BOOK REVIEWS

PARCEL OF ROGUES: HOW FREE TRADE IS FAILING CANADA

TORONTO: KEY PORTER BOOKS, 1990, 246 pp.
by: Maude Barlow

A Review by: Gordon Ritchie, CEO, Strategico Inc., Ottawa

Canadian political debate is marked by a lack of rigour in distinguishing means from ends and defining the linkages of the two. Nowhere is this more true than in the current heated debate over the appropriate national industrial strategy. Maude Barlow's *Parcel of Rogues: How Free Trade is Failing Canada* is the latest contribution to this confusion.

As I read this manifesto, Barlow is deeply committed to a higher standard of living for Canadian men and women. She believes in Canada and the importance of maintaining our identity, our sovereignty and our national integrity. I share these objectives. That is not, in my view, what the debate is all about. The debate is about ways and means of achieving these goals.

Economic nationalists like Barlow are wedded to the view that the state is the chosen instrument for advancing national interests in the face of the growing power of the multinational corporations. They belong to such high-sounding organizations as the Council of Canadians or the Pro-Canada Network. In their demonology, a special place is reserved for the *Canada-U.S. Free Trade Agreement* and its proponents who would, they rightly believe, curb their power and influence.

The preferred tools of the economic nationalists are those of "economic regulation" as broadly defined to run the gamut from exhortation through bribery to coercion and finally to nationalization. All of these techniques have been tried at both federal and provincial levels in Canada. Indeed, *mea culpa, mea maxima culpa,* I have been the author of many of these initiatives and the chief operator of many others as a policy advisor and later, as Chief Operating Officer of the federal Department of Industry and the government director of various crown corporations.

It is therefore with some personal dismay that I have been forced to conclude that, with a very few show-case exceptions, the results have been largely unhappy. Regional and industrial assistance has been largely ineffectual whether given as direct grants or, worse, as tax credits (*viz.* the SRTC). The crown corporations have proved to be extraordinarily expensive white elephants. The regulators have been captured by their industries, and the infant industries protected by tariffs have never made an effort to grow up. If these were isolated cases, one could blame it on the incompetence of the perpetrators; when the experience is so pervasive, even the most credulous must suspect that there are intrinsic flaws in the whole approach.

Why, if these policies have such a poor track record, does economic nationalism retain its appeal and even appear to be enjoying a minor renaissance? Cynics would say that it is because it provides such substantial rewards for the elites who would exercise the power of the state in furtherance of their own interests. With the old dope peddler of Tom Lehrer's memorable song, they believe in doing well by doing good.

I believe the deeper answer lies in the seductive attraction of the promise that everyone will somehow gain without pain. The one common thread of all these policies is the state as *Robin the Hood* taking from some - often the weaker and poorer members of society and often without their knowing - and re-allocating the money, often less a substantial "commission" for administrative costs, to others as a present from the politicians who eagerly take the credit.

As the readers of this review are keenly aware - and as the broad public apparently is not - this

modern miracle of the loaves and fishes is a swindle. The money federal and provincial politicians compete shamelessly to give to firms for projects which would (in at least three cases out of four), proceed in any event, is money borrowed on the taxpayers' credit! The proudly independent dairy farmers hold as their principal asset the licensed privilege to gouge the Canadian consumer, who pays twice the international price for her milk. Strong unions and strong companies agree to wage settlements far out of line with internationally competitive labour costs, secure in the knowledge that the costs can be passed on to the consumer behind the protective walls of tariffs or quotas. Politicians create fiefdoms on the backs of the Cape Breton steel worker or coal miner who labours at his dirty and dangerous occupation in order to receive a fraction of the subsidy charged to the taxpayer. The litany is endless. The result is unequivocally to reduce the overall wealth of our economy in order to undertake a political redistribution which may or may not be more equitable.

This plays powerfully on the unwillingness to face up to today's sometimes harsh realities. In the recent past, Canadians were the beneficiaries of substantial economic rents from our natural resources. In the post-war period, we further benefited, at least in the short term, from a massive inflow of foreign (mostly American) capital and technology which enabled us to grow at an artificially rapid rate. More recently, we have continued to live on money borrowed by the state which has pampered us with services costing $1.20 for every $1.00 the taxpayer has contributed. Consequently, the generation now in positions of power has, as a group, enjoyed a standard of living significantly above what we have earned.

The policies of the current government represent a recognition - belated, grudging and not consistently followed - that this joy ride must some day come to an end and that the later corrective measures are taken, the more destructive the ultimate crash will be. This is unpleasant stuff. It has combined with other factors to reduce the Progressive Conservatives to the lowest popular standing ever recorded by a governing party in a democracy. Canadians are looking for courageous leaders to promise to kiss us and make it better, without further effort on our part.

Barlow's book plays skilfully on these fears and hopes. It turns out that the current government is really the lackey of the multinational corporations and/or the American imperialists. The answer is to undo the structural reforms the government has put in place — re-nationalize corporations, re-regulate industries, abolish taxes such as the Goods and Services Tax (without somehow reducing spending), increasing regional and industrial subsidies, etc., and, above all, repudiate the *Free Trade Agreement.*

Space, indeed life, is too short to recapitulate and refute the myriad claims made by Barlow in support of the proposition that the *FTA* has proved to be a gigantic sell-out, a betrayal by paid conspirators. Most of this is old hat, raised in the election campaign and, I believe, shown to be unfounded (e.g., the patently false proposition that we are obliged to divert our rivers to accommodate the Americans). Perhaps the most interesting material is not in the main body but in the annex, a widely reported 29-page litany of layoffs totalling nearly 100,000 jobs that have gone south because of the *FTA*. Frankly, I am struck by how short the list is - since a normal year sees about two million layoffs in Canada. A quick skim of the list reveals that about half the jobs on the list are concentrated in a small number of large scale layoffs that could not possible be blamed on the *FTA*, coming as they do in sectors that were left outside the agreement — the airlines, trucking, breweries, East Coast fish processing, even government agencies, including the CBC.

I believe Maude Barlow, whom I know to be well meaning to a fault, would make a greater contribution to raising the level of public debate is she were — perhaps in her next book — to apply a bit more rigour to her facts and to her analysis and to address the basic question: On what grounds does she believe that policies of economic nationalism will, in practice, raise the living standards of Canadians?

MERGERS AND THE COMPETITION ACT

TORONTO: CARSWELL, 1989. 750 pp.

by: Paul S. Crampton

A Review by: Prof. D.G. McFetridge, Dept. of Economics, Carleton University, Ottawa

This book is a remarkable scholarly effort. It will be an invaluable reference for both lawyers and economists, whether academics or practitioners, who have an interest in either the foundations or the application of merger law in Canada.

The book can be divided into three sections. The first contains two survey chapters. The first of these explores the history of Canadian merger law and chronicles the events leading to the passage of the *Competition Act* in 1986. The second chapter examines current and past merger policies in the United States, Australia, the United Kingdom, Germany and the European Community.

The second section of the book synthesizes received wisdom regarding the definition of three concepts which underlie public policy toward mergers. These are the concepts of competition (Chapter 3), the (relevant) market (Chapter 4), and the lessening of competition (Chapter 5).

The final section of the book, comprising chapters 6 to 8, is devoted to the interpretation of Sections 93 and 96 of the *Competition Act* and to the explanation of a number of procedural matters including the merger review process at the Bureau of Competition Policy.

The book draws on a vast amount of material from both economics and law. While some of this material, such as (one hopes) the decisions of the Warren Court, is of limited relevance to present circumstances and the author is in some instances distressingly reticent about drawing conclusions, the book is, on the whole, very well done. My review of it is confined to a discussion of some of what I regard as the more important issues it addresses.

The author searches in Chapter 3 for a consensus definition of competition. He concludes that the weight of professional opinion is that competition involves rivalry in a number of dimensions including price, quality, variety and innovation. The intensity of this rivalry depends on the manner in which existing competitors interact with each other and with potential competitors. It may, but need not in Crampton's view, also depend on the number of competitors.

In drawing this conclusion the author distances himself from what he terms the pure structuralist view that there is a continuous relationship between the number of competitors in a market and the intensity of competition. He opts instead for what he calls the centrist view which is that competition may be diminished in some or all dimensions as markets become highly concentrated.

Crampton rejects what he calls the revisionist argument that, absent regulatory restrictions on entry, the competitive process is self-sustaining and that, as a consequence, government control of mergers is unnecessary.

The rejection of revisionism (hence the rationale for government intervention) is based on two propositions. The first is that market concentration and price-cost margins tend, overall, to be correlated at least as strongly as smoking and lung cancer. This is a strange argument given that earlier in his exposition Crampton appears to have accepted the "centrist" view that correlations between concentration and price-cost margins need not imply anything about the relationship between concentration and the intensity of competition.

The second proposition is that innovation or new entry by potential foreign or domestic rivals may take considerable time to erode monopoly or joint monopoly power. Merger policy may be able to preclude the emergence of this power. The abuse of dominant position provision may be able to reduce its duration. In this the author is on firmer ground.

One wishes the rejection of revisionism and thus the rationale for policy intervention were based on more than some largely discredited correlations and the observation that monopoly power may erode slowly. The law and economics literature with which the author is familiar could have contributed more here. Intervention is not costless. The adjudication process uses resources. Mistakes will be made. Some socially beneficial mergers will be forbidden and as a consequence

others will not be proposed. The process will be vulnerable to strategic behaviour on the part of customers, suppliers and rivals. It may be very difficult in a small country to find disinterested industry experts on whom adjudicators can rely.

These considerations may be regarded as irrelevant given that the *Competition Act* is in place. They may still have some relevance, however, to the determination of the threshold of intervention, over which the *Act* has afforded the Director of Investigation and the Tribunal a considerable degree of discretion.

In Chapter 4 the author turns his attention to the question of product and geographic market definition. His analysis, which necessarily draws heavily on U.S. practice, covers four approaches to product and geographic market definition – substitutability, cross-elasticity, price relationships and hypothetical monopolist. A fifth approach based on shipments and purchase patterns, is relevant only to geographic market definition. He sees the substitutability approach as having been the most useful. Indeed, the other approaches are alternative ways of inferring the existence or consequences of substitutability. The author also provides a useful discussion of the various types of evidence from the which the degree of substitutability or interchangeability can be inferred.

In Chapter 5 Crampton attempts to define what might constitute a substantial lessening of competition. After examining Canadian case law, parliamentary debates, Restrictive Trade Practices Commission reports and the practices of other jurisdictions he concludes that a substantial lessening must involve, at a minimum, a significant deterioration in the price or nonprice (quality, variety, innovation) performance of the market in question. He does not explore the question of what a significant deterioration of price or nonprice performance might be. His views on what the structural prerequisites for an inference of significant deterioration would be, appear in Chapter 6.

Chapter 6 is devoted to the analysis of the structural and behavioural factors which the Competition Tribunal may consider when determining whether a merger substantially lessens competition. Two factors are thought to play key roles. These are concentration and market shares and barriers to entry. Crampton regards the joint occurrence of high concentration and high barriers to entry as a necessary but not sufficient condition for the existence of a substantial lessening. That is, a merger which leaves the firm involved with a large share of a market which is difficult to enter may still not be deemed to lessen competition substantially if there is effective foreign competition, easy interproduct substitution, or if the market is characterized by significant innovation.

With regard to concentration and market shares, Crampton extends the conclusion he reached in Chapter 5 that concentration need not be pushed to the point at which the merged firm dominates the market before a substantial lessening can be inferred. He finds a significant professional consensus that there is serious cause for concern when the four firm concentration ratio exceeds 80 per cent. He notes that the 1984 U.S. Department of Justice merger guidelines provide for the likely challenge of mergers involving market shares as low as 16.5 per cent in markets with four firm concentration ratios in excess of 75 per cent. He also notes, however, that in jurisdictions other than Germany, challenges of mergers involving market shares of 35 per cent or less are rare. Finally he observes that the Tribunal expressed the opinion in the *Gemini* case that when there are only two major firms in a market there is increased opportunity for collusive behaviour.

This discussion leaves the reader with the sense that a merger which leaves three roughly balanced firms serving a market not predisposed to collusion might not, in the author's view, exceed the concentration threshold necessary for a substantial lessening, while a merger which left the market largely in the hands of two would do so.

With respect to entry barriers, Crampton recognizes that unless the production or marketing process is characterized by both fixed costs that are significant in relation to the market and by significant sunk costs (market-specific investments), there can be no barriers to entry. He also concludes that, while there is not a generally accepted method of measuring their magnitude, the absence of entry in a growing

market can be an indicator of the existence of significant entry barriers.

Chapter 7 provides a much needed interpretation of the efficiency defence in Section 96 of the *Competition Act*. According to Section 96, if the Tribunal finds that a merger is likely to lessen competition substantially, it is then obliged to compare the effects of that lessening with the gains in efficiency resulting from the merger. It is instructed not to prevent or otherwise alter the merger transaction if the efficiency gains foregone as a consequence are greater than and offset the anticompetitive effects of the transaction.

The merger adjudication process is thus essentially one of benefit/cost analysis, with the Tribunal being obliged to determine whether the efficiency benefits of a merger outweigh the costs associated with the consequent lessening of competition. This approach embodies as a special case the trade-off analysis suggested by Oliver Williamson more than twenty years ago.

The implementation of the benefit/cost approach requires that the effects of a substantial lessening of competition be measured. Crampton concludes, correctly in my opinion, that the appropriate measure is the deadweight loss in surplus resulting from the exercise of the increased market power accruing to the merged entity. As he shows, this deadweight loss can include foregone monopoly profits or quasi-rent as well as foregone consumer's surplus. The effect should not, in Crampton's view, include any redistribution of surplus, for example, from consumers to producers. This would be inconsistent with the goal of maximizing total surplus and would undermine the efficiency objectives of the *Act*.

The author's discussion of trade-off analysis seems to imply that the only anticompetitive effects which are measurable or quantifiable are price effects. There is nothing inherently unquantifiable about nonprice anticompetitive effects. The welfare consequences of changes in product variety or quality are conceptually quantifiable and depend very much on the market circumstances involved. To relegate them to qualitative status is to invite the application of poorly thought out rules of thumb.

In Chapter 7 the author also joins in the speculation regarding the meaning of the phrase "will be greater than and will offset" in Section 96. To him this implies the balancing of both commensurables (quantitative efficiencies versus quantitative anticompetitive effects) and noncommensurables (qualitative efficiencies versus qualitative anticompetitive effects). He also concludes that the arithmetic excess of quantitative efficiencies over quantitative anticompetitive effects may not be a sufficient defence. These propositions raise as many questions as they answer. The discussion does, however, eliminate one disconcerting possibility. Crampton concludes that there is no basis for arguing that "greater than and will offset" means that efficiency gains must be so large that prices in the relevant market do not increase after the merger. In his view the U.S. Department of Justice approach to efficiencies does not apply in Canada.

The author's general approach to the efficiency defence is what he calls "order driven". It requires that net benefits (efficiency gains less anticompetitive effects) be greater under the order contemplated by the Tribunal than if no order were issued. It does not require that the Tribunal (or the Director of Investigation) serve as a social investment banker searching out the merger yielding the highest net benefit. It does require, however, that the Tribunal take into account the possibility that some efficiencies could be realized by other mergers. The author does not discuss how real these alternative mergers have to be or how one determines the efficiencies that might flow from them.

The final chapter of the book contains a discussion of some procedural aspects of the *Act*. It draws some conclusions from the few cases with which the Tribunal has dealt regarding the nature of the orders it will issue and the manner in which it may deal with consent proceedings. The author notes that the Tribunal has indicated a willingness in the *Gemini* case to issue long-term behavioural orders involving the quasi-regulation of markets, provided they can be fashioned so that their provisions would be enforceable if breached. He regards this development as a regrettable departure from the practice in other jurisdictions. Indeed.

With respect to the test the Tribunal intends to apply in granting a consent order, Crampton concludes that, to challenge an order, intervenors

need not show that with it there will still be a substantial lessening of competition. They need only show that the order will not achieve virtually all of its objectives. He sees this as raising the burden on parties to a consent order and discouraging the Director from including provisions in an order which increase competition rather than simply eliminating any substantial lessening.

The insights the author draws from the Tribunal's few decisions provide some of the most interesting reading in the book. This holds out the promise that in subsequent editions he will be able to tell us more about what the law on mergers in Canada actually is. As it stands, the book is a fruitful source of possible interpretations of Canadian merger law. The author notes with approval that the *Competition Act* is regarded as the most economically literate competition statute in the world. His book provides ample evidence that this economic literacy has come at a high price in terms of complexity and uncertainty of interpretation. He assumes that the merger evaluation and adjudication process provided for in the *Act* would itself pass a benefit/cost test. Time will tell if that assumption is warranted.