Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

Scrapping Antitrust Laws

TO THE EDITOR:

In commenting on my article, "The Origins of Antitrust: Rhetoric vs. Reality" (Vol. 13, No. 3, 1990), Justice Department attorney Gregory J. Werden constructs a straw man argument. He attributes to me the assertion that the Sherman Act is "blatantly protectionist," and then cites a few antitrust cases that in his opinion were not. Of course, I could cite hundreds of other cases that were indeed protectionist, including a number of ongoing cases brought by the Bush Justice Department and the FTC. The point of my article was not that every single Sherman Act case is inherently protectionist; my claim was that evidence suggests that the 1890 act was itself a "figleaf" designed to cover up the real source of monopoly—the tariff on manufactures—which was passed just three months after the Sherman Act and sponsored by Senator Sherman himself. In light of this interpretation, I argued, it should be no surprise that for over a century the Sherman Act has indeed been frequently (not always) used to thwart competition.

I disagree heartily with Mr. Werden's statement that the history of antitrust is "unrelated to the policy issues presented to antitrust today." The whole debate over whether antitrust should be "reformed" or scrapped revolves partly around the issue of the historical purpose of the law. Research on the history of the Interstate Commerce Commission as a government-enforced price-fixing cartel surely had an impact on deregulatory policy in the transportation industry, just as historical research is also relevant to contemporary antitrust policy. I do not take seriously the argument advanced by Mr. Werden that policymakers have nothing to learn from history.

Mr. Werden's point that "Congress did not outlaw the trusts" is disingenuous. Of course, it did not; antitrust regulation greatly enhanced the power of Congress to exert its control over private business. For over a century Congress has used antitrust as a means of soliciting campaign contributions from actual or potential victims of antitrust as well as using the laws to protect businesses in their congressional districts from competition (by blocking takeovers, for example). Why would Congress outlaw a particular form of business organization when there is so much political "profit" to be made by regulating it instead? A similar explanation can be given for why the Sherman Act is nebulous, as Mr. Werden points out. A nebulous law gives legislators more latitude to adapt it to their own political uses. Thus, I disagree with Mr. Werden's assertion that "[f]rom a policy perspective, the issue is what Congress actually did rather than why it was done." An understanding of the *political economy* of antitrust is necessary if we are to understand the nature of antitrust and its potential for harming rather than benefitting society.

Professor Stephen Calkins of the Wayne State University Law School seems to agree with me that the Sherman Act was a "smoke screen." He then writes "in praise of smoke screens" to advocate active antitrust regulation on the grounds that such activism would allegedly prevent worse kinds of regulation. This is similar to the argument made by antitrust apologists in the early part of this century that antitrust is desirable because without it the public might demand something worse—socialism. The problem with both these arguments is that they fail to incorporate any kind of understanding of the public choice process.

Because it interferes with freedom of contract within the rule of law, antitrust regulation is an impediment to economic efficiency. Typically, government's proposed "solutions" to sluggish economic growth caused by misguided regulation are more government controls and regulations. Thus, regulation tends to beget even more harmful regulation by rendering industry less competitive, which gives rise to political demands for more intervention, which does even more damage to industry. The cycle is repeated until things become so bad, as they did by the late 1970s, that there are demands for deregulation. If the best argument for antitrust regulation legal scholars can devise is that it is a useful tool for deceiving the public with political "smoke screens," then it really is time to scrap the antitrust laws.

Finally, what Professor Calkins calls an "irony" I consider to be merely a matter of course. He points out that the article by William Shughart in the same issue shows that private antitrust enforcement is characterized by "the frequency with which firms bring suits against their competitors." "If Professor DiLorenzo is correct," he writes, "this is exactly what Congress intended!" Exactly.

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In Defense of Antitrust

TO THE EDITOR:

Several articles in the Fall 1990 issue of *Regulation* disparage antitrust so much that many readers must wonder how the country has survived 100 years of antitrust enforcement. These articles bring to mind an observation on capitalism by Sir Alan Patrick Herbert in 1935: "They tell us that capitalism is doomed; Karl Marx, I believe, made the same announcement 80 years ago. He may still be right: but the old clock ticks on." As with capitalism, the longevity of the antitrust laws in the United States, along with their popular support, suggests that the antitrust laws improve social welfare. Although antitrust enforcement has its costs, anti-

trust as a whole likely benefits both businesses and consumers.

The attack on antitrust began with "Revisiting the Origins of Antitrust" by Thomas DiLorenzo. The article claims that "the antitrust laws restrain output and the growth of productivity, have contributed to the deterioration of the competitive position of U.S. industry, and are routinely used to subvert competition." Yet the article presents no evidence to support these conclusions.

Instead the article argues that the Sherman Act was passed as protectionist legislation for small businesses. But others, such as Robert Lande, have reviewed similar evidence and concluded that the Sherman Act was passed to protect consumer interests. Yet others, such as Robert Bork, claim that the act seeks to promote economic efficiency—the sum of consumer welfare and producer welfare. In fact, all these likely contributed to the coalition that passed the act.

Divining the origins of the Sherman Act is now largely an academic exercise. The law remains because Congress implicitly accepts judicial interpretations, which have varied greatly over the past century. The variability in decisions has two sources. First, as economic theory and empirical evidence develop, our understanding of markets and business practices evolves. Second, the Sherman Act and most of the other antitrust laws are flexible statutes that allow courts to reinterpret the laws as new evidence comes forth about the competitive effects of various business practices. Courts correctly adopt the new positions as a consensus forms, although mistakes along the way are inevitable. The changing positions do create some uncertainty, but the mistakes can be toward enforcement that is excessively lax as well as toward enforcement that is excessively vigorous.

This flexibility is acknowledged in "Innovation, Dynamic Competition, and Antitrust Policy" by Thomas Jorde and David Teece. Their thesis is that antitrust looks at markets only within a snap-shot, or single period. By doing so, antitrust misses the dynamics of market competition and overlooks the most important competitive threat: radical innovation. Moreover, they argue, innovation requires complements that are often found in different firms; therefore, cooperation among competitors through joint ventures or other methods is necessary for innovation. Antitrust blocks this cooperation because it focuses on the short run.

A number of past antitrust cases may have been ill-founded and may have discouraged innovation. There is little evidence, however, showing that U.S. antitrust laws significantly reduce efficient cooperation among competitors and thereby reduce innovation. And there are examples of innovative arrangements that have been allowed under the antitrust laws. For instance, the FTC permitted GM and Toyota to form a joint venture in Fremont, California, to share management and manufacturing technologies. The collaboration was allowed within the context of existing antitrust law, while preventing possible anticompetitive price coordination.

Moreover, antitrust statutes have evolved. In fact, Jorde and Teece's example of the research and development joint ventures allowed by the National Cooperation and Research Act (NCRA) illustrates the point. This law was passed under the expressed recognition that such pooling of R&D activities may often be procompetitive. Such activities, however, could also be used to restrict competition, as suggested by Michael Porter in his recent book, *Comparative Advantage of Nations*. Giving partial shelter from antitrust laws may be quite appropriate, but giving all joint ventures carte blanche with regard to coordination does not appear to be in the interest of competition. Despite firms' slow starts in applying for registration, the NCRA has received 86 applications in 1989 and 1990, which indicates that this evolution in antitrust law appears to be responsive to the needs of business.

Jorde and Teece propose seven additional reforms to make antitrust less hostile to innovation. First, market definition should be tailored to the context of innovation and should consider the market for know-how. Second, rule-of-reason analysis should consider the appropriability and complements necessary for innovation. Third, a safe harbor should be set for horizontal agreements among competitors that comprise less than 20 percent of a market. Fourth, antitrust law should not bias the choice between horizontal agreements and mergers. Fifth, the NCRA should be amended to include joint production efforts to commercialize innovations. Sixth, a certification procedure should be adopted for agreements among firms with market shares above 20 percent when the agreements promote innovation. Liability for such agreements should be limited to equitable relief and attorney's fees awarded to the prevailing party.

Jorde and Teece correctly point out that the first four of their proposals could be adopted by judicial decision without new legislation. But before adopting the Jorde and Teece position, courts will have to be persuaded that such changes are in the public interest. Hence, economists and other researchers will have to garner evidence indicating that the proposed changes are desirable, evidence similar to that which shaped the passage of the NCRA.

On this point, the evidence in their article concerning Japan is not persuasive. There are many exemptions from the antitrust laws in Japan, and most have some rationale that they promote innovation or some other competitive-sounding goal. The result, however, is often greater entry restrictions. For many goods and services, Japanese consumers pay signficantly higher prices than do consumers in the United States—probably in part because of such restrictions. Although Japanese businesses have benefitted from antitrust exemptions, the benefits appear to have been paid for by Japanese consumers. It is not obvious that the United States, especially U.S. consumers, would be better off by granting additional exemptions to the antitrust laws.

In "Turning Back the Antitrust Clock," Donald Boudreaux advocates that "the courts should ignore predation claims." Hence, he makes another call to limit antitrust. This call, however, is misplaced. Current economic theory indicates that predation can be a profitable strategy, and some cases prove that at least nonprice predation in fact occurs.

Predatory pricing provides an example of how our understanding of an antitrust issue has developed over time. At one time there was a common perception that large firms would price "below cost" to drive competitors out of the market. Once the competitors had exited, large firms could raise their prices to monopoly levels.

Many years ago, Aaron Director and his students led the attack on this naive analysis. The predominant view by economists a decade ago was that predatory pricing was not very likely because the losses of the large firm selling below cost would be much greater than the losses of

the small competitors. Thus, price predation may not be profitable. In addition, even if the large firm drove smaller rivals out of the market, the capacity of the smaller firm would often remain in the market. If prices rose above competitive levels, another firm could then use the capacity and compete again, thus reducing the profitability of price predation. These fundamental economic concerns about price predation have not escaped the attention of the courts, as evidenced by the Supreme Court's *Matsushita* decision in 1986. The Court dismissed the allegation that Japanese TV makers had been practicing predatory pricing against U.S. firms for 20 years for the reason that such an allegation made no sense because the Japanese could never adequately recoup their alleged losses.

Economic theory has continued to develop conditions under which price predation is a profitable strategy. The key to these theories is that the firms subject to predatory pricing do not know the cost of the predator, usually the largest firm in the market. If the largest firm can fool the victims of predation into thinking that the predator has a cost advantage, then predation could be successful. This "asymmetric" information situation could occur, although it remains to be seen how often.

For an illustration, consider a monopolist who produces in ten separate markets. A monopolist might practice predatory pricing against entrants in one or two markets to develop a reputation for predation and thereby prevent entry in the other markets. Such behavior might be profitable, depending on the relative costs of the firms, the discount rate, the nature of sunk costs, and whether the predator has more information on costs than the entrants. Thus, economic theory can now describe the facts necessary to determine whether predation can be profitable. If a specific fact situation fits the necessary conditions, then it would be appropriate for antitrust officials to investigate to determine whether price predation exists.

Nonprice predation can also be a profitable strategy. Boudreaux takes issue with the coffee case and the cereals case as examples of nonprice predation. But these cases are also examples of when our legal system worked. The FTC dropped both of these cases once it had developed a record. Such cases can be costly for the participants, but they taught the antitrust agencies and other potential plaintiffs that strong evidence of anticompetitive behavior is needed before any such case is pursued.

Other cases have demonstrated that nonprice predation can occur and that the antitrust laws can prohibit anticompetitive predation. The FTC's AMERCO case is one example. In AMERCO, the parent of U-Haul, U-Haul was a creditor of its primary competitor, Jartran. U-Haul took actions in bankruptcy proceedings that kept Jartran from reorganizing under Chapter 11 and returning as an effective competitor, actions that were also inconsistent with U-Haul's interest as a creditor. An FTC consent order now prevents AMERCO and U-Haul from using such tactics in the future. It is irrelevant whether one calls such a scenario monopolization, nonprice predation, or raising rivals' costs. The antitrust laws prohibit such behavior, and consumers (and producers such as Jartran) are made better off by the prohibition.

Private antitrust enforcement comes under attack in "Private Antitrust Enforcement: Compensation, Deterrence, or Extortion?" by William Shughart II. His article suggests that the predominant effect of private antitrust enforcement is to subvert competition. To any extent that enforcement reduces competition (if it does), the reduced competition represents a cost to antitrust. But what about the benefits of our private enforcement mechanism? Two come to mind.

First, several of the articles discussed here point out that the government is the best granter of monopoly. Why should we entrust the government with a monopoly to enforce the antitrust laws? In Japan private plaintiffs cannot receive treble damages, and private complaints are rare. Perhaps not coincidentally, the Japanese Fair Trade Commission has been criticized for its lack of antitrust enforcement. This may be the reason that Japanese consumers pay significantly higher prices than do U.S. consumers. Competition may be appropriate in civil law enforcement as well as in economic markets.

Second, given asymmetric information between anticompetitive firms and their victims, treble damages for private plaintiffs may be efficient. Treble damages provide plaintiffs with an incentive to try challenging cases. Treble damages may also limit anticompetitive effects from collusion. Colluders may have a greater incentive to limit price increases to prevent detection of collusion. Similarly, a lower collusive price reduces the amount of damages if caught.

Although some private suits obviously do not advance competition, this does not mean that private enforcement is undesirable. Consider, for example, the findings of Pauline Ippolito's study of retail price maintenance (RPM) cases that Shughart discussed. The study points out that about one-third of private cases from 1975 through 1982 alleged maximum RPM as a violation, even though there is little or no economic rationale for showing that maximum RPM damages competition. But such a problem existed because courts had not yet acknowledged the potential benefits of RPM, not because private antitrust is inherently bad.

In summary, antitrust is alive and dynamic. It has stumbled and taken some wrong turns as it has grown up, and may do so again in the future. This, however, does not mean that antitrust is a social evil to be eradicated. Those who advocate abolition of or limitations on antitrust should seriously consider the potential benefits of the legislation that they attack.

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