

THE SOCIAL CONTRACT AT THE BASIS OF ANTITRUST: SHOULD WE RECALIBRATE COMPETITION LAW TO LIMIT INEQUALITY?



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By *Michal S. Gal*



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I. INTRODUCTION

The social contract is a voluntary agreement among individuals by which organized society comes into being and is vested with its rights. While the social contract is a metaphor, the idea at its basis has great value, as it serves to conceptualize the relationship between the state and its citizens, as well as among citizens, and it creates the basis for the legitimacy of state action.

The idea of a social contract appears in the writings of Socrates, and was later developed by modern philosophers. While each suggested a somewhat different basis for the social contract, their theories share several common traits: men voluntarily choose to submit to the authority of a state; they do so in order to be able to live in a civil society, which is conducive to their own interests; the state is directed towards the common good, understood and agreed to collectively. Most philosophers also agree that mutual security and the protection of social and individual welfare stand at the basis of the social contract.

Competition law, like any other form of governmental regulation, is part of the social contract. In market-based economies it constitutes an important element of the socio-economic portion of this contract, which is focused on increasing total and individual welfare. It does so by ensuring that privately-erected artificial barriers to competition are prohibited.

Accordingly, for the social contract to work well, total welfare should increase. Indeed, antitrust is based on the assumption that competition can reduce prices and increase all types of efficiency. The protection of competition also serves non-economic goals such as dispersing power and opportunity, reducing harmful political effects, and supporting democracy.

The social contract should also ensure that individual welfare is increased, at least in the long-run. Antitrust attempts to further this goal in several cumulative ways. Most basically, consumers enjoy better and cheaper products and services, thereby increasing their ability to better fulfill their individual preferences. Competition can also positively affect social mobility and equality of opportunity of members of society.

Of course, competition is not a panacea; it does not work well where significant market failures exist, such as information asymmetries, negative externalities, free riding, or collective action problems. Furthermore, competition does not attempt to solve all welfare issues. Rather, it is part of a broader set of governmental instruments designed -at least in theory- to collectively meet the goals of the social contract. To give one example, education and retraining programs, that increase market entry and mobility, are essential parts of a social contract.

Unfortunately, it seems that at least in some economies the social contract is not working well. Recent years have envisaged an increased rate of dissatisfaction with market economies. A growing number of citizens feel that the promises of the competition-based market system,

which form an important part of the implicit social contract, are not fulfilled and that markets are no longer working in their favor. Indeed, statistics indicate that social mobility is low; that wealth inequality keeps rising; or that education and social security do not create viable solutions for workers to ensure that wide geographic areas or occupational groups are not significantly and irreparably harmed. In the U.S. and the EU, for example, the economic prospects of young people are, for the first time in several decades, grimmer than those of their parents.

This, in turn, creates social unrest and a degree of distrust in the market system which, in turn, reduces the ability of markets and societies to function well. Public debates bring to the forefront questions of whether capitalism and liberalism, the way they are currently practiced, indeed further the interests all members of society.

These developments require us to examine the social contract from which state regulation acquires its legitimacy and determine whether its instruments should be changed, to meet these new challenges. This short article focuses on whether equality and inclusive growth goals should play a more pronounced role in antitrust.

To do so, the connection between social contract and inequality is explored. Next, the interrelation between antitrust and inequality is analyzed. The article then analyzes the assumptions that antitrust is based upon, and the way they are met in the real world. The last part suggests some ways in which antitrust can incorporate some measures designed to reduce inequality, without significantly changing its focus.

II. THE SOCIAL CONTRACT AND INEQUALITY

Is equality part of the social contract, and if so – what weight should be given to it when it clashes with other values? Equality plays different roles in the writings of social contract theorists. All modern philosophers assume that a normative (hypothetical) social contract is created when free and equal persons come together and agree to create a new collective body (the state), directed at the good of all. As such, it should not serve the interests of one group over another. Otherwise, those suffering from such inequality would not have agreed to join the collective.

This idea is embodied, in its most famous form, in Rawls' *A Theory of Justice*,² in which he argues that the moral and political content of the social contract is discovered via impartiality. He suggests the use of a symbolic veil of ignorance, behind which each person is denied any particular knowledge of one's circumstances, such as one's gender, race, talents or disabilities, social status, or preferences. Persons are also assumed to be rational and disinterested in one another's well-being. These are the conditions under which, Rawls argues, one can choose principles for a just society, on which the social contract can be based. Because no one has any particular knowledge that could be used to develop principles that favor his own particular circumstances, the principles chosen from such a perspective are necessarily just.

Rawls argues for two principles of justice that would emerge in such a situation, which determine the distribution of both civil liberties and social and economic goods. The first states that each person is to have as much basic liberty as possible, as long as everyone is granted the same liberties. The second principle states that while social and economic inequalities can be just, such inequalities must be to the advantage of everyone. This means, in Rawls' view, that economic inequalities are only justified when the least advantaged member of society is better off than she would be under alternative arrangements. Accordingly, short-term inequality might be justified in order to serve long-term justice.

Of course, the Rawlsian ideal of a social contract is not the only one possible. Other leading theories include, *inter alia*, utilitarianism and the capabilities approach. Utilitarianism emphasizes the maximization of utility, regardless of its distribution among individuals.³ Inequality should be remedied only if it harms overall utility. The capabilities approach is based on two core normative claims: the freedom to achieve well-being is of primary moral importance, and freedom to achieve well-being is to be understood in terms of people's capabilities, that is, their real opportunities to do and be what they have reason to value. To enable every person to enjoy his right to well-being, at least at a minimum level, distribution should relate not only to the resource which is redistributed, but also to each individual's basic capabilities to use this resource to further his goals. Nobel laureate Amartya Sen emphasizes that this focus is the only way to ensure real equality between individuals to achieve their goals.⁴

Despite the plethora of theories regarding the social contract at the basis of the state, it can be argued that, at least in most Western societies, equality should serve as a basic guiding principle of the social contract. At a minimum, inequality should only be accepted if its benefits

² John Rawls, *A Theory of Justice* (Harvard University Press 1971, revised ed., 2000).

³ See, e.g. Jeremy Bentham, *An Introduction to the Principles of Morals and Legislation* (Clarendon Press 1907).

⁴ Amartya Sen, *Choice, Development as Freedom* (Knopf 1999); *The Idea of Justice* (Harvard University Press 2009).

to the common good significantly outweigh the harm it causes to (some) individuals, and even those individuals enjoy benefits from the overall regulatory scheme, to make their position Pareto-optimal in the long run, relative to a different set of rules governing and regulating society. The following analysis takes this minimum as a basis for the analysis.

Inequality in the marketplace has two main facets: inequality of opportunity to enter and expand in the market (suppliers), to take advantage of what it can offer (consumers); and inequality of wealth, which affects the ability to act both as suppliers and as consumers. Inequality of opportunity may clash with the social contract in at least three ways. First, it does not justly disperse the opportunities for participating in and enjoying the benefits of the marketplace, as it allows some to enjoy a comparative advantage over others. Second, it may clash with the economic goal of increasing the total welfare pie, which could then be distributed among members of society. As economic studies have shown, inequality reduces overall economic growth by preventing or limiting the ability of some parts of society to contribute to the marketplace. Third, and relatedly, inequality of opportunity has psychological consequences: one's satisfaction and motivation to take part in an action is affected by the opportunities others have relative to himself. Accordingly, inequality of opportunity harms individual and societal welfare by creating social unrest which might shake the foundations of society.

Observe, however, that while equality of opportunity in the long-run can be viewed as a foundational legitimizing principle of Western societies, this does not imply complete equality of opportunity at any point in time. Rather, much depends on the conditions which have led to such inequality. To illustrate, a comparative advantage which is a result of hard work and effort, as such, should not be viewed as a manifestation of unequal opportunity.

Inequality of wealth raises more difficult questions. When it results from inequality of opportunity, it is deemed to be unjust. Yet inequality of wealth can also result from other factors, such as talent and motivation. Their acceptance as a basis for inequality of wealth depends on the normative concepts and assumptions at the basis of the social contract. In communist economies inequality of wealth is generally unacceptable, while in market economies it is treated, at least to some extent, as an inherent and even important part of the social contract, as elaborated below.

Of course, reality is much more complicated than this idealized conceptualization of a contract struck between members of society. The idea that citizens are free to choose a society which adheres to their normative values can easily be questioned. So can the idea that the state is a benevolent actor, which strives to fulfill its goals for the welfare of all. Therefore, the social contract is an abstract notion, not to be found in the real world in its pure form. Yet the legitimacy of state action is dependent, in many citizens' eyes, on such action serving at least some basic normative principles that further the common and individual good. In such an environment, extreme and long-term inequality can have a significant destabilizing force. Accordingly, this article examines the current application of antitrust in light of this social contract.

III. ANTITRUST AND INEQUALITY: THE BASIC DILEMMA

Let us now examine the role inequality plays in antitrust. As elaborated, antitrust has an intricate and dual relationship with inequality, which creates a basic tension.

In most jurisdictions, antitrust is applied in a manner in which inequality considerations are dealt with only indirectly. Nonetheless, antitrust's inherent characteristics reduce inequality in several ways. First, by lowering artificial entry barriers, antitrust allows more people to enter the market and compete or expand in it based on merit. Second, by lowering prices and increasing quality, it enables more consumers to enjoy market benefits and it reduces inequality of wealth. Third, by reducing the ability of market players to enjoy non-merit based market power, both types of inequalities are reduced. This is because market power might have been translated into political power and influence, thereby enabling strong groups to enjoy a disproportional part of the welfare pie.

At the same time, antitrust naturally furthers inequality of wealth, at least in the short run. The very concept of competition encapsulates the idea of winners and losers; of Darwinian forces that shape the marketplace based on consumers' preferences and technological abilities. Accordingly, competition naturally results in an inherent inequality of wealth between suppliers. Should the winning suppliers enjoy significant market power, this can also lead to wealth inequalities between suppliers and consumers.

Yet this resulting wealth inequality, it is believed, is what drives competition in the first place. It is part of the engine and driver behind competition. Accordingly, inequality of wealth is often treated as an inherent and even important aspect of competition. Such inequality, however,

is assumed to be short-term with regard to each and every supplier. Competition is seen as a dynamic process, in which those that currently possess market power can be replaced by newcomers. Therefore, most antitrust laws do not place significant weight on issues of the short-term distribution of the benefits from trade. Moreover, it is generally believed that most markets will be competitive once artificial entry barriers are eliminated, and thus inequality will be minimized by the market's invisible hand. Furthermore, inequality is better addressed by other regulatory tools. The question is thus whether and at what point does inequality stop furthering the social contract.

IV. THE DILEMMA: INCLUSIVE GROWTH GOALS IN DEVELOPED JURISDICTIONS

The goal of inclusive growth – reducing inequality in the distribution of benefits created in the marketplace through antitrust – has been advocated for developing jurisdictions. Professor Fox, a leading voice in this regard, argues that such a focus is necessary in order to enable mobility, incentivize entrepreneurship, and stimulate innovation.⁵ It satisfies a need for legitimacy, since a distribution-blind law may not take root. Furthermore, opportunity only to the already powerful means that the country is not making efficient use of the talents and potential contributions of large segments of its population.

Should suggestions for inclusive growth as part of antitrust also apply to developed jurisdictions? The time is ripe for such an exploration, given global dissatisfaction with at least some aspects of capitalism and market liberalism.

To answer this question, we need to reevaluate the assumptions that lead developed countries not to include reduction of inequality and inclusive growth as direct goals of antitrust. Below I analyze four basic assumptions that, I believe, stand as the basis of the existing status-quo.

A. Equality of Opportunity

It is generally assumed that market players from all parts of society have relatively equal opportunity to enter and to expand in the market. While it is acknowledged that people possess different skills and resources, it is generally assumed that the state's efforts in creating and maintaining a reasonable educatory system, and an environment with well-functioning market institutions and due process, create an enabling environment for most people to take advantage of market opportunities, based on their skills and motivations.

But is there real equality of opportunity? At least in some jurisdictions the answer is negative. Successful entrepreneurship in many markets – even more pronounced in today's technologically advanced world – requires inputs that the market or the state do not or cannot easily provide to all potential entrants (e.g. high levels of education). Inequality in such inputs can lead to large discrepancies in access opportunities. Political economy influences might create additional entry barriers.

Indeed, statistics show that social mobility is low. If the market system truly created equality of opportunity, then social mobility should have been at a much higher level. So even according to the free market paradigm, something has gone wrong and the current system cannot be assumed to provide equal opportunity to all market participants.

B. The Market Will Reduce Most Instances of Inequality in the Long Run

The second assumption is that once we deal effectively with artificial entry barriers, the market's invisible hand will reduce most instances of inequality, at least in the long run.

Undoubtedly, limiting artificial entry barriers into markets can increase equality. However, as elaborated above, inequality of wealth is an integral part of the market system, at least in the short and medium run. Furthermore, market failures or political economy influences might create conditions of significant inequality that may not be easily eroded. In such instances, antitrust is a limited tool.

Exogenous factors further increase inequality of wealth on both national and international levels. The main factor is globalization, which strengthen competition over the locus of businesses. Another exogenous factor involves technological changes which reduce the need for many types of human interventions in production or supply processes. This factor also increases the difficulty involved in supplying a safety net in the form of retraining.

⁵ Eleanor M. Fox, "Equality, Discrimination and Competition Law: Lessons from and for South Africa and Indonesia," (2000) 41 HARV. INT'L L. J. 579.

C. Inequality is Inherent to Competition

Indeed, inequality of wealth is an inherent and important part of the competitive process that serves to increase the total welfare pie. Yet it is a matter of degree and of causes. If inequality results from unequal opportunities to participate in the market or take advantage of its offers, then it might be viewed as unjust. Furthermore, much depends on the degree of inequality created by market interactions.

D. Antitrust is not the Correct Tool

The fourth assumption is that even if equality should take precedence in some cases, antitrust is not the correct tool to further it. More efficient tools might include, *inter alia*, tax, social security, support of small and medium businesses, education, requirements for foreign direct investment and creating a better infrastructure for commerce. These tools can, at least theoretically, rebalance the social contract by augmenting and complementing antitrust.

While these tools are important, most suffer from inherent limitations. Education, for example, is very long-term; Social security suffers from psychological limitations, because its recipients might feel that they are left out of the market and are dependent on the government rather than on their own efforts; and political effects shape at least some of these tools so that they are not applied efficiently.

These assumptions challenge the way that free market ideals are currently applied. One of the main arguments is that the social contract is not working well. It promised equal opportunity for all to participate in markets; that if people invest in doing their best (e.g. spend time and resources on higher education), then most will have a good chance to recover their investment and lead a comfortable life; and that the combined efforts of individuals who act in such a way will further public welfare. These promises have not been fulfilled, at least for some citizens. The increased disbelief in the market system is troubling, because for markets to operate, people must believe in their mechanism. Mistrust creates unrest and might disintegrate the social fabric. It also reduces the number of people who are willing to contribute to the market game.

Accordingly, the next section suggests examining the current application of antitrust in light of this failure of the social contract.

V. THE ROLE OF ANTITRUST IN LIMITING INEQUALITY

While education and infrastructure might be more important for increasing equality in the long run, some changes in antitrust might nonetheless be justified as part of an overall societal effort to reinstate a stable social contract which is based on a belief in the market as a source of welfare. While these changes need not be extreme, they can play a significant part in furthering the social contract.

A. When Fine-tuning Might be Required

Before we delve into some suggestions, it is important to observe that antitrust already includes some focus on distributive effects. Most importantly, most laws further the goal of consumer welfare, rather than total welfare. Yet consumers are aggregated into one group, not looking further into the effects on different classes of consumers affected by the conduct. As Farrell & Katz observe, “rich and poor consumers may be differentially affected by an antitrust decision; distributional concerns would suggest weighing the impact on the poor more heavily, but a consumer surplus standard insists that they count equally.”⁶

To strengthen the belief in the social contract at the basis of antitrust, a fine-tuning of the system might be required: giving more thought and weight to where profits accrue: which sub-groups are affected, and the importance of the transaction to their welfare as well as to total welfare. Recognizing differences can create an opportunity for correcting some of the ills of the current system. Yet it must be done carefully, to ensure that the social contract is indeed fulfilled.

Let me give three examples of cases where the above suggestion may be relevant. I do not argue that these examples should necessarily affect the application of antitrust. To determine whether such a change is justified, a deeper analysis is required, which is beyond the scope of this article. Such an analysis must take into account, *inter alia*, the effects of more complicated and nuanced rules on enforcement costs and on the conduct of market players and enforcers, and whether the competition authority is the right body to engage in more nuanced social analysis. Nonetheless, the examples illustrate instances in which it is worth considering performing such an analysis.

⁶ Joseph Farrell & Michael L. Katz, “The Economics of Welfare Standards in Antitrust,” (2006) COMPETITION POL’Y INT’L. 1.

The first example involves a case in which the relevant transaction makes all consumers and suppliers better off or at least does not harm their welfare with regard to the specific transaction. On its face, this transaction should be allowed. Yet this analysis disregards existing discrepancies in society. Let us assume that indeed all consumers are better off, but some – the more wealthy ones – are much better off than the poor ones. Such a transaction will increase existing wealth discrepancies in society, thereby potentially making the overall position of the weaker members of society worse off.

The second example involves a case which is Pareto-optimal to all consumers when focusing only on the effects of the specific transaction. Yet this time only a distinct sub-group of consumers benefit from the transaction. This can be illustrated by two extreme examples: lowering the costs of luxury cars would only affect the wealthier members of society; and lowering the costs of cheap furniture would mainly affect the weaker members of society. Once we look more carefully at which sub-group of consumers is affected, it is clear that in a world of scarce enforcement resources, the second case may serve societal needs and the social contract better. The second case may be Pareto-optimal to all members of society in the long-run.

The third example involves a case in which not all consumers are better off. Rather, some sub-group(s) are better off, and some are worse-off. Under the laws of most jurisdictions, such a transaction would not be allowed. Yet despite the fact that Pareto optimality is not met in the specific transaction, it might be met in the long run, if the transaction significantly benefits the weaker members of society while only marginally harming the wealthy ones. It might also serve Kaldor-Hicks efficiency, whereby overall welfare is increased. Kaldor-Hicks requires that the overall benefits to those that are made better off could in theory compensate those that are made worse off.

B. Some Suggestions

Even if one believes that the social contract is better served by giving weight to equality and inclusive growth considerations, the question remains whether antitrust is necessarily the best tool to achieve these goals. Antitrust suffers from significant inherent limitations. It has a limited number of instruments at its disposal, that mainly include fines and prohibitions; it does not have the information or the ability to see the larger picture, of all the tools available to the state to remedy a problem; it does not have the democratic mandate to engage in balancing exercises which involve public interest considerations that go beyond pure competition concerns.

In light of these limitations, this section suggests several ways in which antitrust can better serve the social contract, without significantly changing its focus and the tools at its disposal, yet introducing a more nuanced distributional dimension into it.

The above considerations should *affect the choice of cases*, especially where enforcement resources are scarce. The authority should consider focusing on market access issues which affect the ability of the weaker parts of society to take part and participate in the market on a larger scale than their current conditions allow. It should also consider giving priority to cases which increase consumer welfare of the weaker groups in society. To use the above example, lowering entry barriers in the market for lucrative cars should be given a lower priority than in the market for cheap furniture.

Moreover, antitrust enforcers should attempt to *unpack the aggregatory group of consumers*, where it is likely to significantly increase social welfare. In relevant cases, Kaldor-Hicks optimality should be preferred to Pareto optimality. To reduce uncertainty, however, the authority should develop tools that clearly spell out the balance to be sought, and only divert from the aggregatory analysis where a more nuanced analysis is likely to bring about significant benefits. Transparency is an essential element of this analysis, to limit political pressures and to increase awareness of the considerations taken into account.

Furthermore, even if antitrust is not the best instrument for furthering the social interest in securing jobs for workers for the long-term benefit of society, we still need to ensure that the application of antitrust *does not inhibit the application of other policies* which are aimed at furthering reinforcing goals. Most importantly, antitrust should not create a *de jure* or *de facto* veto power to antitrust considerations, where it is in the public interest that they be balanced with other considerations.

In addition, the Authority's *advocacy role* should be used to advocate the adoption of governmental policies that further the social contract by complementing antitrust. It should also explain to the wide public the logic behinds the choice of its actions, to strengthen their understanding of the market system and the trust that the actions taken are indeed in line with the social contract. This is especially important where the positive effects of its actions could only be observed in the long run; or where the legal tools are inherently limited and citizens might get the impression that the system is not working for them. Finally, the tool of *market inquiries* enables competition authorities to point out harmful public restraints.

VI. CONCLUSION

Significant and persistent inequality in favor of specific social groups creates a major challenge to the existing social contract, or at least to the way we apply it in practice. This has led to social tensions and unrest around the world. It is thus time to question whether our tools must be changed to enable a better furtherance of the goals of this contract.

As this article argues, the challenges to the social contract, as it is currently applied, go to the heart of the goals at the basis of antitrust. They require that antitrust be sensitive, in appropriate cases, to distributional effects. Yet loading the delicate task of changing the current socio-economic fabric on antitrust alone is highly problematic and might negatively affect the ability of antitrust to achieve its other goals. Antitrust should be one of several tools harnessed for advancing equality and inclusiveness.



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