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The Antitrust Terrible 10
Why the Most Reviled "Anti-competitive" Business Practices Can Benefit Consumers in the New Economy

by Clyde Wayne Crews Jr.

Executive Summary

Antitrust law is a form of economic regulation. And like all economic regulation, it transfers wealth, often in response to special-interest urging. Partly in recognition of such shortcomings, many economic sectors, such as transportation and telecommunications, have been partially deregulated. But antitrust regulation is typically praised. Even in the new economy, this hundred-year-old smokestack era law is used to justify constraints imposed on companies like Microsoft and AOL Time Warner. Antitrust law is almost universally seen as being in the public interest and having a role to play in policing markets.

Yet in antitrust cases, the targeted companies' rivals have a direct financial, as opposed to ethical, interest in the outcome. Assertions that antitrust law is in the public interest do not change the fact that the private motives of rivals, and even ambitious enforcers, are always lurking in the background. The idea that antitrust law helps consumers and that it has a role to play in the new economy deserves close examination.

Under antitrust law, a laundry list of business practices is regarded with suspicion, and other practices are outlawed altogether. But business transactions are fundamentally voluntary, noncoercive dealings—unlike antitrust interventions. From this fresh perspective, one finds that even the most "despised" business behavior—such as collusion and megamergers—can be pro-competitive and pro-consumer. To the extent that antitrust regulations strike down practices that have efficiency justifications that are misunderstood or ignored, those regulations make individuals and society needlessly poorer.

The list of vilified business practices is long, but it needn't be. A list of vilified trustbuster practices might be more helpful to consumers.

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Introduction

> Given the long history of antitrust law and its contempt for true market rivalry, perhaps the most effective pro-consumer program would be to consider federal enforcement of the antitrust laws to be a per se restraint of trade.
>
> *Thomas W. Hazlett*[1]

Even in a digital information age, seemingly everyone believes that antitrust law protects consumers and has an important role to play in policing high-tech markets. But is this popular view really true?

Part of the impulse for more than two decades of deregulation in the transportation, communications, banking, and electricity sectors has been a willingness on the part of policymakers to rethink the presumption that regulation of economic affairs benefits consumers. Policymakers have recognized that economic regulations transfer wealth, which means that in the political swirl surrounding their creation and maintenance, they inevitably attract political entrepreneurs who seek entry or price regulation that will give them an edge on the competition. Consumers get harmed in the process. That healthy touch of skepticism has also contributed to restraint in the regulation of the technology sector.

Since antitrust is a form of economic regulation, it is similarly vulnerable to exploitation both by firms hoping to hobble competition and by a public and private legal infrastructure that lives comfortably off the industry created by enforcement of antitrust laws.

Thus, a skeptical interpretation of the history of antitrust enforcement, up to and including recent campaigns targeting Microsoft, Intel, the AOL-Time Warner merger, and the rejected WorldCom-Sprint merger is that antitrust advances the well-being of political entrepreneurs rather than consumers. Antitrust enforcement, like any economic regulation, often increases price and decreases output by destroying misunderstood or disregarded efficiencies. Those outcomes are the opposite of those allegedly pursued by enforcers. Yet, although the legitimacy of economic regulation is often questioned, antitrust enjoys almost universal support.

Antitrust advocates compare real-world markets with the theoretical world of what economists call "perfect competition," in which there are large numbers of buyers and sellers for each product. In this scenario, if a seller raised his prices, consumers would simply switch to a competing brand. Under notions of perfect competition, strategic rivalry, size, and a commitment to winning—the hallmarks of ordinary competition—can become unlawful behavior whenever the enforcement-minded decide, since all firms have at least some market power.

Successful companies have no way of knowing if and when their business practices will be targeted. As stated so simply by R. W. Grant in *Tom Smith and His Incredible Bread Machine,* if a firm's prices are higher than everyone else's, that implies monopoly power; if everyone's prices are the same, collusion may be alleged; prices "too low" can signify cutthroat competition and predatory pricing.[2] Too high, too low, or the same: each scenario can be targeted by antitrust enforcers. Under these circumstances, flying under the radar can become important.

Typical critiques of antitrust regulation target its inefficiency or unintended effects. A more fundamental, albeit politically less palatable, criticism stems from the rejection of property rights inherent in antitrust. Ungrounded in a concept of capitalism that includes property rights and wealth creation, antitrust advocates regard the economic pie as largely fixed and imagine that one firm can grab too much of the social output. In defiance of basic notions of property rights, antitrust regulation regards conditions imposed on the sale or distribution of *one's own goods,* as in the Microsoft browser and Intel chip-specification cases, as a potential exercise of force against competitors and con-

sumers. In this manner antitrust law is based on a misunderstanding of the very nature of markets and their grounding in private ownership and control. Consumers are not threatened by firms that achieve dominance through internal growth or aggressive competition. In fact, driving out one's competitors is the name of the game in business, and such "restraint of trade" is essential to consumer welfare. No matter how large a company, the capital markets and the rest of the economy arrayed against it are bigger and can appropriately discipline it. Indeed, market conditions can never be frozen—the marketplace is an arena in which seemingly impervious standards (like mainframe computers and vinyl records) are routinely toppled.

Economists, documenting that decades of antitrust enforcement and business regulation in general have failed to benefit the consumer, have noted the pro-competitive elements of a number of practices typically eyed suspiciously by antitrust regulation. But if these practices are actually efficient, that implies that enforcement creates inefficiencies and harm. Policymakers cannot seem to manage the industrial policy scheme called antitrust to consumer advantage, and that invites rejection of the conventional view of antitrust as public interest law.

Although antitrust supporters tend to agree with Adam Smith that self-interest rules in the marketplace, they embrace a contradictory view of human nature with respect to government officials engaged in "protecting competition." Public servants are assumed to lack the capacity for self-serving behavior, the existence of which those very people take for granted in the private sector. But skeptics do not share this view. Instead they ask *whose* wealth is increased by the enforcement of antitrust laws, and they conclude that it is not that of consumers.

To be sure, there does exist such a thing as coercive monopoly power. It stems from government protectionism—from the restriction of entry or the banning of competition.[3] AT&T once enjoyed protection from competition, just as electric power companies and the U.S. Postal Service do in some of their services today. Breaking up *government-granted* monopolies—that is, abolishing exclusive legal franchises, tariffs, quotas, and excessive licensing restrictions would be an antitrust activity worthy of the name.

Although certain business practices have historically been regarded as anti-competitive and harmful to consumers, there may in fact be pro-consumer justifications behind a number of such practices. Alternative interpretations of several of those frowned-upon practices, presented on the following pages, conclude that the quashing of those behaviors only serves to transfer wealth from some producers to others, or even from consumers to producers. In that sense, antitrust enforcement may function as one of today's least-obvious forms of special interest pleading. But better, more economically astute antitrust enforcers are not the answer: the problem lies with the fundamental rejection of property rights and contracts inherent in antitrust law and its flawed view of markets and human interaction.

Antitrust is anti-consumer.

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1: Restraint of Trade and Monopolization

The stated intent of antitrust law is to police restraint of trade and monopolization. The Sherman Act of 1890 makes illegal "every contract, combination, or conspiracy in restraint of trade"[4] and declares that "every person who shall monopolize, or attempt to monopolize or conspire to monopolize shall be deemed guilty of a felony."[5] The 1914 Clayton Act created a list of practices that could entail anti-competitive effects under certain conditions, including tying arrangements, exclusive dealing, mergers, and interlocking boards of directors.[6]

But the notion that restraint of trade characterizes the marketplace at all is suspect. Markets represent the social incarnation of voluntary trade. Take the signature "golden age" or "smokestack" antitrust case

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as an example: As Isabel Paterson wrote in *The God of the Machine:* "Standard Oil did not restrain trade; it went out to the ends of the earth to make a market. Can the corporations be said to have 'restrained trade' when the trade they cater to had no existence until they produced and sold the goods?"[7] Yet similar claims are directed against Microsoft, which caters to a personal computer industry that it largely popularized; at AOL Time Warner's Instant Messenger service, which it indeed dominates but also happens to have created; and at cable broadband providers, who allegedly restrict access to the high-speed Internet services that were made available by these very providers.

In the economists' model of perfect competition, the world is inhabited by identical sellers offering their goods at identical prices. But nearly all sellers have some control over the pricing of their own goods and how much they produce, just as consumers decide whether or not to buy.

Since monopoly is defined by consumer harm caused by lower output and higher prices, the trusts that spurred passage of the Sherman Act should at the very least have exhibited these features. But they didn't. "Output [of industries dominated by trusts] expanded more rapidly than Gross National Product during the 10 years preceding the Sherman Act," according to economist Thomas DiLorenzo.[8] The only exceptions were the match and castor oil industries. As output rose, prices generally fell dramatically across major industries as well. If the trusts were actually raising rather than lowering prices, that would have created cover for rivals to raise prices, too, giving them little incentive to lodge the complaints that led to the antitrust laws in the first place. But hauling one's competitor into court or appealing to legislators when that rival's prices are falling and sales are increasing is consistent with an alternative interpretation of antitrust: that antitrust law helps higher-cost competitors' efforts to hobble their more efficient cousins.

Thus even examples from the golden age lack the reality of consumer abuse. "Abuse" of competitors was surely rampant, but consumers gained unprecedented material comforts at ever-falling prices. In the most dramatic modern case, Microsoft was accused of attempting to maintain a monopoly by bundling a Web browser with its dominant Windows operating system, which runs most personal computers.[9] Yet the charge of monopolization is dubious not just because trustbusters are overly suspicious of aggressive business practices and dismissive of property rights. Trustbusters in this case narrowly and arbitrarily defined the market as *single-user* desktop machines with *Intel* processors—which eliminated all of Microsoft's chief competitors, such as Apple, Sun, and handheld computers, from the market definition.[10]

Despite charges of monopoly and restraint of competition, the reality is that during the Microsoft debate, the market remained wide open for competitors since most American households lacked computers altogether. Even today fewer than 45 percent of Americans have Internet access at home,[11] leaving the rest available to competitors. A "misbehaving" Microsoft invites retaliation from consumers, computer makers, and chipmakers, all of whom enjoy market power and options galore themselves. And it seems clear that computing and Internet access options will only increase in the future, since many of the devices expected to access tomorrow's Web, like phones, TVs, and handheld computing devices, aren't desktop computers at all.

Nonetheless, extreme remedies, including the order to break up Microsoft and proposals in some states to break up local Bells,[12] show just how far some people are willing to go toward imposing a top-down view of competition on the technology sector. This boldness on the part of central planners foreshadows antitrust adventures that will target tomorrow's "monopolies," which now stand aside and cheer. Technology companies should beware the flawed idea that "restraint of trade" is a valid concept as applied to the disposal of one's own property. To be sure, increasing the sales of one's own products

(assuming constant market size) may "restrain the trade" of a competitor—but that is precisely the goal of competitive free enterprise. Antitrust, however, operates on the perverse principles that "no business is entitled to its property if that property can be redeployed so as to expand output" and that business has "no right in principle to dispose of its property as it sees fit, but only a conditional freedom so long as it helps maximize some social utility function."[13] On that premise, "monopolies" can be conjured by enforcers in any business arena they choose.

2: Horizontal Mergers

There is far more to competition than the number of competitors in an industry, or industry concentration. When firms merge, the number of competitors in a particular line of business does decline at least temporarily. But firms that join forces to create a large market share may also generate cost efficiencies that outweigh any decline in their output. Moreover, the combination may be necessary to establish a platform from which to launch new output or lines of business. As the late economist Murray Rothbard noted, talk of mergers "substantially lessening competition" is meaningless; competition is a *process*, not a quantity.[14] Current merger guidelines do take dynamic efficiency effects into account, particularly when those effects cannot be achieved except by merging.[15] Yet challenges to and conditions on mergers are still widespread. Aggressive policing and micromanagement of *technology* mergers is particularly troublesome since this industry is characterized by an ease of entry exceeding that of the smokestack era.

Economist Oliver Williamson demonstrated that a merger leading to market power has two components: the oft-noted restriction of output, which leads to societal "deadweight losses," and the cost savings from efficiencies that may outweigh those deadweight losses.[16]

Consider Figure 1, where consumers pay $1 for Q1 in output. Assume all competitive

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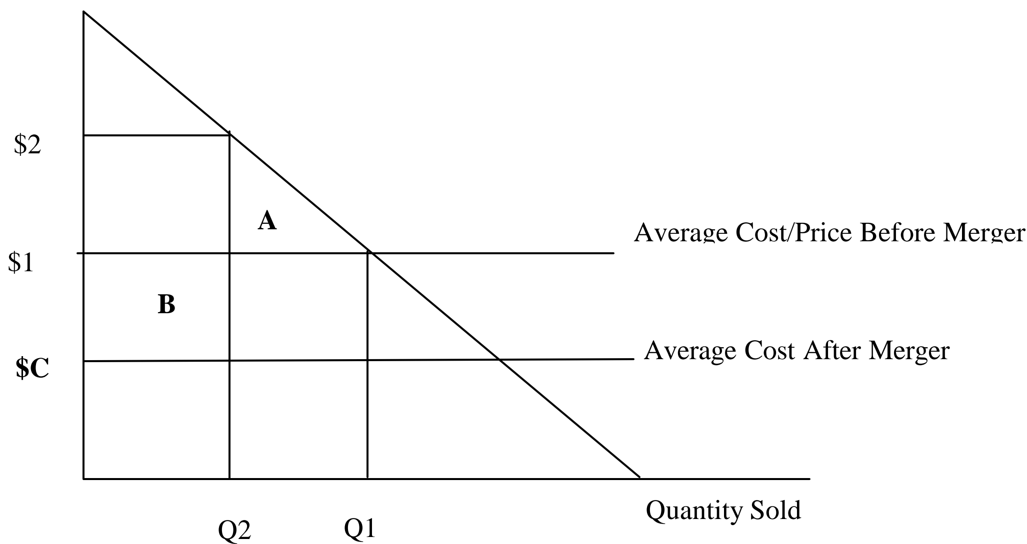
Figure 1



firms' costs are also $1, so total industry profits are zero. If a merger raises price to $2 and decreases quantity sold to Q2, consumers would be willing to pay additionally the amount represented by triangle A—the amount under the demand curve but between the old and new price—for the lost output. But if costs meanwhile fall to $C, and those new savings, represented by the rectangle B, exceed the value of the lost A, the merger makes society better off. And with lower costs, new firms may now have a profit incentive to enter the market, too.

Although merger guidelines do entertain the possibility of benefits to society, what enforcers call "merger to monopoly" is detested. Even if a merger doesn't make society better off, one must ask a more fundamental question: *whose* output is restricted by a merger? In a market economy, producers are free to associate and are not forced to part with their goods on unfavorable terms. Those fundamental property rights—albeit at odds with antitrust philosophy—do not conflict with social welfare but are essential to it. Consumer benefits require the dynamism that both rivalry *and* strategic combinations deliver.

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As noted with respect to the Microsoft case, trustbusters can narrowly define markets in such a way as to magnify the allegedly negative consequences of a merger. The mergers of Coca-Cola–Dr Pepper and PepsiCo-Seven Up were attacked during the 1980s under the arbitrary premise that one need distinguish between "carbonated soft drinks" and "soft drinks" for the purpose of determining whether monopoly power exists.[17] And in 1997, on the basis of a static perception that prices would rise or competitive entry might not happen overnight, the merger of Staples and Office Depot was halted as well, depriving the economy and consumers of the competitive responses of retail giants such as Wal-Mart, and depriving unserved localities of superstores that the merger's profitability might have made feasible.[18]

Because antitrust regulation can hobble the competition, policymakers should be suspicious of objections that come from the direct competitors of merging firms. Such protests can be a tip-off of a merger's efficiency rather than its anti-competitive effects. A merger expected by competitors to generate higher consumer prices—which is what a monopoly allegedly does, after all—would *benefit* those competitors: they could sell more at existing or even higher prices while undercutting the new monopoly.

To be sure, not all mergers work or make sense. More than 4,900 merger filings were made in the year 2000,[19] and it's likely that many of those won't work out. The conglomerate wave of the late 1960s was later taken apart, as was the effort by American Express in the 1980s to venture into several new business areas.[20] Regardless of those risks, market experimentation and trial and error in business arrangements and combinations are vital market processes. Federal Reserve chairman Alan Greenspan warned of the perils of adventuresome merger enforcement in high-technology markets, telling the Senate Judiciary Committee, "I would feel very uncomfortable if we inhibited various different types of mergers or acquisitions on the basis of some presumed projection as to how markets would evolve . . . history is strewn with people making projections that have turned out to be grossly inaccurate." He added that there "ought to be a higher degree of humility."[21]

Of course, whereas government ought not to inhibit mergers, it shouldn't promote them artificially either. For example, where sharing information across firms is forbidden in a misplaced effort to fight "collusion," antitrust regulations can inadvertently foster mergers where a tight research and development alliance would have sufficed.

Despite Greenspan's warnings against second-guessing markets, Joel Klein, former assistant attorney general of the Justice Department's Antitrust Division, had this to say: "We reject categorically the notion that markets will self-correct and we should sit back and watch."[22] Although the vast majority of today's mergers do go through, antitrust

authorities are increasingly extracting concessions from merging companies, often targeting particular high-visibility mergers and prying into the firms' operations well beyond the time of the merger.[23] In the AOL-Time Warner merger, for example, the company was not only forced to share access to both its Instant Messenger service and its cable lines (which will reduce investment by rival firms who otherwise would have needed to negotiate for access or investigate ways of developing their own infrastructure), but a special overseer has been appointed to look over the company's shoulder for the coming five years to make sure these mandates are carried out.[24] Wringing out onerous consent decrees places burdens on market processes, injecting the government into an industry as a potentially permanent, unwanted "partner." In this environment, potential mergers may be chilled and never pursued, or unnecessary concessions may generate less-efficient mergers. The market and shareholders should decide the appropriateness of mergers and structure deals accordingly.

3: Collusion: Price Fixing and Market Division

Collusion or price fixing between competitors enjoys little tolerance even from those who are otherwise antitrust skeptics. Price fixing, it is argued, involves no integration of productive capacity as do mergers, therefore nothing is lost by forbidding the practice.[25] Price fixing is seen as merely a conspiracy to transfer wealth away from consumers. Such collusion is treated as per se illegal and subject to criminal as well as civil penalties.

On the other hand, it's been said that a "conspiracy" is cooperation by those one doesn't like; otherwise, it's just a plan. Except for the preexistence of the companies involved, collusion is nearly indistinguishable operationally from forming a partnership, entering a contract, or the very act of forming a company in the first place.[26] Firms emerge precisely so that they can commandeer proprietary resources unilaterally, instead of having to contract and bid in the open marketplace for every needed input. These "islands of nonmarket control" are a central element of modern market production.[27]

As a partial merger rather than a total integration, colluding "eliminates competition" far less than does merging, for those who speak that language—yet mergers are legal and collusion is not. Markets are dynamic: In the same way that coordination between individuals has obvious benefits, so does coordination across firms. Restrictive combinations of various kinds are efforts by businesses to coordinate and cooperate, to adjust to uncertainties, to cope with imperfect information, and to minimize transaction costs, all to achieve certain business ends. Accordingly, that which is disparagingly called "collusion" could represent an attempt to deal with economies of scale, substantial fixed costs, or market oscillations that hamper business planning.

Collusion and market division may be not only efficient but increasingly essential in a modern global economy that creates and commands vast resources. As economist George Bittlingmayer explains, "Restrictions on competition may have an efficiency defense, and a prohibition of cartel arrangements may entail costs as well as benefits."[28] Efforts to relax antitrust laws for the purpose of promoting interfirm research and development recognize the need to allow resource pooling and avoid needless duplication.

Both cooperation and competition are legitimate features in a market economy that respects the property rights of producers, although enforcers would be hard-pressed to admit as much. Ignoring the potential benefits of cooperation on price or of market division in a complex market economy can harm customers by generating perverse antitrust policy. As economist and lawyer Fred McChesney has noted, there is no shortage of bizarre examples. Take the 1969 *United States v. Container Corp.* case, which imposed liability for a "collusive" exchange of price information that resulted in "stabilizing prices

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downward."[29] Likewise, in the 1972 case *United States v. Topco Associates,* the Supreme Court overturned a lower court finding that the Topco grocery cooperative association's horizontal division of territories to prevent overlap in Topco brands was reasonable and pro-competitive. The Court found a per se violation, despite Topco's argument that such restrictions helped it compete with larger chains and were needed to hold the association together.

If consumer welfare is the goal, policy should not force firms to part with their own products for unattractive prices or on unfavorable terms. When testing and expanding markets, it is appropriate for any firm to seek agreements concerning the goods that it created, owns, or both, just as it is appropriate for a consumer to exercise a right not to buy goods from a particular producer. This guiding principle derives from the tenet that no one can be compelled to produce products in the first place, but once one does, one should not lose rights to determine conditions on which the products are sold.

Even if price collusion were the result of deliberate anti-consumer mischief, we would be better off allowing markets, rather than regulators, to take their course. When all is said and done, the instability of inefficient cartel arrangements serves as a built-in insurance policy for consumers. Price is only one of many variables that can be altered independently or agreed upon by firms. Even if price agreements are made and enforced (which is rare enough in itself), colluders can "cheat" by competing on the basis of alternative features such as quality, delivery or service, warranties, or other add-ons. That tendency to undermine agreements, to seek a bit of competitive advantage, renders inefficient arrangements unstable and sets in motion their destruction (unless government enforces the cartel). Competitive entry by rivals not party to a pricing agreement also disciplines colluders: If prices are too high or territories underserved, in they come. Finally, it is worth noting that genuine problems involving price fixing and overcharging occur most readily when the government, which lacks the motivation to save money, is the buyer.

4: Predatory Pricing

The aim of every competitor is to eliminate rivals and gain as many customers as possible. "Predatory pricing" is a poor way of achieving this goal.

Predatory pricing refers to the act of pricing below cost with intent to monopolize. A firm employs predatory pricing, it is argued, to drive rivals out of business, snatch their customers, and amass an increasingly larger market share. Then the predator happily begins charging monopoly prices. The predator, according to that theory, need only stand vigil: as aspiring rivals surface, the now-monopolist merely cuts price again and drives out the upstart, after which prices again rise.

The problem with that theory is that the monopolist wannabe would need to charge below-cost prices nearly all the time—ultimately bankrupting himself. Predation hurts the predator more than his rivals because, to capture the rivals' market, the predator must expand output and bear losses by pricing below cost and must service the additional demand that the new low price creates. But the targeted rivals can merely cut back on sales. Even if the predator drove out rivals, once he began monopoly pricing, new entrants would force a new round of losses. Another critical problem for a predator is that the immediate losses sustained must be exceeded by discounted future revenues. That is, for every dollar lost, more than a dollar must be recouped in the future in order to break even.[30] And the public would likely grow weary of a company whose product took wide price swings. The Supreme Court's critical 1986 decision in *Matsushita Electric Industrial Corp. v. Zenith Radio Corp.* noted the implausibility of successful predatory pricing schemes—especially when they required coordinated action among predators—given such factors as losses suffered by both the predator and the target, the entrance of new rivals, and

the difficult logistics of actually securing and maintaining a monopoly later to cover losses. (Usually trustbusters worry that colluders will charge too much—here the worry is that they will charge too little!) As Nobel economist George Stigler put it, "Today it would be embarrassing to encounter this argument [that predatory pricing is a monopolizing device] in professional discourse."[31]

Enforcing laws against predatory pricing requires that courts or bureaucrats determine what counts as a genuine predatory price, rather than simply a low one. Such second-guessing of the marketplace subjects business to the shifting winds of antitrust fashion and changing administrations. Ordinary marketing practices, like loss leaders, introductory pricing, or Microsoft-style software giveaways, can be construed as "predatory" and their practitioners threatened by adventuresome enforcers.

Economists Donald Boudreaux and Andrew Kleit have offered important insights into the ways markets automatically police predatory pricing without invoking antitrust law and all its attendant baggage. Predators don't operate in a vacuum. Any predator's behavior would be noticed by its upstream suppliers and downstream business customers who would stand to lose from the predator's successful monopolization.[32] For example, should a retailer become a successful predator and reduce output, its suppliers lose sales. These suppliers can discipline retailers by taking their business to other retailers. Meanwhile, the departure of the low-cost suppliers raises the predator's costs, further decreasing the opportunity for predatory success. Predators' tactics can also be turned against them by capital markets. Predators invite rivals and speculators to form endless numbers of small companies for the sole purpose of slashing the product's price and forcing the predator to match it, while shorting the predator's stock—thereby turning the tables on the predator.[33]

Ultimately, it would take the outlawing of new entrants for a predatory pricing effort to succeed. The predatory pricing fiction allows competitors of efficient firms to substitute competition in the courtroom for competition in the marketplace, since filing lawsuits in anticipation of treble damage awards is easier than lowering price to match the "predator's" price or improving product quality. Such routine abuses of antitrust are far more likely to occur than is successful predatory pricing. Boudreaux and Kleit propose that we deny standing to competitors altogether in predatory pricing cases, eliminating their ability to use antitrust to thwart competition instead of cutting prices or improving quality.[34] At the very least, competitors should bear the burden of proving that consumers, not they themselves, are harmed. The goal of business is to "harm" competitors and put them out of business. It is consumers who benefit from that rivalry.

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5: Price Discrimination

The Robinson-Patman Act, a 1936 amendment to the Clayton Act's catalog of prohibited business practices, was designed to protect small business by limiting the ability to charge similar buyers different prices at the same time. It was enacted during a public outcry against the Great Atlantic & Pacific Tea Company (which might be thought of as the Wal-Mart of its time), which tended to displace mom-and-pop grocers. But artificially protecting small business does not equate with protecting consumers.

Price discrimination is most commonly criticized when small retailers are unable to obtain the same volume discounts from suppliers that larger competitors receive. Small sellers, can, however, form associations to secure such volume discounts—and they do. (It can of course be harder for them to do so—one reason for which they may merge.) IGA, for example, is one of the larger retail food trade groups, and some retailers, such as True Value hardware stores, own their own wholesaler.[35]

Even federal government enforcers tend to regard Robinson-Patman as a holdover from

the mom-and-pop versus chain store era that protects competitors rather than competition.[36] Robinson-Patman could be a key test case for pursuing reform of antitrust regulation—after which the lessons learned could be applied to other areas of antitrust where sufficient skepticism has yet to creep in. Yet while the federal government now exercises restraint, successful price discrimination cases brought by competitors are nonetheless a prominent part of the landscape, given such examples as the Supreme Court finding that Texaco violated Robinson-Patman in *Texaco Inc. v. Hasbrouck* (1990) by offering discriminatory preferential discounts to some distributors ("a price discrimination . . . is merely a price difference").[37]

Private cases proceed at a considerable clip. The American Booksellers Association and a number of other independent booksellers filed, in 1998, antitrust lawsuits against the superstores Borders and Barnes & Noble for receiving volume discounts, favorable terms, and promotion treatment from publishers.[38] The ABA had already secured a favorable settlement against publishers in 1995. But, to qualify for volume discounts in the first place, what must large firms do? The big chains must sell far more, which requires lower prices, better hours, a better shopping environment, and better service and selection—all of which benefit consumers. Book purchases have increased during the rise of the superstores, and consumers have embraced them. (They have also embraced Amazon, which has been a serious threat to the allegedly dangerous chains.)

The bookstore suit led one commentator to warn: "Consider what a general restriction of volume discounts would mean for you. What would it do to the prices you pay at Costco or Sam's Club, Home Base, or Home Depot, and every other discount store you frequent?"[39] The idea that the market doesn't police itself against egregious attempts at price discrimination and requires government intervention is not credible. Publishers themselves have incentives to police any monopoly aspirations of book superstores, since the successful displacement of independent sellers leading to monopoly power on the part of the chains would hurt them by reducing wholesale purchases.

When major stores like Borders and Barnes & Noble are diverted by trial preparations, consumers are presented a shining example of how antitrust protects competitors rather than competition. Forced provision of discounts to the ABA members when it is not economical to offer them would lead to a cutback on overall discounts. When successful, such lawsuits injure consumers by keeping prices charged by large retailers higher than they would otherwise be.

Vibrant price competition and selective discounts should not be outlawed any more than competition on the basis of quality or other factors. As Robert Bork has noted, enforcement against price discrimination is neither workable nor desirable. Rather, markets depend on a seller's "altering a price here and there, testing responses. . . .The evanescent discriminations of competitive markets are the sellers' antennae. This adjustment to shifting costs and demand is socially desirable."[40] It also happens to be the right of a seller, properly speaking.

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6. Manufacturer Price Restraints on Retailers

Vertical price restraints refer to contractual agreements between manufacturers and retailers not to charge prices below some minimum or above some maximum.

Typically, an agreed-upon price will be higher than the price in the absence of such vertical contracts, which concerns antitrust enforcers. Opponents of vertical price fixing generally cite a concern that manufacturers will impose price restraints to facilitate policing of a cartel created out of retailers: since policing retail prices is easy, there is little difficulty detecting cheaters on the cartel agreement. Others worry that retailers themselves may impose price restraints on reluctant manufacturers in an effort to form a cartel.

But, if quantity rises, or if quality and ser-

vices improve, vertical restraints may very well enhance efficiency.

Indeed, price *caps* imposed on retailers from upstream intuitively seem benign and pro-consumer since they limit what can be charged. Yet even this form of price setting had been considered per se unlawful until the unanimous 1997 Supreme Court ruling in *State Oil Co. v. Khan,*[41] which declared price ceilings imposed on retailers subject to evaluation under the rule of reason, which, while an important step forward, basically means, "take your chances, we'll tell you later."

Explicit agreements on *minimum* prices will still trigger per se illegality, recently evidenced in such episodes as the 1991 Federal Trade Commission consent decrees requiring Kreepy Krauly, a maker of swimming pool cleaners,[42] and video game maker Nintendo[43] to halt retail price agreements with dealers. Concessions made in 1995 with Reebok/Rockport[44] and Onkyo provide additional examples.[45] However, less-direct maneuvers by manufacturers, such as distributing lists of recommended retail prices or announcing consumer price preferences at the outset and then retaining retailers on that basis, will not be likely to trigger liability.[46] As so often is the case with antitrust, one must walk on eggshells. The FTC recently brought a case against record distributors for a "Minimum Advertised Pricing"[47] program. The music companies argued that the program protected music-only retailers from being undercut by stores like Best Buy, which could use CDs as loss leaders to get customers in the store. In exchange for adhering to the MAP, major retailers received advertising support.

The competitive, pro-consumer defense of a minimum price requirement imposed by a manufacturer on a retailer (such as the MAP) helps ensure that all retailers' returns are high enough to maintain the manufacturer's preferences for customer service on the product—but not so high that customers are driven away. Minimum resale price maintenance helps overcome a predicament that otherwise could damage a market. In other cases, where retailers sell a complex product, there is a risk that no-frills competitors could take a "free ride" on the back of the full-service retailer. Customers could receive the services—such as demonstrations of audio equipment in costly sound rooms—and then purchase the product from a discounter who offers no similar services. Free rides for discounters can be avoided if a manufacturer can "police" retailers' behavior, setting the minimum price at which any of them—whether full-service or discounter—may sell.

Manufacturers can specify price levels that give retailers a high enough margin to finance product-specific services that customers require. Manufacturers need not even observe retailers' behavior very carefully with resale price maintenance, because the profit margin created will be sufficient to entice retailers to compete—as best they can—on nonprice features like service. Retail price agreements make partners out of retailers, encouraging them to act in the best interests of both manufacturers and consumers.

A presumption of legality or at least an explicit rule of reason should be applied to minimum price agreements. Besides, the option of a manufacturer forming its own distribution system or merging with a retailer to ensure product control is even more "anticompetitive," borrowing the antitrust advocates' language, than resale price maintenance. Again, poor policy that threatens rational market behavior can lead to inefficient mergers or other ill-considered responses.

7: Exclusive Dealing

Exclusive dealing arrangements are those under which a seller agrees to sell only the products of a particular manufacturer and not deal in competitors' goods. A variant is a seller's contracting to purchase all of the output of a supplier. Such exclusive contracts are prohibited by the Clayton Act and the Federal Trade Commission Act where they may lessen competition.

An objection to exclusive dealerships stems

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The idea behind exclusivity is to secure special effort on behalf of a product by the retailer, which implies that the retailer will receive something of value—low wholesale prices, for example—in return.

from the worry that shutting out competing sellers or buyers may be anti-competitive. Another concern is that small retailers may be forced into exclusive arrangements, which they would prefer to avoid, at the behest of powerful manufacturers. But Robert Bork pointed out the fallacy in the latter argument. If a local store is the only seller of the manufacturer's product, *it* enjoys the "monopoly" and is in the better bargaining position.[48] Particularly if the retailer is the sole seller, the retailer has alternative suppliers to which to turn—but the manufacturer has no alternative retail establishments to which to turn.

Arranging an exclusive dealership with a retailer creates efficiencies that warrant recognition. The idea behind exclusivity is to secure special effort on behalf of a product by the retailer, which implies that the retailer will receive something of value—low wholesale prices, for example—in return. An exclusive deal between a manufacturer and a retailer does not harm competition since others remain free to offer better deals and secure their own exclusive dealerships with the retailer. Contracts are often renegotiated, and any dissatisfied retailer can refuse to renew an inefficient exclusive dealership contract.

Making retailers better off means making consumers better off, through, for example, lower prices and superior retailing services. Exclusive dealing may provide a retailer with specialized knowledge about a product and a greater ability and incentive to explain its operation to customers or to service it. In addition, the exclusive arrangement assures the seller that he and his customers will have an unbroken supply of inventory for the duration of the contract.

Since there are generally more vendors than one competing for the allegiance of any one retailer, a manufacturer who secures exclusive arrangements must offer some added value. The retailer's job is to balance the disadvantages of spurning other manufacturers with the incentives offered by the seller under such an arrangement.[49] And if circumstances were to reveal that a manufacturer has secured unfavorable exclusive dealing arrangements among several retailers, those retailers could band together to demand relief. For example, computer makers, if truly disgruntled, could work in concert to alter contracts with Microsoft that they regard as disadvantageous. The problem here, though, is that such coordinated market activity is itself likely to trigger an antitrust complaint, even though it merely represents a market response to another's behavior.

Despite its recognition of genuine business justifications for exclusive dealing, the 1949 Supreme Court case *Standard Oil of California v. United States* found Standard in violation of the Clayton Act's prohibitions on exclusive dealing that may "lessen competition."[50] On the other hand, the Court in the 1961 *Tampa Electric Co. v. Nashville Coal Co.* case found requirements contracts acceptable.[51] Again, businesspeople must tread carefully.

For a manufacturer, markets can exhibit significant volatility, which is one justification for locking in exclusive supply agreements with providers of raw materials. Agreements can also be important for business planning, hedging against inflation, or ensuring an uninterrupted supply of raw material.

From the standpoint of the supplier of raw materials, a deal with a sole producer could reduce expenses associated with seeking multiple buyers, allow the planning and spreading out of production on the basis of delivery date agreements, and help hedge against potential price declines. Excess charges to final consumers would not go unnoticed by suppliers if they were truly monopolistic, because successful monopolization would lead to reduced wholesale purchases of raw materials. As stated earlier, suppliers themselves would keep this kind of activity in check.

8: Tying or Bundling

Tie-in sales are those in which a customer who purchases product A from a firm with market power is required to purchase product B as a condition of the sale. Antitrust proponents charge that such actions unjustifi-

ably extend an existing monopoly into a new product when that new market could otherwise have been competitive. Microsoft's bundling of its Internet Explorer Web browser with its Windows operating system is probably the best-known example.[52] A classic example is the case of *International Business Machines v. the United States*, in which IBM was found in violation for requiring users of its machines to also use IBM's punch cards.[53]

The error in the tie-inf logic is the failure to recognize that monopoly profit, assuming it exists, can be collected only once. If IBM or Microsoft exploited all of its monopoly power from its primary, "monopolized" product, and consumers regarded the tied good as worthless, consumers would pay only the price for the monopoly good and no more. Any higher price charged for good B, if the consumer regards it as worthless, is really only regarded as a part of the price of A rather than an addition to it. To ignore this is to commit "double counting of monopoly power."[54]

Another problem with the idea that tying harms consumers is the difficulty of knowing when one product becomes two. Every product possesses more than one characteristic or consists of some bundle of products, making every sale a "tie-in" sale: drills come with bits, cars come with engines, televisions come with remote controls, and cable television packages come with channels that no one wants. "The automobile dealer who refuses to sell only the chassis or the grocer who declines to subdivide a can of pears," as Bork put it, "are engaged in tying."[55]

The Microsoft case, as well as the 1992 case of *Eastman Kodak Co. v. Image Technical Services, Inc.*,[56] reopened the door to unnecessary suspicion of bundling. In Kodak, the Supreme Court found that Kodak engaged in monopolizing behavior by unlawfully tying the sale of its photocopier replacement parts to purchases of its copier repair services.

But these tying or bundling arrangements can perform important economic functions. In the cases of IBM's punch cards, Microsoft's Internet Explorer, and Kodak's copier services, bundling may have helped ensure the primary product's longevity, functionality, integration, and perceived quality by discouraging the purchaser's experimentation with complementary products offered by rivals. In this manner, tie-ins can help a seller avoid warranty expenses and product complaints. In fact, some warranty provisions may be available precisely because of the quality control that tying can allow.

Aggressive enforcement of tying measures can be unfair to small or innovative firms, since tie-in sales can function as a marketing technique to induce customers to try something new. Tie-ins can also help small firms that lack the financial wherewithal of larger rivals to avoid duplicating selling and administrative expenses across their products, thereby getting more bang for the buck. Such duplication of effort, especially if products are inherently related, can be an unfair burden on smaller firms. Tying can allow any seller to take advantage of the scale economies generated by the reduced selling and administrative expenses that result from spreading costs across more than one product. Tie-ins also may help reduce the costs of ensuring customer satisfaction with products that are related in some manner to the tied item.[57]

Although Robert Bork ended up as a critic of Microsoft's business practices and came under fire for doing so,[58] it is he who properly characterized the tying issue: "There is no viable theory of a means by which tying arrangements injure competition, and there are several obvious ways in which they benefit both seller and consumer."[59]

9: Strategic Predatory Behavior

Efforts to induce one's rivals to suffer increased costs (or decreased revenues) are sometimes regarded by enforcers as forms of predatory behavior. So-called predatory pricing allegedly lowers price and thus the revenue and profits of rivals. But rivals' profits can also be reduced by other strategic behavior, known as "nonprice predation."[60]

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Altering advertising intensity and altering product quality are examples. Another strategy is exclusive dealing arrangements that seek to shut out competitors.

Manipulating rivals' profitability can clearly be accomplished through a number of avenues, and is the very essence of business since in typical markets these "crimes" are indistinguishable from ordinary, healthy, competitive rivalry.

Theorists have undermined the justification for much antitrust activism. But more recently, the quite ordinary competitive market behavior of causing one's rivals to face higher costs has spawned a veritable academic industry devoted to identifying competitive strategies as means of "monopolization." But this approach seemingly amounts to old wine in new bottles. Unfortunately, antitrust regulators rarely atone for the punishment of conduct that is later recognized as beneficial or benign, and they will likely not express regret for their misrepresentations of today's alleged "evils."

The very act of competing aggressively can itself become a crime under theories of strategic predation. At best, a firm's guilt depends on an enforcer's opinion that its successful efforts to serve the market—and, hence, to force rivals to work harder—has a "dangerous probability of success" in creating a monopoly.[61] But the entire purpose of competition is to oust or supplant less-efficient rivals, leaving the least-cost producers in place. However, low price is not the only competitive feature of products: quality and other features are also manipulated to serve consumers. Consumer welfare depends on that market process, and the search for appropriate levels of these features must be regarded as part of the market's discovery process rather than treated with suspicion.

Moreover, as Donald Boudreaux illustrates: "All methods of raising rivals' costs depend on the ability of a predator to secure contracts that exclude its rivals. Such a result requires that the predator's rivals and its suppliers remain ignorant about its intentions."[62] Competitive markets routinely remedy that kind of ignorance.

Clearly, the alleged predator is never the only one capable of strategizing in a "predatory" manner. Self-interest and business survival will always involve working to outmaneuver any potential predator rather than remaining oblivious to its intentions. All market participants should be equally free to act in their own self-interest, as well as to mobilize capital markets and partners against a renegade firm's efforts to monopolize. Of course their joint efforts may themselves face antitrust scrutiny, meaning that antitrust law can actually stand in the way of the market's ability to police predatory elements. Cooperation with other businesses—even competitors—can be an essential tool in offsetting another firm's efforts at monopolization. But cooperation in self-defense can itself be a crime under antitrust law.

There is, however, one form of nonprice predatory behavior that genuinely is anti-consumer and anti-market: the seeking of government regulations that impose excessive burdens on rivals. That is nothing new. For example, Clean Air Act standards requiring coal-burning utilities to install sulfur scrubbers regardless of the sulfur content of the coal burned were implemented at the needless expense of low-sulfur plants.[63] This technique works in the antitrust arena as well and truly qualifies as "strategic predatory behavior." Bringing an antitrust suit against more-efficient rivals is itself one of the most effective ways of raising rivals' costs, as evidenced by a healthy and prosperous antitrust bar. If a "predator," that is, a low-cost producer, can be forced to keep prices high—either through fear of triggering an antitrust claim or by a court decision branding it a predator—then less-efficient competitors are protected. These efforts obviously differ in kind from competition that is confined to the marketplace.

10: Exploiting Technological Lock-In

The term "network effects" refers to the phenomenon peculiar to certain goods that

gain value with a greater number of users. Telephones or fax machines, for example, are useless if only one individual possesses one. But such machines become increasingly valuable as ownership spreads.[64] Some people worry that this value-in-adoption mechanism can lead to inefficient products becoming locked in, either inadvertently or by scheming manufacturers, merely because a lot of people happen to use them or because someone got a head start. Microsoft's Windows operating system and AOL's Instant Messenger are prominent examples. In recent statements on merger policy, the FTC has indicated its intention to "apply heightened scrutiny to the assessment of competitive conduct" within markets exhibiting network effects, the premise being that inefficient products can become locked in.[65] Judge Jackson in his findings of fact claimed that Microsoft worked to sustain an "applications barrier to entry," which is a variant of network effect.[66]

The FTC, as well as the Justice Department's Antitrust Division, clearly believe they are qualified to substitute their choices for market outcomes and to successfully arbitrate among technological paths. Yet there is no example in the marketplace of network effects leading to the lock-in of an inferior technology, absent a governmentally established franchise.

The victory of the QWERTY typewriter keyboard layout is universally presented as an example of bad technology winning out over superior alternatives. But tests of competing keyboards in the early days of the typewriter proved QWERTY to be inferior to none, and the story of lock-in of inferior technology to be just a myth.[67] Even today, if competing key layouts were truly ergonomically superior, large companies could switch to save money. Such switching of keyboard layouts can be done instantly on all of today's computers. But people don't bother.

Other examples of network externalities leading to lock-in are equally flawed. Betamax videotape was not inferior to the VHS: both used the same underlying technology, and they had a patent-sharing agreement.[68] Both, however, were superior to the "locked-in" reel-to-reel systems they replaced. For typical office word processing and spreadsheet functions, the higher expense of Macintosh computers in relation to Windows/DOS machines has been hard to justify, particularly given that Apple requires reliance on one vendor for both the hardware and the operating system. Both types of computer, however, are superior to the "locked-in" slide rules, calculators, and mainframes they replaced.

A world of "inefficient lock-in" would be one without compact disks and players, because everyone would already own vinyl records. Cars couldn't emerge since there would be no gas stations. Color television broadcasting would never emerge because most homes would own black-and-white sets.

Theories of path dependence don't appreciate the fact that undesirable or inefficient "lock-in" presents a strong profit incentive for entrepreneurs to deliver a new standard. Indeed such incentives are a driver of technological innovation. For starters, entrepreneurs can offer rebates to those who trade in the old technology. Yet even if permanent, inefficient lock-in really existed, we should not substitute the politically motivated choices of government for the choices of millions of consumers. Governmentally imposed commandments in the technological marketplace, binding on all, would be the ultimate lock-in.

Conclusion

Antitrust law has long been perceived as taming the excesses of capitalism and the free market and thereby protecting consumers. But the law's creation and enforcement are rife with tales of its transformation into a tool for regulatory excess. Indeed, many of the practices disparaged by antitrust regulation and targeted by enforcers are in fact good for both competition and consumers—albeit bad for competitors. Particularly in the new informa-

Even if permanent, inefficient lock-in really existed, we should not substitute the politically motivated choices of government for the choices of millions of consumers.

tion economy, conventional thinking regarding smokestack era antitrust law and the allegedly harmful practices it targets must be challenged. Antitrust, in the final analysis, is now and has always been just another form of inefficient economic regulation.

Notes

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