Competition, Open Social Democracy, and the COVID-19 Pandemic

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Competition law and health crisis

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1. In the March 21st edition of the magazine *The Spectator*, the British journalist Matt Ridley, who blogs on science, the environment, and the economy, wrote: "*Never once in my six decades did I expect to be back in a 17th-century world of social and physical distancing as a matter of life and death.* (…) *Many people will die prematurely. Many will lose their jobs. Many businesses will go under.* (…) *The only question is how many in each case. We are about to find out how robust civilization is. The hardships ahead are like nothing we've known*."[1]

2. The ongoing medical crisis is particularly challenging for two reasons: first, it develops while we do not know the rules of the game to organize neither a proper defence (vaccine) against it nor a proper social protection through an impossible general distancing, and second it shakes the very foundational factors of our strong long-term socio-economic growth, indeed of our civilization. As for the developing economic crisis, which the medical crisis and our best response to it are generating, it has two prongs: first, the lost jobs and failing firms and supplier-business-customer networks and second the attacks against our

[1] M. Ridley, We are about to find out how robust civilisation is, *The Spectator*, March 21, 2020.

economic institutions and organizations by sorcerers' apprentices and fake intellectuals. The latent discourse against markets, competition, economic freedom, and globalization, will likely amplify in the coming months.

3. The ability to trade, especially with strangers, is a distinguishing characteristic of humans. This ability is unique to us and far exceeds the simple reciprocity observed in other animals, where it is typically limited to individuals of the same clan or family—frequently involving goods of the same undiversified kind received or consumed within a relatively short period of time.

The emergence of economics

4. The emergence of economics as a positive science, which studies the evolving incremental accumulation of trade, coordination, and incentivization mechanisms that has allowed a truly collective intelligence to flourish within mankind, has led to a normative science of ways and means, tools and instructions to foster the further development, improvement, and resilience of our collective intelligence.

5. The development of civilization follows a fundamental guiding principle: the ongoing quest—in a sometimes orderly and stepwise and sometimes random and haphazard progression—for mechanisms of exchange, trade and specialization, coordination, communication, and incentivization that are increasingly efficient and effective.

6. This quest relies on factors such as urban density, open and integrated transportation systems, specialization of tasks, reduced environmental footprint, and social institutions that generate mutual trust between strangers. Each one of us, focused on our specialized task, is literally depending on a vast number of strangers: simply counting the people who worked for my well-being this hour would take many days.

The collective intelligence

7. The collective intelligence that coordinates the work of billions of cells (all of us) within modern society seen as a social body, through competitive markets, market-like institutions, and competitive international trade, needs to, and does continuously, bolster this body's resilience to the inevitable shocks and spells of chaos and dysfunction: pandemics, wars and military escapades, and economic crises. As a result, our world has become more cooperative, safer, more resilient, and more innovative. The marginal deviant behaviour reported in the news and to be eradicated remains mostly insignificant.

8. To paraphrase Matt Ridley, let's just say that sometimes we have no choice but to play Russian roulette, remaining optimistic while venturing into the unknown. It takes time for Mother Nature to get the live round into the proper chamber, combining high contagion with asymptomatic carriers and a significant mortality rate, but sometimes she pulls it off, leaving us with the major pandemics and catastrophes of the past and today's COVID-19—black swan events.

9. So far, we have made it through every one of them, though sometimes with considerable losses and scars that persist for decades.

10. There are those who complain that we should have seen it coming and been better prepared on the basis of the precautionary principle. However, when confronted with many risks, especially those that are unknown (the unknown unknowns, the ones we don't know we don't know)[2] or poorly understood and of very low probability, a surfeit of caution may result in needless and costly paralysis and stagnation. However, once the triggering event has been observed, it would be a serious error to allow the effects to unfold exponentially. That is where we are at with COVID-19.

The financial crisis and recession of 2007-2010

11. The financial crisis and recession of 2007–2010 was caused by the gaming of poorly designed incentive mechanisms and a collapse of interbank confidence because of free-riding and financial fraud. The solution was a massive injection of financial liquidity to prevent a total collapse and targeted investments of public funds in major financial and manufacturing institutions. This government largesse was offered on draconian and costly terms. Banks were charged high interest rates to motivate them to quickly restore their balance sheets by raising new equity. And failing private firms were acquired, once bankrupt, by the government and later resold.[3] This was strong medicine.[4]

The current situation is very different

12. The current situation is very different! At its core, the COVID-19 crisis does not find its roots in distorted incentives or a generalized loss of confidence, but rather in a lack of medical knowledge compounded by social proximity, which, having previously improved our public health and resilience,

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2 D. Rumsfeld (2002), the former US Secretary of Defense: "[T]*here are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns – the ones we don't know we don't know. And if one looks throughout the history of our country and other free countries, it is the latter category that tend* [sic] *to be the difficult ones*" (https://archive.defense.gov/Transcripts/Transcript.aspx?TranscriptID=2636)

3 *See* M. Boyer (2015), Growing out of the Crisis and Recessions: Regulating Systemic Financial Institutions and Redefining Government Responsibilities, *CIRANO Scientific Series* 2015s-01, 54 pages, https://www.cirano.qc.ca/files/publications/2015s-01.pdf, and http://cirano.qc.ca/files/publications/2017MO-04.pdf (Tome 2, chap. 24); See also P. Veronesi and L. Zingales (2010), Paulson's gift, *Journal of Financial Economics* 97, 339–368 (note: the article predates most reimbursements by the banks). For disbursement by and reimbursement to US Treasury over time for all TARP (Troubled Asset Relief Program) funds, see the TARP tracker at https://www.treasury.gov/initiatives/financial-stability/reports/Pages/TARP-Tracker.aspx#All.

4 In spite of the government heavy-handed interventions, the market discipline eventually prevailed and, contrary to entrenched popular beliefs, responsibilities and liabilities were broadly imposed and implemented.

has now mutated into an engine of dissemination of the virus. We are living through a pandemic and a global economic stress that will be remembered for generations.

13. The actions taken by most governments thus seem appropriate, at least as of March 31: temporarily reduce social proximity to curb the spread of the virus, accept that this will induce an expected significant but temporary economic recession, cushion the harm to individuals and businesses resulting from this recession by public support programmes, invest massive resources as of immediately in the search for a vaccine, and accept an explosion of public debt way above the limits governments were trying to abide by.

14. These public policies come with significant costs and risks. Reducing social proximity risks to translate into national proximity rules against international trade and institutions, a major factor of economic development and growth, and civilization. Accepting that these policies will trigger a deep recession if not an outright depression is playing with the fire of inequalities as recessions are tilted against the poor, individuals and countries. Cushioning the harm to individuals and businesses through generous public programmes risks developing a sense of irresponsible dependence and reliance on pyromaniac firefighting governments. Investing massive resources in pharmaceutical research on COVID-19 may grasp resources from other important research, pharmaceutical or otherwise. Finally, accepting an explosion of public debt will require strong discipline to pay it back through either savings, taxation, and inflation or reduced lower-quality public services.

15. The ratchet effect of Leviathanesque governments and public sector bureaucracy is the direst possible consequence of the above policies. While hoping that the measures are adequate, we must not neglect to prepare for the economic recovery when the time is right. The first and foremost challenge will be to avoid throwing out the baby with the bathwater as fear may remain present. We must be careful not to damage the engines of growth and civilization that has generated enormous benefits to mankind over the last decades or centuries: the quest for efficiency and effectiveness through exchange, trade and specialization; and the capacity and willingness to identify and adopt inventions and innovations, whether technological, social or organizational. Such capacity and willingness are rooted in individual attitudes towards change, which itself depends on incentive mechanisms and financial and insurance instruments, which individuals, organizations, and firms can rely on to manage change and global risks as well as fears.

16. Shrinking reliance on competitive markets and competitive-like institutions and a general tendency to turn in upon ourselves and return to outmoded concepts of buying local or national represent the direst risks of current public policies. Insofar as the USA behaves in an irresponsible "Me First" way at the international level by forcing private firms to terminate contracts with foreign firms and governments under the Defense Production Act (1950),[5] other national governments are likely to follow in a movement toward a bad but stable Nash equilibrium, with disastrous effects for all.

17. More than ever, we must secure strong international health and agro-food clusters. These two clusters could be the first sectors to experience increasing government intervention, interference and regulation, under the flag of health and food sovereignty, for the benefit of some niche stakeholders and countries but at the expense of mankind as a whole. Stressing national clusters would impact negatively the situation in developing countries, thereby increasing the risk of new pandemics in developed countries. More than ever, we as humans are all in the same boat, but the boat is too big for some to see it as such.

18. The current fear-based policies will make further development of a one-world vision of globalization and international trade very difficult. One can expect that this development will be stopped and even recede. It is important to recall and stress that all countries can and will benefit from such trade, independently of their absolute competitiveness. This statement is arguably the most important finding in modern economic theory. It is the foundation of free-trade policies against protectionism, that is, the foundation of policies favouring social well-being, poverty eradication, wealth creation, and social and economic growth against the specific private interests of lobby groups, whatever the grandiloquence of such interest groups.

19. Paul A. Samuelson, the 1970 Nobel laureate in economic sciences, once answered a challenge from mathematician Stanislaw Ulam to name one proposition in all of the social sciences which is both true and non-trivial.[6] His answer: "*Comparative advantage. That it is logically true need not be argued before a mathematician; that it is not trivial is attested by the thousands of important and intelligent men who have never been able to grasp the doctrine for themselves or to believe it after it was explained to them*."

The huge Increase in public debt

20. The huge increase in public debt may send the signal that debt is good and apparently cheap. If governments could implement such a recourse to debt to fight COVID-19, why not use debt also to overcome climate change, to invest more in our health and education sectors at all levels, to meet our significant needs in infrastructures, etc. Remember the warning of the dismal science: Needs are infinite, but resources are limited. The ensuing drop in fiscal discipline, rather than moving us towards a more cooperative world, is the seed of forthcoming aggressive political battles and social disruption.

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5 Such international trade restrictions could be termed "overreaching/illegal use of the Act."

6 In Understanding the WTO, World Trade Organization (2007). https://www.wto.org/english/thewto_e/whatis_e/tif_e/utw_chap1_e.pdf.

21. This brings us a dangerous fallacy, which is often repeated both in the private and public sector. In its simplest form, the fallacy is as follows: since the private sector cost of capital (cost of borrowing or raising equity finance) is higher than the public sector cost of capital (cost of borrowing), then the cost of a public sector business must necessarily be less than the cost a private sector firm would incur for producing, distributing and delivering the same goods and services. Yes, governments can borrow at lower rates than private organizations but an important cost of government borrowing is hidden from the casual observation of published rates or yields.

22. A government can borrow at lower rates because it has the right and power to raise if necessary additional taxes to reimburse its debt holders, that is, if its activities and projects fail to deliver the expected returns. A private sector firm has no such right or power and this justifies the requirement by lenders of a higher interest rate. However, from the point of view of the citizens who are the ultimate risk bearers as customers and taxpayers, the right and power of the government to literally withdraw money from their bank accounts to cover financial distress situations does have a price: it is the option value today of the government right to require and obtain from them additional funds to cover what may turn out to be *ex post* socially non-profitable projects. The cost of the explosion of public debt is much higher than it looks, not for governments, not for lenders, but for citizens and taxpayers.

23. In other words, if the citizens were to grant a private organization the right and power to "tax" them if it ends up in financial distress, then this organization would be able to raise capital at the same conditions as the government. Hence, the claim that the governmental sector can produce at lower costs because the government can raise money at lower interest rates is a subtle but clear fallacy.

The reforms of social democratic societies

24. The reforms of social democratic societies' "capitalism for the people."[7] Pre-COVID-19, there was significant pressure being exerted on social democratic societies and their institutions to adapt to a more competitive environment in their political, economic, social and cultural spheres. To maintain their social security programme that has conditioned their economic performances and characterized their high quality of life, social democratic societies were under pressure to become more efficient and effective in delivering those programmes as well as other public and social goods and services, efficient in reaching the goals and objectives set and effective in doing it at the lowest possible cost.

25. There is a real danger that the COVID-19 crisis will obscure the urgent renewal of the legal, political and social interfaces between the public and private sectors in making democratic societies strong and innovative ones, societies in which justice, equity and entrepreneurship are valued principles.

26. The COVID-19 has in no way reduced the creeping inefficiency in the production, distribution and delivery of public and social goods and services. This inefficiency has many roots, but the most important ones find their sources in two subsets of factors. The first subset revolves around the omnipresent confusion between goals/objectives and ways/means. This confusion is the source of numerous fruitless debates. It is time to clarify the goals and objectives and to ensure that the most efficient, least costly and least risky ways and means are used and harnessed to reach the goals and objectives to be pursued.

27. The second subset proceeds from the capture of large segments and portions of the production, distribution and delivery processes of the public and social goods and services by well-organized, entrenched and highly protected interest groups and lobbies. Those groups have, over the years, become capable of imposing hurdles of many kinds, which have impaired sustainable performance and productivity gains. COVID-19 may have entrenched even more their power.

28. It is always time to reaffirm the preponderance of goals and objectives and give all citizens the right to displace inefficient providers of public and social goods and services. Many observers claim that our health, education, infrastructure, and environment systems are failing to provide citizens with the level of services that they could and should provide, in spite of increasingly important resources being invested. How could and did we end up with so many problems in the production and distribution of public and social goods and services, considering that we have become richer and richer almost every year over the last half-century and more?

29. If social democratic societies really aim to improve or simply maintain their broadly defined social protection and security programmes (including universal access to high-quality education, training and health services, unemployment benefits, environmental protection and restoration policies, extensive water and sanitation services, recreational and cultural activities, etc.), they will have to run those programmes and deliver the associated public and social goods and services they are supposed to provide in a much more efficient and effective way. Competition is key.

Competition is key

30. Competition is the key to the emergence of more efficient and effective ways and means by which the public and social goods and services will or should be provided in the future. The increasing economic pressures arising from both the globalization of markets and the internationalization of cultures will lead to a reduction, shrinkage or even abandonment of those publicly provided programmes one way or another—perhaps not officially, but certainly in practice with lower-

[7] To borrow the title from L. Zingales (2012), *A Capitalism for the People*, Basic Books.

quality goods and services and/or slower delivery, increased uncertainty, and lower dependability. This reduced quality of public and social goods and services will occur not because we cannot afford them anymore but because these goods and services are produced with increasing inefficiency and ineffectiveness.

31. The current political debate on the failure of the health system, education system, and infrastructure system to deliver the goods and services they are supposed to produce and distribute is centred on government budget allocation. Different groups call for more money, sometimes under the more acceptable pseudonym of "reinvestment," for health, education, infrastructure, environment, etc. These calls will become louder, now that we have learned that we could increase debt through the ceiling.

32. The fundamental problem is one of organizational or systemic efficiency and effectiveness, not one of money or budget per se. Social democratic societies have become well-educated, highly skilled societies with significant entrepreneurial capabilities. They have also reached a high level of tolerance for diversity, not regarding fundamental principles and objectives (justice, equity, inclusion, efficiency, effectiveness), but regarding the different ways and means by which those principles and objectives may be achieved or met in practice in different contexts.

33. Misunderstanding the role of competition and the reality of uncertainty and risk can lead to years of suboptimal and even wasteful allocation of resources, human, natural and technological. Human behaviour can be explained from two major fears: the fear of competition and the fear of uncertainty, insecurity and risk. In the current fight against COVID-19, both fears may reinforce each other to move us toward a big brother nationalist society and be powerful engines of stagnation and negative growth.

34. But they can also be powerful engines of growth and opportunities to increase the well-being of all. Negating or misunderstanding the role of competition and improperly assessing the importance of uncertainty, insecurity and risk are the two most important roadblocks towards an improved social democratic society.

35. To (re)build an open social democratic model and project after the COVID-19 crisis is behind us, three principles should be relied on: the rationality of individuals; the efficiency of incentive mechanisms; the efficiency of competitive mechanisms.

36. Rational behaviour can be characterized as the pursuit of a coherent set of objectives and the use of appropriate means to reach them. Frank Hahn (1978)[8] proposes the following definition: "*Given a set of possible actions, the agent chooses rationally if there is no other action leading to preferred consequences to those of the action chosen*." Rationality is an amoral concept that sees saints, criminals, and, of course, ordinary citizens, as rational people: rationality can serve the betterment of society as well as its enslavement. When properly understood, rationality presents the greatest advantage of allowing predictions of human behaviour and, in particular, changes in behaviour due to altered incentives.

37. No economist would pretend that everyone is rational in the above sense in all circumstances and at all times. The notion of rationality must be understood in a broad sense, including constrained and bounded rationality as well as imperfect and incomplete information rationality. Moreover, the oft-assumed selfishness of the individual incorporates interests and opinions of others insofar as they are part of the individual's preferences.

38. Behaviour is a function of preferences and incentives. It is difficult to change preferences, but incentives can be used to lead individuals towards contributing not only to their own well-being but also to the well-being of all.

39. The rationality of the individuals leads quite naturally to the second postulate: incentives are a powerful tool that favours efficiency in reaching the objectives of the open social democratic model and project. The importance of properly understanding and designing incentive mechanisms can be illustrated by the agricultural crisis of 1959–1961 in continental China. Autonomous agricultural collectivization began around 1952 and was immediately a clear success: the agricultural production increased in an impressive way between 1952 and 1958. In contexts where information can be manipulated, production cooperatives can be extremely profitable if certain organizational requirements, mainly those that allow for the proper handling of coordination and motivation through adequate mechanisms, are met. It appears that the organizational structure of the Chinese agricultural cooperatives met these requirements in the first few years.

40. The number of cooperatives had grown to more than 735,000 in 1957 with 119 million households as members for an average 160 households per cooperative. Members of a cooperative had the option of withdrawing their labour or physical capital in order to join another cooperative project if they believed that the productivity or their share of the benefits was insufficient in the former cooperative.

41. Following the success of the first cooperatives, the Chinese government decided in 1958–1959 to extend the collectivization project to the whole agricultural production. The government cooperatives gathered an average 5,000 households and the right of withdrawal was abolished to simplify the administration of the system. Compensation was also changed from a distribution based on points of merit to a system primarily based on the members' needs, independently of productivity. The mutual observation of the comrades' effort provided was possible when there were 160 households in the cooperative but impossible with 5,000 households. Abolishing

[8] F. H. Hahn (1978), On Non-Walrasian Equilibria, *Review of Economic Studies* 45, 1–16.

the right of withdrawal made the complementary threat from more productive members totally void. By 1961, grain production plummeted more than 30% below the levels reached in 1958.

42. Justin Yifu Lin (1990),[9] an economist of the University of Beijing at that time, attributes most of the fall in production to the modified organization of the cooperatives. The modification significantly reduced the possibility of effective coordination and efficient incentives for effort and resulted in a famine that caused an estimated 30 million deaths!

43. Such misunderstood role of asymmetric information leading to opportunism, free-riding and hold-up behaviour can have disastrous effects. Efficient contracting for the production or distribution of public and social goods and services must include incentive-compatible mechanisms that are intended to optimally reduce the impact of such potential sources of inefficiency.

44. The third basic principle is that competition generates efficiency, growth, and consequently well-being. This postulate is quite often subject to ill-informed and biased criticism. The following is a typical criticism: "Competition is not the way to create a strong community. If you compete with your neighbour, there will be a winner and a loser. We do not want losers."

45. The absence of competition generates only losers, besides the bureaucratic central-planning illuminated leaders who claim to know better than the citizens themselves what is good for them. Proper, open and transparent competition pushes everyone upwards. Modern history hardly leaves any space for doubt regarding relevancy and truth in the statement that such proper competition generates a win-win society where markets and solidarity are reconciled for the benefit of all.

46. Complementary competitive mechanisms, such as benchmarking, competitive tendering, public-private partnerships, and competitive answers to NIMBY could be particularly efficient as needed transition mechanisms in the public sector.

47. Only proper, open and transparent competitive mechanisms, making an optimal use of new information and communication technologies, can guarantee the emergence of a society where the interests of the citizens prevail, where choices of production, consumption and investments, public and private, are made on the basis of the best information available, best competencies available, and best development prospects.

Conclusion

48. Let us hope that the march towards more cooperation and competition, more innovation, and more globalization, that is, the march towards a more civilized one-world vision survives the current handling of the COVID-19 crisis. There are significant risks that it will not, at least for a long time. ■

[9] J. Y. Lin (1990), Collectivization and China's Agricultural Crisis in 1959–1961, *Journal of Political Economy* 98, 1228–1252. *See also* J. Y. Lin and D. T. Yang (2000), Food Availability, Entitlements and the Chinese Famine of 1959-61, *The Economic Journal* 110, 136–158.