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# Reality Bites (or Bits): The Political Economy of Antitrust Enforcement

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# Reality Bites (or Bits): The Political Economy of Competition Policy in Small Economies

Michal S. Gal

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## **Abstract:**

A realistic analysis of antitrust must deal in positive terms with political influences. Political influences are especially strong in the antitrust arena, where decisions and policy measures often significantly affect the profitability of market players. It is thus important, in designing an antitrust regime, to acknowledge such influences and to design institutions and methods that will harness political aspirations to the achievement of antitrust goals. Accordingly, the goal of this article is to analyze the different effects political motivations might have on antitrust, and to suggest tools that may minimize such effects. A short theoretical analysis of the political economy of antitrust enforcement is followed by some recent and interesting examples of cases in which political influences shaped antitrust decisions. The conclusion that is reached is that we should wisely recognize that politics cannot be simply ignored. Building upon this conclusion, the article then introduces and analyzes some institutional design mechanisms that can be applied in order to reduce political pressures and even harness them for the goals of antitrust.

## Chapter 23

# REALITY BITES (OR BITS): THE POLITICAL ECONOMY OF ANTITRUST ENFORCEMENT

*Dr. Michal S. Gal*<sup>†</sup>

### I. INTRODUCTION

Enabling competition to take its course is the stated goal of most competition policies adopted around the world. Antitrust, however, operates in the real world. In the real world, political considerations affect all stages of antitrust – from the adoption of antitrust principles to their application in practice. Antitrust policies affected by political considerations may, however, come with a large price tag attached: the loss of clarity and visibility of the decision parameters that are essential for setting guidelines for business conduct and the loss of credibility of the antitrust authority.

A realistic analysis of antitrust must, therefore, deal in positive terms with political influences. Accordingly, the goal of this article is to analyze the different effects political motivations might have on antitrust, and to suggest tools that may minimize such effects. The focus will be on antitrust enforcement in small economies.<sup>1</sup> Why small economies? Small economies usually exhibit stronger political pressures on their antitrust systems than large ones, all else equal. The reason is that economic power in small economies tends to be more concentrated in the hands of a few rather than dispersed amongst many small groups. Small economies tend to be dominated by several large conglomerates that have better resources to overcome the high entry barriers that exist in many of their industries.<sup>2</sup> Moreover, their economic and governmental elites are often intertwined. This reality increases the probability of lobbying, rent seeking behavior and political influences aimed at the pursuit of private objectives.

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1. A small economy is defined as an independent sovereign economy that can support only a small number of competitors in most of its industries. See Michal S. Gal, *Market Conditions Under the Magnifying Glass: Optimal Competition Policy in Small Economies*, (forthcoming, Harvard University Press 2002).

2. *Id.*

Most of the analysis pertains to the political economy of antitrust enforcement, that is, once antitrust principles are adopted. In this framework, political considerations will be defined as those outside the ambit of the stated goals of the antitrust policy. Put differently, political considerations are those that interfere and may even distort or pervert the objectives adopted by an antitrust policy. This definition is easily workable as it enables us to distinguish between goals on which the policy is based and later influences to deviate from the stated policy.<sup>3</sup> Another implication of this definition is that what may be political in one jurisdiction may not necessarily be so in another.

I proceed by first defining the political motivations that may affect antitrust. The short theoretical analysis is followed by some recent and interesting examples of cases where political influences shaped antitrust decisions. The conclusion that is reached is that we should wisely recognize that politics cannot be simply ignored. Building upon this conclusion, the section III introduces and analyzes some tools that can be applied in order to reduce political pressures and even harness them for the goals of antitrust. As elaborated below, such methods include extensive judicial review of the decisions of the competition authority and non-politicization of the appointment process of its director. Section IV raises the question of whether and when the antitrust system should embrace broader policy goals that might assist the government in achieving its goals. I hope the analysis provides at least some partial answers to Professor Jenny's most pertinent and thoughtful questions.

## II. POLITICS CANNOT BE SIMPLY IGNORED

### A. *How Does Politics Affect Antitrust?*

Antitrust is most commonly adopted for the economic as well as the non-economic benefits competition and the reduction of artificial entry barriers promise.<sup>4</sup> These benefits are inherently *non-sector-specific* and look at the *long run-horizon*. For example, a merger that would create significant market power would be prevented even if it results in adverse human, societal and financial consequences for the different groups affected by the firm's operations. Accordingly, the antitrust system usually spells out a long-term vision for society, beyond the immediate pain of the adjustment or change in specific industries.

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3. Yet even narrowly stated goals can be interpreted differently, depending on the values and views of the interpreter. For a most interesting article on this subject, see Eleanor M. Fox, Chairman Miller, The Federal Trade Commission, and Economics, and Rashomon, 50 *Law & Contemp. Probs.* 33 (1987).

4. Of course, this is a generalization. Other reasons may also induce a government to adopt an antitrust regime. We learn from David Lewis' paper in this book (Chapter 24) that South African competition policy is geared, inter alia, towards distributive goals. Similarly, one of the stated goals of EU antitrust policy is market integration.

Yet it is exactly these two traits of antitrust – non-sector specific principles and its long-term horizon – that create political pressures to include non-economic considerations in antitrust laws or to modify their application in practice.

*The decision horizon of politicians* The achievement of long-term goals usually requires political fortitude that is typically in short supply among political figures. Most professional politicians who rely on regular and frequent popular elections are mainly concerned with their personal survival and advancement. This implies that they have an inherent tendency to discount heavily all events occurring beyond their personal time line.<sup>5</sup> Instead, they tilt towards the achievement of short-term goals.<sup>6</sup>

*Sector-Specific Objectives* Politicians may also concede the central significance of long-term and general welfare in favor of the interests of specific sectors in the economy. Sector-specific objectives generally arise from producer capture.<sup>7</sup> Such capture arises when small groups with large per capita stakes in a policy organize and cause the government to regulate in ways that are against the public interest and usually against consumers, who are poorly organized and have small per capita stakes in the specific regulation. As the electoral connection is never far from the politicians' minds, such groups might influence their considerations. This effect is exacerbated where the ultimate policy decision lies in the hands of one politician (for example, the relevant minister) rather than the government as a whole, as specific, well-organized sectors can ensure his reelection.

Of course, the higher the stakes of private groups in the policy at hand, the stronger the motivations to influence the policymakers. According to some scholars, such groups would invest in securing or maintaining a policy that favors them up to the total expected profits they stand to gain from it.<sup>8</sup>

Given these political motivations, we should wisely recognize that politics cannot be simply ignored. Instead, it requires a modicum of responsiveness, away from Adam Smith's absolute economic liberalism, and a properly arranged institutional design. This will be the focus of the next section. But first let me turn the spotlight to some reality bits: real-world examples of political intervention in the antitrust system.

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5. This should be discounted by the fact that the interests of whom they are beholden for their political survival and the political parties to which they attach themselves may be long-lived.

6. Kenneth A. Shepsle, *The Political Economy of State Reform – Political to the Core*, presented as the Centennial Lecture at the London School of Economics and Political Science, February 1999.

7. John Wiley Jr., *A Capture Theory of Antitrust Federalism*, 99 *Harvard L. Rev.* 713 (1986).

8. Richard A. Posner, *Antitrust Law: An Economic Perspective* 8-18 (1976).

### *B. Reality Bits of the Political Economy of Antitrust*

Politics may affect antitrust enforcement in several ways. I have chosen to focus on three different examples in the order of the severity of their transgression on antitrust policy: political considerations that fuel the enforcement mechanism, political considerations that determine the outcome and those that motivate the adoption of legal exemptions from the application of antitrust principles.

#### 1. Political Influences that Help Fuel the Antitrust System

Antitrust authorities have limited enforcement resources. This necessitates the enforcer to decide which markets or cases to investigate and prosecute. Absent political pressures, such decisions would be based on the strength of the evidence of an antitrust violation, its severity and its welfare effects. Political considerations may, however, tilt the balance towards specific markets or firms or shift the investigation away from them.

This can be nicely demonstrated by a theoretical example. Last year, worldwide gas prices rose due to an increase in oil prices attributed to cartelistic activities of Arab refineries. This gave rise to public demonstrations in several jurisdictions and to claims that high gas prices were harming the economy. Assume that in order to reduce current public pressures and to take the hot potato out of the fire, the government announces that the antitrust authority would embark upon an antitrust investigation of the market imperfections in the gas supply market, with the hope that market conditions will have changed before the decision of the antitrust authority is rendered and public pressure will have subsided.

Why is this such an interesting example? The reason is twofold. First, it seems like the trigger for embarking upon the investigation is the lack of any efficient tool to combat the heart of the problem, the illegal price fixing of the Arab refineries. Second, the gas supply market creates, by its nature, oligopolistic coordination, given a homogenous product and open price postings. Spending scarce investigative resources on such an endeavor may be futile, as it is extremely difficult to devise a remedy that would reduce prices, even if a market imperfection were to be found. Yet the antitrust system is utilized here to help calm public opinion by taking some governmental action in the affected market. Although antitrust was not reshaped in order to fit the offense, political considerations did shift some of the scarce investigative resources into a relatively futile investigation.

Political influences that fuel the antitrust system do not necessarily clash with the merits of antitrust. Yet for harm to be minimal, two conditions should be met. First, political influences should not determine the final outcome. Second, the antitrust authority should not be regarded as a puppet in the hands of the government.

## 2. Political Considerations that Determine the Final Outcome.

Many antitrust decisions require a balancing of competing considerations. When weighing the relative merits of such considerations, political influences may directly or indirectly tilt the scales in one direction or the other.

This can be exemplified by the Israeli *Iscur* decision.<sup>9</sup> The Israeli law limits the discretion of the Director of the Antitrust Authority to consider only the lessening of competition when authorizing a joint venture. The Director nonetheless authorized a joint venture between three vertically connected firms in the market for the production and supply of light posts. He based his decision, *inter alia*, on the fact that the joint venture would prevent the closure of a plant in a secluded and unemployment-ridden town. The Tribunal overturned his decision, stating that only the Tribunal was authorized to consider such issues. This example is unique in that the considerations that are not included in the law were the Director's rather than a result of external pressure.

### *C. Political Influences that Motivate the Creation of Laws that Bypass Antitrust*

Political pressures may also motivate the creation of laws that bypass antitrust policy. Such laws are sector-specific and generally are the result of producer capture, as defined above. Although such laws clearly exempt specific industries or specific conduct from antitrust scrutiny, they are usually the most difficult way for political groups to influence the antitrust system. The reason is that the enactment of a law that bypasses antitrust necessitates the government to state clearly that it prefers some specific interest to the generally applied antitrust principles. This exposes the governmental decision to public scrutiny. The antitrust authority, assuming it is non-political, may play an important part in this public debate by taking an active part in the enactment process and by ensuring that the legislator and the public are well aware of the consequences of the decision. Once such law is enacted, the antitrust authority should ensure that the legal limits set in the bypassing law are strictly met.

Unfortunately, such examples are plentiful. The Israeli Electricity Supply Industry Act, for example, cannot be justified or explained based upon pure welfare or competition considerations alone. The Act sets critical limitations on the opening up of the electricity supply industry to real competition. Although the Israeli Antitrust Authority was not able to prevent the enactment of this law, the Director has used its powers in order to take every legal action to ensure that the several procompetitive conditions in the Act are met.

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9. Appeal 1/97 before the Competition Tribunal *Iscur sherutei Pladot vs. Director of Competition Authority* (unpublished).

### III. COMBATING POLITICAL INFLUENCES THROUGH INSTITUTIONAL DESIGN AND SOCIAL PLANNING

The silver bullet that will erase all political influences on antitrust has not yet been found (or at least I was not told so). The antitrust agency is, by nature, exposed to political pressures, as it is part of our system of government. Yet the influence of political motivations on antitrust can be significantly improved upon by careful institutional design and social planning. The task is to find ways in which problematic political motivations can potentially be harnessed and constrained for the long-term goals of antitrust.

I analyze below some of the mechanisms that can be used as for combating political influences. The key is the creation of an autonomous, impartial and professional agency. I will mostly refer to the institutional design of the Israeli antitrust agency. What makes the Israeli system a most interesting example is the fact that most the mechanisms designed to minimize external political pressures are relatively new and thus enable us to compare two situations.

#### A. *Autonomous Agency*

The antitrust authority should be set as an autonomous agency. This can be exemplified by the Israeli experience. In the past, the antitrust agency was a sub-division of the Ministry of Commerce. Starting in 1995 the agency became a stand-alone agency that is directly subordinated to the Minister. This institutional change has given the authority much independence in its actions.

In some exceptional circumstances, however, the politicization of the antitrust authority need not be harmful. Russia provides a fascinating example.<sup>10</sup> Russia adopted an Antimonopoly Law ten years ago as an integral part of wide-scale economic reforms to move from a centralized, communist government to a more market-oriented economy. The Russian Antimonopoly Ministry is headed by a minister, who is an active member of government. This has proved to be beneficial. The antitrust principles were so different from the embedded ones that, to be effective, the head of the antitrust authority had to be a strong political figure who took part in the ministerial discussions on the adoption of economic policy. Although some decisions were based on political considerations, others could not have been reached or implemented without strong political power. Once the new economic order matures, however, it might be wise to change the institutional organization and create a more autonomous agency.

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10. See, e.g., the interesting paper of Ilya Yuzhanov, *Competition Law and Policy – The Role of Political Influence*, Chapter in this book.

### *B. Non-political Nomination of the Director*

In reality, the head of the agency largely determines the authority's priorities and the outcomes of its decisions. Even if he is not legally empowered to authorize certain types of conduct, he may nonetheless decide whether or not to conduct an inquiry of certain markets. It is thus crucial that he not be politically oriented towards any specific group of interests. Although political pressures on the nomination process cannot be totally eliminated, the Israeli system attempts to minimize such pressures. In the past, the Minister of Commerce chose the Director of the Antitrust Authority. Nowadays he is chosen by a special committee headed by a judge, who selects amongst the contenders to a public tender in accordance with their personal qualifications. Only one of the three committee members is appointed by the Minister. The chosen director must meet the criteria necessary for a justice of peace. This process reduces political pressures on an important decision.

### *C. Independent Budget*

Even the most impartial person will have limited ability to disregard political considerations if he does not have the fiscal resources to carry out his actions. It is thus extremely important that determining the agency's budget be free of political considerations. Although this cannot be accomplished in full, the agency being part of the government, there are several methods to reduce political pressures through budget setting. One method is to base at least part of the budget upon some income that is generated by the agency. Several agencies' budgets are based, *inter alia*, on fees charged by them for merger decisions and pre-rulings. Another important method is to separate the agency's budget from that of other governmental functions and make it open to the public. The stronger the public scrutiny, the more difficult it is for the political system to cut back the agency's budget.

### *D. Juridical Scrutiny*

Juridical scrutiny of the antitrust authority's decisions may also be used to reduce political pressures. For such scrutiny to be meaningful, the scrutinizing court should be an expert one that is empowered to hear cases *de novo*, rather than determine whether the decision was reasonable. This is the legal situation in Israel. In South Africa the court was granted special inquisitorial powers. Of course, juridical scrutiny is a limited tool for several reasons. First, it is very difficult to question cases in which the authority has decided not to take any operational step. Second, there may exist informational asymmetry problems between the agency and the court. Third, for such scrutiny to be operational, there must be a plaintiff who is willing to invest resources in questioning the authority's decision. Fourth, juridical scrutiny is often not timely.

Yet juridical scrutiny may be effective in reducing political pressures to open an investigation. A recent Israeli case provides an interesting example. The Minister of Commerce summoned a press conference regarding what

she described as the cartelistic prices of frozen meat. Following the press conference, the Minister approached the Director of the Antitrust Authority and requested that he open a criminal investigation. The Director declined to do so, since the evidence on the price rise did not point in the direction of cartelistic behavior but rather was most likely the result of a rise in input prices. The Minister was finally convinced that based on the existing evidence, the Competition Tribunal would most likely throw the case out for lack of sufficient evidence.

#### *E. Legal Limitations on Discretion*

Another method for limiting political pressures on the authority is by setting legal limitations on the discretion of its director. In Israel, for example, the antitrust agency is legally allowed to consider only competition issues in collusive agreement cases. Instead, the Competition Tribunal, which is an expert court that is part of the Israeli court system, is legally empowered to consider broader public good considerations.<sup>11</sup> This division is a healthy one, as it minimizes pressures on the antitrust agency and it allows for a clear and consistent policy. Yet while such separation of powers is effective in collusive agreement cases, it is much more problematic in merger and joint venture cases where timely decisions are of essence.

It should be noted, however, that some jurisdictions go in the reverse direction. In a recent decision<sup>12</sup> the Canadian Federal Court of Appeal replaced the total welfare standard that was applied for many years by the Canadian Antitrust Bureau in merger cases, with the more flexible but amorphous balancing weights approach.<sup>13</sup> Under the new standard, the antitrust authority must balance between economic efficiency and social goals such as distributive effects and loss of product choice, but none of these factors would be assigned a fixed, a priori weight. Undoubtedly, this test significantly increases the discretion of the antitrust authority to evaluate a merger on non-economic grounds and it reduces the predictability of a legal outcome.

#### *F. Joining Forces with other Governmental Bodies*

In politics as in politics: Another way that is used in practice to combat political influences is to join forces with other governmental bodies with similar goals. This can be illustrated by the battle against the Israeli monopoly in public transportation. For years one firm dominated the Israeli public transportation market. The Ministry of Transportation was under

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11. Section 10 of the Israeli Restrictive Trade Practices Act 1988.

12. Commissioner Of Competition vs. Superior Propane Inc. and ICG Propane Inc (not published. Decision delivered on April 4, 2001)

13. It should be noted that the Canadian Competition Bureau advocated the adoption of the balancing weights test. This position departed from the Bureau's own Merger Enforcement Guidelines, which set out a total surplus standard.

strong political pressure from the monopolist not to open up the market to competition. The Antitrust Authority joined forces with the Ministry of Treasury to create public opinion for the introduction of competition into the market, which eventually led to the creation of more competitive conditions.

#### *G. Transparency of Decisions*

An important method for minimizing political influences is by ensuring the transparency of antitrust decisions for public scrutiny.

#### *H. Empowerment of Consumer Groups*

Another method to reduce political pressures is to grant consumer groups standing in the judicial decision process.<sup>14</sup>

#### *I. Positive Public Opinion*

An extremely powerful and important method for combating political influences on antitrust policy is the creation of strong and educated public opinion in favor of the long-term goals of antitrust. Educating the public in the benefits of competition might be a fruitful investment, as it may refocus the political interests of politicians on long-term and general goals and lead to the channeling of their private aspirations in more constructive and overall efficient ways. Even if politicians may not look beyond the next election, the interests of those who choose them may be long-term and non-sector specific. Education thus has the effects of lengthening the time horizon. The Antitrust Authority plays an important role in this education process, as it may utilize its resources to make its decisions clear and open to all, and to educate consumer groups, businessmen and academia alike on the merits of antitrust enforcement.<sup>15</sup> In a cyclical manner, the less political the authority's decisions are perceived to be, the stronger public support and the more powerful the public opinion to reduce political pressures in the first place.

#### *J. Criminalization of Antitrust Proceedings*

Interestingly, the criminalization of antitrust proceeding may serve to limit political pressures on the antitrust authority. Where interference with an ongoing criminal investigation is an offense, politicians might be more cautious before intervening in an antitrust investigation.

The last condition can be exemplified by a recent Israeli example. Gas prices in Israel are capped by the Israeli Minister of Infrastructure. In their struggle to influence the government to raise the capped price, most Israeli gas companies raised the service surcharge on gas supply at the same rate and on the same date. This created public pressure on the Minister, who is a

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14. See, e.g., section 15 of the Israeli Restrictive Trade Practices Act 1988.

15. This suggestion is based on the assumption that the antitrust authority is non-political.

political figure, to cancel the surcharge. It also led to the opening of a criminal investigation by the Israeli Antitrust Authority based on circumstantial evidence of a cartel among the gas companies. Shortly after, the gas companies met with the Minister and offered to cancel these surcharges and requested that the antitrust investigation be dropped. The minister declined to put pressure on the antitrust authority to stop its on-going investigation, inter alia, given that it would constitute an interference with a criminal investigation.

#### IV. IF YOU CAN'T BEAT THEM – JOIN THEM?

Should political, or, for that matter, short-term or sector-specific considerations always be rejected in favor of long-term competition concerns? Might it be that under some circumstances it is justifiable and efficient to embrace broader social issues by the antitrust authority? The following discussion brings forth some of the considerations that shape the debate for the use of some flexibility by antitrust authorities when balancing short-term and long-term economic goals.

To concretize the debate, let me use a real case with a factual twist. Several years ago, the Director of the Israeli Competition Authority was asked by private litigants to declare El Al, the Israeli airline company, a monopoly. Under Israeli law, the Director may declare any firm a monopoly if it controls more than 50% of the relevant market. The declaration may then serve as prima facie evidence of the existence of a monopoly in civil cases. The monopoly may also be subject to legal limitations imposed on its conduct by the Director or the Tribunal. The Director declined to issue such a declaration, stating that there was insufficient factual basis for a finding of a monopoly. Let us assume, for the sake of an argument, that the facts, at the time, indicated that El Al enjoyed a dominant position in the relevant market.

El Al is partly owned by the Israeli government. It suffered severe operational deficits that were covered by the Israeli government. Its existence was nonetheless justified, based upon the security interest in operating a national airline for a country that is geographically secluded from its allies. El Al was not exempted from the antitrust law. Yet applying the antitrust laws against El Al would have enlarged the losses to be covered by the same government that funds the antitrust authority.

Or consider another case: the prevention of a merger in accordance with antitrust principles would lead to the closure of a firm, that would result in significant harm to the economic stability of a secluded geographic area.

These examples raise some interesting questions: Should the antitrust authority base its decisions whether or not to declare a firm a monopoly or to authorize a merger on considerations that go beyond market power indicators and are not included in the law? Should antitrust enforcers take into account the “big picture” or just the antitrust pieces of the puzzle?

Seen from one perspective, antitrust is just another “tool in the bag” of governmental policy. Should the antitrust machinery be employed, the government would have to utilize another economic tool in order to ensure the existence of a national airline or the viability of a geographic region, by

way of fiscal grants or beneficial franchises. Applying antitrust would thus raise the costs of achieving the governmental policy.

At the same time, there are substantial reasons not to base antitrust decisions on sector-specific or short-term considerations. For one, applying different sets of rules to different market players might result in a serious loss of credibility of the antitrust authority. As argued above, it is extremely important that antitrust enforcement be based upon clear principles that can be followed by all market players alike rather than on broader and sometimes incoherent goals.

In addition, the antitrust authority might not be the right vehicle to balance competing considerations. The authority does not have the tools to evaluate all the implications of a broader social policy. It may also not possess the most efficient tools for achieving these goals, such as providing grants or tax exemptions to firms that operate in underpopulated and remote areas. Also, making broad policy decisions that might carry social, political or cultural consequences is not within the mandate of the antitrust authority and may even impair democratic values. Public policy should rather be determined by the government.

Nonetheless, when the strict application of antitrust principles necessarily clashes with broader public objectives, the antitrust authority might exercise some flexibility through the allocation of burdens of proof and non-use of legal presumptions. Yet such flexibility should not be exercised everywhere. Rather, it should be limited to cases where the basic principles of a market driven by competition are not seriously harmed and where the gain to broader policy goals is significantly larger than the harm to competition.

It is noteworthy that in determining the scope of application of broader social values within the antitrust regime, one must be sensitive, however, towards the special circumstances and underlying policy objectives of the specific competition policy. In some economies broad social goals other than the enhancement of competition and general welfare play a decisive role in the adoption and application of antitrust principles. South Africa, for example, adopted its competition policy both for the enhancement of competition and for distributional principles. There, competition serves to help distribute wealth more evenly among different sectors.<sup>16</sup> The EU Treaty of Rome<sup>17</sup> was adopted in order to, inter alia, ensure free movement of goods among member states. When a competition policy is adopted for broad policy goals, enforcement should be sensitive to their application in practice. This does not reduce the need, however, for the adoption of institutional measures that are designed to minimize political pressures to reach decisions or adopt policy measures that fall outside the ambit of the adopted policy.

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16. See Lewis, *supra*, note 4.

17. Treaty Establishing the European Economic Community, 1957.

## V. CONCLUSION

Political influences are part of our reality. They are especially strong in the antitrust arena, where decisions and policy measures often significantly affect the profitability of market players. It is thus important, in designing an antitrust regime, to acknowledge such influences and to design institutions and methods that will harness political aspirations to the achievement of antitrust goals. This article has suggested some institutional design mechanisms that may reduce political influences on antitrust enforcement, for the achievement of stated antitrust policy.