

# PUBLIC CHOICE AND ANTITRUST

*Robert D. Tollison*

## I. Introduction

The field of antitrust and industrial economics is one of the last bastions of the economics profession to be untouched by the public choice revolution. Economic analysis in this area proceeds in roughly the following way. First, the efficiency of market arrangements and organizations is analyzed. Second, those markets found wanting on the efficiency scorecard are assigned to government, through an antitrust case, to correct. The first step in this process is unobjectionable and represents one of the richest applied parts of modern economics. The second part is weak because it rests on a public interest theory of government. A market failure (monopoly) is found in the private sector, and government (an unexamined alternative) is invoked to correct it. Judges and antitrust bureaucrats are assumed to operate in the public interest, which in this case means the promotion of economic efficiency in the economy.

This is not a very useful way to approach antitrust (or any other) economic analysis. As a positive theory, it is wrong. As many critics have shown, the historical record of antitrust decisions will not support the public interest theory. If we are to understand the course of antitrust better, the behavior of the relevant actors must be made endogenous to our explanation of antitrust outcomes. As a normative basis for criticizing antitrust, the public interest approach is not very helpful. When all is said and done and government is not following one's conception of the public interest in antitrust, we are reduced to such tried and true nonsense as "better people make better government." Change the decision makers and the policy will change. This sounds good but it never seems to work. Government cranks

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along by an internal logic of its own, which in this case we do not know because we have not tried to find out what it is. If we want to have a powerful critique of antitrust, the first thing that must be done is to achieve a positive understanding of how antitrust decision makers behave. Launched from such a platform, antitrust criticism and reform can be more effective.

My interest in this paper is to review the state of the (small) art with respect to developing a positive public choice theory of antitrust and to illustrate the potential of this approach. In Section II, I offer the reader a brief introduction to public choice. In Section III, I briefly outline the prevailing public interest approach to antitrust commentary. In Section IV, I survey some of the useful steps that have evolved in the literature away from the public-interest perspective. In Section V, I present some of the literature directly on the positive economics of antitrust and detail a couple of examples of the approach. Finally, in Section VI, I offer some concluding remarks.

One caveat is in order at the outset. I have not tried to be copious in my search of the literature. As a result, I have undoubtedly missed work that bears on the issues of this paper. My apologies are offered in advance for any glaring omissions.

## II. Public Choice

“Public choice” refers to a revolution in the way government is analyzed. Before public choice, government was treated as exogenous to the economy, a benign corrector of the market economy when it faltered. After public choice, the role of government in the economy became something to be explained, not assumed. As a result of the public choice revolution, economists now place government failure alongside market failure as a useful category of analysis.<sup>1</sup>

What is public choice? I advance my own particular answer to the question. Public choice is an expansion of the explanatory domain of economic theory. Traditional economic analysis uses the apparatus of economic theory to explain the behavior of individuals in private settings. Public choice represents the use of standard economic tools (demand and supply) to explain behavior in nonmarket environments, such as government.

This expansion of economic theory is based on a simple idea. Individuals are the same people whether they are behaving in a market or nonmarket context. The person who votes also buys

<sup>1</sup>See Mueller (1979) and Buchanan and Tollison (1984) for useful surveys of public choice research.

groceries; the workers in government bureaucracies do not have radically different temperaments from workers in corporations; and so on. There is no Dr. Jekyll and Mr. Hyde dichotomy in economic behavior whereby we behave one way in the private sector and another way in the public sector. As a practical working hypothesis, individuals seek to promote their self-interest in any given situation. Public choice represents the application of this axiom to behavior in nonmarket settings. This approach has been employed by public choice analysts to explain the behavior of voters, bureaucrats, politicians, interest groups, and other political actors and organizations.

Obviously, this is not an argument that rational behavior in private and public settings leads to the same types of outcomes. The result of self-interest in government manifests itself in a different way than elsewhere because the constraints on individual behavior are different. The managers of a private corporation and a government bureau behave differently, not because they are different people but because the rules that govern their behavior are different. This is a simple but important point.

Finally, note that public choice closes the behavioral system of economic analysis (Buchanan 1972). It incorporates the behavior of government actors into economic theory, and it pushes us beyond the Pigovian fantasy that the market is guided by private interest and the government is guided by public interest. It is this step that is sorely needed in the field of antitrust and industrial organization.

### III. The Antitrusters' View of Government

There is a nearly unanimous tendency in antitrust commentary toward a *public interest theory of government*. In short, there is an implicit and unexamined view in the literature that antitrust decision makers are benign seekers of the public interest. If they knew better, they would do better. This case can be made without much effort by drawing selective references from the literature.

The primary U.S. antitrust statutes—the Sherman Antitrust Act (1890), the Clayton Antitrust Act (1914), and the Federal Trade Commission Act (1914)—are largely seen as being without economic motivation. Rather they are seen as efforts by the Congress to protect the public interest (Bork 1966, p. 7). Moreover, the role of the antitrust bureaucrats put in place by this legislation is seen as that of maintaining a competitive economy (Bain 1968, p. 515). Scherer (1980, p. 491) summarizes when he observes that antitrust is “one of the more important weapons wielded by government in its effort to harmonize the profit-seeking behavior of private enterprises with the

public interest." In a similar vein Posner (1976, p. 4) suggests that the importance of economic efficiency as a social norm "establishes a prima facie case for having an antitrust policy." Neale and Goyder (1980, p. 441) put the matter as well as anyone when they observe that "it is tempting (and common) to regard the antitrust policy simply as a kind of economic engineering project."

I could go on in this vein, quoting famous students of antitrust of various ideological and methodological stripes, but the point is the same. Antitrust policy, whether discussed in terms of the origin of antitrust laws, the behavior of the antitrust bureaucracies, the behavior of judges, and so on, is predominantly discussed in public interest terms. The market fouls up; government corrects.

Of course, the public interest approach may be right, although the trenchancy of the antitrust critics with respect to selected policies and decisions seems to suggest that it is not. Moreover, the solutions that the public interest approach offers do not seem to work. The public interest approach says that more information or better people will lead to better antitrust. There is obviously some truth to such an argument, but it does not seem to be very important in the actual conduct of government affairs.

An alternative way to approach the problem is by the route of positive public choice. What can be said about the *actual* or *predicted* course of antitrust policy, as opposed to the *desired* course? By learning first about how antitrust decisions are actually made and how antitrust decision makers behave, we are surely in a better position to reform antitrust institutions—if that is what we want to do.

#### IV. Steps in the Right Direction

The idea that I espouse, the application of positive economics to antitrust issues, is not new. Efforts in this direction have just not been systematic, and they have been scattered around in the literature for some time. This section briefly reviews some of these early steps toward positive analysis.

##### *Empiricism*

One way to find out what antitrust authorities do is to look. In this spirit there have been several statistical studies of antitrust enforcement. The primary example is a paper by Posner (1970). Other studies include those by Stigler (1966), Gallo and Bush (1983), Clabault and Block (1981), Shughart and Tollison (forthcoming), Elzinga (1969), Asch and Seneca (1976), Hay and Kelley (1974), and Palmer (1972).

What can this approach teach us? Primarily, it can yield clues about the interworkings of the enforcement agencies. Shughart and

Tollison (forthcoming), for example, study the incidence of recidivism in Federal Trade Commission (FTC) enforcement activities since 1914. They find that the rate of repeat offenses is very high, constituting about one-quarter of historical agency enforcement actions. Why is this rate so high? Is it because it is bureaucratically easier to keep track of and to prosecute the same firms over time (cost-minimizing bureaucrats), or is it because offenders find it worthwhile to violate the antitrust laws repeatedly over time? While these questions cannot be resolved on purely empirical grounds, the data point to an interesting process in FTC enforcement to be explained. This is one way in which the empirical study of antitrust can be useful.

As Posner (1970, p. 419) concludes, "antitrust enforcement is inefficient and the first step toward improvement must be a greater interest in the dry subject of statistics."

#### *Organizational Behavior*

Another way to find out what antitrust authorities do is to ask them. This is essentially what Weaver (1977) and Katzman (1980) have done in providing organizational studies of the Antitrust Division of the U.S. Department of Justice and the FTC respectively. Both of these authors base their analyses on extensive interviews with agency staff. The primary value of such studies is that they point the way to a bureaucratic model of agency behavior. Katzman, for example, finds that the desire to gain trial experience biases FTC lawyers toward shorter and less complicated initiatives as opposed to the FTC economists who are for the most part long-term employees with an interest in more time-consuming structural assaults on industry. The moral is that personnel turnover patterns may provide an important clue about agency behavior.<sup>2</sup>

#### *Cost-Benefit Analysis*

There has been an attempt to apply cost-benefit analysis to antitrust case-bringing activity. The basic paper here is by Long, Schramm, and Tollison (1973), with follow-up studies by Asch (1975) and Siegfried (1975). The thrust of applying the cost-benefit approach to antitrust is interesting. On the benefit side, industries are ranked according to their estimated degree of deadweight costs attributable to monopoly power. The cost side is represented by the costs of legal action by the government. Cases are then targeted according to a rule of marginal benefit equal marginal cost until the enforcement budget is exhausted.

<sup>2</sup>Also see Clarkson and Muris (1981) for an organizational-type study of the FTC.

There are many pitfalls in such an idealized approach to antitrust. At the theoretical level, it is not clear, for example, how deterrent effects should be treated in the case-allocation decision. At a practical level, reliable empirical estimates of monopoly deadweight costs are hard to obtain, and legal action against firms and industries based on such evidence is probably not sustainable (antitrust as economic surgery seems out of fashion). For such reasons no one has ever pushed very hard on applying the cost-benefit calculus to antitrust problems. Long, Schramm, and Tollison (1973), however, find that the actual cases brought by the Justice Department do *not* correspond to what a welfare-loss model would imply. In other words, *ceteris paribus*, cases are not brought where welfare losses are higher. This is fairly strong evidence that the goal of antitrust enforcement is not linked closely to the economist's conception of social welfare.<sup>3</sup>

## V. Antitrust as a Problem in Positive Economics

The literature that takes the positive public choice approach to antitrust is small in quantity and admits of no easy organizing principle. In this section, accordingly, I first offer a brief survey of this literature and then produce two applications of the approach to illustrate more clearly its potentiality.

### *Explaining Antitrust*

The papers using the positive approach fall mainly into two broad categories. In the first category are papers that apply the so-called interest group theory of government to antitrust. In the second category are papers that seek to identify the winners and losers from particular antitrust actions.

The interest group theory of government, in its modern form, is normally credited to Stigler (1971). This theory suggests the forces by which some groups win at the expense of others in the political process. Efforts to model antitrust in this spirit include Stigler's (1984) attempt to explain the origin of the Sherman Antitrust Act, Baxter's (1980) insightful paper on the political economy of antitrust, the work of Faith, Leavens, and Tollison (1982) and of Weingast and Moran (1983) on the influence of congressional committees on FTC activities, a paper by Amacher et al. (forthcoming) on the counter-cyclical and cartelizing nature of historical antitrust enforcement

<sup>3</sup>In recent years the standard Harberger treatment of monopoly welfare loss has been modified by the concept of rent seeking. Briefly, rent seeking means that trapezoids and not triangles are the relevant geometrical unit of calculation for measuring welfare loss. For more details see Tollison (1982).

activity, and a paper by Higgins and McChesney (1983) explaining the FTC ad substantiation program in interest-group terms.

This small body of literature is distinguished by the development of a testable model of an antitrust process and a test of the model on available data. The main conclusion of this work seems to be that government works in this area much the same way as it works in others; namely, that antitrust is at least partly a veil over a wealth-transfer process fueled by *certain relevant interest groups*. Moreover, where the conventional wisdom points to policy failure to explain deviations in antitrust, this work suggests that the deviations are readily understandable as self-interested behavior under the relevant constraints. Thus, for example, the Robinson-Patman Act is not a mistake of antitrust policy but a rationally designed law to buffer certain firms against losses when aggregate demand falls.

The second category of positive literature looks directly at the wealth losses and gains from antitrust actions. These papers differ from those in the first category in that the unit of analysis is the firm and the concern is not with modeling the political process that guides antitrust. In a way this work can be seen as searching for important clues (who wins? who loses?) about the identity of the relevant interest groups that undergird antitrust activities. Important papers in this tradition are a study by Ellert (1976) of mergers and antimerger law enforcement, an examination by Burns (1977) of the famous oil and tobacco dissolutions in 1911, and a study by Ross (1984) of the origin of the Robinson-Patman Act suggesting that the wealth effects of the law and its enforcement transferred wealth from large chain stores to small firms and brokers. These papers are all heavily empirical, and, in particular, they employ capital market data to test hypotheses. This movement away from the reliance on accounting data is a heartening development in industrial organization research.

At base, then, the positive approach to antitrust analysis is represented by a *small body of literature*. Although I have undoubtedly missed some papers and other efforts, my aim is not to be comprehensive in reviewing the literature, but to show something about what has been done and, more important, what can be done.<sup>4</sup>

### *Dual Enforcement*

Antitrust laws in the United States are enforced by the Antitrust Division of the Department of Justice and by the FTC. The critical

<sup>4</sup>I should also mention a particular effort to study the FTC that grew out of my experience as director of the FTC's Bureau of Economics from 1981 to 1983. A group of my FTC colleagues and I undertook systematic studies of several aspects of FTC activities that will appear in Mackay, Miller, and Yandle (forthcoming).

literature on this dual enforcement system has been exclusively normative. Some observers have criticized the quality of FTC cases, and some have criticized the FTC internal procedure whereby commissioners sometimes sit as both prosecutors and judges for the same cases. Normally the brunt of dual-enforcement criticism is aimed at the FTC, with many calls being made for its abolition.

There is a prior problem, however, which is that of how well the dual-enforcement system works in practice. That is, what are the positive economics of dual enforcement? Higgins, Shughart, and Tollison (forthcoming) recently have tackled this problem. Their approach is simple. Dual enforcement can be modeled as an example of two bureaus competing with one another. Thus, Higgins, Shughart, and Tollison posit a model—the H-S-T model—of two budget-maximizing bureaus that behave according to Cournot output conjectures. The results of this analytical exercise are straightforward. Independent agency dual enforcement leads to more output (cases) per budget dollar than either single agency or collusive dual-agency enforcement. Begging the question for the moment of what is being produced, competition in government operates as it does anywhere else—it acts to increase output.

History provides a natural experiment for the H-S-T model. From 1890 to 1914 the Antitrust Division was the sole antitrust agency (single-agency enforcement). From 1914 to 1948 the FTC competed vigorously with the Antitrust Division (independent dual-agency enforcement). From 1948 to this day the two agencies have colluded under a liaison agreement with respect to who will bring what case or contest which merger (collusive dual-agency enforcement). Moreover, budget and output data are available for the two agencies for the years 1931 to the present. The model's implications about cases per budget dollar can therefore be tested.

Using the period 1932 to 1948 as the period of competition between the two agencies and the period 1948 to 1981 as the period of collusion, the H-S-T model has been used to compare mean annual case output, real budgets, and real output per budget dollar for the two agencies over the two periods. The authors have found that in the two periods, total cases remained roughly the same, but average cases per budget dollar fell substantially (by about half) in both organizations. This implies that more inputs were used per case in the period of collusion, or that, put another way, collusion led to increased rents to bureaucratic input suppliers (lawyers, economists).

Positive economics thus teaches us a familiar lesson in this application. For a given enforcement budget, independent dual enforcement will yield more cases per dollar spent. On such grounds one

may mount a serious scientific case for dual enforcement without collusion; that is, for scrapping the so-called liaison agreement. There remains, however, a major question: Are these agencies producing "goods" or "bads"? If the latter (as the first part of this paper more or less argued), single or collusive dual-agency enforcement would be preferred on the grounds of restricting the output of a "bad." If the former, then competition between the two bureaus is the best policy. Either way, however, a positive understanding of the implications of dual enforcement provides a basis for knowing what to recommend.

### *Antitrust and Jobs*

Time after time, regulatory programs have failed a cost-benefit test, and the econometric assault on regulation has spawned a significant regulatory reform movement in this country and abroad. For some reason, though, antitrust activities have largely escaped this type of careful, applied analysis.

In a recent paper Shughart and Tollison (1984) seek to take a first step toward remedying this situation. They propose to look at the impact of antitrust on the economy, and as a start, they look at the impact of antitrust on the level of unemployment. The purpose of this work is to try to achieve a preliminary understanding of how antitrust is related to basic economic welfare. Jobs seemed a good place to start in this regard.

The methodology used by Shughart and Tollison is quite simple. They searched the literature for a standard model of the unemployment rate in the United States and then augmented this model with a measure of antitrust activity—cases per real budget dollar brought per year by the Antitrust Division under the Sherman and Clayton Acts (a complete set of data is available for the 1947–81 period). Estimating this relationship by using ordinary least squares analysis reveals that over this period a 1 percent increase in Justice Department cases leads to a 0.17 percent increase in the economy's unemployment rate, *ceteris paribus*. Moreover, accounting for the fact that the aggregate economy and antitrust are jointly determined leaves this basic result intact.

The results yield to a natural interpretation. What Shughart and Tollison have found is an antitrust Phillips curve. When the model is run on definitions of expected (predicted) and unexpected (unpredicted) antitrust cases, it has been found that unexpected antitrust drives the result. This is analogous to unexpected money in the traditional Phillips relation. Furthermore, the numerical results are consistent in this specification of the problem. Using conservative

estimates, the Shughart-Tollison study suggests that over the 1947–81 period, a 1 percent increase in annual enforcement activity added about 7,000 individuals to the mean stock of unemployed persons in the economy.

Now to the important question: How can this be? If antitrust causes unemployment in one sector, will not these workers and resources find employment in an untargeted sector? The answer is yes where antitrust activities are predicted. If antitrust actions are accurately forecast, the indicated resource adjustments will take place. It is the unexpected component of antitrust that causes unemployment.

Consider the following hypothetical situation. Suddenly the merger rules are changed for large tire firms. New mergers are challenged under stricter rules and old mergers are dissolved. Firms react by reducing the optimal scale of tire production, laying off workers as planned production falls. Unemployment rises during the adjustment period. Other industries face similar antitrust uncertainty, and they expand less as a consequence. Economywide, the unemployment rate goes up and stays up owing to the uncertainty over being targeted for an antitrust complaint. This simple Phillips curve theory explains the Shughart-Tollison results.

Some other points worth noting about these results are (1) they do some damage to the esteem with which the Sherman and Clayton Acts are held by most observers; (2) the Phillips curve explanation is quite consistent with the new learning critique of antitrust decisions, which suggests that antitrust normally attacks efficient firms or commercial practices; (3) the idea that antitrust is about equity suffers in this analysis; and (4) we are at some distance here from the public interest theory.

## VI. Conclusion

The thesis of this paper is that we need to know how and why antitrust decision makers behave before we can make intelligent criticisms of antitrust policies; science must precede prescription if prescription is to be meaningful. My focus has been on enforcement officials. Judges also are important antitrust decision makers, but they have been largely exempt from the discussion. How do judges behave and why? The flat answer is that we simply do not know. We know that their antitrust decisions often evoke reams of criticism, but we have made almost no progress in developing a theory of judicial decision making in antitrust or any other area of the law.<sup>5</sup>

<sup>5</sup>See, however, the work of Landes and Posner (1975) on the independent judiciary.

So there is work, much work, to be done to achieve a fusion of public choice with antitrust law and economics. I predict that this work will emerge, and that it will provide a rich empirical basis for deciding whether antitrust is a boon or bane for the economy. Moreover, this work will help to cast the role of antitrust in more reasonable terms. Our choice in this area of government policy, as in all others, is between imperfect markets and imperfect government. In the public interest approach, government always gets a green light in antitrust. In the public choice approach, government will often face red and yellow lights, and a little bit more *laissez faire* will be allowed to prevail in the world.

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## “PUBLIC CHOICE AND ANTITRUST”: A COMMENT

*Kenneth G. Elzinga*

To assume a position on the economics faculty at the University of Virginia in the 1960s was a remarkable experience. Public choice—as a new field of economics, as a new subculture within the economics profession, and as a new journal—was in first bloom.<sup>1</sup> Graduate students in economics at the University of Virginia, such as Bob Tollison and others, had more impressive publication records than most of the assistant professors, as James M. Buchanan challenged a group of students to take economic reasoning down new avenues and to submit the fruits of their inquiry to leading journals.

For those of us on the faculty outside the field of public choice, Virginia was also a perplexing place. If we had any previous acquaintance with the field of public finance, we thought of its concerns as being tax policy and fiscal policy. But at Virginia, the meat and potatoes of graduate courses in public finance were topics such as reward structures in bureaucracies and legislatures. Even those of us not doing public choice heard with interest, and shall I add even some pleasure, the howls of protest from political scientists as their turf was invaded by first a platoon, later a battalion, and now a division of public choice theorists. And, of course, many of these political scientists were eventually to throw down their arms and don the methodological uniform of the public choice economist.

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<sup>1</sup>The journal is *Public Choice*. When the publication first began in 1966, it was entitled *Papers on Non-Market Decision Making*. The original issue contained articles by Duncan Black, James S. Coleman, Otto A. Davis, M. A. H. Dempster, Aaron Wildavsky, E. A. Thompson, Gordon Tullock, and Richard Wagner. The journal became *Public Choice* with the Spring 1968 issue. For a summary of the origins and growth of public choice, see Tollison (1984a, pp. 3–8).

Robert Tollison drank of that heady brew while a graduate student at the University of Virginia, and now is one of the discipline's leading brewmasters. It is almost a paradox for me, as one who has learned so much from Tollison (not an easy thing to admit since he is a former teaching assistant of mine), that I find myself in disagreement with the basic proposition of his paper, namely:

When all is said and done and government is not following one's conception of the public interest in antitrust, we are reduced to such tried and true nonsense as "better people make better government." Change the decision makers and the policy will change. That sounds good but it never seems to work. Government cranks along by an internal logic of its own . . . .

[Tollison 1985, pp. 905-6]

This is vintage public choice dogma. It makes for wonderfully provocative classroom discussion. There is a lesson to these words that is very basic to the case for limited government. And for all I know, it may be empirically on the mark with regard to many government agencies. But not with regard to antitrust.

I cite these illustrations to support my case, drawn from the Antitrust Division of the Department of Justice, the Federal Trade Commission (FTC), and the federal courts. All belie the public choice axiom that better people do not make for better government.

A little more than a decade ago, the Antitrust Division embarked on a modest crusade against conglomerate diversification. Lawsuits against ITT, LTV, and Northwest Industries were prominently noted and often acclaimed by the press (Green et al. 1972, pp. 99-106). It was thought, in some circles, that the conglomerates would use their financial deep pockets to subsidize acquired subsidiaries, thereby lessening competition in these markets. Vertical mergers and loose-knit vertical arrangements were also regularly attacked. Indeed, as recently as the Carter Administration, vertical price fixing was viewed as a criminal offense by the assistant attorney general for antitrust.

Under the direction of William F. Baxter, the Antitrust Division attacked no conglomerate mergers. Horizontal mergers continued to be examined for possible anticompetitive offenses. But conglomerate mergers (and vertical mergers as well) were viewed as being inoffensive, even benign.

Note that this switch did not involve a change in political parties in the White House. A Republican occupied the presidency during the anticonglomerate campaign of Richard McLaren. A Republican commanded the executive branch during Baxter's regime. The office of assistant attorney general and its considerable perquisites were the same, the antimerger statute was unchanged, the budgetary

process for the agency was the same; in Tollison's language, the "rules that govern their behavior" were the same. But the two men carried different ideas to the office. To argue, as Tollison does, that changing "the decision makers" to improve a bureau's performance "sounds good but it never seems to work" is to ignore the recent history of the Antitrust Division, where profound changes in enforcement direction have taken place—because, in large measure, a decisionmaker made a difference.

For my second illustration, I turn to the counterpart agency, the FTC, where Tollison himself served until recently. I can only surmise that the diligence of his labors at the agency clouded for him the picture of what has occurred at the FTC that is contrary to the thesis of his paper. Once again, there were no statutory changes and no changes in the budgetary procedures by which the agency is funded. The FTC, now in its 70th year, should be a representative example, as Tollison puts it, of "government cranking along by an internal logic of its own." But when James C. Miller assumed the chairmanship, the crank, if there was one, became like a tiller. And the tiller's direction was changed notably.

As I understand one theme of the public choice literature, the directors of bureaus are presumed to behave purposefully, and while there may be several arguments in the bureaucrat's utility function, the maximization of the agency's budget is presumed to be dominant (Mueller 1979, pp. 156–67). Chairman Miller repeatedly violated this fundamental axiom of public choice theory by endeavoring to reduce the size of the agency's budget and even to eliminate the institution's field offices ("FTC Votes . . .," p. 191; "FTC Regional Offices . . .," p. 640). Moreover, he has authored opinions and taken administrative steps that have limited the potential for increasing litigation and the regulatory scope of the agency, thereby reducing the potential for larger staffs and budgets.<sup>2</sup> An acquaintance with the Jeffersonian principles of limited government and the principles of economics (principles in which Miller was instructed at the University of Virginia) explains the "internal logic" of Miller's enforcement themes, and in that sense his actions may be predictable. But they are not the actions of an "internal logic" of an agency that somehow "cranks along" heedless of those who head it.

The third example I select is that of the federal courts. Public choice, as Tollison concedes, has not been as fruitful in analyzing

<sup>2</sup>See, for example, the commission's opinion, *In the Matter of General Foods Corporation*, FTC Docket No. 9085 (6 April 1984) and the commission's resolution of the Borden ReaLemon case ("Divided FTC . . .," p. 491).

the behavior of courts as it has with regard to bureaus and legislatures. However, I shall argue that utilitarian maximizing principles will not capture, and may cause us to overlook, the proposition that in judicial decision making, ideas matter—and people count. It is not necessary to change an economic incentive structure to reform antitrust. Reform has been happening for some time, and economic *ideas* have been the mover-and-shaker, not economic *inducements*.

One is tempted to cite the case of Aaron Director, whose influence first at the University of Chicago and later at the Hoover Institution has altered the way in which economic theory is used in antitrust analysis (Kitch 1983, pp. 181–95). Or one is tempted to cite the effect of the Areeda and Turner (1975) article on predatory pricing, which on one level affected the way courts view predation, but on a different and ultimately more influential level affected the eminence courts give to economic literature in reaching their decisions. Instead I shall mention the influence of Henry G. Manne who, for a generation now, has trained both law professors and judges in the elements of economic analysis.<sup>3</sup> As a result of the former effort, any student who now enrolls in a major law school ignorant of economics does so with temerity. And as a result of the second batch of students, the federal judges, it is increasingly with temerity that an antitrust lawyer argues a case ignorant of the economic issues and without casting the case in terms of economic analysis.

The point of my remarks is not to say that the reward structure of an institution does not matter, or that antitrust bureaucrats do not respond to economic incentives. The economic model of human capital accumulation explains very cogently the propensity of the young antitrust attorney to (1) want to begin a career with a government agency, (2) exhibit a strong desire to file cases, (3) be relatively unconcerned with remedy and relief in a particular case, and (4) not continue with the agency. For this reason and others, I am uncomfortable with even the appearance of being a critic of the public choice paradigm as applied to antitrust. So I take comfort in Seymour Siegel's story of the wise rabbi who told one disputant strongly holding to a particular view, "I think you're right." When the other party to the dispute protested, the rabbi said to him, "Well, you're right as well." And when both protested as to how each of them could be right, the rabbi said, "That's right too."

Tollison is right when he calls for making the actors endogenous to our analysis of antitrust outcomes. But I am right in suggesting that his statement, "looking for better people will not change the

<sup>3</sup>Done under the auspices of his Law and Economics Center, now at Emory University.

results," which was a favorite cry of the free market proponent at a time when free market proponents had little influence in government, is more a tactical argument than a proposition of inerrancy. A more accurate statement, to which Tollison alludes later in his paper, is that if the output of the agency is a public bad, putting even good people in charge may not remedy the problem of government failure.<sup>4</sup>

After setting out the public choice approach to economic phenomena, Tollison contrasts this with the public interest approach, arguing that most antitrust observers naively have viewed the institution of antitrust in this latter context. He finds this disconcerting, in light of the "trenchancy of the antitrust critics with respect to [antitrust policies] and decisions," and he argues that this criticism suggests that the public interest approach does not hold. I am not so sure. Before Jonas Salk, physicians were distressingly unsuccessful in preventing poliomyelitis. But their failures were not the result of a lack of concern for their patients' health. Doctors were ignorant of the methods by which infantile paralysis could be prevented. In like fashion, antitrust authorities (and federal judges) in the recent past may have been ignorant of the free-rider effect in vertical distribution, uninformed of the existence of the market for corporate control and its implications for conglomerate mergers, not yet aware of the obstacles to successful predation, and unaware of the complex relationship between the concentration and efficiency. As economists, Tollison and I must be forgiving of them. For many who practiced the dismal science did not know of these economic characteristics either.

The important contribution of Tollison's paper is his review of the public choice approach to antitrust, and every bit as useful, his commentary on the studies that have been done.<sup>5</sup> Scholars as yet untutored in public choice will also appreciate his succinct manner in setting forth the approach of this form of analysis. I particularly appreciated his analysis of dual enforcement of the antitrust laws and the insights of the public choice approach to the coexistence of the Antitrust Division and the FTC, a duality long accepted by scholars who would never propose multiple Environmental Protection Agencies or Federal Communications Commissions. The possibility of

<sup>4</sup>Though even here the example of A. E. Kahn's presiding over the demise of the Civil Aeronautics Board, and his active encouragement of this regulatory agency's disappearance, could be cited as a notable counterexample.

<sup>5</sup>Tollison apologizes that his review of the literature may not be complete. Neither is my own. But one cost-benefit study, contemporaneous with the Long, Schramm, and Tollison (1973) article, that goes unmentioned is that of Leonard W. Weiss (1974, pp. 35-56). Weiss finds a more economical allocation of the enforcement resources of the Antitrust Division than do Long et al.

reviving a Phillips curve for antitrust, a curve thought to be put to rest by devotees of rational expectations, is also provocative. It offers, perhaps for the first time, the possibility that antitrust will be taken seriously at a macroeconomic workshop.<sup>6</sup>

Let me close by returning to my opening focus: the economics department at the University of Virginia. Also bringing luster to this department in the 1960s was G. Warren Nutter. In his last article in the *Journal of Law and Economics*, Nutter (1979) warned of excesses in the economizing paradigm. There is always the danger, not easily recognized from within the discipline, that unflagging application of the utility maximizing model leads to a nihilism or cynicism about human behavior. It borders on teaching this proposition: My taking any action is conditioned upon it being only in my narrow self-interest.

In the public choice paradigm, narrowly construed, it is as if Martin Luther had said at Worms, "Hier maximiere ich. Hier handele ich zu meinem eigenen Vorteil; ich kann nicht anders" ("Here I maximize. Here I behave in my self-interest. I can do nothing else."), instead of his famous statement, which says something quite different: "Hier stehe ich; ich kann nicht anders" ("Here I stand; I can do nothing else").

Luther was not calculating an expected lifetime earnings stream. Further, we can take grateful note that Professor Baxter did not ask, "Here I stand; how can I maximize the number of cases filed?" And Chairman Miller did not inquire, "Here I stand; how can I maximize my agency's budget?"

Tollison (1985, p. 908) writes that "The public interest approach says that more information or better people will lead to better antitrust. There is obviously some truth to such an argument, but it does not seem to be very important in the actual conduct of government affairs." I disagree. One is not limited to contemporary antitrust affairs for other corroboration. A study of the Antitrust Division under Thurman Arnold also illustrates my point. There are times when you change the decision makers, and change *only* the decision makers, and the policy will change. As an academician, I find it heartening that decision makers can change, not because the institutional reward structure has been altered, but because ideas have consequences.

<sup>6</sup>The statement is not quite accurate. For about two decades there was significant interface between industrial organization economists and macroeconomic policy, by way of the study of administered prices in oligopolistic industries and their influence, if any, upon inflation. With the waning interest in antitrust as an anti-inflationary device, the Tollison paper suggests that antitrust endeavors may have employment consequences.

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# EFFICIENCY, LIBERTY, AND ANTITRUST POLICY

*D. T. Armentano*

**R**obert Tollison (1985) has written an interesting and thoughtful paper on how to critically evaluate antitrust policy. He first suggests that the public interest theory of antitrust enforcement makes little theoretical or empirical sense and we should discard it. He then argues that public choice theory—which has been useful in understanding governmental regulatory behavior—be applied to antitrust policy; after all, antitrust is regulation too. Finally, he devotes considerable attention to reviewing some of the empirical work from the public choice and interest group literature, as well as discussing the importance of recent attempts to measure the macroeconomic effects of antitrust policy. He concludes, correctly, that such evidence is probably necessary in any serious effort to reform antitrust policy in the United States.

## The Antitrust Revolution

The intellectual effort to reform antitrust policy is well underway; thus Tollison's paper is both timely and important. There have been important breakthroughs in our theoretical understanding of how markets work, of how market performance affects market structure, of how private "restraints" that limit "free-riding" enhance market efficiency, and of how generally (with horizontal collusion being the primary exception) free markets tend to be efficient markets. In addition, there have been important empirical studies—the so-called new learning—that call into serious question the conventional beliefs and alleged evidence associating market concentration and poor economic performance (Goldschmid, Mann, and Weston 1974). Indeed, the weight of the new evidence has shifted the burden of proof

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entirely regarding this important issue (Brozen 1982). Finally, the antitrust authorities themselves, since roughly 1980, have embarked on a new direction in antitrust policy that is generally coincident with the theoretical and empirical revolution now ongoing in industrial organization.<sup>1</sup>

One of the clear tasks that remains is a serious investigation of the incentives and behavior of the antitrust decision makers themselves. Especially relevant and useful would be information concerning the behavior of the regulatory authorities, the courts, and the administrative law judges. Tollison's call for more research in this much-neglected area is certainly welcome. Such information would help complete our understanding and criticism of antitrust policy, and would form the basis for an all-out political effort to reform (or repeal) antimonopoly law.

### Public Interest versus Public Choice

There are some small bones to be picked with several of Tollison's arguments and some larger issues that need to be taken up concerning the scope of his paper and related matters.

Tollison's position on the public interest theory of antitrust would appear to be too extreme. We are told at one point that changing the decision makers to change policy "sounds good but it never seems to work"; at another point we are told that it is "tried and true nonsense" that "better people make better government." One can certainly be sympathetic with Tollison's skepticism on this issue, given our long and suffering experience with governmental mismanagement. However, it does seem clear that changing ideas and people has mattered in the quality of antitrust enforcement over the last few years. (Tollison himself has been an important part of that antitrust policy change at the Federal Trade Commission.) Whether these are long-run permanent changes is, itself, another matter entirely; if that matter is what Tollison has in mind with regard to his criticism, then his extremism may well be warranted. After all, the recent changes in antitrust policy are entirely administrative and the laws themselves are still firmly in place. It may be too early, therefore, to tell whether Tollison's extreme position on the public interest theory is as unwarranted as it first appears.

<sup>1</sup>See, for instance, the discussion in Meadows (1981) and the talk before the American Bar Association by Federal Trade Commission Chairman James C. Miller (1984).

## Antitrust and Liberty

A far more serious issue concerns Tollison's complete silence on matters related to economic liberty—the theme of the conference for which this paper was prepared. To put the matter succinctly: What is the relationship, if any, between economic liberty and the antitrust laws? As Tollison is silent on the entire issue, let us attempt to raise (but not answer fully) some of the relevant questions and issues.

It has been apparent from the start that the administration of the antitrust laws has posed serious difficulties for those committed to notions of individual rights, consent exchange, and due process. The laws, by their very nature, seem to interfere with and infringe directly on individual rights, on the freedom to transfer (or not transfer)—through consent exchange—legitimately held property or titles to property (Pilon 1979). Antitrust laws against price discrimination, merging, tying, price fixing, and even (free-market) monopolizing appear to prevent freely contracting parties from making, or refusing to make, certain contracts they believe to be in their best interests. There may be reason to prohibit or regulate such activity from some economic perspective; however, as we have argued, the theoretical case for prohibition and regulation in antitrust has been dramatically narrowed. Economic matters aside, these private activities do not violate any property rights in the ordinary use of the term—that is, they do not involve force, fraud, or misrepresentation—yet their regulation or prohibition by the state directly violates the property rights of the market participants. From a strict libertarian or natural rights position, therefore, the antitrust laws are inherently unjust. Even Adam Smith, despite all of his reservations about businessmen and price conspiracy, rejected any antitrust law on the grounds that its enforcement would not be “consistent with liberty and justice” (Smith 1937, p. 128).

In addition, there have always been serious due process problems associated with antitrust law and antitrust enforcement. Can we really know what it means to “reduce competition substantially”? Can we really know what it means to prohibit “unreasonable” restraints of trade? Can we really know what it means to prohibit “attempts to monopolize”? Can we even know what any given “relevant market” is or whether there is an “intent” to destroy “competition”? And can we know these things prior to any legal action and prior even to any alleged violation of antitrust law? If we surely cannot know these things, and most students of antitrust enforcement would agree that we cannot with certainty know these things, then antitrust “law” is capricious and arbitrary in the extreme, and those firms and

individuals tried under it can hardly be said to have experienced any real "due process."<sup>2</sup> Thus part of the case to be marshaled against antitrust concerns itself with basic questions of economic liberty and fairness. Tollison might at least have made this a part of his recommended research agenda in the antitrust area.

## Liberty and Efficiency

Existing antitrust law, as we have seen, is inherently hostile to the notion of individual property rights and consent exchange. The laws aim to enhance market efficiency, but inevitably they interfere with someone's liberty—the liberty, say, to price discriminate or to fix prices and divide markets. Can liberty and economic efficiency be reconciled?

Most who would accept existing antitrust law, or at least the minimalist prohibition on "naked" price-fixing agreements (Bork 1978), would appear to accept that some individual freedom (say the freedom to collude) must be sacrificed or traded off to preserve efficiency and competition. For example, agreements to restrain output—absent any other effects—are usually considered socially inefficient in that they would tend to raise market prices above marginal cost and create a deadweight loss for consumers (Liebeler 1978). The standard neoclassical approach therefore sees a conflict between efficiency and economic freedom, while recognizing that most free-market processes are socially efficient. Tollison generally appears to endorse the conventional welfare analysis (Tollison 1982).

Although the neoclassical theories of competition and efficiency are still widely accepted, there has recently been increasing criticism of the conventional theory and of its welfare implications (Rizzo 1980). Critics have argued that the standard view is a static and partial equilibrium analysis and, more seriously, that the conventional theory of efficiency assumes information concerning social costs and social benefits that is impossible, even in theory, to obtain (Rothbard 1979). The issue can be put as follows (Armentano 1983, pp. 9–10):

The costs of an action are the subjective opportunities foregone by the person who makes the decision; the benefits are the subjective satisfactions. . . . Since costs and benefits are subjective they are not cardinally measurable. There is no standard unit of value that would allow the summing up of individual costs and benefits into social aggregates for comparison. Thus it is misleading to suggest that a rational antitrust policy can weigh the costs against the gains of

<sup>2</sup>This has been most obvious in Federal Trade Commission enforcement of the Robinson-Patman Act (1936). See, for instance, Armentano (1982, chap. 6).

restrictive agreements, and then decide which agreements are socially efficient and which are not.

If this methodological criticism of standard theory is valid, it creates important difficulties for any "rational" antitrust policy. Most discussions of a rational antitrust policy have assumed that the state should prohibit those agreements that have the likelihood of raising social costs without offsetting social benefits, that is, those agreements that are socially inefficient. However, if it is impossible, even in theory, to calculate social costs and benefits, then any hope for such a policy appears doomed to certain failure, regardless of the behavior of the antitrust decision makers.

If the standard theory of efficiency (and competition) has serious methodological difficulties, it may be useful to suggest some alternative approach to efficiency that may be relevant in discussions of antitrust policy. Such a theory, ideally, would seek to avoid the methodological pitfalls of the neoclassical approach, while at the same time permitting a reconciliation between economic liberty and efficiency. Indeed, such a theory might even be able to ground economic liberty solidly on scientific rather than purely normative considerations.

### Alternative Perspectives on Efficiency

An alternative perspective, well within the neoclassical paradigm, would be to argue that all agreements (intend to) "lower costs" and that because opportunity costs are ultimately subjective and personal, such "savings" could always offset any so-called welfare losses (due, say, to higher prices). The easy assumption in antitrust has always been that the costs of "naked" collusive agreements greatly outweigh the benefits (if any), and that their flat prohibition per se is "efficient."<sup>3</sup> Yet if costs are subtle and subjective, such an easy antitrust conclusion may no longer be warranted. Market division agreements may end costly cross-hauling and advertising. Agreements between competitors (in transportation) may reduce information and transactions costs. Horizontal agreements that reduce risk and uncertainty can promote efficiency. Further, as only the parties to the agreement can evaluate the "cost savings" associated with agreement, no antitrust regulation of such activity could be rational.

An even bolder alternative to the standard theoretical approach would be a "plan-coordination" theory of efficiency. This theoretical

<sup>3</sup>For a review of the law on price fixing, see Easterbrook (1983). His call for a "rule of reason" approach in price fixing is subject to all of the criticism just reviewed concerning the subjective nature of costs and benefits.

perspective would hold that all voluntary agreements—including so-called restrictive agreements—are consistent with a process of efficiency in that they all aim, *ex ante*, to bring into coordination the respective plans of the market participants to the agreement. Because market information is never perfect, and because information is constantly changing, this process of plan coordination (through agreement) could never attain any final equilibrium. The end-state equilibrium, however, cannot be the focus of analysis (Hayek, 1972). The open-market process itself would continuously create powerful incentives to discover and use the best information available to correct plans that fall short of objectives (Sowell 1980). Thus an efficient market is an open market in which individuals are constantly learning, and one that tends to provide the widest scope and encouragement for private plan making, private plan correction, and private plan coordination.

This approach to efficiency would allow a condemnation of legal restrictions on competition (and on cooperation) independent of any neoclassical cost-benefit or welfare-loss calculations. Legal restrictions on trade and exchange would be harmful (inefficient) in that they would directly limit market information and the scope of voluntary plan coordination. In addition, this alternative approach to efficiency would encompass the (now) entirely troublesome “cooperative” agreements that can exist between “competitive” business organizations. Cooperation, so essential to any understanding of efficiency inside the firm, has always been suspect between firms because (according to conventional analysis) it tends to “reduce competition.” Once we adopt a plan-coordination theory of efficiency, however, we are able to see rivalry and cooperation not as antagonists or opposites but as simply different elements in an entrepreneurial process of market plan coordination (Kirzner 1973). Presumably firms are in the process of minimizing their own costs either as rivals or as participants in some joint venture. As no outside observer is in a position to observe these costs, and as all voluntary agreements are consistent with plan-coordination efficiency, the determination to be rivalrous or cooperative can be left entirely up to the participants involved in these agreements. This insight ends the presumption that the Federal Trade Commission or some regulatory authority can ever judge rationally the social efficiency of any merger or joint venture.

## Conclusion

A plan-coordination theory of efficiency and competition is not without difficulty; this is not meant to be an exhaustive treatment

but merely a suggestive one. Recall the modest objectives: to avoid the methodological pitfalls of the standard welfare approach and especially to reconcile individual liberty and "efficiency." What is being argued here, in contrast to Tollison, is that some of the most important remaining questions in the antitrust area are theoretical rather than (necessarily) empirical. Knowledge of how antitrust decision makers behave is important, especially in any attempt to revise antitrust enforcement. Yet fundamental theoretical questions concerning the notion of "market failure" itself (apparently taken as a given in the Tollison paper) would appear to precede any concern with additional empiricism. Tollison states that "we need to know how and why antitrust decision makers behave before we can make intelligent criticisms of antitrust policies." Perhaps so, but it can be argued instead that we need to rethink the entire notion of market failure and economic inefficiency before we can possibly understand the relevance of any additional empirical information, or even know what empirical information to seek. Any serious effort to reform or repeal antitrust will depend not so much upon antitrust impact studies—although they may be relevant—but upon a fundamental rethinking of theoretical questions concerning liberty and efficiency.

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