

Why competition? 250 years of learning and forgetting in political economy

George Yarrow

Regulatory Policy Institute, Oxford

CCP/RPI Conference on the Role of Competition in
Public Policy, Westminster, 8 March 2010

Why competition?

- It's not monopoly.
- The rest is footnotes.

The problem of the unexamined alternative (the grass looks greener)

- A Polish story: Capitalism and the repair of pot holes.
- Risks from 'idealisation of the alternative'.
- Risks of over-selling: the 'Invisible Hand' as an 18th sound-bite. The actual reasoning is much deeper and much more subtle than that.
- Response to the pot-holes:
 - *“The real world is not like that. Market processes are often messy: outcomes can be both inefficient and unfair. The soundest argument for markets ... is simply that, very frequently, they are the least bad of the alternatives. To paraphrase Churchill's remark on democracy, markets are the worst method of resource allocation, except for all the others that have been tried.”* Yarrow, Three Lectures on Privatization, Jagiellonian University, Krakow, April 1990.

Limited reading and/or selective memories?

- The Poles had had a close up look at the defects of monopoly. We, today, have less excuse for ‘idealising the alternative’, yet there is constant cherry picking of established reasoning, often driven by ‘interests’ and advocacy.
- E.g. misuse/misunderstanding of the Invisible Hand metaphor, e.g.
 - *“Networks of individuals provide pathways for states of happiness, fatness, health and even life expectancy to spread. Who you know – or don’t – is who you are and how you live. This is an utterly different way of looking at the human world from ... the 18th century idea of the market as the “invisible hand” ... (Prof N Christakis, as quoted in the Sunday Times, 21/02/10).*

Views of the founding fathers

- Opening paragraph of the Theory of Moral Sentiments (TMS):
“However selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it. ... The greatest ruffian, the most hardened violator of the laws of society, is not altogether without it.”
- Westermarck on TMS: the most important contribution to moral psychology made by any British thinker.
- Contrary to Hobbes, Rousseau and other ‘social contract’ theorists, the Scottish literati held that there can be no ‘state of nature’ for man other than a social state:
“If both the earliest and latest accounts collected from every quarter of the earth, represent mankind as assembled in troops and companies; and the individual always joined by affection to one party, while he is possibly opposed to another; employed in the exercise of recollection and foresight; inclined to communicate his own sentiments, and to be made acquainted by those of others; these facts must be admitted as the foundation of all our reasoning relative to man.” Ferguson, Essay on the History of Civil Society

Views of the founding fathers (cont.)

- A major pre-occupation was with how to achieve ‘large scale’ co-operation and co-ordination, so as to enjoy its benefits (“progress”, for example via division of labour and specialisation) without incurring heavy social costs.
- The ‘small platoons’ are taken as givens ... “*the foundation of all our reasoning relative to man*”.
- Context: post-union Scotland. Question: how to be a successful small country in a big world?
- Serious concerns over possible, adverse implications of the division of labour, including “*the clamorous importunity of partial interests*”. See Smith on the case for mandatory, universal education; and Ferguson on republican/ civic virtue.

The critique of monopolies, whether public, private or political

- Higher prices, of course
- Capture of political monopolies by sectional interests: “*the clamorous importunity of partial interests*” (Smith)
- Adverse effects of arbitrariness in the exercise of discretionary power. Then taxation, now regulation? Links to the fear of loss?
- Combining the two points: the general problem of policy instability.
- Poor performance incentives of monopoly:

“Monopoly, besides, is a great enemy to good management, which can never be universally established but in consequence of that free and universal competition which forces every body to have recourse to it for the sake of self defence.” (Smith, Wealth of Nations)

- Note:
 - Focus on limitations of monopoly, not the virtues of competition
 - Fear of loss as a principal psychological factor
 - Protection from challenge is the main indicator of monopoly
 - Reference to universality of effects

No merit in competition *per se*

- Mill
 - *“I do not pretend there are no inconveniences in competition, or that the moral objections urged against it by Socialist writers ... are altogether groundless. But if competition has its evils, it prevents greater evils.”*
- Marshall:
 - *“If competition is contrasted with energetic co-operation in unselfish work for the public good, then even the best forms of competition are relatively evil; while its harsher and meaner forms are hateful. (But when Marshall goes on to examine that alternative – energetic co-operation in unselfish work for the public good – he finds it unavailable as a universal possibility) “But in the responsible conduct of affairs, it is worse than folly to ignore the imperfections which still cling to human nature.”*
 - Preferred to talk of economic freedom – e.g. freedom from the exercise of monopoly power of all types – than of competitive markets.
- The tradition: warm hearts, cool heads

Mill on the limitations of monopoly/government

- Information and incentive problems of monopoly
- Performance incentives are weak:
 - *“All the facilities which a government enjoys of access to information; all the means which it possesses of remunerating, and therefore of commanding, the best available talent in the market—are not an equivalent for the one great disadvantage of an inferior interest in the result.”*
- Limited information processing capacity:
 - *“It must be remembered, besides, that even if a government were superior in intelligence and knowledge to any single individual in the nation, it must be inferior to all the individuals of the nation taken together.”*

Mill on monopoly and innovation

- *“In addition to the tax levied for the profit, real or imaginary, of the monopolists, the consumer ... pays an additional tax for their laziness and incapacity. When relieved from the immediate stimulus of competition, producers and dealers grow indifferent to the dictates of their ultimate pecuniary interest; preferring to the most hopeful prospects, the present ease of adhering to routine. A person who is already thriving, seldom puts himself out of his way to commence even a lucrative improvement, unless urged by the additional motive of fear lest some rival should supplant him by getting possession of it before him.”* cf Hayek on discovery.
- Again, fear of loss is emphasised: prospects of ‘lucrative improvement’ are not the decisive influence.

Hayek

- ‘Discovery ‘ and the division of labour in knowledge
- Competition is the most effective, known discovery procedure:
 - *“a procedure for discovering facts which, if the procedure did not exist, would remain unknown or at least would not be used”*
- A more precise specification of the problematic aspects of state interventions:
 - *“... the planning against which all our criticism is directed is solely the planning against competition – the planning which is to be substituted for competition.”* The Road to Serfdom, 1944.
 - *“An effective competitive system needs an intelligently designed and continuously adjusted legal framework as much as any other. “*
(Comment: Arguably more than any other -- *“freer markets, more rules”*.)

A problem for today: arbitrariness and instability in political monopolies

- Analysis of the governance of state-owned enterprises showed the difficulties of managing under unstable political preferences: “*the clamorous importunity of partial interests.*”
- Reformed regulatory arrangements and reformed competition law as recent examples of progress.
- But: “*The spectre of policy instability still lurks*” (Vickers and Yarrow, *The British Electricity Experiment*, 1991).
- In 2010, the spectre is doing more than lurk, having been called back to life by a new, system-wide propensity to favour , at the margin, the substitution of planning for competition.

The answer repeated

- “... *wherever competition is not; monopoly is.*” Mill, Principles of Political Economy, 1848.
- And monopoly has tendencies toward high prices, poor performance incentives (laziness/inertia), and limited intelligence (measured at the level of the market or system as a whole).
- But it often comes in disguise -- not necessarily wearing a black cloak and/or clunking boots.