Readings

Competing Competitive Policies

The Law and Economics of Competition Policy
edited by Frank Mathewson, Michael Trebilock, and Michael Walker
(Fraser Institute, 1990), 441 pp.

Reviewed by George Bittlingmayer

If competition policy were merely a matter of passing laws, Canada would have been ahead of the United States from the beginning. Canada's Anticombines Act, which prohibits combinations that "unduly" lessen competition, predates the 1890 Sherman Act by one year. Mergers and monopolization that would hurt consumers *or* producers were added as offenses in 1910, four years before the Clayton and FTC Acts became law in the United States. Canada outlawed predatory pricing and price discrimination in 1935, one year before the Robinson-Patman Act saw the light of day.

Canada's lead in antitrust legislation turned to outright contradiction in 1952, however, when Canada prohibited resale price maintenance (RPM) at the same time that American legislators made it easier for manufacturers in fair-trade states to enforce uniform resale prices. The United States did not close this embarrassing gap until the Miller-Tydings Act was repealed in 1975.

But statutory development is one thing; actual enforcement is another. Until the 1970s, Canadian antitrust enforcement focused on a smattering of cartel cases and a heavy dose of RPM actions. In practice, Americans were much more serious about big time trust-busting. But this changed in 1975, when undue restraint of trade in services as well as goods, vertical restrictions, and bid-rigging were added to the list of offenses in Canada.

The 1986 Competition Act went even further. It bolstered anticartel provisions that had been weakened by the courts, and it added substantial control of mergers and of "abusive" practices. These amendments also resulted in more active enforcement, which led to a 1988 Fraser Institute conference that was designed to expose "the competition bar in Canada, growing in numbers, to a lively and scholarly set of papers that reflect the current learning in legal and economic circles on competition matters."

The organizers can take credit for scoring a bull's-eye. The resulting conference volume contains an impressive assembly of lawyers and economists from Canada and the United States, who offer a cornucopia of sage, but often conflicting, advice and analysis for what will undoubtedly be a Canadian growth industry.

Michael Trebilock's essay on the evolution of competition policy compares and contrasts Canadian, American, and European approaches to regulating competition and monopoly. Antitrust is coming into its own outside the United States, but the emerging differences on a range of issues—the treatment of vertical restrictions, private enforcement, treble or single damages, the role of antitrust agencies, and the use of per se and rule-of-reason approaches—offer fertile ground for empirical work.

William Baxter delivers with exquisite irony a dissection of the prohibitions against "bad acts" in U.S. law. The most obvious bad act, charging the profit-maximizing price, is legal. "If simple monopoly pricing is removed from the category of bad acts," he asks, "what is left? One embarrassing answer is price discrimination." His major thematic point, namely that the law currently puts excessive emphasis on whether ownership or contract is used to effect integration, will undoubtedly surface again and again in legal research and economically oriented jurisprudence.

The problem of innovation, which is typically treated as an awkward afterthought in economic approaches to antitrust, is placed on center stage in Reuven Brenner's paper. He supplements insightful and idiosyncratic analysis with a wonderful collection of obscure but instructive antitrust vignettes. For example, the first liquid synthetic detergent,

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Lestoil, languished until the firm advertised heavily, offered retailers a 26 percent margin, and insisted on no discounting. Brenner also advances a new interpretation of the 1931 *Cracking Patents* case: the cross licensing of a set of related oil refining patents was a response to poorly defined patent rights and to the resulting patent disputes.

John L. Howard and William Stanbury offer to fill the alleged yawning gap in Canadian policy on the "oligopoly problem." Despite a welter of learning that includes 116 footnotes and 278 references for 42 pages of text, the authors offer no evidence that Canadians are in fact beset by tacitly colluding oligopolists. Indeed, I doubt that the prices, products, and innovations available to 27 million Canadians, half of whom live an hour's drive from the U.S. border, are seriously restricted by Canadian oligopolists, unless, of course, the Canadian government is helping them out. Discussant David Scheffman, former head of the U.S. Federal Trade Commission's Bureau of Economics, commented, "The problem you want to address may be out there somewhere, but we haven't seen it." Moreover, if "conscious parallelism" were a problem, what, short of drastic structural changes, would the remedy be?

First prize for best title in this collection is shared by Lester Telser ("Competition: Master or Servant?") and Donald Armstrong ("My Lady of the Law Is No Economist, My Lady of Competition Law Is No Lady"). Using game-theoretic concepts, Telser illustrates that a competitive equilibrium may not exist, but that appropriate restrictions on competition may make an efficient outcome feasible. This is, or should be, an uncomfortable insight for defenders of per se rules.

Armstrong employs familiar economic notions to make a related point. Industries producing homogeneous products with high fixed costs will not be able to recover all costs with competitive, marginal-cost pricing if slack capacity is required on average to meet peak demand. For the record, J.M. Clark said the same thing 50 years ago, and Telser and William Sharkey of Bell Labs have derived careful theoretical results on the existence of competitive equilibria in industries with fixed costs and variable demand. But it is nice to see a completely different approach leading to the same conclusion.

Interestingly, Armstrong's discussant, Donald Thompson, objects not one whit to this scenario of "destructive competition," which has been a favorite source of derisive merriment for generations of U.S. economists. There is a distinctive Canadian approach to competition policy, even among economists, suggesting that attitudes toward antitrust are partly cultural and political baggage, and not merely the result of lofty scientific cognition.

Herbert Hovenkamp offers as a definition of market power "the ability of a firm to make a profit by raising its price to unacceptably high levels." He defends this alternative against the neoclassical, 1984 Department of Justice Merger Guideline definition that emphasizes market reaction to a small, permanent increase in price. The summary of the law and economics of vertical restraints by Frank Mathewson and Ralph Winter mirrors the unbalanced literature in this area—large doses of theory and selected cases, but little systematic evidence. Donald McFetridge reviews the predatory pricing debate, Espen Eckbo shows how stock market data can be used to analyze the effect of mergers on competition, Frederick Warren-Boulton offers the modest advice that antitrust officials should "concentrate on what we can do best and then stop," and Benjamin Klein emphasizes that down-to-earth economics should be used in the courtroom. The logic of including Sir Alan Walters' lively defense of U.K. deregulation and privatization escapes me.

These papers will no doubt help Canada's competition bar grapple with the business generated by the 1986 Competition Act. Economists should also benefit since Canadian lawyers will now know that there exists expert economic advice for all antitrust occasions. But I am disappointed that the Fraser Institute did not set its sights higher. For example, how much worse off or better off was Canada for having lagged behind the United States for most of the last century in enforcing its antitrust laws? Was there a palpable monopoly problem in Canada before 1986? Imagine a conference volume spawned by new import restrictions or across-the-board increases in protection for agriculture without at least one paper's saying, "Thanks, but no thanks, we were doing just fine," and offering supporting evidence. Or imagine such a volume without a paper looking at the political economy of the new legislation asking, for example, "Is competition policy a type of economic regulation unto itself?"

A decade of evidence on who wins and who loses from competition policy as actually practiced will have accumulated by 1996. Perhaps a conference volume by the Fraser Institute marking the tenth anniversary of the Competition Act will put that evidence to good use.

Debating the S&L Debacle

The Great Savings and Loan Debacle
by James R. Barth
(American Enterprise Institute, 1991), 177 pp.

Reviewed by Dan Brumbaugh

Two respected economists have published books this year on the savings and loan debacle. Their perspectives are richer than most because both of them also held high positions in the chief federal regulatory agency for savings and loans. Although each book is excellent in its own right, the contrast in the conclusions of the two books about the causes and cures of the savings and loan problem makes them fascinating.

James R. Barth has written *The Great Savings and Loan Debacle* and Lawrence J. White has written *The S&L Debacle: Public Policy Lessons for Bank and Thrift Regulation*, which was reviewed in the Winter 1991 issue of *Regulation*. From 1987 to 1989 Barth, now a professor of finance at Auburn University, was chief economist at the Federal Home Loan Bank Board and its successor, the Office of Thrift Supervision. He was also a visiting scholar at the bank board in 1984 and 1985. From 1986 to 1989 White, now a professor of finance at New York University, was a member of the bank board.

These two books should be in the library of anyone attempting to understand what is happening, not only with savings and loans, but also with commercial banks and deposit-insurance reform. Only a few other books belong in one's S&L library. Andrew S. Carron's two books, *The Plight of the Thrift Institutions* and *The Rescue of the Thrift Institutions*, are excellent treatments of the interest-rate crisis of the early 1980s. Edward J. Kane's two books, *The Gathering Crisis in Federal Deposit Insurance* and *The S&L Insurance Mess: How Did It Happen?*, reveal Kane's early insights into a wide range of issues that still baffle many analysts.

The titles of these book suggest that we are dealing with a plight, followed by a temporary rescue, and a gathering crisis that turned into a mess, then a debacle, and finally a great debacle. What is most intriguing about the two newest books is that Barth and White have come to completely different conclusions about the causes and cures of what they both consider to be the savings and loan debacle.

"I did a thorough examination.... Nice carpet... Liked the wallpaper, too."

For example, White asserts: "The accounting system that generates the basic financial information for bank and thrift regulation must be changed. This is *the* most important reform." The word *the* is underlined in my prepublication copy of White's book. Although White pays appropriate attention to the pluses and minuses of other reform components, he holds as central the need for market-value accounting in any reform.

But Barth observes that "all the savings and loans that were resolved throughout the 1980s had *reported* their insolvency for years before finally being resolved. The 205 institutions resolved in 1988, for example, had reported being insolvent, on average for forty months, or three and a half years." Again, the italicized word *reported* appears in the text. Barth is thus throwing down the gauntlet, challenging the importance of market-value accounting.

Barth is essentially saying that market-value accounting cannot be as important as White asserts if reported historical-cost accounting measures of net worth identify insolvent savings and loans, and they are still not closed. The implication is clear: if savings and loans were open and operating while reporting insolvency based on historical cost accounting, then more insolvent savings and loans would have been open longer if insolvency were calculated by market-value accounting. It would indeed be enlightening to know what the bank board would have done with market-value accounting data, given what they did not do with historical-cost accounting data.

Barth concludes that the main lesson to be learned from the debacle is that savings and loans "must be able to respond to changing market forces

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through an evolving institutional design . . . [and] if they operate with federally insured deposits, they must always be adequately capitalized. It is owner-contributed equity capital, not activity and ownership restrictions, that ultimately protects taxpayers." For Barth the central issue is that federally insured savings and loans, and really all depositories, should have the freedom to adapt to changing market conditions as long as they are adequately capitalized. Trouble arises when capital erodes, he thinks, and no federally insured depository should be allowed to remain open without adequate equity capital.

Thus, the distinction between Barth and White becomes even more stark. White emphasizes that the deposit insurer should be armed with market-value accounting to respond more quickly and effectively if deterioration in the performance of an insured depository occurs. Barth's position is that this is essentially nonsense because regulators have not acted appropriately even when historical-cost accounting revealed deterioration.

This debate between two knowledgeable economists with regulatory experience is important at the moment partly because it punctures a prominent conceit. The Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) of 1989 requires the formation of a presidential commission to study the savings and loan debacle. The *New York Times* has editorialized that the commission is a waste of time because the causes of the debacle are well understood—primarily fraud, mismanagement, and deregulation. The causes being well understood, according to the *Times* and others, Congress should just get on with fixing the mess. One of the Senate sponsors of the commission has sheepishly said that the legislation was not his most shining moment. The significant differences between White and Barth suggest that such a commission may be an excellent idea precisely because a consensus among thoughtful analysts has not yet emerged. Barth, a Republican, and White, a Democrat, would be appropriate commission members.

If the two economists are not selected for the commission, the commission should be locked up with the two economists' books when the commission first meets. The Barth book begins with a historical perspective that is relevant to their deliberations. He points out, for example, that from 1900 to 1980 the share of financial assets held by private and public pension funds, finance companies, nonlife insurance companies, money market mutual funds, and mutual funds grew from 3 percent to 30 percent of U.S. financial assets held by financial services firms.

Barth suggests that the policy reaction to this growing competition from nondepositories was inappropriate, because evolving policies made it more difficult for depositories to adapt to the competition. Adjustable-rate mortgages for federally insured savings and loans were forbidden until 1981, for example. Rather than allowing insured depositories to adapt to competition with fewer activity restrictions, the net regulatory carapace became thicker.

Historical examples are most instructive when they become part of a pattern that endures. As Barth shows, the share of U.S. financial assets held by U.S. chartered commercial banks has fallen from 66 percent in 1900 to 24 percent in 1989, with a significant decline in the past 10 years. The savings and loan share fell from 15 percent in 1980 to 12 percent in 1989. The mutual savings banks' share declined over the 1980s, and the credit unions' share has declined since 1988. The Speaker of the House is reported to oppose the development of a banking bill this year that would address activity relaxation. So the carapace is likely to remain.

Barth relies heavily on data that he presents well to buttress his points. (In fact, a lot of people rely on Barth's data. I counted 13 tables in White's book, for example, and 3 tables in Kane's 1989 book that report Barth as the tables' major source.) An important debate centers on the role of state versus federal charters and stock versus mutual forms of ownership in the savings and loan debacle. White emphasizes, for example, the disproportionate costs imposed on the savings and loan insurance fund because state charters provided powers beyond those provided by federal charters. Barth emphasizes ownership form by pointing out that stock-type savings and loans accounted for 77 percent of the total estimated present-value costs from 1980 through 1988. Barth's cost data are new. The implication is that incentives created by stock ownership are more important than allowable activities.

To develop this point further Barth presents new data on growth by charter and ownership form. He sets up this section of his book by showing how reduced capital requirements in the early to mid-1980s allowed, among other things, a new stock-type institution to lever $2.0 million in owner-contributed equity capital into $1.3 billion in assets by the end of its first year in operation. It is not surprising then to find that federal and state stock savings and loans grew substantially while federal and state mutuals were growing slowly or shrinking.

In 1984, for example, federal and state stock savings and loans' assets grew 83 percent and 61 percent, respecively, while federal and state mutuals' assets changed by −14 percent and 8 percent, respectively.

Barth also presents an illuminating summary of cost estimates of resolving insolvent savings and loans. The bank board's estimates from 1985 onward were consistently and substantially lower than those outside estimates that proved to be most accurate. The Federal Savings and Loan Insurance Corporation was insolvent long before the bank board was willing to admit it. This is an instructive reminder, given the current debate about whether the Bank Insurance Fund is solvent.

The savings and loan problem has been with us for 11 years and has metamorphosed into the federally insured depository debacle with profound problems in all three deposit-insurance agencies and among all the insured depositories. When big problems lumber along for many years, we tend to become inured to them and complacently accept the most frequently repeated reasons for their causes and cures. *The Great Savings and Loan Debacle* by James Barth in many ways breaks the big problem into a number of more manageable pieces and presents original interpretations of them. It is a useful book for anyone whose imagination needs a jump start in thinking through this true debacle.