The Economist

Special report:
Companies and the state

Competition policy

Crossing continents

Competition authorities are increasingly reaching beyond their countries' borders

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WHEN TWO AMERICAN presidents, Theodore Roosevelt and William Howard Taft, embarked on a trustbusting mission a century ago, they were taking government into a new policy area: competition. Industrialisation was still relatively new, and any monopolies that had emerged, such as the British and Dutch East India companies, had been created by governments.

The robber-baron companies of the late 19th century were accused of using their industrial muscle to drive competitors out of business. Private monopolies, the argument ran, diminished the benefits of capitalism; by definition, the existence of a monopoly made it impossible for a free market to operate.

Since then, governments have generally had some kind of competition policy, though not necessarily a coherent one. Politicians have tried to juggle a number of different priorities, among them putting government in control of "strategic" industries (a category that has always included defence but often also a range of other industries, from airlines to car manufacturing, power generation and telecoms); shielding domestic businesses from foreign ownership or competition; and protecting consumers from price-gouging.

In the past two decades a new concern has emerged: that monopolies may be restricting innovation. The technology industry seems to have been particularly prone to creating near-monopolies, from Microsoft in software to Amazon in retailing and Google in internet search. This is due to network effects. Consumers gravitate to the dominant technology, either because it offers more products or because many of their friends are already using the network concerned. These monopolists, it is feared, will be slow to introduce new technologies that might cannibalise their existing business; and they will be so entrenched that new competitors will find it hard to get a foothold.

Microsoft bundled its Internet Explorer browser with its dominant Windows operating software on personal computers. America's Department of Justice saw this as an attempt to force Netscape, a rival browser, out of the market. In a long court case that began in 1998, Microsoft was initially ordered to break itself in two. This ruling was overturned on appeal and a less onerous settlement was arrived at.

At the time many commentators felt that the authorities had overreached themselves. Internet Explorer was provided free of charge, so it was hard to see how consumers were being harmed. But this is a tricky area. On the one hand, rapid technological change can cause once-dominant companies to lose their position very quickly if they do not adapt; look at Nokia's and BlackBerry's mobile-phone businesses. Some argue that if the market is capable of such adjustment, governments should not get involved. "The fact that some consumers make the wrong decision some of the time is not the basis for intervention, as long as all consumers are not being ripped off," says Simon Bishop of RBB Economics, a consultancy. On the other hand, such rapid change makes it hard to tell whether monopoly positions are being exploited, or whether a more competitive market would have produced more innovations.

Competition authorities have also had to rethink their role in cross-border deals. If one multinational takes over another, that might not create a monopoly in the country where the two groups have their headquarters, but it could do so in another country. A proposal for a merger between General Electric and Honeywell, announced in October 2000, was cleared by America's Department of Justice but blocked by the European Commission the following year. That objection appeared to herald a new era of transatlantic takeover disputes; in fact it remains the only deal so far to have been cleared in America but blocked on the other side of the Atlantic.

However, there have been other instances of transatlantic disputes. In 2009 the European Commission imposed a €1.06 billion ($1.4 billion) fine on Intel, a chipmaker, after a complaint brought by an American rival, AMD. The ruling seemed to suggest that multinationals faced the prospect of "double jeopardy" because of inconsistent international rules.

We do it our way

There are some philosophical differences between Europe and America. Europe has a long tradition of state ownership of industry; even after privatisation, many such companies retain dominant positions, at least in their national markets. In America, by contrast, market leaders have got there the hard way, by having superior technology or being more efficient. In Europe competition policy tends to be rules-based, with the European Commission issuing guidance for future mergers to follow; in America merger decisions tend to be hammered out in the courts, establishing legal precedent.

But multinationals also have to deal with competition policy in emerging markets. China is a particular challenge. "The Chinese use competition policy to achieve other ends—to keep out foreign firms or attack existing foreign businesses," says one expert. Latin American countries have tended to adopt the American model of competition policy, whereas eastern Europe has followed the EU's example. Merger authorities from different countries have set up the International Competition Network to share experience. Such efforts may reduce the double-jeopardy problems in international mergers, if only because rules may be applied more consistently.

In the longer term, the question is whether national competition policies will prove adaptable enough to cope with a globalised economy. It may make economic sense for global companies to exploit economies of scale and bring down prices for consumers, but national governments may be reluctant to accept the loss of control involved. In air travel, for example, fares have been reduced under pressure from low-cost airlines, but these newcomers are still being held back by policies that favour flagship carriers. If regulators in rich countries were to prove more zealous than their counterparts in emerging markets in restricting the size of multinationals, Western firms might be put at a competitive disadvantage.

New concerns for competition authorities are emerging all the time. Chris Walters, acting chief economist of Britain's Office of Fair Trading (OFT), cites the practice of "pay-for-delay", whereby a firm that holds a drug patent pays a generic manufacturer not to launch a rival drug to preserve the patent-holder's monopoly profits. And

David Currie, the chairman of the Competition and Markets Authority (which will take over from the OFT in April), recently pointed to a vast new potential problem, which he described as “the growing collection, processing and use of consumer-transaction data for commercial ends. This is proving an increasingly important source of competitive advantage; we need to be alert to the possibility that it will be an increasing source of consumer detriment.”

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