The Social Contract at the Basis of Competition Law: Should we Recalibrate Competition Law to Limit Inequality?

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Forthcoming, Competition Policy: between Equity and Efficiency (Lianos and Gerard eds., Cambridge University Press, 2017)

“The third law of nature is also a source of justice for society, in that covenants and contracts between people must be honored if a stable system of government is to be established”.²

Thomas Hobbes, Leviathan

Abstract

Competition law constitutes an important part of the social contract that stands at the basis of market economies, which conceptualizes the relationship between the state and its citizens, as well as among citizens, and legitimizes state action. This article seeks to unveil the social contract that stands at the basis of competition laws by shedding light on the assumptions at its basis. It then explores whether these assumptions indeed further the goals of the social contract, namely total and individual welfare. In particular, in light of recent challenges to the welfare effects of market economies, this short article seeks to determine whether equality and inclusive growth goals should play a more pronounced role in the competition laws of developed jurisdictions, and if so, by what means.

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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. Indeed, this enormously influential metaphor has served as the basis for one of the most dominant theories of moral and political theory of modern history.

The idea of a social contract appears in the writings of Socrates, and was developed in the modern era by philosophers such as Thomas Hobbes, John Locke, Jean-Jacques Rousseau, John Rawls, David Gauthier and others. While each philosopher suggested a somewhat different basis for the social contract, their theories all 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, once formed, 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, where possible, privately erected artificial barriers to competition are prohibited. To be sure, the conceptions of total and individual welfare may differ even among market economies. For example, jurisdictions may give different weight to total over individual welfare in the short run, or they may value dynamic efficiency more than allocative efficiency. They may also give more value to considerations of equal access into markets over lower prices. Yet such economies all share a core assumption that the total and individual welfare of members of society (rather than, for example, a dictator), stands at the basis of the social contract.

Accordingly, for the social contract to work well, at a minimum its conditions should ensure that total welfare will be increased, at least in the long-run. Indeed, competition law is based on the assumption that competition can reduce prices and increase all types of efficiency, including allocative, productive and dynamic efficiency. The protection of competition also serves non-

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3 See, e.g., Celeste Friend, 'Social Contract,' INTERNET ENCYCLOPEDIA OF PHILOSOPHY http://www.iep.utm.edu/soc-cont/

economic goals such as dispersing power and opportunity, reducing socially harmful political effects, and supporting democracy and freedom of speech.\textsuperscript{5}

Furthermore, the social contract should ensure that individual welfare is also increased, at least in the long-run. It is assumed that competition law does so in several cumulative ways. Most basically, consumers enjoy better and cheaper products and services, thereby increasing their ability to better fulfill their individual preferences.\textsuperscript{6} Of no less importance, Competition can positively affect social mobility and equality of opportunity of members of society. By lowering artificial barriers to entry, potential competitors will be able to enter or expand in the market, compete on merit, enjoy (at least partially) the fruits of their success. Indeed, social mobility is a likely and expected outcome of competition. This is due to the fact that people with good ideas or good managerial skills do not necessarily come from any particular part of society. Moreover, those from lower socio-economic classes often have a stronger motivation to succeed economically and climb up the ladder, thereby leading them to invest more effort in the market game than those who treat their economic benefits as natural.

Of course, competition is not a panacea; it does not work well where significant market failures exist, such as information asymmetries, natural monopolies, 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 entry and mobility in the market, are essential parts of a social contract aimed at increasing total and individual welfare in the long-run.

Unfortunately, it seems that at least in some economies the socio-economic social contract is not working well in practice. Recent years have envisaged an increased rate of dissatisfaction with market economies. A growing number of citizens believe that the promises of the competition-based market system, which form an important part of the implicit social contract, are not fulfilled and that capitalistic markets are no longer working in their favor. Indeed, statistics indicate that social mobility is low; that wealth is aggregated disproportionately in the hands of the already well-off;\textsuperscript{7} that wealth inequality keeps rising;\textsuperscript{8} that several large firms dominate the digital economy, thereby blocking at least some of the promises that technological changes were

\textsuperscript{5} A vast literature exists on the goals of competition law. For a good analysis of the different goals adopted by competition law see, e.g., Waked, \textit{ibid}; Daniel Zimmer ed., \textit{The Goals of Competition Law} (Edgar Elgar 2012).

\textsuperscript{6} Observe, however, the consumers’ preferences may change with the change of options in the market, and the ability of their reference group to consume similar products, thereby not necessarily significantly increasing their feeling of well-being for a long time.


thought to bring about; that technological changes such as robotics create significant disruption effects and have negative implications on the labor market; or that education and social security do not create viable solutions for workers in order to ensure that wide geographic areas or demographic groups are not significantly and irreparably harmed. In the U.S. and the European Union, 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. This unrest has led, inter alia, to social protests, such as the Israeli so-called “Cottage Protest”, referring to the increase in price of Cottage cheese, and the U.S. movement “We are the 99%,” whose name indicates the fact that a large part of the wealth is concentrated in the hands of the few, pointing to the significant and growing inequality in the distribution of economic resources. The Arab spring was also, at least partially, based on the upheaval of the under-privileged against inequality in sharing the gains from trade. The recent elections in the U.S. have also brought to the forefront questions of whether capitalism and liberalism, the way they are currently practiced, indeed further the interests all members of society, or whether they serve only some parts of society. All these protests share a common belief that the dogma of open markets and free trade is, in practice, working well for the elites, but not for the masses.

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. In particular, this short article focuses on whether equality and inclusive growth goals should play a more pronounced role in competition law. Some leading scholars, spearheaded by Eleanor Fox, argue for the inclusion of such goals in developing countries. This article explores whether these goals should also be given more weight in developed jurisdictions as well, and if so—how. As noted, competition law is only part of the regulatory toolbox which affects socio-economic conditions. Yet because it is the basic instrument that regulates competition in most markets, the time is ripe to ask whether its current form indeed serves the social contract.

To do so, I first explore the connection between the social contract and inequality. I then explore the interrelation between competition law and inequality, exposing the duality and the dilemma which it creates, which go to the basis of competition law. I also analyze the assumptions that competition law is based upon, and the way they are met in the real world. The last part suggests

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some ways in which competition law 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? Interestingly, equality plays different roles in the writings of social contract theorists. According to Rousseau, inequality stood at the basis of the formation of the social contract: The invention of property strengthened the initial conditions of inequality in the state of nature. It therefore was in the interest of those who had property to create a state that would protect them from those who did not possess property but might have been able to acquire it by force. So, while the social contract purported to guarantee equality and protection for all, its true purpose was to fossilize the very inequalities that private property has produced. Rousseau then argued for a normative social contract, which is meant to respond and remedy these social and moral ills, and determine how we ought to live. It is this normative social contract that I wish to focus upon.

With regard to the content of a normative (hypothetical) social contract, all modern philosophers assume that the state is formed when free and equal persons come together and agree to create a new collective body, directed to the good of all. As such, it should not serve the interests of one group over another. Therefore, inherent inequality could not form part of the social contract. 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*, 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, particular 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 or her 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 principle states that each person in a society is to have as much basic liberty as possible, as long as everyone is

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12 This part is partly based on Friend (n 3). Other contractualist perspectives on inequality also exist. See, e.g., T.M. Scanlon, *What we Owe to Each Other* (Harvard University Press 1998).
granted the same liberties. The second principle (known as the Difference Principle or the Maximin 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. Rawls also emphasizes that a just distribution should be based on real fair equality of opportunity, and that this principle has precedence over the maximin principle. Observe that these principles do not necessarily lead to a situation in which citizens are equal, either in each point in time or in the end state. Rather, short-term inequality might be justified in order to serve long-term justice. Nonetheless, distributional effects are put under a magnifying lens: it matters not only which general groups benefit from the action, but rather if weaker individuals also benefit.

Rawls’ conception of a just social contract can, however, be questioned. Some have argued that the rules chosen behind a veil of ignorance depend on the level of risk aversion of the individuals determining the contract, and the rules by which the contract is set. Should most individuals be risk neutral or have a low level of risk aversion, and the gains to the total welfare pie would be large as a result of inequality, we might envisage a social contract which does not necessarily embody the Maximin principle in its strictest form, but rather embodies a rule which maximizes the average welfare while ensuring some minimum standard of welfare to all. Also, much depends on the normative values at the basis of each society. Furthermore, Rawls does not look at the conditions which have led to a situation in which the individual is less well off. Yet we may wish to treat differently one who was born with a low income and one who lost his wealth due to laziness. Other theorists question the incentives which the Rawlsean contract create: whether it creates incentives for individuals to contribute to society in a way which will maximize the total welfare pie, so that it could then be distributed among members of society.

Of course, the Rawlsean ideal of a just society is not the only one possible. Others put more emphasis on different values at the basis for the legitimacy of the state. One such theory is libertarianism, which gives liberty precedence over other values, including equality. Robert Nozick, a leading scholar in this school of thought, views the role of the state as one respecting citizens’ individual liberties, mainly property rights, rather than ensuring a just distribution of means. Accordingly, such liberties should not be sacrificed, without the individuals’ consent, in order to achieve broader social goals, including distributive justice. This night-watchman state, which completely disregards distribution concerns as such, was not adopted by any state in this strict form. Criticisms of this view focus, inter alia, on the fact that it is assumed that current

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15 Ibid 122-3.
16 For some of the criticism on Rawls’ work see e.g., the sources cited in the following discussion as well as Gerald A. Cohen, *If You’re an Egalitarian, How Come You’re So Rich?* (Harvard University Press 2000).
property rights are based on a just distribution, and that it fails to recognize the fact that property rights, in themselves, limit the liberties of others.\textsuperscript{18}

Other leading theories of justice include, inter alia, utilitarianism\textsuperscript{19} and the capabilities approach.\textsuperscript{20} Utilitarianism emphasizes the maximization of utility, regardless of its distribution among individuals. 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 (as suggested by liberals such as Rawls), 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.\textsuperscript{21} Martha Nussbaum argues that the capabilities approach remedies a basic flaw in many modern conceptions of a social contract, which envisage a negotiation between rational and physically and mentally sound individuals, not taking into account those that do not belong to this group. Critics of the capabilities approach emphasize, inter alia, the difficulties in comparing the capabilities of different individuals.\textsuperscript{22}

Despite this plethora of theories relating to the goals of 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.\textsuperscript{23} At a minimum, inequality should only be accepted if its benefits 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

\begin{enumerate}
\item\textsuperscript{19} See, e.g., Jeremy Bentham, \textit{An Introduction to the Principles of Morals and Legislation} (Clarendon Press 1907).
\item\textsuperscript{21} Ibid.
\item\textsuperscript{22} See, e.g., Martha Nussbaum and Amartya Sen (eds.), \textit{The Quality of Life} (Clarendon Press 1993).
\item\textsuperscript{23} For a similar argument see Piketty (n 1) 571 (unchecked and growing inequality is “potentially threatening to democratic societies and to the values of social justice on which they are based”); Baker and Salop (n 10) 24.
\end{enumerate}
disperse the opportunities for participating in and enjoying the benefits of the marketplace, as it allows some to enjoy a comparative advantage over others. Put differently, it severs or weakens the connection between one’s contribution to the marketplace and one’s reward. Second, it may clash with the economic goal of increasing the total welfare pie, for the benefit of all, 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 not only economic consequences but also psychological ones. As psychologists and others have shown, one’s satisfaction and motivation to take part in an action is based not only on what one has in absolute terms, but, even more importantly, on the opportunities others have relative to himself. Indeed, we do not live as separate individuals but rather interactions and comparisons form an integral part of our well-being. Accordingly, inequality of opportunity further harms the economic goal of individual and societal welfare by creating social unrest which can 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 many Western societies, this does not imply a 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 and unjustified. 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, inter alia, 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, by moving between states, 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, free of political influences that serve specific groups at the expense of the general public. 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 suggests examining the current application of competition law in light of this social contract.

III. Competition law and Inequality: The basic dilemma
I now turn to examine the role inequality plays in competition law. This requires us to go to the heart of the goals and values at the basis of this regulatory tool. As elaborated below, competition law has an intricate and dual relationship with inequality, which creates a basic tension.24

In most jurisdictions competition law is applied in a manner in which inequality considerations are dealt with only indirectly. Nonetheless, competition law’s inherent characteristics reduce inequality of both opportunity and wealth in several ways. First, by lowering artificial entry barriers into the market, competition law increases equality of opportunity by way of allowing 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 the benefits that the market can bring 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 creating political economy effects that enable strong groups to enjoy a disproportional part of the welfare pie.

At the same time, competition law 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, regardless of the effort invested by each supplier or his non-market-rewarded traits. In extreme cases, just like in the Abba song, “[t]he winner takes it all.” 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. The U.S. Supreme Court’s famous dictum in *Trinko* emphasizes this point: “[t]he opportunity to charge monopoly prices- at least for a short period- is what attracts ‘business acumen’ in the first place; it induces risk taking that produces innovation and economic growth.”25 Add to it the fact that people’s motivation to invest time and effort are often driven by their comparison to their peers, and it becomes clear that inequality plays an important role in bringing about the benefits that competition has to offer. Furthermore, where equality of opportunity exists and entry barriers into the market are low, inequality of wealth is deemed to reflect the comparative efforts of individuals. This is because success in the market game is affected, inter alia, by the motivations of individual to use their comparative advantages in order to create better products and services. Accordingly, inequality of wealth is often treated as an inherent and even important aspect of competition, which, while creating harmful static short-run effects, is necessary to create the more important long-term

24 See also Pradeep Mehta, ‘Preface’ in Pradeep Mehta and Taimoon Stewart (eds.) *Should Competition Policy and Law be Blind to Equity: The Debate* (CUTS, 2013).
dynamic effects that, as Nobel laureate Robert Solow and others have shown, are the main drivers of welfare in Western societies.\(^\text{26}\) It is an “inherent bad” of market societies.

Inequality of wealth, 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 into the market. Therefore, most competition laws do not place significant weight on issues of the short-term distribution of the benefits from trade.\(^\text{27}\)

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. The common view that inequality of better addressed by other regulatory tools also contributes to this policy.\(^\text{28}\)

The increased reliance on the market’s invisible hand, which does not deal directly with inequality issues, also follows libertarian ideals: Reducing regulatory interference in the market to the minimum necessary, and allowing private forces to take their course. Inequality of wealth which results from competition on the merit can also be justified, at least to some extent, by other theories as well, including utilitarianism and some libertarian approaches. The question then becomes at what point does inequality of wealth stop furthering the social contract that lies at their basis.

**IV. Furthering equality in developing jurisdictions**

The goal of inclusive growth—reducing inequality in the distribution of benefits created in the marketplace through competition law—has been advocated for developing jurisdictions. Professor Eleanor Fox has been a leading voice in arguing that fighting long-term and entrenched inequality should be one of the main goals of competition law in developing countries. According to her thoughtful and thought-provoking scholarship, the goal of maximizing welfare should be understood as “inclusive welfare:” building a ladder of mobility from the lowest rung up in order to enable mobility, incentivize entrepreneurship, and stimulate innovation.\(^\text{29}\)

In our joint paper on competition law for developing jurisdictions, Professor Fox and I have argued for sensitiveness with regard to where the benefits from trade fall.\(^\text{30}\)

What are the reasons that lie at the basis of such suggestions? First, it satisfies a need for legitimacy. The safeguarding of economic opportunity and the distribution of benefits may be so


\(^{27}\) For a discussion of such considerations in the context of developing jurisdictions see, e.g., Michal S. Gal and Eleanor Fox, ‘Drafting Competition Law for Developing Jurisdictions: Learning From Experience’ in Gal et al. (eds.) *Competition Law for Developing Jurisdictions* (Edgar Elgar 2014).

\(^{28}\) See discussion in section V.D. below.


\(^{30}\) Gal and Fox (n 27).
important to legitimacy that a distribution-blind law may not take root. This is especially important in those developing economies in which a distribution-blind welfare approach might prevent societal acceptance and disintegrate the social fabric because it would strengthen or maintain existing wealth disparities, especially where it parallels a racial divide. As Chua has argued, the overlapping of class and ethnicity characteristics, which characterize many developing economies, mandate that the distributional effects of a market economy be taken into account. Otherwise, this may create instability, which could convert into an engine of potentially catastrophic ethno-nationalism. Indeed, in a recent OECD roundtable on competition and poverty reduction, delegates of competition authorities in developing jurisdictions argued that “the political credibility of the competition policy authorities depends to a large extent on how they are seen as contributing to poverty reduction and employment creation. It would be risky for them to state that their only target is combating harm to competition by producers, and that the impact of their efforts on poverty or inequality is irrelevant.”

Second, 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. Indeed, the current literature on development and growth stresses the importance of inclusive growth. It suggests that developing countries need to give weight not just to efficiency defined as increased aggregate wealth- but efficiency defined also in terms of enabling the masses of people to participate on their merits in the economic enterprise. Observe that this goal also requires that consumer welfare be taken apart, to determine which classes of consumers are benefitting from the economy.

Third, Fox argues, “antitrust for developing countries must be seen in a larger context. The canvas includes the dire economic conditions of developing countries...Developing countries often see free-market rhetoric and aggregate wealth or welfare goals as inappropriate to their context because of the tendency of free-market policies to disproportionately advantage the already advantaged in every game played.”

The importance of inclusive growth was also recognized by the Spence (World Bank) Growth Report, which concluded that "not only does growth critically matter, but inclusive growth


32 OECD (n 5) 7.

33 Equality (n 25) 114.


35 Equality (n 29).
critically matters. Distribution counts. And distribution of wealth and, more important for our purposes, of opportunity and chance for mobility was [and is] deeply skewed.36

V. The Dilemma: Inclusive Growth Goals in Developed Jurisdictions

Let us now explore the limits—rather than the limitations—of the suggestion for inclusive growth as part of competition law. In particular, should its justifications be taken one step further and apply to at least some 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 look deeper into the assumptions that generally lead developed countries not to include reduction of inequality and inclusive growth as a direct goal of competition law, but rather to treat them as indirect—yet important—results of competition. Accordingly, this chapter sheds light on four basic assumptions that, I believe, stand and the basis of the existing status-quo of many competition laws in developed economies:

1. All market players have relatively equal opportunity to enter and to expand in the market, to be used based on their personal skills and motivations;
2. Once we deal effectively with artificial entry barriers, the market’s invisible hand will reduce most instances of inequality;
3. The remaining inequality is an inherent and important part of the competitive process that serves to increase the total welfare pie;
4. Even if equality is an important goal that should be given priority over total welfare in at least in some circumstances, competition law is not the correct tool to limit it.

Below we analyze each of these assumptions.

A. Equality of Opportunity

With regard to equality of opportunity, the assumption on which competition law is based in developed jurisdictions is that people have relatively equal opportunities for access and expansion in the market. While it is acknowledged that people possess different skills and resources, it is 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 at least most people to take advantage of market opportunities. For example, a well-functioning market can provide sufficient funding opportunities for good ideas for those potential entrants that do not possess personal funds.

Why is this assumption important? Because it supposes that participation and success in the market are dependent, mostly, on the motivations of people to invest in the market game. It also supposes that all citizens are given a relatively equal shot at the market game. Moreover, it supports at least one form of social justice: those who contribute most to society because they

create new and better widgets, get a larger share of the welfare pie, which indicates their contribution to overall welfare.

But is there real equality of opportunity in developed jurisdictions? As the statistics cited above indicate, at least in some economies the answer is negative. Successful entrepreneurship in many markets—even more pronounced in today’s technologically advanced world—requires inputs that the market does not or cannot easily provide to all potential entrants, and that states often fail to provide at an adequate level. These include, inter alia, high levels of education (which provide necessary skills for the marketplace including adaptability to new environments) and social connections to other, successful, market players. Inequality in such inputs can lead to large discrepancies in access and expansion opportunities.

Another challenge to equality of opportunity is created by competition itself. In some markets fierce competition exists over entry spots, which creates advantages to those with existing funds. For example, competition has led to a situation in which in some markets interns work for free. Accordingly, only people with funds can afford to work as interns, and without the experience you will generally not be hired. So the ability to enter the profession is dependent on more than skill.

Add to this political economy influences: in many developed economies policies backed by captured politicians and regulators sometimes benefit the few which have a strong hold on the market. In such an environment, even investments in costly higher education do not provide the key to unlocking the door of success.

Indeed, statistics show that social mobility in many developing economies 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—the main task that competition law seeks to perform—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, while the above assumption may be true in a jurisdiction in which all, or most, markets enjoy conditions of perfect or at least workable competition, it is not true once market failures are taken into account. Rather, market failures such as asymmetric information, collective action problems, or political economy influences may create conditions of significant

37 Fox provides such an example, see Equality (n 29) 112-3.
38 Section II infra.
inequality that may not be easily eroded. In such instances, competition law is a limited tool. Moreover, one of the major tools that competition law has to offer- merger law- generally applies only to firms that already possess significant market power or are likely to possess such power as a result of the merger. When the door to proving such market power is based solely on turnover rates, merger law does not capture under its wings instances in which transactions can create significant market power in new markets, power that might not be easily eroded afterwards.³⁹

Exogenous factors have further increased inequality of wealth on both national as well as international level. The main factor is globalization and the internationalization of trade, which strengthen competition over the locus of businesses, based on their relative comparative advantages. This is due, in part, to the lowering of transportation and transaction costs that enable distant producers to become potential suppliers. Another exogenous factor involves technological changes such as the increased use of robotics and computerized systems to perform many actions, thereby reducing the need for many kinds 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, especially where the need for middle-class workers is significantly shrinking and the education system is not designed to enable most workers to perform technologically advanced jobs. The combined effect of these factors has led to a troubling situation in which it is much more difficult nowadays to be gainfully employed. Indeed, studies show that the current generation is not likely to be better off economically than its parents. Jobless citizens are subject to a myriad of negative effects. These include adverse economic, psychological and health-related effects, mistrust in the capitalistic market system, and lower buying power that directly affects the level of dynamic efficiency in markets. Often the harm is not limited to individuals, but also affects local communities that have lost their comparative advantages. Observe that while most developed jurisdictions do not suffer from large economic discrepancies between different ethnic groups, social unrest can be created based on inequality between different socio-economic groups (e.g., blue collar vs. white-collar), which are exacerbated as a result of globalization and technological changes. When the market does not offer viable alternatives for such workers, a sole focus on lower prices or higher quality products may seem to some to be misguided.

Inequality of wealth can be further increased by discrepancies between consumers, which are not equally equipped to take advantage of potential market opportunities. To make optimal decisions, consumers need to be able to compare options and choose the one which best serves them. Digital literacy is an important factor, as is access to information and comparison tools (such as telecommunication networks and computers) that enable better comparisons, and transportation infrastructure (such as roads and trains) that enlarge the scope of potential suppliers. Inequality of opportunity of consumers to take advantage of market opportunities is especially pronounced when these consumers are also suppliers.

³⁹ Some jurisdictions have started to look into such issues.
C. Inequality is inherent to competition

Indeed, there can be no doubt that 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. Competition law is not the correct tool

The fourth assumption on which competition law is based is that even if equality should take precedence in some cases, competition law 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 competition law.

While these tools are important, most have inherent limitations that should be recognized. 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 instead than on their own efforts; and political effects shape at least some of these tools so that they are not applied efficiently. Furthermore, as elaborated in the next chapter, competition law can be shaped, at least in its margins, to take distributive and inequality concerns into account.

It is noteworthy that an important difference exists between artificial entry barriers (such as those that result from political economy effects) and natural barriers (such as those that result from lower labor or transportation costs elsewhere) that affect comparative advantages. While the first may potentially be reduced by competition or competition law (but not always), the second cannot. In fact, some types of natural entry barriers are taken as a given in all governmental policies.

These assumptions, taken together, challenge the way that the free market and libertarian 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; it promised 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 segments of the population. The increased disbelief in the market system as it is currently applied is troubling, because for the market system to operate, people must believe in its mechanism. Such trust, in turn, legitimizes the economic system and creates stability. Cynicism, on the other hand, creates unrest and might disintegrate the social fabric of societies. It also reduces the number of people who can and are willing to contribute to the market game.

Accordingly, the next section suggests examining the current application of the competition law in light of this failure of the social contract. This point of view emphasizes the links between efficiency and distribution as well as between profitability and sustainability, which can reinforce each other.41

VI. The Role of Competition Law in Limiting Inequality

While education and infrastructure might be more important tools in increasing equality in the long run, some changes in competition law might also 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 nonetheless play a significant part in meeting the goals of the social contract.

A. When fine-tuning might be required

Before we delve into some suggestions, it is important to observe that competition law in developed jurisdictions already includes some focus on distributive effects. Most importantly, most competition laws further the goal of consumer welfare, rather than supplier or total welfare.42 Even Canada has moved from a pure total welfare approach towards a more nuanced one, which looks at where the benefits from the trade fall. The EU has gone a bit further, requiring that restrictive agreements be allowed only if consumers enjoy a “fair share” of the benefits from the joint venture; and that monopolists not be allowed to charge “excessive prices,” even if they result from competition on the merit.43 Yet all these laws aggregate consumers into one group, not attempting to look further at the effects on different classes or types of consumers that are affected by the conduct or the transaction. As Farrell and Katz have observed, “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.”44

43 Articles 101-2 of the Treaty for the Functioning of the European Union.
To strengthen the belief in the social contract at the basis of competition law, a fine-tuning of the system might be required: giving more thought and weight to where profits accrue. Not only whether consumers or producers, as two distinct groups, are affected, but also which sub-groups are affected, and the importance of the transaction to their welfare as well as to total welfare. This requires going beyond simple legal assumptions, taking the position that differences between sub-groups should not be ignored, and accommodating the special characteristics and needs of some sub-group over others. Recognizing such 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 four examples of cases where the above suggestion may be relevant. I do not argue that these examples should necessarily affect the content and application of competition law. To determine whether such a change is justified, we need to engage in a deeper analysis which is beyond the scope of this short paper. 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. Such an analysis will also need to determine whether the competition authority is the right locus to engage in more nuanced social analysis, in light of the tools at its disposal as well as its democratic mandate and its level of susceptibility to political influences. Nonetheless, the examples illustrate instances in which it is worth considering performing such an analysis.

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, so that the condition of Pareto Optimality is met, that is, no other distribution of benefits from the transaction could make at least one person better off without making someone else worse off. On its face, this transaction should be allowed and indeed will be allowed in most- if not all-developed jurisdictions around the world. Yet this analysis disregards existing discrepancies in society and treats all consumers as equal. 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. Observe that this example does not fulfill the Maximin principle suggested by Rawls as a basis for a just social contract.

The second example adds additional sets of considerations, such as the agency’s limited resources. Consider, for example, 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. Other sub groups of consumers are not affected by it because they do not consume the relevant product or service. This can be illustrated by two extreme examples:

\[45\] It should not be automatically assumed that competition law offensess necessarily harm the poor and enrich the rich. For such an exposition see Daniel A. Crane, ‘Antitrust and Wealth Inequality’, 101 CORNELL L. REV. (2015).

\[46\] For simplicity, I refer to consumers. Yet in some cases the relevant group might be workers or even shareholders such as pension funds of middle-class workers. Whether policymakers wish to capture and differentiate such groups is a policy question subject to the same decision-theory considerations noted above.
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. Indeed, in choosing between the two cases, using scarce enforcement resources to follow the second one 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) of consumers are better off, and some are worse-off. Under the competition laws of most developed jurisdictions, such a transaction would not be allowed. Yet despite the fact that the condition of 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.

So far we have disregarded suppliers. Indeed, the competition laws of most developed jurisdictions generally use consumer welfare as a proxy for total welfare, thereby disregarding effects on suppliers. Moreover, even when such a focus is added, as in Canada, the analysis does not take apart the effects of suppliers on other groups in society, most importantly the suppliers’ workers or the workers of other market players which interact with them. As noted above, this is partly based on two assumptions: (a) that while the supplier might need to leave the market, most of its workers will not leave the job market since they could relatively easily switch jobs; and (b) even if they cannot finds job easily on their own, other governmental instruments, such as retraining programs, provide relatively efficient instruments designed to assist workers in finding new jobs. As elaborated above, in reality these assumptions are often problematic, and several factors combine to make the realization of these goals much more difficult than in previous decades. Such an environment crystallizes issues of inclusive growth and significant economic inequality in the gains from trade. Accordingly, society must ask whether it would better serve its social contract to focus solely on lowering prices and potentially increasing quality, even marginally, at the expense of losing jobs, or whether a more delicate balance should be struck which gives more weight to the interests of society in its citizens as workers.

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 competition law is necessarily the best tool to achieve these goals. Competition law suffers from some significant inherent limitations. It has a limited number of instruments at its disposal, that mainly include fines and prohibitions, rather than tools that allow for transfer payments between different groups of

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47 One caveat exists once we add the globalization dimensions: if the wealthier ones have other options and are likely to move to other jurisdictions if prices for luxury goods are much higher than elsewhere.
society; 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 and the state’s overall interests in remedying it; it does not have the democratic mandate to engage in such 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 competition law 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. As noted above, more significant changes, while possibly justified, require a deeper analysis based on decision theory considerations, balancing between benefits and costs in light of realistic options.

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 them. 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, competition law 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 to social welfare. 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 competition law 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 competition law does not inhibit the application of other policies which are aimed at furthering reinforcing goals. Most importantly, it must be ensured that competition law does not create a de jure or de facto veto power to competition law considerations, where it is in the public interest that they be balanced with other considerations. Israel provides an illustrative example. Offers to buy a large bankrupt firm must receive both the approval of the Bankruptcy Court and the Competition Authority. Under Israeli merger law, the Authority can only take into

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49 For a suggestion that goes further, arguing that competition law should take into account distributional concerns see Anthony B. Atkinson, Inequality: What Can Be Done? (Harvard University Press 2015).

50 For a similar suggestion see Baker and Salop (n. 10).

51 For such an example see, e.g., South African Competition Act, Act No.89 of 1998, ch. 1, para. 2(f).
account competition law considerations.\textsuperscript{52} Wider considerations can only be taken into account, if at all, by the Competition Tribunal, in a lengthy process. This creates a de facto veto power to the Authority to block mergers with bankrupt firms that significantly harm competition, even if wider public interest considerations would have led to a different result.

In addition, the Competition Authority’s \textit{advocacy role} can play an important double role in augmenting and strengthening the social contract. It should be used to advocate the adoption of governmental policies that further the social contract by complementing competition law. These may include, inter alia, increasing possibilities for market entry, relocation and retraining programs for workers, and incentives for creating jobs in unemployment-ridden areas. They should also include tools that create an equitable system of social redistribution, both in the short and in the long run.

Relatedly, in those cases in which the straight-forward application of competition laws harms the furtherance of equality and social justice, competition law may need to be calibrated to do so. Crane offense an eye-opening example with regard to the application of competition law rules to limit subsidization of the less profitable women’s sports teams, which could limit the furtherance of such sports teams.\textsuperscript{53}

The Competition Authority should also use its advocacy role to explain to the non-competition-law-educated wide public the logic behinds the choice of its actions, to strengthen their understanding of the market system and in the authority’s choices. 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. Such advocacy can strengthen the trust that the actions taken are indeed in line with the social contract.

Merger policy should also be changed so it would capture more firms that create significant economic power. As Maurice Stucke suggests, it should be expanded to ensure that concentration without offsetting benefits is arrested in its incipiency.\textsuperscript{54} Also, antitrust agencies and courts should be careful not to focus solely on static price competition and productive efficiencies.\textsuperscript{55}

Finally, as suggested by David Lewis,\textsuperscript{56} the tool of \textit{market inquiries}, used by a growing number of jurisdictions around the world, enables competition authorities to point out public restraints that

\textsuperscript{52} Israeli Competition Law 1988, Section 21.
\textsuperscript{53} Crane (n. 45) 4.
\textsuperscript{54} Stucke (n 41).
\textsuperscript{55} Ibid.
\textsuperscript{56} David Lewis as cited in Mehta (n 24).
strengthen or maintain elite dominance. This is because it grants them formal powers that extend beyond the traditional powers of enforcement.⁵⁷

VII. 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, unrest and protests 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 short article has showed, the challenges to the social contract, as it is currently applied, go to the heart of the goals at the basis of competition law. They require that the goals of competition law be broadened, in appropriate cases, to include distributional effects. Indeed, suggestions with regard to inclusive growth are relevant, at least partially, to developed countries and not just to developing ones.

It should nonetheless be stressed that in order for inequality to be reduced, competition law should be one of several tools harnessed for advancing equality and inclusiveness. Loading the delicate task of changing the current socio-economic fabric on competition law alone might be highly problematic and negatively affect the ability of the competition law to achieve its other goals.