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ECONOMIC LIBERALIZATION AND ANTITRUST IN MEXICO

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Abstract

Mexico recently adopted antitrust legislation modeled after that in the European Union and the United States. The law established an enforcement agency, the Federal Competition Commission, and gave it the fundamental task of preserving economic reforms. Accordingly, the agency initiated a vigorous program of traditional antitrust enforcement, including merger oversight and investigations of both horizontal and vertical business activities.

The theoretical framework proposed in this paper suggests that dedicating resources to traditional antitrust enforcement may not be an appropriate policy for a liberalizing economy. Instead, the agency should devote its resources to competition advocacy – especially during Mexico's transition to a more open economy – and limit its enforcement activities to unambiguously anticompetitive horizontal restraints on competition. Traditional antitrust enforcement, especially against business activities with ambiguous anticompetitive effect, may simply encourage producer interest groups to lobby other government agencies for protection. This protection will be counterproductive to the goals of liberalization and may often be more anticompetitive than the cure.

Qualitative evidence suggests that the Federal Competition Commission

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has allocated its resources toward its competition advocacy role by challenging government-generated barriers to entry, growth and exit. These resources are expected to have greater returns in terms of economic reform than do traditional antitrust enforcement efforts. We conclude that conventional antitrust enforcement should be relegated to mature developed economies and that competition advocacy be emphasized for economies in transition.

I. Introduction

Many developing countries are establishing antitrust policies in the belief that antitrust is essential to a well-functioning market economy.[1] The Mexican competition law, known as the Federal Law of Economic Competition (LEC), took effect on June 23, 1993.[2] The newly-created Federal Competition Commission (FCC) was charged with this law's enforcement.

Many developing countries have enacted legislation and pursued policies that draw upon the antitrust experiences of the United States and European Union, each of which have a longer antitrust histories and expertise. In general, antitrust agencies have authority to investigate and prosecute potentially illegal mergers and horizontal and vertical restraints. In addition, an antitrust agency may take the role in government as an advocate of appropriate competition policy.

Despite general praise for the export of antitrust, some commentators have questioned the effectiveness of adopting conventional antitrust policies in developing countries. Waller (1994), for example, highlights the tensions that result from transferring antitrust laws between differing legal systems and countries with different economic and political histories. These inherently intractable problems suggest that the development of antitrust enforcement in transitional economies is unlikely to be smooth.[3]

Newberg (1994) raises two concerns about the applicability of antitrust to Mexico. First, Mexico has no antitrust tradition comparable to that of the United States and therefore does not have the legal structure necessary to reach predictable (and coherent) antitrust policy. Second, the civil law system in Mexico does not consider the precedential value of previous antitrust decisions and therefore resulting policy is not likely to be as predictable as in a common law system. Furthermore, Mexican judges and administrative agencies are proscribed from making comments or otherwise influencing the development of antitrust doctrines.[4]

Other commentators argue that current antitrust enforcement practices, which are based on a static allocative efficiency goal, may be incompatible with policy objectives of other government agencies premised on achieving dynamic efficiency. These problems are exacerbated in economies in transition, where the demands for foreign investment are significant.[5] To see this, consider the following example. Foreign investors will demand an *ex ante* premium on investment to cover potential government policy reversals and the subsequent holdup problem. Governments in developing countries will accommodate such concerns to attract investment and often impart this premium by granting protection from competitive pressures to favored investment. This protection allows firms to exercise market power and obtain supracompetitive returns. Because these returns reduce consumer welfare, the competition agency may challenge such protectionist arrangements although they may be clear policy objectives of other branches of the government.

Taken to its logical conclusion, the steady reliance on a goal of achieving static allocative efficiency in the vigorous enforcement of antitrust laws may retard economic development. This happens because traditional antitrust enforcement reduces the incentives of firms to invest in a reforming economy since antitrust may limit the ability of firms to enter into efficient long-term contracts.[6]

The style of antitrust enforcement can reduce the incentives to invest in a developing economy in a different way. This can be examined by comparing the conflicting policy goals underlying U.S. and European antitrust standards. The United States antitrust agencies explicitly try to maximize static allocative efficiencies while the Europeans have more overtly political goals. In the United States, antitrust enforcement largely emphasizes challenging firms amassing market power through illegitimate means and not those firms obtaining market power through superior business acumen or simply selling a better product. European policy, on the other hand, often attacks business practices under an "abuse of dominance" standard. Under this standard, a showing of market power is not necessary; it may be sufficient to establish that the firm engaged in practices that conflict with the explicit *political* policy goal of consolidating the European Union.[7]

One further criticism of antitrust in developing economies, this time from a political economy perspective, argues that antitrust policy will generally be ineffective at encouraging a competitive economy because antitrust as practiced challenges only private cartelization.[8] The salient problem restraining reforming economies from competitive results is not illegal cartel behavior, but rather the susceptibility of government agencies to interest group lobbying to replace those tariffs reduced through liberalization with non-tariff barriers and other protectionist devices.[9] Specifically, the relative costs of seeking government protection rather than cartelizing are lower in Mexico because of Mexico's historic reliance on the Import Substitution Industrialization (ISI) model.[10] One outcome of the many years of collaboration between the private sector and the government is the investment in highly specific human and institutional capital. As such, the government/private partnership has led to an inflexible, inefficient, and highly concentrated capital structure whose sunk costs continue to influence economic conduct and performance to this day.[11]

In this paper, we rely on the theoretical framework developed in our political-economic criticism of antitrust in developing economies. We find that, under general and plausible conditions, the establishment of antitrust enforcement will cause an increase in rent-seeking and non-tariff impediments to trade. While the potential loss of competitive performance in the long run is undesirable, higher non-tariff barriers are at odds with the direct objectives of the liberalization program. In particular, we examine Mexico's recent (and relatively short) antitrust

experience using this analytical framework. We find that the FCC devotes significant effort to competition advocacy, perhaps in response to increased rent-seeking and non-tariff barriers.

This paper is organized as follows. Section 2 presents a model that demonstrates how antitrust enforcement (rather than competition advocacy) encourages non-tariff barriers as interest groups substitute away from cartelization. With this theoretical framework, the third section of the paper analyzes some of the FCC's caseload and enforcement priorities. We conclude that the FCC has directed substantial resources from conventional enforcement to competition advocacy. Our analytical framework is not specific to Mexico and, accordingly, the last section discusses how lessons learned in this paper can be applied to other reforming economies.

II. The Political Economy of Competition Reform

Economic liberalization programs and accompanying deregulation are designed to eliminate barriers to trade and encourage the free flow of resources to their optimal uses. Once artificial restrictions that limit market entry and exit are eliminated, one would expect that only firms that have the most efficient cost structures will survive in any given market. Because economic liberalization will reduce the economic waste inherent in inefficient production, more income should flow to the factors of production (labor and capital). This will increase the overall demand for goods and services. Thus, the liberalization of an economy can generate additional wealth through increased specialization in production and economies of scale effects. The lack of barriers to internal and external trade should increase the flexibility and innovativeness of a liberalizing economy.

While the overall economy should benefit from liberalization, some sectors of the economy particularly favored by previous government action may suffer from increased domestic and foreign competition. Once the liberalization is completed, political pressures from interest groups may shift, but they do not disappear. As both foreign and domestic competition threaten a previously-protected industry's monopoly rents, the industry's interest groups (both owners and workers) will lobby their political patrons in an attempt to impede liberalization. Thus, the elimination of tariffs will not automatically result in free trade. In fact, there are potentially a countless number of ways by which government can interfere with the flow of trade without resorting to changing tariff policies. For example, in replacing protectionist tariffs, the government can frustrate trade liberalization by imposing quotas, filing of dumping and countervailing duty petitions and issuing inappropriate quality, health and safety regulations.[12] Rent-seeking will reduce many prospective benefits of reform and, in fact, the overall economic welfare of a society may decrease with liberalization.

A competition agency should consider that rent-seeking and the establishment of non-tariff barriers is likely to affect its effectiveness in preserving and supporting competition. Unless the antitrust agency has a clear understanding of how

political pressures may influence its goals and capabilities to affect these goals, the benefits of liberalization may be elusive. In fact, if a competition agency fails to recognize these political realities, the agency may, as shown by the model presented below, create greater incentives for interest groups to seek rents.

A. *A Model*

This model examines tradeoffs in the supply side of the political marketplace to show how the establishment of an antitrust regime may lead to greater non-tariff barriers to trade. Specifically, this model formally analyzes how producer interest groups to choose whether to obtain anticompetitive rents from either cartelization, which the competition agency might challenge, or lobbying the government for protection, over which the competition agency has little direct control. The model assumes that interest groups choose the combination of collusion and government protection that maximizes their expected rents. Rent-maximizing interest groups allocate resources between cartelization and government influence based on the relative costs and benefits of these two activities.

Two results emerge from this analysis. First, these cartelization and rent-seeking are substitutes in raising prices above competitive levels. Second, increased traditional antitrust enforcement cannot, as its advocates claim, return prices to competitive levels and it may, in fact, raise prices further.

The first portion of the model shows that cartelization and rent-seeking are substitutes in the "production" of anticompetitive price increases for an industry interest group. One can show this by examining a simple model of linear supply and demand curves (as illustrated in Figure 1). Because one can model both monopolization and taxation using a supply and demand model, one can also examine the relationship between efforts to cartelize through private action and efforts to influence government to erect non-tariff import barriers.

The equations for the demand and supply curves are given in equation 1.[13] Under perfect competition, the supply curve, which represents the marginal (either domestic or international) firm's willingness to supply an additional unit of output, will be the industry marginal cost curve.

$$D\text{: } P = P_D - m_D Q \quad \textit{and} \quad MC = S\text{: } P = P_S + m_S Q \tag{1}$$

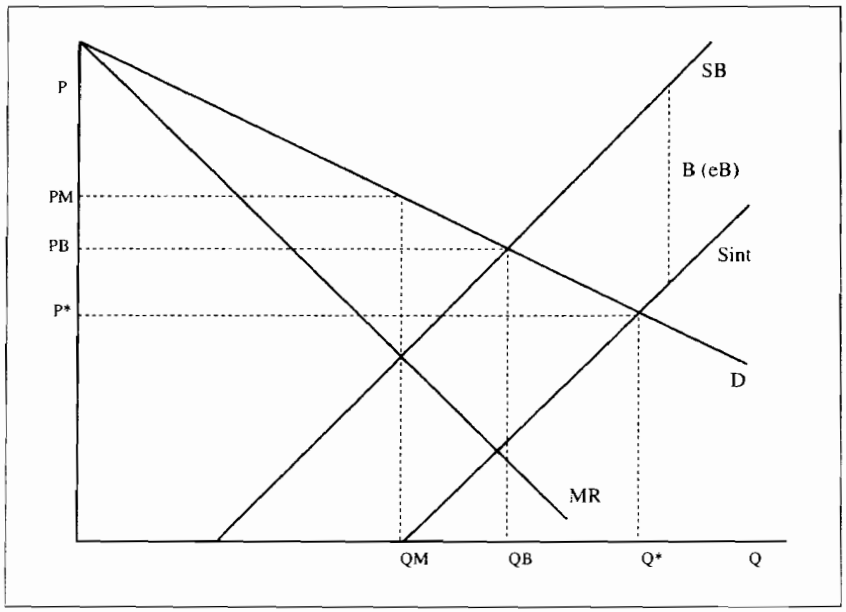
As long as international firms have higher costs of production than the domestic firms, the establishment of a trade barrier by a government lobbied by a producer interest group can be modeled as a shift back in the supply curve. By expending effort e_B, a producer interest group can influence government to erect a barrier of size $B(e_B)$.[14] As the barrier gets higher, more and more foreign firms will find that it is no longer economic to sell in the domestic market and this shifts the supply curve to the left in a parallel fashion.[15] The new supply curve, which represents the marginal opportunity costs of supplying an additional unit of output for the domestic firms, is as follows:

$$MC^B = S^B: \quad P = P_S + B(e_B) + m_S Q \tag{2}$$

The imposition of a barrier of size $B(e_B)$ will raise the equilibrium price to P^B by an amount:

$$\Delta P_B = P^B - P^* = \frac{m_D B(e_B)}{m_D + m_S}$$

FIGURE 1



The increase in price depends positively on the size of the trade barrier, the elasticity of supply and inelasticity of demand. Thus, the economic distortions of trade policies that impede imports are similar to those that would result from a domestic monopoly or a price fixing cartel.

Cartelization can be represented as a movement along the demand curve toward the position where a monopolist would operate. The expenditure of effort to cartelize (e_C) will allow the interest group to achieve a price closer to the monopolist's price. The fraction of the distance the industry achieves to the monopolist's price from the equilibrium price without cartelization will be denoted $C(e_C)$.[16] A monopolist with marginal costs curve MC^B will set its price as:

$$P^M = P_D - m_D\left(\frac{P_D - P_S - B(e_B)}{2m_D + m_S}\right) \tag{4}$$

Thus, private cartelization efforts by the interest group will further raise the price above P^B by:

$$\Delta P_C = C(e_C)(P^M - P^B) = C(e_C)\hat{m}\left(\frac{P_D - P_S - B(e_B)}{(2m_D + m_S)(m_D + m_S)}\right) \tag{5}$$

The increase in price depends positively on cartelization effort, inelasticity of demand and elasticity of supply, but it is decreasing to influence government to erect trade barriers.

The producer interest group faces the following "production function" in raising prices given its "inputs", the efforts devoted to seeking government influence and cartelizing:

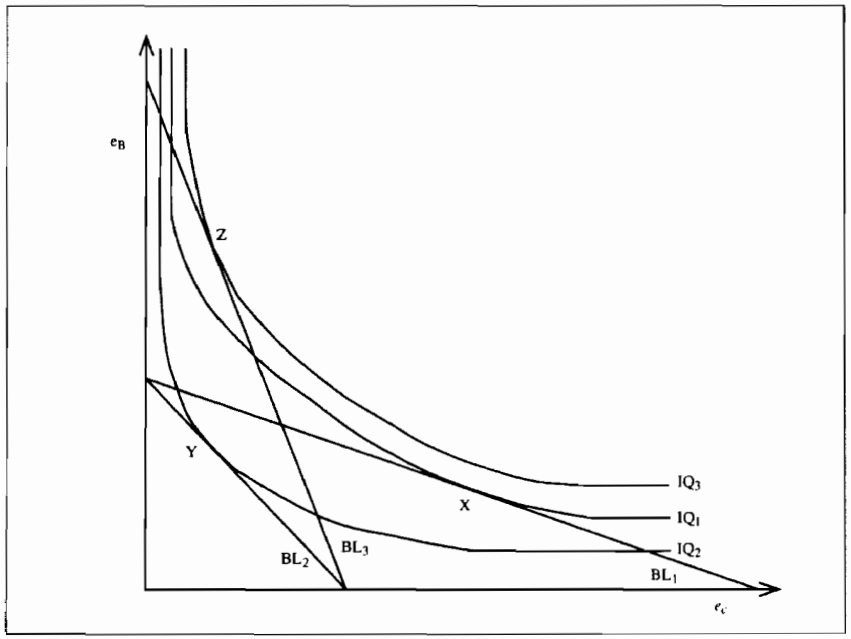
$$\Delta P(e_B, e_C) = \Delta P_B + \Delta P_C = \frac{m_D}{m_D + m_S}\left(B(e_B) + \frac{C(e_C)\, m_D\,(P_D - P_S - B\,(e_B))}{2m_D + m_S}\right) \tag{6}$$

This "production function" is locally concave in its inputs, the efforts devoted to cartelization and rent seeking, under general conditions specified in that paper.[17] This means that efforts devoted to cartelization and efforts devoted to rent seeking are substitutes in the "production of higher prices". An increase in one type of effort diminishes the price-raising value of the other type of effort. For example, if a producer interest group spends lots of energy lobbying government to raise tariff barriers, then, as a result, the non-cartelized price will be high. Because of this initially high price, it does not make much sense to cartelize the market further since the monopoly price is not as far above the non-cartelized price as if there were no trade barriers.

The second half of the model analyzes the behavior of an interest group whose efforts at private cartelization and rent-seeking act as substitutes at raising prices above the costs of production. The interest group's decision-making process is analogous to that made by a firm in the standard cost minimization/output maximization problem as illustrated in Figure 2. Assume that a producer interest group maximizes price above competitive levels subject to a resource constraint, a limit of the level of effort it is willing to devote to rent-seeking and cartelization behavior.[18] One can analyze the imposition of antitrust as a raising of the price of cartelization.

"Isoquant" curves IQ_1, IQ_2 and IQ_3 draw out sets of points where the amount of effort devoted to the two strategies (lobbying the state or organizing a cartel) yield the same levels of price increase (and benefit to the interest group). Isoquants that are farther from the origin correspond to larger price increases and monopoly rents. As shown earlier, under general conditions, cartelization and rent-seeking

FIGURE 2



efforts are substitutes and ΔP is quasiconcave in either type of effort.[19] As such, the "isoquants" of the "production function" are convex in the conventional manner.

"Budget lines" draw out the set of points where the total resources devoted to cartelizing and seeking favors from the state are the same. These lines follow equations of the form $r=p_B e_B + p_C e_C$, where r is the total resources that the group will allocate to these activities, p_B is the unit price of lobbying the government for the erection of trade barriers and p_C is the unit price of organizing, monitoring and enforcing a cartel. For any given level of resources r, the group will attempt to reach the highest "isoquant". Thus, a group will choose its level of activity at the point where the "budget line" is tangent to the "isoquant".

Consider initially that a producer interest group chooses to devote resources to cartelizing and lobbying so that it is on budget line BL_1.[20] Under this constraint, the interest group will choose to allocate its resources at point X on curve IQ_1, the highest isoquant obtainable on budget line BL_1 and where the price increase over competitive levels is maximized. If an antitrust agency is established, p_C, the unit price of cartelization efforts, rises and this shifts the group's budget line to BL_2.[21] The group then shifts its composition of efforts to point Y on curve IQ_2.

Obviously, economies of scale and scope in political influence may cause different firms to face different relative prices for particular resources. However, as the costs of cartelization rise relative to rent seeking, at the margin,[22] the interest group may seek more rents through government protection. The establishment of an antitrust regime may cause an increase in other forms of government protection. If the starting of an antitrust agency only makes it more difficult to cartelize, the special interest group is worse off than before.

As shown, lobbying the government for protection may be substitutable for organizing cartels. While the stated intent of increasing antitrust activity is to encourage market competition, in reality utility-maximizing interest groups will shift resources into seeking monopolization through government protection that shields them from competition. This shifting of resources may have other social costs beyond deadweight-loss triangles and socially inefficient rent-seeking (Posner, 1975). While monopolists have the same incentives as competitive firms to minimize costs by producing efficiently with the appropriate technology and factor mix, firms operating under non-tariff barriers may not. In this sense, increasing cartel enforcement may cause inefficiencies that are worse than the allocative losses against which antitrust legislation is designed to defend.

The previous analysis assumes that antitrust will be effective in raising the costs of cartelization. Faith *et al.* (1982) and Benson *et al.* (1987), however, have noted that the establishment of an antitrust agency may also create another target for rent-seeking by interest groups. If the competition agency has more discretion in its enforcement agenda (*i.e.*, the ability to challenge competitively-ambiguous vertical activities under, for example, an "abuse of dominance" standard or the ability to pursue explicitly political goals), then the agency can more easily make decisions based on more arbitrary goals than allocative efficiencies. This, in turn, will encourage producer cartels to lobby the competition agency itself to protect that group from competition. This will eventually undermine the agency's influence and relevance in policy-making.

If the competition agency becomes subject to rent-seeking, one can analyze this as a reduction in the cost of rent-seeking.[23] Referring to Figure 2, such a fall will shift the interest group's budget line from BL_2 to BL_3. The interest group would then maximize its expected benefits on the isoquant IQ_3 at point Z. If the price of rent-seeking falls, interest groups will seek even further protection at the margin. Indeed, benefits to the interest group and prices may be higher with both the increased price of private cartelization and the reduced price of rent-seeking if IQ_3 is to the right of IQ_1 (as shown).[24] As such, the establishment of an antitrust regime may actually advantage targeted producer interest groups acting anticompetitively.

B. *Implications of the Theory*

The theory in the previous section, although simple, gives insight to many of Mexico's experiences with its liberalization and establishment of a competition agency. Indeed, the theory has many implications that could enhance the competitiveness of the Mexican economy.

As interest groups find it less costly to seek preferential treatment and shift resources to lobbying the state for favors, the FCC must make a fundamental choice whether to challenge these lobbying activities by emphasizing its competition advocacy role or acquiesce to an increasingly irrelevant role of challenging business activities with limited potential for anticompetitive harm. The FCC faces three problems if it fails to limit the effectiveness of rent-seeking activities by interest groups. First, the agency's jurisdiction is likely to erode slowly via legal exemptions as has been the experience in the United States. Second, Mexico will experience "NTB-creep", the slow encroachment of non-tariff barriers and other anticompetitive legislation that will subvert the intent of economic liberalization. Last, a lack of political will in not pursuing an active competition advocacy agenda would suggest that the FCC may limit its challenges of cartelization to politically vulnerable firms. This "hot dog vendor" effect (*i.e.*, only challenging activity of insubstantial firms like hot dog vendors) limits political challenges to the agency's survival.

The political vulnerability of the FCC can be reduced so that the agency can be a better and direct advocate for appropriate competition policy. The agency should seek mechanisms that reduce its susceptibility to potentially antagonistic political interests. One method of accomplishing this is through international collaboration with other antitrust agencies. International collaborations effectively commit the agency to a procompetitive course of action and credibly increase the costs to the FCC and Mexico of abandoning stated competition policy and other economic reforms.[25] Besides the higher visibility and increased resistance to policy reversals gained from international forums, the FCC will increase its antitrust credibility and strengthen itself against rent-seeking from domestic cartels. Furthermore, the perception that the Mexican government is committed to economic reform enhances investor confidence in the reform process. The recent (and increasing) collaboration between the FCC and the U.S. Federal Trade Commission is a good example of this phenomenon. While initially driven by NAFTA,[26] these collaborative efforts have developed more recently into a more steady, although informal, working relationship.

An alternative way that the antitrust agency can aid economic reform is to reallocate resources toward competition advocacy and away from some traditional, but still controversial, enforcement policies, such as competitively-ambiguous challenges to vertical business relationships and unilateral activities. The agency can de-emphasize conventional enforcement and actively oppose interest groups that pressure the government for preferential treatment. Antitrust agencies are designed to analyze how various business practices may lead to reductions in consumer welfare by restricting competition. This is the same type of analysis that should be used to determine whether non-tariff barriers and other forms of government intervention into specific industries are likely to reduce consumer welfare. Therefore, the competition agency may be especially qualified to advocate appropriate competition policy within the government.

Although the FCC regularly intervenes in privatization efforts, it seems appropriate that the agency expands its role by commenting on governmental legislative and regulatory action. However, it is important to realize that not all legislation and regulation is inherently anticompetitive, protectionist or driven by special interest influence. In fact, some interest group regulation may be procompetitive. A competent competition advocacy role must determine whether a particular regulation is, in fact, anticompetitive and whether it is the result of interest group pressure.[27]

Challenging lobbying efforts by producer interest groups may infringe or limit traditional constitutional rights to petition one's government and freedom of speech. Conversely, such actions may jeopardize a targeted agency's mission and prevent it from effectively discharging its functions. Given government's distaste for interagency squabbling, it is likely that this type of competition advocacy might not be politically popular. Thus, although competition advocacy activities challenge interest group activities are a promising and attractive option from a technical efficiency perspective, they may not be politically viable.

In any event, antitrust agencies should continue to enforce relatively specific *per se* laws against horizontal price-fixing and other non-ambiguous forms of anticompetitive behavior. As the model suggests, vigorous scrutiny of potential horizontal cartels will encourage potentially anticompetitive rent-seeking that the antitrust agency has a role to criticize. It should relish that opportunity. By limiting itself to a narrow and unambiguous enforcement agenda, the antitrust agency will increasingly become irrelevant at influencing government policy unless it acts as an enthusiastic competition advocate.

III. Mexico's Competition Initiative

In the 1980s, a group of prominent scholars and policy-makers reached what is commonly known as "the Washington Consensus"[28] to spur the economic development of Latin America. Mexico's economic liberalization, with its accompanying antitrust reform, is consistent with the Consensus. In its first year, the FCC investigated both merger and non-merger activities as required in the Mexican competition law.[29] While traditional merger enforcement accounted for a total of 28% of official activity, other activities with a stronger competition advocacy component represented the rest of the agency's efforts.

The division of the FCC's efforts is summarized in Table 1. Because of data limitations, the presented numbers should only be taken as suggestive.[30] It is hard to determine the extent and influence of the FCC's competition advocacy function for two reasons. First, other agencies have competition advocacy roles. Second, some FCC enforcement actions have advocacy content. The inherent complementarity between the FCC's antitrust mission and its competition advocacy role suggests that our estimates of the resources that the FCC devotes to competition policy prescriptions may be understated.[31]

These figures suggest that the FCC has focused its activities on *traditional* competitive advocacy over those areas that it has enforcement powers. Commenting on public bids and private suits and providing legal opinions do not involve the Commission using its enforcement powers and therefore are clearly fall into the category of competition advocacy. Public bids, where the FCC comments on

TABLE 1

FEDERAL COMPETITION COMMISSION
ACTIVITIES FOR 1993-1994[32]

Activity	Number of Cases	Time Allocated	Percent of Total Time	Percent of Cases
Mergers	46	1660	28	39
Public Bids	34	1163	19	29
Ex Officio				
Investigations	6	717	12	5
Private Suits	17	1829	30	15
Legal Opinions	14	676	11	12
Totals	117	6045	100	100

Source: FCC Annual Report 93-94

efforts to sell government assets, accounts for 19% of the FCC's time. The 30% of its time that the FCC allocates to private suits refers to comments on private antitrust matters. Lastly, legal opinions, where the FCC comments on the legality of proposed contracts, account for 11% of the Commission times. *Ex officio* matters refer to the Commission investigating business activities for potential illegality with opening a formal investigation. It is unclear whether the Commission seriously contemplates using its enforcement powers in these investigations or whether the Commission might be using these non-formal matters to "spread the word" of what is appropriate behavior in a competitive economy. As such, it is unclear whether *ex officio* time should be considered competition advocacy or traditional antitrust enforcement.

The FCC's advocacy efforts attacking state-sanctioned anticompetitive barriers to trade appear to have generated both publicity and results. When the FCC has used its expertise and enforcement authority to challenge policy-generated barriers to entry, growth and exit, it has been extremely successful. For example, the FCC's challenge (coinciding with the interests of foreign competitors) of barriers to entry in the Mexican long-distance telephone communications market is hailed not only as a triumph for the credibility of economic reform in Mexico, but also as an indication of the Commission's independence from political influence (The Economist, July 9, 1994; FCC Annual Report 93-94). Similarly, the agency's victorious challenge to vertical control of service station concessions by PEMEX, the state-owned oil company, has achieved noticeable and rapid results (FCC Annual Report 93-94, at 33-34).[33]

It is well known that the state is often responsible for anticompetitive regulations and other barriers to trade that reduce market entry and expansion.[34] One might question why, given its previous success stories, the FCC does not increase its advocacy efforts against these state-sponsored barriers. The FCC can, at least in theory, challenge anticompetitive state practices. Articles 3 and 4 of the LEC

grants the FCC authority to challenge federal, state or municipal public administration activities unless these activities are explicitly exempted. Furthermore, the agency's president has observer status in the cabinet.

We do not expect the FCC to expand its role of challenging state-sponsored anticompetitive actions greatly. Government and industry groups are likely to retain their symbiotic relationship after the economic liberalization. Although this government/industry collaboration may change in subtle ways to reduce its visibility, the relationship may still generate onerous anticompetitive actions. The FCC, of course, realizes the challenges to competition that this alliance may create. Further direct challenges to the government/industry alliance may reduce the Commission's political viability.

IV. Concluding Remarks

The FCC is obliged by law to emphasize merger and other enforcement functions over advocacy. It seems that the FCC is challenging anticompetitive behavior sanctioned by the state. We believe that a program emphasizing traditional antitrust enforcement will not be very effective in promoting a competitive economy because private interest groups will try to circumvent enforcement activities by seeking favors directly from other government agencies. Producer interest groups have successfully petitioned Mexican governmental authorities to enact barriers to entry, exit and growth in response to reductions in tariffs and other components of the Mexican liberalization program. As a general point, the private gain to producers from cartelization is often vastly outweighed by anticompetitive from seeking preferential treatment from the state. As such, developing economies, and Mexico in specific, should de-emphasize traditional western antitrust enforcement and emphasize competitive advocacy programs. An FCC that focuses its efforts on enforcement will find itself increasingly irrelevant in the policy-making arena as Mexico strives for a more competitive economy. The FCC should shift its priorities to *first advocate, then enforce.*

Will antitrust succeed in speeding the economic reform process for developing countries? It is now too early to tell. It seems, however, that traditional antitrust may be counterproductive at worst and ineffective at best. Most, if not all, developing countries lack both a history of and a natural constituency for a successful antitrust policy. If it is viewed as merely a technocratic fix, the top-down imposition of antitrust will not have broad political support and its influence will be minimal. One should wonder whether, as the influence of pro-liberalization technocrats fades, the fortunes of antitrust agencies will fade as well. Hopefully, an understanding of how the economics and political economics of antitrust interact will help the FCC in its goal to be both viable and effective. With this understanding, competition agencies should emphasize those areas in which they can command the best results: investigating and challenging the state's imposition of anticompetitive barriers to trade. If not, competition agencies may find that they are ineffective in their support of pro-market economic reform.

Notes

1 See, e.g. Willig (1992). Khemani and Dutz (1994) and references therein.

2 Ley Orgánica del Artículo 28 Constitucional en Materia de Monopolios. Diario Oficial de la Federación [D.O.], (Dec. 24, 1992). The basic concept of antitrust is not new in Mexico. The Federal Competition Commission's Annual Report for 1993-94 notes that monopolies were constitutionally prohibited in Mexico as early as 1857. The 1857 antitrust statute predates the competition law of the United States, which enacted the Sherman Act in 1890. Article 28 of the 1934 Mexican Constitution expressly prohibited monopolies, protection, or privileges for industry, and tax exemptions. The prevailing economic theory of that time, however, did not emphasize the value of price competitio, which presupposes current market-based antitrust.

3 Waller (1994) refers to this as the "transferability problem". Consider the following important example. In the United States, current antitrust understanding developed under a common law system that was shaped by a specific historical and social environment. By contrast, civil law countries rely largely on codes or statutes drawn up by the legislature. However, as Merryman (1985) observes, the distinction between common law and civil law traditions lies more in the source of the law rather whether the statutory code exists at all. In common law countries, the actual statutes are quite broadly written and judges have a tendency to "make" the specifics of the law. These procedures cannot be easily transferred to foreign with civil law systems such as Mexico. Civil law requires very detail statutes and judges who have little discretion. This "transferability problem" suggests that Mexico may have difficulty in adopting of U.S.-style antitrust laws, Schuck and Litan (1986) discuss "chastening" effects that Peru faced when it adopting a U.S.-style regulatory policy.

4 Several papers published in The International Review of Law and Economics (1991) discuss the interaction between economic analysis and civil law systems and raise similar concerns to those raised by Newberg (1994) and Waller (1994).

5 Godek (1992).

6 Rodriguez and Coate (1996).

7 Waller (1992).

8 There have been several papers that analyze antitrust from a political economy perspective [Faith, Leavens and Tollison (1982), Benson, Greenhut and Holcombe (1987), Shughart (1990), Buchanan and Lee (1992), Hazlett (1992) and Rubin and Cohen (1992)]. We don't see any reason why of this analysis is not equally applicable to developing economies. However, to our knowledge, the issues have been specifically directed at economies in transition only by Rodriguez and Williams (1994) and Williams and Rodriguez (1995).

9 The thesis that non-tariff barriers and other consequences of rent-seeking behavior are substitutes to cartelization or any other type of private coordinated activity is not new [See e.g. Azcuenaga, (1990), Rubin and Cohen (1992), and, more generally, Mueller (1989) and references therein].

10 For a good portion of its recent history, Mexico based its industrial policy not on market principles or free competition, but rather, on policies which justified more intense state control over the economy. Although the ISI model became the prevailing approach from the 1950s to the late 1970s, earlier periods reflected equally burdensome anti-competitive government-sponsored policies (Aguilar Alvarez de Alba, 1994; Solis Mendoza, 1992; Casar et al, 1990).

11 The Federal Competition Commission, in its Annual Report (1993-1994), states the following: "The Mexican economy has inherited a substantial number of business activities where competition has been needlessly curbed. This may have a negative effect on efficiency and equity for many years to come".

12 See, generally, Runge, (1990); Coughlin (1991); Krouse (1994).

13 All parameters are positive.

14 It is appropriate to make certain assumptions on the functional form of B(.). Its first derivative is assumed to be positive, the second negative: the expenditure of more effort should increase the level of trade barriers, but with diminishing returns. Lastly, the trade barrier should never grow so great as to eliminate the domestic market, or

$$0 \leq B(e_B) \leq P_D - P_S$$

15 If marginal costs between firms are distributed such that the marginal firm (that firm with the highest marginal costs that is still willing to supply the market) might be either a foreign or domestic firm, then the imposition of a barrier to trade may have the effect of rotating the supply curve counterclockwise to the left. If this is the case, the qualitative results of the model remain: efforts devoted to rent-seeking and cartelization are substitutes under a wide variety of general assumptions on the functional forms of the various parameters.

16 It is necessary to make a few general assumptions on the functional form of C(.). C must lie between 0 and 1 and its first derivative is positive and second negative. These say that the producer interest group never raises price above what a hypothetical monopolist would charge and that additional cartelization efforts are effective at raising prices, but with diminishing returns.

17 See Williams and Rodriguez (1995) for details sufficient conditions for this concavity.

18 Because the producer interest group's monopoly rents are always increasing with price as long as the price remains below the monopoly level (*i.e.* the monopoly rent function is homothetic with respect to the "price production function" within the relevant range), the interest group will always want higher prices and marginal productivity of expending additional effort of either type is positive.

19 Actually, P is generally concave in both types of efforts, a stronger condition than quasiconcavity.

20 A change in the relative prices of lobbying versus cartelization may induce the interest group to change the total amount of resources devoted to these efforts. We do not address this nontrivial issue in this paper.

21 Note that BL_2 intersects the rent seeking effort axis at the same point as BL_1 if the cost of rent-seeking has remained the same.

22 The marginal rate of substitution is the instantaneous slope of the "isoquant" curve. This slope is steeper at point Y than point X.

23 As the technology to rent-seek expands, the costs of rent-seeking cannot go up *ceteris paribus*. If the new technology – lobbying the antitrust agency – is more efficient than other technology such as lobbying congressmen, then the cost (price of effort) of rent-seeking falls. Modeling this as a rotation of the budget line implicitly assumes that lobbying the competition agency and lobbying other agencies is a homogeneous good.

24 Whether prices are higher depends upon the size of the shifts in prices of rent-seeking and cartelization, as well as the position of the original equilibrium and the shape of the isoquants. Price will be higher if the income effect outweighs the substitution effect.

25 There is a large economic literature showing how making credible commitments by limiting one's discretion can result in greater benefits. See, for example, Williamson (1983) and Kronman (1985).

26 NAFTA, which took effect on January 1, 1994, stipulates that each member country shall adopt or maintain "measures to proscribe anti-competitive business conduct and take appropriate action with respect thereto, recognizing that such measures will enhance the fulfillment of the objectives" of the agreement. Paragraph 1501(1) obligates the parties to consult "from time to time about the effectiveness of the measures" undertaken by each party. Paragraph 1501(2) further provides that the parties agree to "cooperate on issues of competition law enforcement policy".

27 That the regulation adversely affects competition is a necessary but not a sufficient condition for it to be challenged; there are many types of regulation that may be socially efficient yet may restrain competition. A proposed regulation should not be challenged if it directly solves a serious market (or social) failure whose unavoidable efficiency losses likely outweigh the costs of the regulation. If the costs of the regulation outweigh the benefits, the regulation should be scrapped.

28 The principal objective of reaching the Consensus was to encourage prudent macroeconomic policy-making, microeconomic reform increased and increased foreign trade in Latin America. See Williamson (1990).

29 The FCC classifies its activities into three areas: evaluation of mergers between two or more economic agents: ex-officio investigations of possible monopolistic practices and assessment of private suits filed in connection with possible monopolistic practices. FCC Annual Report, *supra*, note*, at 11.

30 For example, an antitrust agency often conducts preliminary investigations before a matter is formally opened. If after preliminary investigation the matter is closed, we would have no record of the time allocated to that investigation nor, for that matter, would we know of the investigation's

existence. Furthermore, there is no way to account for the time the FCC allocates to preliminarily investigating matters whether the investigations are formally opened or not.

Additionally, *ex officio* investigations, unlike merger investigations, rarely face statutory deadlines. (Article 21, section III of the LEC, obliges the FCC to decide a merger under review within 45 days.) As such, the time devoted to merger activities may require considerably more agency resources that a similar hour devoted to an *ex officio* investigation. Thus, our tabulation may overestimate resources allocated to non-merger activities. On the other hand, staff investigating mergers often spend weekends and holidays at the office work. If the FCC's accounting system takes this into account, then the bias in our tabulation will be minimal.

The timing and magnitude of merger activity is often unpredictable and something over which the FCC has little control. As such, the percentage of resources devoted to merger activity may reflect the demand for the agency's services rather than a conscious decision to devote that level of resources to merger investigations if the level of merger activity over the sample is aberrant.

[31] The economic concepts necessary to analyze antitrust issues are the same as those needed to discover government-imposed barriers to trade. In general, an antitrust economist needs to ascertain whether actions by other firms (by either entering into or expanding in a market) will mitigate any alleged anticompetitive effects. In addition, an antitrust economist will try to seek alternative efficiency explanations for firm behavior in addition to any anticompetitive motivations. Efficiency explanations for firm behavior often require that property rights be well-defined and protected. As such, an antitrust practitioners need to understand how certain barriers to trade (which reduces someone's propriety rights to trade his product in whichever manner he wishes) can force inefficient economic outcomes.

Not only are antitrust agencies uniquely qualified to properly analyze those economic phenomena necessary for a competitive economy, but also with its broad authority to monitor and investigate commercial conduct, the competition agency is well-situated—perhaps the best situated—government entity to give expert analysis of competition issues.

[32] Total number of days accounts for all days, including weekends and intervening holidays, starting from the day when the agency was notified to when the case was completed.

[33] In March 1995, Gabriel Castañeda, at the time the Executive Secretary of the FCC, relayed to Dr. Rodriguez that, in the nine months after the PEMEX action, just under 2,000 new service station concessions had been granted. This has markedly improved the quality of service in the retail market.

[34] See, generally, Colander (1984) and High (1991).

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