COMBINES ACT AMENDMENTS - ONCE AGAIN

By L.A. Skeoch

General

Bill C-29 represents the latest in a long, costly, and, so far, unfruitful, series of government efforts to amend the combines legislation. This is only part of the longer-term record in combines administration which cannot, unfortunately, be described in flattering terms. The factors accounting for this indifferent record are complex, and their analysis would require information, time and resources - all in short supply.

The pressure for combines legislation arose from concern that the private economic sector - or, at least, some sections of it - was diverging from the ideal of a decentralized, flexible, market economy. It has been generally recognized that a decentralized market economy would function effectively with a minimum of information in the areas of resource allocation, promoting technological change, co-ordinating supply and demand, and the like; it has also been generally recognized that the development of large-scale units in an industrial society invalidates some of the assumptions on which the simple market model was based.

What is not so frequently appreciated is that other sectors of the economy, as well as the business sector, have changed significantly from the structural - behavioural pattern assumed for them in the general decentralized model, and that the cost of providing, disseminating and assessing economic information for political policy-making in this changed environment may very well reach prohibitive levels. These costs take a variety of forms.

The investigatory costs of compiling data on the need for public-policy controls over the economy as a whole or in a given industry can, themselves, be very high, apart altogether from the cost of generating new and unique knowledge. This information-gathering process also appears to have an inherent tendency to expand over time. According to a Swedish economic report, a committee analyzed the energy industry, in a report, published in 1970, that ran to only 120 pages. The report strongly supported the adequacy of the market as the central instrument of resource allocation, with government policy being limited to such matters as environmental control and military requirements. Both politician and citizen could satisfy their information needs on energy policy with only a few hours' effort. In 1978, a new report was circulated for study by politicians, organizations and private citizens. This study, however, was approximately 10,000 pages in length, and supplementary reports from expert groups made up an additional publication of the same size. It was estimated that an individual would require a year's working time to go through the material with care.

Although a similar comparison is not available for Canada, it is worth noting that the seven-volume petroleum industry study by the combines branch would impose a substantial burden on all those responsible for, or interested in, energy issues.

Analyses of technical economic questions also involve costs, not only of preparation, but, perhaps more importantly, in terms of understanding and evaluation by politicians and other participants in the formation of public policy. Economic analysis is complex in the sense that it requires the use of concepts and relationships which are not common in "every day" economic life.

The late Professor H.A. Innis cautioned - perhaps excessively - against the notion that economics can be readily grasped by the non-economist.

> "I do not expect to exert any influence on your views on any question of public policy, and I do not expect that many of you will undertand any economic exposition which may be advanced in this paper .... But let me warn you that any exposition by any economist which explains the problems and their solutions with perfect clarity is certainly wrong. Economics is an extremely difficult biological subject not discussed or understood (sic) by groups of preferably about three trained economists". (Canadian Problems, p. 70.)

The acceptance of this view - which I share only in small part - may explain why economists who enter into the public debate on industrial organization policy encounter such strong resistance from a variety of organizations. We may be faced with a parallel to Gresham's law in the area of the dissemination of economic information. Simple and sometimes erroneous messages may tend to displace complex and more relevant information. Certainly, the cost of bringing complex economic analysis to bear on the formation of public policy will be high.

It is basic to the issue of substituting political decisions for market decisions to realize that the total capacity for political decision-making and information evaluation is a strictly limited resource. The Cabinet, government officials, and Parliament, to mention only the most obvious examples, cannot handle more than a few issues at a time; concentration on one issue, such as energy policy, means that other policy matters are delayed. As the political system struggles to process information on the extending range of policy interventions, it is forced to resort to strong simplifications and to suppress or delay decisions, with possibly serious long-run effects on market investment decisions.

It is my strong impression that policy on industrial organization has been approved without penetrating analysis or discussion. As more and more decisions are transferred from markets to courts or public tribunals, there is good reason to adopt a pessimistic attitude about the possibility of achieving rational economic decisions that are adaptable to rapid change and that promote economic change.*

The Merger Section

In dealing with the details of Bill C-29, a selective approach will be adopted which will focus on mergers, abuse of dominant position, and the shifting of merger and monopoly cases from the criminal law section to the civil law section. Even within this limited area, attention will be concentrated on one or more strategic matters related to the importance of promoting a flexible, dynamic economy.

In the merger section the baisc unit of analysis for the determination of the effect of the merger on "competition" is repeatedly identified as "a market". It is pointed out, for example, in the "Explanatory Notes" that "the number or size of mergers provide little indication of their economic or social significance. What we need to know is their effect on the nature and intensity of competition in individual markets". (Emphasis added)

As I have argued elsewhere, such an approach possesses the text-book virtues of neatness and logical precision. However, it is vital that all the market-related elements be explored in detail. Recent merger activity has involved partial mergers and quasi-mergers between multi-product and multi-process firms, joint ventures of variable durations, collaboration agreements, international arrangements, and so on. The pertinent market is not something that can be defined apart from the analytical needs of the specific problem under consideration.

Indeed, the late Professor Corwin D. Edwards emphasized repeatedly that market analysis alone was not adequate. Significant changes in the complexity and scale of business decisions have accompanied changes in economic organization. Decisions by multi-market enterprises, based on the over-all strategy of a diversified firm can no longer be adequately analyzed by the market approach required by the legislation. Dynamic change is continuously altering the size and shape of markets. Enterprise strategy is

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*I have had the opportunity to read with profit an article by Ingemar Stahl, "Problems of Information in Economic Policy", Skandinaviska Enskilda Banken Quarterly Review, 1-2, 1979.

frequently multi-dimensional, so there is need for simultaneous analysis of several relevant markets. Substitutes make the boundaries of a market fuzzy, involving substitution in use and in the production process. And these two "markets" may be quite different. The market concept may provide a bad fit for the facts when there is a chain of overlapping groups of sellers. It is often important to take account of potential competitors but it is difficult to identify them. In sum, a broader and more flexible approach is required than the proposed legislation provides.

The legislation directs the court, in appraising whether the adverse effect of the merger on competition is or is likely to be "significant" to consider eleven categories of factors plus "any other factor that is relevant". Some of these relate to market definition, others to structural elements, and others to behavioural elements. There is, however, no indication of their relative weights. In the circumstances, it is not clear why a much simpler general criterion was not specified.

Even where the court finds that the merger involves a significant prevention or lessening of competition it will have no jurisdiction to make a particular remedial order where "the merger or proposed merger has brought about or is likely to bring about gains in efficiency that will result in a substantial real net saving of resources for the Canadian economy and that the gains in efficiency could not reasonably be expected to be attained if the order were made".

There are two aspects of the "defence" provision that merit comment. First, the "gains in efficiency" tests reflects a comparative statistics approach which is inappropriate as a basis for intervention requiring a lengthy period of time for completion. Further as Professor Thomas Wilson, Glasgow University, has pointed out:

> "The final point to be made ... is a reminder that it will not do to concentrate attention on static economies of scale. Even if costs could be lowered by 5-10 percent by means of the amalgamation, this will probably be equivalent to only two or three years' rate of growth of productivity. It is the effect of the amalgamation on future growth that will really matter". (Emphasis added).

The additional requirement that the efficiency gains must "not reasonably be expected to be attained" by means other than the merger represents a concept of economic causation that must cause serious concern. To successfully meet this requirements would demand techniques of economic analysis that are so far unknown. The number of issues in economic history or in recent economic policy to which it would be possible to assign sole determinants or for which it would not be possible to reasonably ascribe alternative determinants must be very few, indeed.

There is a tendency in these sections for the drafters of the legislation to inhabit a city of words. If only they can give names to things, they assume that they acquire a degree of control over events that behave in such unpredictable fashion in the real world.

The sections dealing with "Abuse of Dominant Position" require little additional comment since they are subject to the same "market-definition" weaknesses as the merger sections. There will, obviously, be problems associated with the identification of "exclusionary intent". Imperfections of competition in supplying or receiving markets may, in fact, be reduced by what might very well appear to be "abusive" actions listed in the legislation. Given an expanding and changing economy, there must necessarily at any instant be a host of markets out of equilibrium, into which it becomes profitable to integrate. This would explain the existence of vertical integration even in the absence of attempts to pre-exempt an essential resource in order to prevent competitors from using it, or to insure the "right" kind of price policy at later stages.

The "abuse" section clearly requires re-thinking.

Adjudication in Civil Court

The Explanatory Notes make much of the proposed change which would shift the evaluation of the laws relating to mergers and the use of monopoly market power from the criminal courts (where the offence must be established beyond a reasonable doubt) to the civil courts (where the facts must be established on a balance of probabilities). The Notes go on to claim that "Because Canada has been working with a criminal law that is quite ill-adapted to the task, there has never been a conviction in a contested merger case". And, again, "They (the courts) have concentrated on such specific adverse effects as prices and profits and have been unwilling to consider larger issues of public policy".

These are very serious and very broad charges which would appear to require some qualification. In the Canadian Breweries case (Regina v Canadian Breweries Ltd. (1960), O.R. 601), which has come in for extensive criticism, it can be demonstrated that it was neither the restraints of criminal law tests nor "unwillingness" to consider larger issues of public policy that were responsible for the unsatisfactory nature of the outcome. In very sketchy terms, the analysis of the staff of the Director of Investigation and Research provided a highly competent study of the issues, both short-term and long-term, for presentation to the court. This writer was retained to act as economic adviser to the highly qualified legal counsel who conducted the case. My first responsibility was to prepare a statement of "the particulars of detriment" which dealt with issues of prices and profits and of longer-term matters such as barriers-to-entry, dynamic change in the industry, and so on. This basic document was almost immediately blue-pencilled beyond recognition,

particularly with respect to the longer-term matters. As a result, I immediately resigned from the case, and the prosecution went forward on a much narrower front. This was not because of "unwillingness of the court" to consider such issues nor of criminal law tests; the matters were simply never placed before the court. There was a decision of the court on pricing matters in which vital documentary evidence was rejected on grounds that to this day I find impossible to comprehend. As a result, the merger-induced changes ended up with the creation of an industry marked by grossly high levels of rivalrous advertising, vastly enhanced barriers to entry, and very little effective competition of benefit to consumers.

In another case - related to attempted monopolization - I was asked by the Director of Investigation and Research to appear as an expert witness to explain what considerations would be involved in the economic evaluation of monopoly behaviour. In this instance, it was not again a matter of unwillingness to consider larger issues of public policy or of criminal law tests; I was bluntly refused permission by the court to appear as a witness on any matter.

What is at issue, in the final analysis, is whether law courts, civil or criminal, provide effective conditions for analyzing relatively complex economic issues, or whether there are more effective alternatives. This is an issue which is dealt with in detail in Section IV-1 "A Specialized Adjudicating Body" in the report, Dynamic Change and Accountability in a Canadian Market Economy. (1) This anlaysis, primarily the work of Mr. Bruce C. McDonald, provides a sophisticated yet realistic survey of the issues, conceptual and administrative, that require consideration, and makes clear the need for more profound remedies than a mere shift from criminal to civil tests.

(1) By Dr. Lawrence A. Skeoch with Bruce C. McDonald in consultation with Mr. Michel Belanger, Mr. Reuben M. Bromstein and Mr. William O. Twaits, Ottawa, 1976.