Indeed, the size of domestic Latin American markets, independently considered, may not support investments above certain levels.

For example, the *Sindicato Antioqueño*, a Colombian group representing approximately one hundred independently-owned firms, and including some of the country's largest and most advanced retailers, joined Holland's *Makro* and Venezuela's *Polar* in order to bring about Venezuela's largest chain of supermarkets (fifty *Cada* outlets) and department stores (eight *Maxy's* stores).⁶⁴ The new chain of supermarkets and department stores, together with the *Makro* bulk retail outlets that are expanding rapidly in Venezuela, provide a powerful, ready-made distribution channel for the *Sindicato's* wide range of manufacturing firms, including *Noel*. Once on the brink of bankruptcy, these firms have been revitalized by the new capi-

62. See Tara Sullivan, *El Desafío de Competir: Rompen Esquemas*, AMÉRICA ECONOMÍA, Apr. 9, 1998, at 51.

63. See *id.*

64. See Gómez, *supra* note 27, at 235.

tal and "knowledge" provided by their new partners. The old owners, the *Cisneros Group*, divested themselves of both the *Cada* and *Maxy's* retail networks in order to raise the vast amount of capital required for their hemisphere-wide entry bid into satellite television.⁶⁵

Corporate restructuring may prove decisive in a rapidly changing business environment, as exemplified by *Grupo Hermes*.⁶⁶ This formerly protected Mexican industrial group survived the 1994 recession and foreign competition by selling its interests in the manufacturing sector and focusing on the energy sector and telecommunications.⁶⁷ The group is now the main shareholder of *Grupo Cerrey*, which produces energy plant containers. By restructuring, the group was able to build on its previous manufacturing experience of automobile parts.⁶⁸

For complementary investments, some local multinational companies contract the services of domestic firms ("outsourcing"), rather than develop internal units or vertical integration. By doing so, these firms acquire the knowledge and expertise to develop export sales. For example, *Cartonajes Estrella*, a leading carton maker in Mexico, obtained a contract to supply cups to McDonalds and soon afterwards began servicing the firm's needs in Costa Rica, Ecuador, and Argentina. Another carton supplier, *Convermex*, also supplies McDonalds, as well as KFC, Domino's Pizza and other fast food suppliers in Mexico and elsewhere in the region. As Gómez indicates, "[b]y serving as local suppliers of multinationals, these Mexican firms learned how to cater to customers that demand consistent quality, low prices and large volume."⁶⁹ Another case is the experience of *Alicorp, S. A.*, a large Peruvian food manufacturing company.⁷⁰ This company regards its distribution network system, based on effective outsourcing, as the key to its success over its competitors. In 1993, the company began an aggressive expansion plan, which included buying its two most important rivals, thus reducing costs—payroll was reduced by

65. See *id.*

66. See Sullivan, *supra* note 62, at 52.

67. See *id.*

68. See *id.*

69. Gómez, *supra* note 27, at 235.

70. See Sullivan, *supra* note 62, at 56.

43%—and developing a reliable distribution network.⁷¹ The results: in 1997, the company's sales return was estimated at US\$600 million a year, compared to US\$120 million in 1993.⁷² Outsourcing enables *Alicorp* to reach clients that would otherwise be too expensive to serve, because its distributors have lower cost structures. In this relationship, *Alicorp* provides its distributors with capital, knowhow and access to its network of clients.⁷³ A similar business strategy explains the success of *Polar*, the largest Venezuelan brewery, which has survived *apertura* and foreign competition because of its excellent distribution network system.⁷⁴

The pressure of internationalization has forced Latin firms to either seek alliances or integrate in order to meet the challenge of international competition. A good example of integration is the Mexican cement industry, formerly dominated by dozens of family-owned companies spread across the country. Once trade barriers came down, small companies were absorbed by Mexico's *Cemex*.⁷⁵ This company is now on par with the three Swiss, Italian and French multinationals that, together with *Cemex*, dominate the world cement market.⁷⁶ Steel producers provide a contrasting example of alliance. Firms in this industry have remained largely independent, but this has not prevented them from developing strategic alliances for solving specific problems, such as the imposition of dumping duties in foreign jurisdictions.⁷⁷ Steel producers from Brazil and Chile were brought into a newly privatized Argentinian firm to create *Aceros Paraná*, the first steel-producing firm to form part of a regional group.⁷⁸ In Mexico, *Tamsa* entered a strategic alliance with Argentina's *Siderca*, which is part of the *Paraná* complex.⁷⁹

Sometimes strong investments in technology may be necessary to reduce labor costs, as the example of *Companhia Textil*

71. *See id.*

72. *See id.* at 56, 57.

73. *See id.*

74. *See* ANTONIO FRANCES & LUIS DAVALOS, *LA CORPORACIÓN CUATRO DIMENSIONES* EDICISUIS IESA 110 (1992).

75. *See* Gómez, *supra* note 27, at 236.

76. *See id.*

77. *See id.*

78. *See id.*

79. *See id.*

de Minas Gerais, S.A. (Coteminas), a large Brazilian textile manufacturer illustrates. An investment of US\$450 million in machinery enabled this firm to compete successfully with Asian rivals, whose labor costs are 50% lower.⁸⁰

Gómez vividly describes the challenges which lie ahead in the process of corporate integration in the region: "Early in the coming century, [it is conceivable that] the food marketer's dream could well come true: millions of consumers throughout Latin America that, prompted by a region-wide, satellite-beamed advertising campaign, begin each day drinking the same brand of juice (or soft drink) and the same breakfast cereal!"⁸¹

Finally, in order to remain efficient (i.e. adapted to the Latin American setting), these forms of coordination have encouraged firms not to grow too fast or too much, and not to adopt values which run counter to conventional business. As an example of the first situation, Dávila and Samper relate the case of *Ekare*, a Venezuelan child's book publisher, which has attained world-class stature, based on the excellence and originality of its product brought about by avoiding excessive growth.⁸² To explain the second situation, they quote the case of *BICE*, a medium-sized Chilean bank, which is part of a powerful business group, and has become a leader in fiercely competitive corporate and institutional banking.⁸³ The success of this bank, in their opinion, is based on local cultural values; in particular, a personal selection process built on family unity and religious values that would be considered "unthinkable" in a modern business setting.⁸⁴

To sum up, the evidence presented above supports the conclusion that businesses regard predictability as essential in their transactions. As a result, they attempt to increase their certainty, even at the expense of restricting the possibilities for action, if that can enhance their expectations of the reliability of the market where they are planning to invest. One should not forget that market arrangements are shaped by the structural conditions of the markets involved, and that these condi-

80. See Sullivan, *supra* note 62, at 58.

81. Gómez, *supra* note 27, at 242.

82. Dávila & Samper, *supra* note 53, at 675.

83. See *id.*

84. See *id.*

tions (the technologies involved, legal rules, customs, economies of scale, and others) cannot be dismissed in the appraisal of such restrictions.

V. DRAFTING AN ALTERNATIVE POLICY FOR THE PROMOTION OF BUSINESS COMPETITION IN THE CONTEXT OF A MARKET PROCESS THEORY

Of course, viewing market "restrictive" arrangements as devices to diminish uncertainty in an evolving world does not mean that in particular instances entrepreneurs will choose the most efficient agreement. Again, perfect knowledge is not assumed; rather, the possibility of making mistakes is always there. Individuals may eventually choose those arrangements that suit them better, but they may do so after a learning process involving costs. Again, from a view where knowledge constantly changes, nothing ensures that an overall tendency towards equilibrium should prevail, but it is reasonable to expect that entrepreneurs will arrange their affairs in an attempt to achieve equilibrium in their particular transactions.⁸⁵

85. Economists debate on whether a tendency towards equilibrium leading to social progress does exist. Guided by Herbert Spencer's notion of progressive social development, some argue that equilibrium may not be a suitable heuristic appraisal for reality, but it is undeniable that a tendency towards equilibrium does exist; otherwise, economic theory (explaining certain patterns of conduct) would be meaningless. See, e.g., Israel M. Kirzner, *Entrepreneurial Discovery and the Competitive Market Process: An Austrian Approach*, 35 J. ECON. LITERATURE 60 (1997). See generally HERBERT SPENCER, *FIRST PRINCIPLES* (1862). As Moss contends, Alfred Marshall's vision of the economic process bears this particular mark. Lawrence Moss, Geoffrey M. Hodgson, *Economics and Evolution: A Review Article*, 4 MARSHALL STUD. BULL. 33-49 (1994) <<http://www.cce.unifi.it/rivista/moss.htm>>. Other scholars argue that modern biological reasoning, led by Charles Darwin, is about evolutionary process; hence, it is about the errors as well as the successes proceeding irreversibly along time's arrow with no teleological goal in sight. There is no move towards equilibrium; adjustment is made without any consideration for social progress. This view is advocated by G. Hodgson in the following terms: "in the biological and the economic context, evolution is not a grand optimizer, or a perfectionist. Evolution is awesome and inspiring, but also messy, stupid and tragic." GEOFFREY M. HODGSON, *ECONOMICS AND EVOLUTION: BRINGING LIFE BACK INTO ECONOMICS* 212 (1993). In the realm of economic theory, this perspective is represented in the idea of "disequilibrium," best espoused by G. B. Shackle. See LUDWIG M. LACHMANN, *Professor Shackle on the Economic Significance of Time*, in CAPITAL, EXPECTATIONS AND THE MARKET PROCESS: ESSAYS ON THE THEORY OF THE MARKET ECONOMY 81, 81-93 (Walter E. Grinder ed., 1977). In our opinion, the argument should distinguish between short term and long term equilibrium. The first is sought by transacting parties to arrange their affairs so as to suit them,

In the realm of market transactions, individual transactions may appear in the short run to limit the freedom of others to enter into a given market, or to act in a particular way. However, in the long run, these arrangements will favor the necessary predictability to invest in new markets in developing innovations and new products. This clearly shows that equilibrium and social efficiency are not necessarily synonymous, as they appear under mainstream economics.

In the long run, achieving equilibrium is not necessarily a precondition for attaining social efficiency. Efficiency, rather, is linked to the coordination of individuals for achieving their plans. For this reason, the efficiency of social rules (laws, customary rights, etc.) is not associated with a given resource allocation devised by an enlightened social observer, but rather, with the possibilities that it offers to individuals for coordinating their conducts mutually according to *their* goals. Property rights, freedom of contract, protection of intellectual property rights and the like appear as preconditions for achieving such coordination.

Advocating against antitrust policy does not belittle a government's involvement in promoting competition. On the contrary, it is unthinkable to imagine economic transactions occurring in an institution-free setting. Markets can *only* function within a defined framework of rights, and this is the main responsibility of governments. Yet, the preceding caveats should immediately make us aware that such intervention bears a different sign and purpose. The question, then, is what sort of competition policy is compatible with market functioning?

Political authorities can foster several proactive national, regional and local level government initiatives aimed at making business environments much clearer and more predictable.

albeit not for allocative purposes, but for achieving a better coordination of their individual positions. Individuals can identify such equilibrium from an ex-ante perspective, but that does not ensure that they will be right from an ex-post perspective. In the long run, the essence of the problem is different, and equilibrium cannot be taken for granted. The evolutionary process may lead to cumulative individual "mistakes" that will be reflected in the flaws of the rules developed to enable coordination of individuals. Moreover, the long term perspective will show how from the ex-post appraisal, individuals may not always reach optima. In sum, it is futile to judge individual short term transactions through rules conceived to judge from a long term perspective.

The goal is to create a favorable setting where managerial innovation, creativity, and the emergence of valuable market information—in the form of improvements, new knowledge, technologies and processes—can develop.

To address this goal, it is necessary to eliminate the sources of interference created at the public and private level. These sources could impose upon society severe inefficiencies in the form of misallocation of resources, and even more importantly, in the interference they posit to the emergence of new valuable knowledge and information. For this reason, "public interest" demands a clear definition of an individual's right to prevent unauthorized subjects (public and private "free riders") from obtaining undeserved benefits from the investments made by legitimate owners. This is a task that governments can perform themselves, or allow individuals to perform through private means of "exclusion."⁸⁶

First, a more effective definition of individual rights is necessary to allow firms to know the extent of their actual access to social resources. Therefore, it is necessary for entrepreneurs to have reliable expectations about the conditions within which they can acquire property rights.

Second, a proper delimitation in the sphere of individual rights would encompass not only clarity in the initial assignment, but also clearer rules on the transmission of such rights. In other words, entrepreneurs must possess reliable expectations about the conditions under which they can trade their property rights under contractual arrangements.

The adverse effects of a poor definition and enforcement of

86. According to game theory models, free riding generates an incentive to develop Prisoner Dilemma's situations where some parties seek to gain advantages from cheating the rest; these situations call for intervention to discipline members of the group. See AVINASH K. DIXIT & BARRY J. NALEBUFF, *THINKING STRATEGICALLY: THE COMPETITIVE EDGE IN BUSINESS, POLITICS, AND EVERYDAY LIFE* 89 (1991). The application of game theory models into the law is explored in DOUGLAS G. BAIRD ET AL., *GAME THEORY AND THE LAW* (1994). The view of the phenomenon of free riding under antitrust policy is ambiguous. For example, this policy subjects exclusive contractual arrangements excluding "free riders" (e.g., exclusive distribution or supply agreements) to a rule of reason analysis, in order to determine their restrictive effects. Therefore, the legality of these agreements will not depend so much on their economic beneficial effects, as on the concentration they generate in the market, by excluding alternative sources of rivalry (e.g., non-exclusive suppliers or distributors). It is overlooked that by their very nature, these agreements are aimed to exclude ("free riding") competitors from the market. Once more, antitrust analysis reveals itself as lacking touch with reality.

property rights resulting from administrative discretion are even more evident within weak institutional settings, such as those found in developing countries.⁸⁷ As Eggertsson stated:

Weak institutions are usually associated with a weak state. In some circumstances various decentralized groups (trading companies, guilds) have taken over the role of the state and succeeded in providing stable property rights, but a system based entirely on decentralized property rights is unlikely to provide a foundation for a modern industrial economy.⁸⁸

For this reason, it is essential to control government discretion over trade and economic transactions. Administrative discretion over judging the "fairness" of contracts harbors multiple forms of trade restriction leading to uncertainty, lessening business expectations about the initial assignment of rights. In this context, it is clear that as far as antitrust policies are concerned, they must reconsider their central object of regulation. Conduct currently prohibited under these statutes (price fixing, output restrictions, exclusive dealings, resale price maintenance, mergers and acquisitions, joint ventures and so on) may be considered under a dynamic view of markets as conveying necessary restrictions of freedom to market participants that they voluntarily enter into for reducing business uncertainty. Therefore, they should not be condemned under an unrealistic structural appraisal of markets, but allowed.

Finally, government intervention to protect dynamic competition and innovation should focus on protecting the content of individuals' spheres of action in cases where initial entitlement becomes challenged due to insufficient clarity in the assignment. This results in two or more entrepreneurs holding legitimate expectations about the extent of their respective entitlements over a disputed social resource. For this reason, a real competition policy should implement efficient dispute settlement mechanisms allowing the elimination of any source of interference and uncertainty in the initial allocation or transfer of rights. An efficient dispute settlement system would allow the solution of ex-post conflicts over the use of resources

87. See Thráinn Eggertsson, *The Economics of Institutions in Transition Economies*, in *INSTITUTIONAL CHANGE AND THE PUBLIC SECTOR IN TRANSITIONAL ECONOMIES* 19, 22 (Salvatore Schiavo-Campo ed., 1994).

88. *Id.* at 25.

due to a poor ex-ante identification and assignment of rights.

Much of this institutional *transparency* could be attained through effective "competition advocacy" aimed at eliminating the sources of government interference upon a clearer definition of property and contractual rights, and secondly, through challenging business misbehavior which can diminish the expectations of individuals due to confusion introduced in the entitlements.

Competition advocacy is particularly important in Latin America because of the former experience of misled government intervention in the region, which is responsible for the current competition and innovation problems. Competition agencies are increasingly considering this sort of policy enforcement, but regretfully they are ill-suited to go too far in these activities since they lack the proper legal powers to coerce government agencies beyond mere recommendations and providing opinions. This is not surprising since the logic justifying this "competition advocacy" is completely divorced from that which led to the emergence of antitrust statutes. In this regard, antitrust provisions emerged from a recognition that "markets fail" to deliver social good, whereas competition advocacy is justified on the basis that "government fails" to provide for suitable "official" institutions within which to work out social and economic interaction.⁸⁹

Competition advocacy could adopt many modalities. For example, it could entail forming a public prosecutorial agency entrusted with the protection of economic rights, as well as official initiatives to deregulate the economic process. It could also entail a clarification or a limitation of those conditions triggering the alibi of "public interest," which has always invited obstructive government. There are many forms in which such initiatives could be implemented, provided they include a clear commitment to clarify the institutional framework officially and managerially that evolved.

In addition, government intervention should ensure that market transactions are not adopted under conditions of violence, duress or fraud. For this reason, it is necessary to en-

89. See C. Curiel, *Elementos para la Aplicación de Competencia en Economías en Transición: La Experiencia en Venezuela*, Paper presented at the seminar *Políticas de Competencia en América Latina y el Caribe* (Oct. 23-24, 1995) (sponsored by UNCTAD and held in Caracas, Venezuela).

sure that individuals preserve their expectations about the identity of those with whom they trade. This is the rationale for pursuing a policy against conduct that is regarded as an "unfair" expression of competition, in the sense that it misleads the public.

Consider the legislation dealing with intellectual property. This legislation aims to identify and protect certain sorts of (intellectual) entitlements over things, the intangible nature of which makes them difficult to grasp, let alone to protect legally. In these cases, governments explore the difficult task of detecting the infringement of these rights, the legal qualification of which makes them particularly subtle. For example, how is it possible to determine that a product has been reproduced similarly enough to create confusion in the consumers' perceptions about the identity of the rightful producer? How is it possible to establish that a negative opinion spread about a competitor's product constitutes the denigration of his reputation and therefore, a legal wrong? The delimitation of individual rights is frequently difficult and therefore, requires particular care and commitment from the government in its enforcement.

These elements provide the blueprint for the formulation of an adequate competition policy: to ensure economic freedom to market participants in international trade, in order to provide them effective market access which is frequently denied in order to satisfy the interests of particular groups seeking protection from international trade. This sort of intervention would warrant positive results for the promotion of competition, in a more effective way than chasing elusive monopolistic practices.

In sum, the goal of an alternative competition policy in international trade is to enhance the predictability of market participants through the reduction of uncertainty regarding their individual rights. Such protection would do much more for enhancing individual rights and trade than any well-intentioned antitrust scheme.

VI. CONCLUSIONS

Determining whether antitrust policy is "convenient" for promoting competition in Latin America cannot be deduced by simply appealing to the linguistic interpretation of the stat-

utes. It is not possible to appeal to the traditional method of legal science in order to examine the implications of enforcing antitrust regulations in Latin America. The traditional method of legal science is formalistic in the sense that it views social rules as simple instruments emerging from those bodies formally acknowledged as law-making entities. This method is based on the literal interpretation of written rules enacted through codification. It has emerged as a by-product of the influence of logical positivism in social sciences since the mid-nineteenth century.⁹⁰ The method inadequately casts light on the reality of developing countries, where official authorities clearly possess limited legitimacy in their law-making activities, which are frequently surpassed by social interaction.⁹¹

In addition, the conventional legal method of analysis is insufficient to explain the complexity of social interaction in creating market rules. Adopting a formalistic approach to the analysis of social reality is not only inconvenient but also improper, since it excludes by definition the non-legal substratum of ideas implemented through government mechanisms. Hence, legal institutions may be more fully understood by using a method of analysis which enables the observer to apprehend the richness of those ideas in shaping government, in a way

90. From this period, social science lost all significant contact with political philosophy and social scientists concentrated on achieving value-neutrality in science. A more precise conception of science emerged, focusing on causal laws and quantitative methods. Separate disciplines of political economy, history, philosophy, and law emerged within more precise technical boundaries. Making positive law the central focus for study required a change in legal method. As a result of this intellectual influence, the methodology of legal science changed dramatically, from an historical, sociological and explanatory approach to a mechanical one, mostly concerned with explaining legal rules in terms of "facts." "Since science was engaged with the [factual] realm of inquiry a science of law would, it was assumed, need to be erected on a foundation of fact. This objective became the quest of legal positivism, which was pioneered by Bentham and refined by John Austin." LOUGHLIN, *supra* note 4, at 20. Consequently, formalism remained, in the sense of law being "a self-contained body of rules which operates by means of a distinctive system of the conceptual thought." *Id.* at 22. The formal classification approach to public law that emerged had achieved a pre-eminent status by the turn of the century and has remained the dominant method ever since. As Loughlin states: "although Austinian positivism is no longer the primary theory, Austin's *method* remains dominant." *Id.* It is this paradigmatic way of understanding social rules that the conventional legal method favored and which provided the setting for the emergence of antitrust regulations.

91. On this question, see ROBERT BALDWIN, *RULES AND GOVERNMENT* 59-121 (1995).

that a formal appraisal cannot reveal. As Baldwin contends, arguing the "legal" nature of government rules is irrelevant for the purposes of exploring their normative force, and their implications within society.⁹² It is necessary to transcend the limitations imposed by the positivistic distinction between "fact" and "value," particularly in the realm of law.

Understanding social rules properly requires an alternate interpretation of approximate reality. This is particularly useful in the analysis of public law because it overturns the vacuum of conventional legal analysis, which merely focuses on determining what internal connections the observer can construct between rules belonging to a predefined set of legislation. In this way, an alternative method could provide a clearer understanding of public regulations by exploring more closely their "values," thus linking their legitimacy to their implications within society.

The analysis of regulation, around which the discussion of competition policy revolves, cannot avoid linking the analysis of reality to certain guiding values. This is inevitable, if the aim of the scientific quest is to explore the logical basis for the interpretation of social facts. As Demsetz contended, it is ideas that provide the tools for the interpretation of facts rather than facts that shape ideas.⁹³ This is clearly so in economics, and particularly in discussions on competition.⁹⁴

Promoting competition and innovation is crucial for developing countries to spur growth, but easy answers are not available yet. Today, policy makers are less optimistic than a generation ago, but this conviction has also made them more realistic about the complexity of the problem, and therefore, the changes that are necessary to undertake to achieve this goal.

In this regard, policy makers are progressively shifting from their former "social engineering," which purported to change market outcomes according to some vague "development" standards, into a new "paradigm" of regulation, which is

92. *Id.* at 7.

93. Harold Demsetz, *Two Systems of Belief About Monopoly*, in *INDUSTRIAL ORGANIZATION* 164 (Oliver E. Williamson ed., 1996).

94. *See id.* In this field, it is not possible to dissociate fact from value, since, as Berlin stressed, human beings (whose interaction constitutes the subject matter of the social sciences) are self-interpreting creatures. *See* Berlin, *supra* note 9, at 13 and accompanying text.

increasingly acknowledging the need to support market mechanisms in order to create wealth and progress.

The above considerations should clarify how much antitrust theory is divorced from promoting innovation and entrepreneurship. By protecting a structural notion of competition, antitrust policy is more concerned about preserving a minimum number of firms within a given industry, rather than creating the conditions for any interested and alert entrepreneur to discover new valuable information and knowledge, either through rivalry or through market cooperation.

Machlup explains the sources of this confusion: "The confusion is understandable: where there are *many* sellers already, why should there not easily be *more* sellers when profits lure? In actual practice easy entry into a trade and large numbers in the trade go well together."⁹⁵ However, "even if a large number of sellers and an augmentable number of sellers seem to be closely correlated, logically the two things are completely divorced from each other. And, it will be seen, (they are concepts) of very different nature; indeed, *they belong to different spheres of thought*."⁹⁶

In sum, antitrust theory confuses the causes of the complex process whereby firms are at times induced to make investments to gain a "competitive edge" vis-à-vis their competitors, and at times prefer to cooperate with them to avoid more costly uncertainty.

Under an alternative institutional perspective, markets are embedded within the social institutions where they grow, but certainly policy action can improve their functioning; in particular, governments can provide for more certainty which would enhance the legitimate expectations of market players.⁹⁷ This is the essence of governmental restrictions upon trade, competition and innovation.

Of course, these perceptions are influenced and even built upon by the way they grasp the real world. These paradigms make up for their interpretation of social reality. This is cru-

95. Fritz Machlup, *Competition, Oligopoly and Profit*, ECONOMICA, Feb. 1942, at 1.

96. *Id.* at 1-2 (emphasis added). See also GEORGE J. STIGLER, MEMOIRS OF AN UNREGULATED ECONOMIST 92-93 (1988).

97. See generally 2 FRIEDRICH A. HAYEK, LAW, LEGISLATION AND LIBERTY: THE MIRAGE OF SOCIAL JUSTICE (1976).

cial for legal enforcement. Depending on the paradigm relied upon, one behavior will appear either as a "market failure" deserving "corrections" (i.e., public intervention ruling a different outcome from the one it would have prevailed under strict market conditions), or an "institutional failure," in need of correction through policy action. Here the correction would indeed require policy action, but in the sense of reinforcing markets, not making them more transparent. The point, however, is that a decision among paradigms leaves aside all discussion about conflicting theories within each paradigm. Therefore, it is irrelevant for these purposes to argue about the validity of the empirical evidence in support of such conflicting theories.

Instead, the problem centers around identifying which method examines the real world more accurately. Equilibrium, the most frequently used method of deducing economic "laws" based on the appraisal of empirical evidence provides a poor description of social phenomena. This is particularly true in the area of competition, because the corresponding models, no matter how many variables they include, cannot deal with them all simultaneously. The evolving essence of information that markets disclose gives market competition a dynamism which cannot be appraised under such a method properly. In fact, as Kirzner contends, the method by definition denies its very essence.⁹⁸ Consequently, as Sowell indicates, those supporting antitrust have scored a "verbal coup," by confusing the meaning of "competition" as related to market share controlled by certain firms "as if they were discussing prospective behavior rather than retrospective numbers."⁹⁹

There are conflicting views about the method of social scientific inquiry, but some views are more realistic than others. It is clear that the role of institutions cannot be ignored, as it has been from the conventional neo-classical analysis nourishing antitrust predictions and theories. A constructive

98. ISRAEL M. KIRZNER, HOW MARKETS WORK: DISEQUILIBRIUM, ENTREPRENEURSHIP AND DISCOVERY 21-30 (IEA Hobart Paper No. 133, 1987). McNulty also emphasized how the conventional notion of neoclassical competition is at odds with the one that entrepreneurs face in the market. See Paul J. McNulty, *Economic Theory and the Meaning of Competition*, in THE COMPETITIVE ECONOMY (Y. Brozen ed., 1975).

99. THOMAS SOWELL, KNOWLEDGE AND DECISIONS 205 (1980).

and more profound perspective must not attempt to isolate social reality and market functioning from those sets of rules that enable them to function. Constructing public policies on the basis of ideal worlds can only lead to contradictions and institutional failures. The theoretical shortcomings and the enforcement experience of antitrust policy shows the possible consequences of these rules as applied to international trade relations. In fact, more than anything, the concerns about restrictive trade and business practices in international trade relations show, in the words of Godek, "an unhealthy anxiety about the imagined ills of capitalism."¹⁰⁰

One must be especially wary of the claims of scholars, particularly (but not exclusively, it is fair to say) in the legal field, who take these policies at their face value without regarding the economic theory and the implications behind them and the results of such implementation. It is impossible to disagree wholeheartedly with Ackerman, when he sarcastically put the matter in these terms: "When they speak so resonantly of 'public policy,' do lawyers have the slightest idea what they're talking about?"¹⁰¹

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100. Paul E. Godek, *One U.S. Export Eastern Europe Doesn't Need*, *INT'L MERG-ER L.*, Sept. 1991, at 3.

101. BRUCE A. ACKERMAN, *RECONSTRUCTING AMERICAN LAW* 22 (1984).

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