REVIEW ARTICLE: Donald Armstrong, Competition vs. Monopoly:Combines Policy in Perspective, The Fraser Institute, Vancouver, 1982.

This book is apparently intended to do two things - to influence the way in which the courts look at competition, and to influence possible changes in the Combines Investigation Act.

The volume may ultimately have some influence on the courts. If so, the likely result will be the lengthening of cases beyond their already excessive dimensions, by the promotion of a debate over what are essentially non-issues. The book is unlikely to persuade many economists, or to have much influence on the reform of competition policy.

The author says that the study reflects "recent thinking that has started to emerge within the economics profession". This review looks at several major themes in this "recent thinking" before commenting on the policy proposals. One theme may be introduced with the following quotation. "It is the major thesis of this study that economists have built a theory ... of competitive behaviour based on an over-simplified and, for the purposes of studying competitive behaviour, an inappropriate theory of the firm". The author deplores "the grip of neoclassical price theory on the thinking of most of the economic fraternity". He contends that this leads to an excessive emphasis on price and on price competition by economists and by administrators of anti-trust policy.

There is one aspect of the price issue that the author ignores in his complaint, that is particularly important in today's circumstances. When markets are highly concentrated, firms tend to de-emphasize price competition because it is too lethal - it tends to produce immediate shifts in market shares. Consequently producers are led to engage in other forms of rivalry. To the extent that some of these forms provide buyers with better quality or desired services or new products, they may be equally (or sometimes more) advantageous to buyers. But to the extent that rivalry takes the form of increased sales promotion, fancy packaging, etc., company policies may offset each other and raise everyone's costs. For the Government, this adds to the difficulties confronting demand management. When demand falls, and prices are rigid downward, the necessary adjustment in the market will involve more unemployment and less price reduction than otherwise would be the case. It is therefore not surprising that at a time when the author urges economists to downgrade the importance of price competition, authoritative voices in the country are calling for more price flexibility. Within the past year the Bank of Canada, the Economic Council and the C.D. Howe Institute have all drawn attention to the fundamental importance of greater price flexibility.

The related idea that monopolistic firms are more likely than not to seek a quiet life - to allow costs to escalate and to avoid risky new ventures - gives Professor Armstrong considerable difficulty. He acknowledges that most textbooks on industrial organization have accepted the importance of "X-inefficiency" and quotes as typical of the current acceptance of this principle, the following statement by Professor Christopher Green: "A lack of competitive pressure on monopolistic firms may result in a rise in costs as well

as price. That is, the average cost curve may shift upward. This so-called 'X-inefficiency' may arise if the slack provided to the protected monopolist results in his failure to adopt least-cost methods of production, or if he fails to purchase inputs at the lowest available prices". (Canadian Industrial Organization and Policy, Toronto, 1980, page 38).

Professor Armstrong asserts that economists have not only built an inappropriate theory of the firm, but "they have an overly simplified and inaccurate theory of managers and of managerial work". He contends that psychologists have established human need hierarchies which are incompatible with the idea that either conspirators or monopolists seek a quiet life. Self-esteem, the need for self-respect, autonomy, status, reputation, self-actualization and so-on, he says, all suggest a quest for better performance and achievement.

Existing evidence, however, supports the economics profession rather than Professor Armstrong. Such evidence is of various kinds. There is, for example, the evidence provided by case studies - in Canada these include Eddy Match,[1] B.C. Sugar[2] and Erco.[3] There is the history of the decline of once-dominant firms. This suggests that there are more organizations like Gutta Percha, Johns-Manville, Canadian Breweries, etc. than there are organizations like Northern Telecom. There is the evidence of what happens when de-control removes the umbrella over a cartelized industry. Airlines eliminate surplus staff and begin to tailor the aircraft used on particular routes to the traffic available. Trucking firms begin seriously to resist the demands of the Teamsters. There is the evidence of broad cross-section studies in the U.S. which show, for example, that high concentration means a higher differential between union and non-union wages, holding the proportion of non-union members constant. In other words, the more competitive pressure there is, the tougher firms become in bargaining with unions. One could go on.

Consistent, Professor Armstrong says, with the economic model's over-emphasis on price is the over-emphasis on consumers. This represents a second theme. The author contends that "any model of the firm that does not specifically acknowledge that managers must be concerned about the offers made to all participants is going to be misleading". In the managerial model apparently, "...management must balance all of the offers it makes. It is therefore not sufficent....to look only at an offer-improvement path from the point of view of buyers. Workers, shareholders, managers and suppliers also want, expect and event demand offer improvements over time". There are a number of problems with this balancing approach. The author fails to explain how his model will work where management in the pursuit of efficiency decides to automate completely a unit of production, thus reducing the offer to workers to zero. Similarly, where management decides "to make" rather than "to buy", thus reducing the offer to suppliers to zero, we are left in the dark about how the managerial model applies. But the fundamental objection is that the only purpose of production is consumption. The interests of the particiapnts in the production process certainly act as constraints, but in no way can these interests be equated with consumer sovereignty in guiding production.

1. Eddy Match Company Limited et al. v The Queen (1954), 18.C.R. 357
2. Regina v. British Columbia Sugar Refining Company Limited et al. (1960)32 W.W.R. (N.S.) 577
3. Regina v. Electric Reduction Company of Canada Ltd. (1970), 61 C.P.R. 235

One of the most important themes to which Professor Armstrong returns again and again is the idea that the economics profession is divided into those who take a structuralist view and those who take a behaviouralist view of competition. According to the preface, written by Walter Block, editor of the volume, "You don't need a cast of thousands to ensure competition. This, in a nutshell, is the message which emerges from this study by Professor Armstrong". If indeed this is the message, it must surely be redundant. Dr. Block goes on to explain that in the structuralist view, "what matters is not how firms act, or what they do - a mere nose-count can determine the degree of competition in existence".

Conventional theory, of course, says that both behaviour and structure matter. If three firms agree on a common price (behaviour), it makes a difference whether these are the only firms in the industry (structure) or whether there are 30 other firms. Apart from the proportion of the market covered by the agreement, there are other reasons why structure matters. It is much easier to reach agreement among three firms than among 30, and any agreement among three firms is more likely to hold firm than an agreement among 30. Both structure and behaviour likewise matter in monopoly cases. It makes a difference whether a single-firm monopoly seeks to maintain its position by behaviour designed to raise artificial barriers to entry, through practices which are unnecessary to the efficient conduct of the business; or whether it seeks to maintain its position by supplying existing products at the lowest possible price and bringing to market improved products as rapidly as possible.

Unfortunately there is evidence that some people are taken in by the author's straw man and accept his spurious dichotomy. In a column in the Globe & Mail of October 7, 1983, Ronald Anderson mentions Professor Armstrong's views and reports that in a speech to the International Bar Association, J.W. Rowley asserted that in recent years competition policy has been debated on the basis of two competing concepts of the nature of industrial organization and of competition - the so-called structuralist philosophy, and the behaviouralist philosophy. This will be news to most participants in the debate.

In his book, the author devotes considerable attention to the concept of barriers to the entry of new competition. However, he develops a unique version of the concept, and this represents a fourth theme. As we shall see, his policy prescriptions rely heavily on the assumption that new entry is almost costless. He tells us that, "in the absence of government laws preventing entry, no successful firm can enjoy any significant amount of competitive advantage that will not be joined in hot pursuit". The author has discovered a new principle which ensures that everything is for the best in the best of all possible worlds. That principle is that "dissatisfied customers make entry easy, if not free".

For reasons which are never spelled out, control of production techniques via patents or secrecy cannot represent a barrier to the entry of new competition. He acknowledges that the whole purpose of a patent is to permit the owner to exclude others from the use of the technology for a fixed period. "Even so", he says, "it is stretching things a bit to call a patent a barrier to entry". Nevertheless he acknowledges that in order to enter into an industry a

new firm may have to innovate its way around somebody else's innovation. The author says that "in this age of substitutability, it seems difficult to see why it is any more of a problem for a firm to innovate its way around a resource constraint than around a product or technological constraint". Other barriers to entry are explained away in similarly unconvincing fashion. Established brand names, capital requirements and economies of scale apparently represent barriers to entry only so long as the established companies are able to maintain an improving stream of offers.

The importance which the author attaches to this subject can be deduced from the following passages: "We have seen that even within the limitations of price theory, it cannot be claimed that the monopolists' price will be above the perfectly competitive price so long as there is freedom of entry". And, a few pages later: "It is valid to generalize the conclusion that so long as there are no prohibitions on entry, a monopolistic position cannot be maintained unless it involves making a better offer than can be made by firms operating under conditions of perfect competition". These propositions, however, are not the same. The first statement is correct if, as seems intended, it assumes no barriers to entry. The second statement is not correct in circumstances where entry barriers merely impede entry (by far the most common situation) but do not actually prohibit entry. This distinction is of cardinal importance. The reader will be led astray if he does not realize that Professor Armstrong generally employs the word "barrier" to mean a "prohibitive barrier", whereas in standard economic usage entry barriers are matters of degree.

Professor Armstrong's hostility to an effective merger law, which is discussed below, appears to spring from another theme in the book. The author has a fairly unqualified belief in the advantages which large size confers on the firm. "We can summarize the argument of this chapter by answering a single question: Are the various participants in an industry likely to receive the best range of offers, and the best rate of improvement, if the managers and workers in the industry are organized into a few firms or into many? The sum of the behavioural considerations discussed in the chapter suggests that the answer is 'a few' - with the one reservation: 'few' will find it easier to conspire than 'many'". It is the author's opinion that "if public policy is not to be neutral it should lean in the direction of fewer, not more, firms". With respect to the one reservation mentioned, while he acknowledges that other things being equal, firms will find it harder to conspire the more there are of them in the industry, the issue he says is not whether the proposition is true but whether it is important. Not surprisingly, his answer is that the proposition is unimportant.

In his discussion of the advantages of large size, the author does not address himself to the question of whether the penalties for operating at less than minimum efficient scale are substantial in most industries. This of course is the key question. If such penalties are not significant in an industry, they may be overcome for any given firm by advantages of location, or greater flexibility, or other things.

Against this background it is interesting to look at some of what the author has to say about research and innovation. Professor Armstrong likes to use boxing metaphors. Acccordingly the reader should be warned that he may be dazzled by the author's fancy footwork. Professor Armstrong first

acknowledges that in some industries, especially those concerned with fashion, small flexible companies do much of the innovating for a particular market segment. Large companies, he says, enter only when it has been demonstrated that the product is suitable for mass production and mass marketing. He also quotes F.M. Scherer, a leading scholar in this field, "One conclusion relevant to public policy follows immediately. No single firm size is uniquely conducive to technological progress. There is room for firms of all sizes. What we want, therefore, may be a diversity of sizes, each with its own special advantages and disadvantages". Notwithstanding these comments, Professor Armstrong is somehow able to write the following: "On both a priori and empirical grounds, it is universally accepted that larger scale promotes innovation, at least up to a substantial size of company".

The rest of this review is devoted to Professor Armstrong's policy proposals. The author's analysis leads him to the conclusion that we can largely forget about anti-competitive agreements. For most firms, he says, conspiracy is neither practical nor desirable. It isn't desirable because if firms slow down the rate of offer improvement, they make themselves vulnerable to the entry of new firms, to the threat of imports, or to inter-industry competition. It isn't practical because offers are almost invariably multi-dimensional, and apart from bidding situations, there are ample opportunities for each firm to cheat, even if a solemn agreement on some dimensions exists, by continuing to make increasingly attractive offers on other dimensions. For these reasons, the author asserts, agreements are unlikely to occur and are not very important. He contends "that we have no evidence that they are made in any significant numbers or that they do any more than make a modest reduction in the risk of price wars in certain types of industries".

To deal with the last point first, the author ignores the pre-war record of cartelization in Europe, when none of the leading industrial countries had any anti-trust laws. He ignores also the pre-war history of cartelization in the United States, when the anti-trust laws were in effect suspended for several years under the N.R.A. He ignores the post-war record of hundreds of successful prosecutions of price-fixing and market-sharing agreements in Canada, the United States, Britain, Germany, etc.

It is, of course, true that there are many dimensions to competition, but there are several reasons why this does not mean that agreements are easily evaded and will necessarily break down. In other words, there are good reasons why businessmen are right about the practicality of collusive activity and why the author is wrong. One reason is that where firms agree on market shares, the freedom to act independently in other respects is illusory. Another reason is that agreements often cover most dimensions and involve, for example, product standardization and uniform terms and conditions of sale as well as price. Another reason is that price agreements will not necessarily break down even if other dimensions of competition are not covered, involving for example sales promotion or fancy packaging, because, although consumers will be responsive in some measure to such competition, it will often bring about only slow changes in market shares. A further reason is that it is possible to employ various devices to monitor the faithfulness of the participants to the terms of the arrangement. A still further reason is that participants in general want to make the agreements work, and notwithstanding Professor Armstrong

the entry of new producers may be impeded by high though not necessarily prohibitive barriers.

Some of the author's policy recommendations suggest that he does not have a firm grip on either the law or the administration of the law. He writes, for example, "It sometimes happens that companies may be charged with a very specific illegal act for which Consumer and Corporate Affairs has reasonably reliable proof before a charge is laid. Charges regarding conspiracy, however, are likely to be made when there is a complaint or a suspicion, but little else". The author's understanding is defective here in two important ways. First, the conspiracy provisions of the Combines Act are of course part of the criminal law, and in order to succeed in a prosecution, the Crown has had to meet the standard of proof beyond a reasonable doubt. Until recent years the Crown was able to meet this standard and to secure convictions in the large majority of conspiracy cases brought. Second, Professor Armstrong seems not to be aware that it is the Attorney General and not the Department of Consumer and Corporate Affairs who makes the decision to prosecute. Over the period from 1972 to 1983, 193 cases of all kinds (excluding only misleading advertising) were referred directly to the Attorney General by the Director under The Combines Act, because he believed further proceedings were warranted. Of these, 46 inquiries were subsequently closed on the recommendation or the Attorney General of Canada. In most such cases the Department of Justice concluded that the evidence was not sufficient to justify proceeding. It is therefore clear that in fact as well as in law, the crucial decision is not made in Consumer & Corporate Affairs.

The author's comments on inferential conspiracy are particularly unhelpful. There are cases where there is no overt evidence of agreement and where the existence of agreement must be inferred from the behaviour of the participants. In order to prove an inferential conspiracy beyond a reasonable doubt, it is sometimes necessary to rely upon thousands of documents coming from the possession of the participants. Not surprisingly, when the court finds against the Crown, the judgment cannot be expected to detail the evidence tendered. This may explain how Professor Armstrong could go so far off the track as to make comments such as, "To charge, as has been done, that businessmen are not being competitive if they keep a close eye on their rivals is clearly ridiculous". Or, "That the law should attempt to treat states of recognized inter-dependency or conscious parallelism, which, in many markets, are the sine qua non of competition as being indictable monopolistic offences is absurd". The author does not seem to be aware that in the real world there are a whole range of devices that can be used to facilitate collusion and the close coordination of production and marketing policies. No one has ever been convicted of conscious parallelism.

Most of the author's proposals for reform employ the word "undue". With respect to collusion, for example, he says the law "should declare that actions that produce or threaten to produce an undue restraint on entry are illegal, whether those actions are carried out by one firm or a group of firms acting under agreement". This has a certain plausibility until it is examined closely. One wonders why the author chose the word "undue" without proposing

any tests by which it might be measured. One wonders why he does not mention what Aetna Insurance[1] and Atlantic Sugar[2] have had to say about "undueness" in present Act. If he doesn't know about the recent cases before the Supreme Court of Canada, he is not in a good position to offer advice. If he does not know what these cases have had to say about undueness, it is disingenuous not to mention them, since most writers believe they have seriously weakened the existing provisions.

In his approach to merger policy, the author apparently does not see any difference between concentration that results from internal growth of the firm (which is prima facie evidence of efficiency) and concentration that results from mergers (which may have nothing to do with efficiency and may be evidence of nothing more than the urge for market control).

Professor Armstrong's prescription for merger policy is to say the least permissive. The following general comments are illustrative. "As far as the dynamic, innovative-imitative aspect of competition is concerned, common sense suggests that, in view of the openness and limited size of the Canadian market, the thrust of public policy in Canada should be to facilitate rather than discourage mergers. Better still, perhaps, it should remain neutral". Or again, "Lower concentration levels are by no means in the interests of Canadians. In Canada the merger policy we have makes sense". There are only two things wrong with the latter quotation. First, no one in Canada has proposed a policy of lower concentration (i.e., de-concentration) - the debate has been over the conditions under which increased concentration by merger should be allowed. Second, "The merger policy we have" is one under which no contested case has even been won by the Crown.

It is difficult to know how much weight to give the author's specific recommendations, since he misreads the existing law on merger. He writes, "Section 33 of the Combines Investigation Act states that 'Every person who is a party or privy to or knowingly assists in, or in the formation of, a merger ... is guilty of an indictable offence and is liable to imprisonent for two years'. It is a tribute to the good sense of Canadian courts that the above words have not been given their ordinary meaning; what the law has been interpreted to mean is that it is only those mergers that are of detriment to the public interest that need fear prosecution". With all due respect to the courts, one assumes that section 2 of the Combines Investigation Act, which defines a merger as "the acquisition...of any control over...the business of a competitor, supplier, customer or any other person whereby competition...is or is likely to be lessened to the detriment or against the interest of the public" has had something to do with the interpretation referred to by the author.

(1) Aetna Insurance Company and 72 other Corporations v. The Queen (1977) 15 N.R. 117.

(2) Atlantic Sugar Refineries Co. Ltd., et al v. Attorney General of Canada (1980) 2 S.C.R. 644

Professor Armstrong proposes that if mergers are to be subject to judicial review, "Consumer & Corporate Affairs should in the future monitor only those mergers that threaten to produce single-firm industries or that might have the effect of unduly discouraging entry". He suggests no tests to assist the court in deciding when the discouragement of entry should be held to be undue. Such light as he does throw on the application of his proposal comes from his statement that "it is to be expected, however, that mergers that reduce the number of effective competitors from two to one would be disallowed by the courts in most cases, as indeed they are now". This doesn't help much. In support of the statement as to the existing law he cites the Erco case. But in fact there are no others. Thus we are left in the dark about the meaning of "most cases", both now and under his proposed policy.

The author makes several policy recommendations relating to monopoly or monopolization. As in the case of mergers, he seems unaware that the charging section, Section 33, must be read in conjunction with the definition of an illegal monopoly in Section 2. As the law now stands, he says, it gives the appearance of making monopoly illegal and therefore attaches a stigma to the word "monopoly". He says it might be argued that he has set up a staw man - that the courts do not in fact interpret monopoly to mean the making of a unique offer. If this is true, he says, there should be no objection to changing the law to make the words in their usual meaning correspond to intent.

He does go on to propose that the law should declare it to be a civil offence for any company, association, union or other organization, to take actions the intention of which is to unduly limit the freedom of others to make or accept offers. Once again, no criteria are proposed to define undueness and no reference is made to recent interpretations of the Supreme Court of Canada.

The reader is left with considerable uncertainty about what Professor Armstrong's specific recommendations in this area are. This difficulty is not clarified by another comment that "A good case can be made that as long as the criminal law deals firmly with protective rackets, goon squads and other forms of harassment, a competition law per se does not need to deal with private prohibitions of entry. Certainly any advances towards achieving our economic goals by including provisions about private prohibitions will be as nothing compared with the great leap forward that could be made by dismantling the network of government prohibitions". Without accepting much of the analysis that has gone before, at least one can agree that there are far too many government restrictions on entry and that the elimination of many of them would make a major contribution to improvement in the performance of the Canadian economy.

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