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How Antitrust Regulation Hinders Innovation and Competition

Framing a Broken Debate

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Few economic concepts elicit such strong reactions as that of monopoly, and the policy intended to address it—antitrust regulations (called competition policy in the European Union). Yet, both supporters and opponents of antitrust regulations agree on one fundamental point—that effective competition is vital to the American economy and the welfare of its citizens. However, they differ in how the law should encourage this. There are essentially three schools of thought regarding antitrust policy:

1. ***Interventionist***. Regulators should use the law proactively to break up companies that are abusing their market power and restore a competitive market. The size of a company is a good guide as to when this should be done.
2. ***Consumer welfare***. Abuse of market power is rare and dominant market positions can be achieved through delivering improvements in consumer welfare. Therefore, antitrust laws should be used not to break up companies that have grown big through successful competition, but to address instances of collusion, price fixing, or other anti-competitive behavior.
3. ***Free market***. Antitrust law is unnecessary. Market processes routinely undermine monopolies—and attempts to create monopolies. Laws against "unfair competition" prevent property owners from experimenting with joint ventures and other innovations that can improve consumer welfare.

Until recently, there was a sharp partisan divide between these schools, which can be roughly described as liberal, conservative, and libertarian, respectively. Traditionally in practice, this meant that antitrust conservatives would more often side with the libertarian camp, while leaving some room for cooperation with the liberal faction. However, the recent rise of "big tech" has led some conservatives to turn to the most interventionist approach with a zeal that threatens innovation in America's world-leading technology industry.

The interventionist approach suffers from the same problems classical liberal economists have long identified with government interventions in markets.

First, there is the "knowledge problem"—how do regulators know better than the market what the best market structure is?

Then there are what are known as public choice considerations—regulators might exercise their powers to promote their own preferred policy positions. The very existence of those powers will lead to intense lobbying by regulated entities—both those seeking regulatory relief and those who benefit from entry barriers that limit competition from potential new entrants in a market.

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The consumer welfare approach also has problems. Retaining antitrust law as an option that may be used against entrepreneurs carries the same threat to innovation posed by the interventionist approach. For instance, politicians with an animus against certain companies may pressure regulators into opposing mergers involving those companies. Regulators assessing unfair competition will not be immune from the knowledge problem and public choice effects. Entrepreneurs, eager to avoid provoking antitrust enforcement actions, will be dissuaded from pursuing innovations that might run afoul of the law.

The third approach, abolishing antitrust law, is extremely controversial. There is a widespread belief, among policy makers, the media, and the public, that without the threat of antitrust law, companies will disregard customer preferences, extract excessive profits, and kill off competitors. Yet there is no such thing as a dominant market position unless it is guaranteed by government. AOL, Borders, Blockbuster, Sears, Kodak, and many other firms once considered dominant in their markets have fallen as the result of competition, without any antitrust action.

This process of creative destruction, succinctly described by the economist Joseph Schumpeter, is a major driver of the kind of innovation that helps raise living standards. It will surely continue unless, ironically, antitrust regulators gain too much power. Were that to happen, large firms will be tempted to reach accommodations with a government that restricts their activities in exchange for not being broken up. Those accommodations will usually include protections and guarantees that act as entry barriers against potential innovative challengers. The result will be less competition, fewer innovations, and lower consumer welfare.

Creative destruction is the best answer to dominant market positions. Rather than use antitrust law aggressively, those who wish to see big companies fall quickly should instead work to end antitrust law. As for other barriers to creative destruction—for instance, financial regulations that make launching an initial public offering of stock prohibitively costly—increased competition can be achieved through deregulation in those other areas.