Available online at www.sciencedirect.com
ScienceDirect
International Journal of Industrial Organization
24 (2006) 1267–1297
International Journal of Industrial Organization
www.elsevier.com/locate/econbase

Imperfect competition law enforcement☆

Maarten Pieter Schinkel [a,*], Jan Tuinstra [b]

[a] *Department of Economics and ACLE, Universiteit van Amsterdam, Roetersstraat 11, 1018 WB Amsterdam, The Netherlands*
[b] *Department of Quantitative Economics and CeNDEF, Universiteit van Amsterdam, Roeterstraat 11, 1018 WB Amsterdam, The Netherlands*

Available online 5 June 2006

Abstract

Competition policy is a subject of often heated debate. Competition authorities, seeking to prevent or battle anticompetitive acts in complex cases to the best of their abilities, regularly find themselves advised by rival economic theories and disputed empirical analyses. As a consequence, there is a real possibility that they may occasionally err, missing true violations of competition law or finding firms liable that actually had no other intentions than good competition. In this paper, possible consequences of such imperfect competition law enforcement on firm strategies are considered. In a simple model of collusion, it is found that the incidence of anti-competitive behavior increases in both types of enforcement errors: Type II errors decrease expected fines, while Type I errors encourage industries to collude precautionary when they face the risk of a false conviction. Hence, fallible antitrust enforcement may stifle genuine competition, thus stimulating the very behavior competition policy is meant to deter. When enforcement errors are non-negligible, competition authorities run the risk of being over-zealous, in the sense that welfare is best served by an authority that is selective and conscientious in its targeting of alleged anticompetitive acts.

JEL classification: L40; D40

Keywords: Antitrust; Competition policy; Competition law enforcement; Type I and Type II errors; Collusion; Abuse of dominance

☆ Part of this research was conducted at Universiteit Maastricht, for which financial support from METEOR is gratefully acknowledged.
* Corresponding author.
E-mail addresses: m.p.schinkel@uva.nl (M.P. Schinkel), j.tuinstra@uva.nl (J. Tuinstra).

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doi:10.1016/j.ijindorg.2006.04.008

1. Introduction

Competition policy is controversial and often advised by rival economic theories. Many contributors to the central debate whether antitrust intervention is a cure for imperfect competition and inefficiency or rather a cause take the latter view as point of departure. Exponents of what is commonly referred to as 'the Chicago School', such as Robert Bork and Richard Posner, point to a variety of reasons for why one should be wary of competition policy.[1] They stress that it is often difficult to determine in merger control, for example, whether the alleged significant lessening of competition is really there, and if so, whether there is indeed a net consumer detriment when the potential efficiency gains in mergers are properly taken into account. Likewise, in antitrust investigations, these scholars would point out that it is no easy matter, surely not a simple question of empirics, to discriminate between alleged anticompetitive behavior, such as predatory pricing, and good competition.[2]

In particular also, these scholars express concern for the efficiency of the enforcement process. In his now classical monograph *Antitrust Law*, first published in 1976, Posner warned in no uncertain terms that in his experience antitrust cases are complicated and costly, yet often handled by

> "[t]rial lawyers [that] tend to be combative rather than reflective, and … division's trial lawyers [that], because they are relatively poorly paid, tend to be young or mediocre, or to be zealots, [… who, …] [a]s a result of neglect of economic principles, … have fashioned a body of substantive doctrine and a system of sanctions and procedures that are poorly suited to carrying out the fundamental objectives of antitrust policy—the promotion of competition and efficiency." (Posner, 1976, pp. 231–236)[3]

This concern for government failure is taken a step further in Baumol and Ordover (1985) by raising the issue of antitrust institutions being strategically misused as an instrument to hinder competitors. The authorities may be misguided, i.e., to bring spurious antitrust cases, intended to subvert competition – a "specter," they say, that is likely to be "… more than offsetting the contributions to economic efficiency promised by antitrust activities," and that we "would do well to take steps to exorcise."[4] And in fact, there now is a substantive literature on perverse strategic firm behavior in the presence of an antitrust authority.

The wording that these authors choose is rather strong, yet caution towards antitrust intervention is found with scholars that are sympathetic to promoting competitive processes through antitrust interventions, as well. Franklin Fisher, an antitrust veteran in both defendant and plaintiff camps, for example, writes on the difficulty of establishing true anticompetitive behavior that:

> "Economists and others ought to approach the public policy problems involved in these areas with a certain humility. Real industries tend to be very complicated. One ought not to

[1] Cf. Bork (1993) and Posner (1976, 2002).

[2] Allegedly, Ronald Coase said he had gotten tired of antitrust because when the prices went up the judges said it was monopoly, when the prices went down, they said it was predatory pricing, and when they stayed the same, they said it was tacit collusion. See Landes in Kitch (1983, p. 193). We thank Joe Harrington for giving us this reference.

[3] In the recent and extensively re-edited 2002 edition of this classic, Posner expresses – albeit in somewhat milder terms – a similar concern for particularly the enforcement process as the main open problem area in competition policy today. Posner (2002, Chapter 10).

[4] Baumol and Ordover (1985), p. 247.