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Antitrust and Development: Reassessing the Role of Competition Policy in Economic Growth

Radu Cristian Mușetescu, PhD
Associate Professor
Department of International Business and Economics
Academy of Economic Studies
Bucharest, Romania

Octavian Dragomir Jora, PhD
Lecturer
Department of International Business and Economics
Academy of Economic Studies
Bucharest, Romania

Athens Institute for Education and Research
8 Valaoritou Street, Kolonaki, 10671 Athens, Greece
Tel: + 30 210 3634210 Fax: + 30 210 3634209
Email: info@atiner.gr URL: www.atiner.gr
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Radu Cristian Mușetescu, PhD
Associate Professor
Department of International Business and Economics
Academy of Economic Studies
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Octavian Dragomir Jora, PhD
Lecturer
Department of International Business and Economics
Academy of Economic Studies
Bucharest, Romania

Abstract

There are several economists who argue that an activist antitrust policy could lead to significant economic development. Today, countries which actively enforce such antitrust policies, such as United States of America, seem to experience higher economic growth than countries with less activist antitrust, such as the member states of the European Union or Japan. Even some developing economies enforce antitrust policy with the goal of economic growth in mind. Enforcement agencies claim that such a public policy promotes a better (allegedly optimal) allocation of resources and, in consequence, maximization of not only consumer welfare but even of total welfare. From a theoretical perspective, economic development derives from this situation. We argue however that such a perspective overstates the role of such a public policy.

The traditional theory of economic development has put a strong focus on other factors as critical for economic growth. They stem from social institutions such as private property and the ability of legal system to defend and enforce such institutions to time preference at social level and propensity for saving. Or, in this respect, consumer welfare standard is not a direct causality. Moreover, we even advance the idea that, in certain cases, a too activist antitrust policy and the narrow focus on strict consumer welfare could lead to an inhibition in economic growth.

Key words: antitrust, economic development, consumer welfare, market delineation

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Contact Information of Corresponding author:

Whether the enforcement of a competition policy could be related with the macro-economic performance of an economy and particularly with its economic growth is an interesting, albeit arguably underexplored, issue in political economy. Taking into consideration that not only developed countries have adopted and enforced anti-trust legislation but also a significant number of developing countries, it is a theoretical challenge whether such an approach in state interventionism does allow a better macroeconomic performance. Moreover, such a theoretical question is relevant even for developed economies where policy makers must be aware of the collateral impact – if any – of such public policy. And especially during economic depressions, such an issue is critical for the coherence of public policy reactions.

In order to scrutinize the relation between the enforcement of a competition policy and economic development, an analyst has to advance both a theory of how the enforcement of competition law impacts the allocation of resources in an economy and the incentives of individuals to act in an economic manner as well as a theory of economic development. Each of these two branches of academic theorizing is significantly complex and experience contradictory arguments from different schools of thought. We will employ in our analysis the line of argumentation advanced by the economists belonging to the so-called Austrian School of Economics. This brand of economic thinking uses *ex ante*, logical, argumentation starting from the definition of conceptual categories. It employs what is called methodological individualism and it is critical to the empirical approach that draws economic conclusions from the study of historical events. However, it does not deny at all that the development of historical events could confirm the *ex ante* known theories. Austrian economists argue that free exchange among market participants *ex ante* maximizes aggregate welfare through demonstrated preference for exchange (Rothbard, 1956).

The objective of competition policy

The function of antitrust is the reorganization of capital goods in society as well as the restriction in the exercise of private property rights in order to reach public policy objectives. The common wisdom in economics is that market economy maximizes general welfare through an optimal allocation of resources. In the framework of economic freedom, any resources will be attracted towards the most useful production activity as entrepreneurs are not prevented from bidding the services of such resource.

However, mainstream economics argues that governments should alter the private conduct of producers that seems to be in contradiction with the state of perfect – or at least workable – competition. Competition law does not replace criminal or civil law but it supplements it for further political objectives. For the moment, the objective of competition policy is to increase consumer welfare (Bork, 1967) but, during its existence, competition law had also some other objectives. In consequence, nobody could rule out the possibility of a change in its objective in the near or distant future (Foer, 2006).

One of the implicit assumptions under the competition law it is that its enforcement deals with present consumer welfare. Competition policy does not – and, arguably, could not – deal with consumer welfare in the future. It is not prepared to assume the uncertainty of dealing with future conduct of private agents as they cannot be *ex ante* controlled under the political regime of a democracy and human rights. The impact of competition policy on the future derives only from the incentives of producers and consumers which are determined by the operation of such policy.

The consumer welfare standard has historically caused a widespread debate among economists, jurists and policy makers. It has been advanced by representatives of the Chicago School of Economics and it has been initially equated with the so-called '*total welfare standard*'. The total welfare standard is composed of the '*consumer surplus'* (the difference between what consumers are willing to pay for a good and the actual price they pay) and '*producer surplus*' (the difference between what producers are willing to accept as the price for a good and what actually they receive). However, as several analysts pointed, it evolved somehow into an acceptance that takes into consideration only the '*consumer surplus*' (Rule, 2005). Such a development is highly significant as it ignores '*dynamic efficiencies*' and take into consideration mainly '*static efficiencies'* – or allocative efficiencies in a narrow sense (Williamson, 1969).

The preference of anti-trust authorities for '*static efficiencies*' at the cost of '*dynamic efficiencies*' is, in fact, the same preference for present at the expense of the future. It is an understandable choice for any public policy in a democratic state. But this could be the point of departure that relates antitrust and development.

A theory of economic development

The theory of economic development attempts to analyse which are the factors that generate economic growth and how they contribute to the process of development. There are a lot of competing arguments attempting to explain such a phenomenon starting from those that highlight cultural factors to that point to technological factors, political governance and so on.

Among these arguments however, one of the core dilemma consists in the choice between consumption and saving. In other words, does a society grow from an economic perspective when its members prefer to consume the largest part – or even all – of their income or save? The ratio of consumption versus saving from its income plays a critical role in the theory of development.

While nobody could give up consumption, the possibility that a society consumes everything it produces is very real, both at an individual and at an aggregate level. In other words, any income derived by an individual from his

labour is used for buying economic goods whose only utility derives from consumption.
Skousen (1992) points to the historical dilemma between two schools of thought. On the one hand, there are those that criticize saving and argue that only the support of consumption could assure economic growth and further development of a society. It is the case of lord John Maynard Keynes and all those who took over his insights into public policy. On the other hand, economists belonging to the Austrian School of Economics seemed to have agreed that the critical process needed for economic growth and development is saving.
In fact, Hayek (1975) has termed this causal relationship as *'the paradox of saving*'. In few words, the paradox states that individuals must refrain from consuming all their income in order for economy to grow. As opposed to those who consume all their income and compensate the existing producers for their past decision to invest – they maximize present production – saving allows the creation of new capital which is needed for the adoption of any new idea and technology into actual production. An industry becomes more efficient not by maximizing the present production but also by adopting new ideas and technologies that allow it to maximize future production.

Competition policy and the credit market

We argue that the current objective of competition policy, which is the maximization of present consumer welfare, is in fact an encouragement of consumption over saving. Consumer welfare is understood as dealing primarily with the consumer wealth on the consumer goods markets. Even if antitrust law is also enforced on the markets for capital goods, its ultimate impact is on the markets for consumer goods.
However, antitrust law does not operate on the critical market for credit. The underlying logic of the credit market is that the institution of central bank, through the instruments of monetary policy, establishes the rate of interest according to its policy objectives. As any other public intervention that has a deep and direct impact on a supply of a good – fundamentally, from an Austrian perspective, money is an economic good (Mises, 1980) – the policies of a central bank could have dramatic anti-competitive effects. But our task in this paper is not oriented towards such dimension.
Besides the actions which are determined by the central banks, financial institutions could engage in what are qualified as anticompetitive practices such as cartels, vertical restrictive agreements or attempts to monopolize the market through economic concentrations. But such practices could be prosecuted by antitrust authorities only in what regards particular practices dealing with present goods or services (such as commissions for certain types of financial transactions). Again, the core good it supplies – which is, at aggregate level, present goods at the expense of future goods – are not in the attention of competition policy.

In fact, monetary policies as applied by contemporary central banks have a bias towards encouraging present consumption over future consumption, that is, consumption over saving. Historically, central banks have used the tools of monetary policy in order to attempt to encourage economic growth. Their primary mechanism has been the lowering of the interest rates and the expansion of money supply in order to spur present consumption and investment, that is, the expansion of present production (de Soto, 1998). This is especially the impact of the encouragement of consumer credit. Consumer credit is used in order to buy consumer goods at the expense of saving and future consumption. In fact, any policy that encourages present consumption penalizes future consumption. It supports present production at the expense of future production.

The apparent neutrality of competition policy towards time preference

At an apparent level, competition policy does not position itself towards the time preference of the population in society. There are several arguments in this respect.

First of all, competition policy punishes anticompetitive practices which are understood as conduct of private producers that extract wealth from consumers. At practical level, a producer which employs an anticompetitive practice leads to a surcharge taken from consumer surplus. But competition policy does not – and even it is not interested in – how such a producer or a group of producers allocate such an extracted wealth. In this respect, it is obvious such resources do not disappear from the economic system. They are just redistributed to other categories of economic agents.

Any wealth that is controlled by a firm has two primary destinations: in the first case, when the firm is not profitable, such wealth is directed towards the acquisition of goods and services from the economy, from other producers. Fundamentally, any producer on a particular market is at its turn a consumer on other markets. This is what has been called "*Say's Law*", which is a critique of the later "*Keynes's Law*" that advances the concepts of aggregate demand and aggregate supply without realizing that they are not independent variables (Kates, 1998).

In the second case, such a firm, besides procurement, has an economic profit which, at its turn, is directed towards two secondary destinations: one of them is the expansion of the firm (through retained earnings), which fundamentally means investment. The other destination is the distribution of such value added towards the suppliers of capital, that is, its investors or shareholders. In this respect, these ultimate shareholders have also the possibility – available to original consumers – to increase their consumption or allocate such wealth towards saving.

In consequence, theory could not argue *ex ante* how consumer and producer surplus are allocated in the economy. It only could argue that the consumer surplus extracted by firms through anti-competitive practices from the consumers is redistributed towards other categories of participants in the economic system. In this respect, economic theory and competition jurisprudence is neutral on the effects of anti-competitive practices on time preference (consumption versus saving) and allocation of capital in society. In fact, anticompetitive practices just transfer some monetary resources from consumers from particular markets to shareholders of the producers on the same or other markets.

Whether the enforcement of a competition policy encourages consumption over saving is a matter of time preference of those who are engaged primarily in consumption over those who are engaged particularly in saving and investment. Are consumers more oriented towards consumption and financial investors towards saving? There is no an *ex ante* ruling on this dilemma.

But such neutrality however could not rule out that, in particular circumstances, redistribution through anticompetitive practices spurs saving. This is the case when the ultimate benefiters of such redistribution, the shareholders of producers engaged in anticompetitive practices, have a lower time preference (prefer saving over consumption) than consumers whose welfare is diminished.

It is also important to point that the most logical assumption would be that the time preference of individuals is an *ex ante datum* of the human action and not a *residuum* of their choices. In other words, individuals allocate their income towards consumption after earning an income taking into consideration the time preference. Obviously, the decision to consume or to abstain from consumption is intrinsic in every decision to act. But without a general plan regarding the ratio of consumption versus saving and the allocation of his income, the human action would not be consistent and the concept of time preference devoid of any content.

So when consumers retain what is called consumer surplus after taking part in market exchanges, they normally reallocate this surplus towards consumption of other goods. Even if the scenario that they direct such a surplus towards saving could not be ruled out – as the time preference before the exchange could change after the exchange – if we keep the above-mentioned assumption regarding time preference as constant, we realise that the consumer surplus is more plausible maintained by consumers towards consumption. As a consequence, the operation of the competition policy does not, by itself, spurs saving.

The spurring of consumption by competition policy

Public policy redistributes the existing property rights in society as well as act as a deterrent for future conduct of individuals and firms. As any action which is qualified as illegal is punished with the force of law, individuals will attempt to avoid such a punishment through the adjustment of their future conduct.

As competition law punishes anticompetitive practices that, at the end of the day, have the effect of an increase of price above competitive levels as well as

a restriction of output as compared to the same competitive level, producers that operate on markets with a concentrated structure – the markets where competition policy is very plausible to be enforced – will, because of the prospective punishment, attempt to establish the price even at a under-competitive level as well as produce more than the competitive level. Few individuals have the risk profile to follow a thin red line.
Ttaking into consideration the harsh punishment associated with competition policy, producers – in order to eliminate the possibility of being prosecuted by anti-trust authorities even by accident and with no legal consequences – will most probably adopt a conduct that prevents them from being in such a situation. And that means lower than competitive prices and larger than competitive production. Such a conduct of producers will however encourage at its turn an increased consumption at the expense of saving.
Moreover, such an alteration of behaviour will lower the rate of profits in the industries frequently exposed to the enforcement of anti-trust law. Such industries will be avoided by the marginal capital looking for investment and, at an aggregate level, will reduce the level of investments in the production sector. Such capital may be channelled either towards 'non-productive' investments (such as financial or real estate markets) or back towards consumption.

The cross-fertilization of competition policy and monetary policy

The effects of the deterrence of competition policy are however multiplied by the operation of monetary policy. In fact, Austrian economics argues that the phenomena of business cycles – the alternation of periods of apparent high economic growth with periods of economic recession – are in fact mainly the result of the operation of monetary policy.
The principal mechanism through which central banks influence the rate of growth in the economy is the coupling of the reduction of the interest rate with the infusion of liquidity – in fact, the expansion of the money supply. But the rate of interest promoted by the central bank comes into conflict with what has been called the natural rate of interest (Mises, 1980). Such rate is formed on an unhampered credit market through the meeting of supply of credit – the savings available as a result of abstention from consumption – with the demand for credit – both from consumers and producers. It is the result of a social time preference.
The reduction of the rate of interest by central bank on a hampered credit market induces an increase in the time preference of individuals at the aggregate level, albeit temporarily. Individuals, confronted with more available credit and at a lower rate of interest, are ready to expand their consumption on credit.
At this point, the operation of the two public policies leads to a multiplied effect on the increase in the present consumer welfare at the expense of the future consumer welfare.

Monopoly and time preference

Let's assume that we witness an economy where in every branch of industry there is only one producer. There are two fundamental scenarios: in the first case, such a situation is a result of government licenses. In the second case, we assume that these are the most efficient producers. Is there any impact of such non-competitive market structures on the way that such an economy develops?
In both cases, it could be argued that monopolists could extract supra-normal profits as there is a common confidence that, at least on the short term, there are no other competitors that could pressure them. The difference between the two cases is that, in the first instance, we could witness monopolists which were not the most efficient producers. The allocation of the monopoly right is based on other criteria than efficiency as the theory of special interests (Rothbard, 2004) argue that licensed monopolists usually specialize in other skills than those related to efficiency (such as bargaining, political negotiation, so on).
Each monopolist would adjust its production level and prices in order to maximize their overall sales. They won't attempt to increase prices to infinite and lower the production level to zero as they won't sell anything and their turnover will be zero. But, under the assumption of a given demand curve, the two monopolists would be positioned at different points as the structure of their costs would be different. Arguably, the most efficient monopolist would be positioned at a point with a lower price and a higher production on the demand curve. From this perspective, there will always be a difference in the level of present affluence of the society between the two cases.
But the core difference lies in the different path that such economies will follow in what regards the distribution of the overall income at the social level as well as the operation of the investment channels. That is, how savings will transform into investments.
The difference between the two monopolists is that, in the first case, we could witness monopolists which were not, even in the first instance, the most efficient producers. When such a producer gets the monopoly license, he will employ factors of production that would not be used in the most efficient way. In other words, such a less efficient monopolist would keep employed factors of production that would lay barren (for the specific ones) or be employed in other lines of production (for the non-specific ones). In such complementary lines of production, the prices of the factors would have been lower absent the monopolist. The difference between such an economy and competitive economy would be the level of output and the distribution of income. Such a society would be poorer in terms of the quantity of present economic goods available to consumers. Producers which are monopolized would be richer in terms of wealth, at the expense of consumers as producers which are not monopolized.
Moreover, even if such state licensed monopolists would have a low time preference and save their monopoly rents, such a capital won't find any employment in the economy but only through the financing of existing

monopolists. Or, these monopolies already discovered the level of production that maximizes their income. The possibility of emergence of producers that could compete with the existing monopolists would be blocked by the state license system.

In such an economic system where every line of production is protected by monopoly rights, the structure and the stock of capital goods would most probably be invariable or slowly dynamic. Saving won't be transformed into investment but only in hoarding as there is no investment channel towards the production system in the economy. Such an economy will most probably experience a low performance.

But how will perform the other economy, where the monopolists are the most efficient producers and there are no barriers to entry?

Competition and innovation

One of the most acclaimed benefits of a competitive market system resides in the spurring of innovation. In addition to what could be called endogenous motivations in the spurring of innovation – such as a passion for innovation or accidental innovation – there are also exogenous motivations. Among them, the existence of a competition in particular industry induces to all market participants to outperform their competitors through the adoption of innovative methods of combination of capital goods. Innovation is also critical to differentiation among competitors and the acquirement of competitive advantage. For undifferentiated competitors on the same market, the competitive position is a result of hazard due to the fact that, from the perspective of consumers, it is irrelevant what producer offer they choose as long as it is the same product.

But the core issue in innovation is not the existence of novel knowledge or technological idea but the capital needed in order to implement these novelties into the process of building capital goods. Any producer – new or old – has to raise capital in order to restructure its stock of capital goods and increase its efficiency. Innovation won't find by itself the resources to be embodied in capital goods. Innovation has to meet saving in order to induce restructuring in the stock of capital goods in society.

Economists have long ago debated whether the adoption of new technologies destroys the wealth of existing producers. For example, assume that a monopolistic producer discovers a new technology (Knauth, 1915). His choice for keeping the current structure of capital goods – and postponing the adoption of the new technology – or for the immediate alteration of the structure of capital goods (and abandonment of the old structure of capital goods) will be based on the relative merits of the two investment projects. The investment in the new production structure together with the present value of the past investment must create a positive VAN (taking into account the modified sales). Otherwise, the monopolist won't adopt the new technology.

On the other hand, if there are two producers on the market – a former monopolist and a new entrant – if the innovation is discovered by the new entrant, the latter won't have any past investment to burden his present decision. Will the new entrant destroy wealth in society by the fact that he forces the former monopolist to exit the market?
The answer is negative. The capital goods of the former monopolist won't exit the production system. Depending on their specificity, they will be either abandoned or employed in other lines of production, where they will lower their price.
Our conclusion is that a system where each particular market is dominated by a sole producer – the most efficient monopolist – but there are no barriers to entry, can witness a significant economic growth. This is a true statement for any market structure with low barriers to entry and a free movement of capital among lines of production. The condition for such a development comes from a monetary policy that won't alter the perception of consumers and individuals regarding the social time preference. That is, the monetary policy is not expansionist.

Perfect competition and development

The theory of perfect competition and competitive markets is neutral in what regards the time preference in such society. While competition works for the present allocation of resources in the economy, it cannot advance statements about the ratio between consumption and saving. In other words, we could witness a system with perfectly competitive markets that is, however, from the perspective of the abundance of consumer goods, not affluent.
Mises (1996) differentiates between a static, a progressing and a retrogressing economy. But the critical factor is not how competitive these states of economies. It is the per capital quota of capital and whether it is constant, increasing or decreasing. Mises warns that that:

> 'the vehicle for economic progress is the accumulation of additional goods by means of saving and improvement in technological methods of production the execution of which is almost always conditioned by the availability of such new capital'.

Historical lessons

The attempt to relate the active enforcement of a competition policy and the rate of economic growth in a country is a hugely complex enterprise. On the one hand, there are different and numerous factors that influence the process of development and, on the other hand, there is very difficult to measure the energy of antitrust enforcement.

Despite these difficulties, it is not useless to point to several correlations regarding the two dimensions, that is, competition and development. First of all, the highest periods of growth in the history of the large economies from the Western world are not simultaneous with the enforcement of a competition policy. In this respect, nineteenth century United States as well as Western Europe till the middle of the twentieth century is a significant example in this respect. Monopolized or cartelized economies such as those of Germany or Italy have historically experienced high rates of economic growth at the turn of the twentieth century. More recent cases such as Japan and South Korea moreover confirm the reticence in equating in all cases a competitive economy with a progressing economy. All these examples, however, share a common experience: a significant inclination of their populations towards saving.

For example, Barlett (1992) documents that 'whereas Keynesian doctrine favored high tax rates in order to discourage saving, Japan adopted low tax rates and large incentives to save'. Meanwhile, other commentators highlighted the historical lack of an active enforcement of anti-trust policy in this country. Porter and Sakakibara (2004) point to the fact that:

> 'The striking economic success of Japan was widely attributed to a set of economic institutions and policies that encouraged collaboration and limited competition. The Japanese case, then, called into question many of the bedrock assumptions of competition thinking. It seemed to show that there was a different path to economic prosperity'.

The same statement could be advanced regarding, for example, South Korea, where large and diversified big producers – the so-called 'chaebol' – have dominated the economy.

Conclusions

An economy with a competitive market system allocates the resources attracted in the production process in a more efficient way. Maybe paradoxically however, such an economy could be qualified as a non-developed economy according to different standards of defining development. And such a highly competitive economy could also be qualified as a stationary economy according to the standard advanced by the Austrian economist Ludwig von Mises.

Antitrust enforcement highlights that its core objective is the maximization of present consumer welfare. It can be said that is has a bias towards it. It is ignorant towards the future and time preferences in society, seeming to encourage present consumption over saving. In other words, competition policy seems to multiply the effects induced by the operation of contemporary monetary policies which are fundamentally penalizing saving for the benefit of consumption.

Taking over other arguments advanced in the economic literature, we argued that a less than competitive economy could do a better work than a perfectly competitive economy in fostering development. The incentives to innovate, which are a hallmark of a competitive market economy, are fruitless in the absence of savings that could channel them into production. In this context, the enforcement of antitrust statutes in developing countries could, in particular conditions, trigger a slowing in their development process.

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