Perspectives on current developments

Antitrust: Fear of Fairness

In December 1985, a comprehensive Reagan administration plan for both substantive and procedural reform of the antitrust laws was made public. Under the plan, the Justice Department's 1984 merger guidelines would be codified in the Clayton Act; restrictions on interlocking directorates would be relaxed; industries affected by imports could seek antitrust waivers as an alternative to tariffs or quotas; plaintiffs could be assessed attorneys' fees for filing frivolous antitrust suits; treble damages would be eliminated in many cases; and the full share of damages of settling defendants (instead of just the settlement amount) would be deducted from the damages available against the remaining defendants. While not as sweeping a reform as some administration officials would have liked—Commerce Secretary Malcolm Baldrige, for instance, has publicly called for outright repeal of the Clayton Act—the proposal is the most important to come along in many years.

Congress is also considering some less dramatic proposals for antitrust reform. On July 29 the Senate Judiciary Committee held a hearing on S. 1300, a bill that would largely abolish joint and several liability in antitrust suits alleging "horizontal" price-fixing conspiracies. The bill has eleven sponsors on the Judiciary Committee, including all eight Republicans, and counts among its supporters former Carter administration attorney general Griffin Bell, the Antitrust Section of the American Bar Association, and virtually all major business lobbies.

Joint and several liability has long been a controversial part of antitrust law. Courts decided early in this century that antitrust plaintiffs not only could sue any or all of the potential defendants in a conspiracy case but could also collect their damages after trial from whomever and in whatever proportions they chose. The Supreme Court further confirmed in 1981 that antitrust defendants have no "right of contribution" against each other, so that if one defendant is forced to pay more than its seemingly fair share of the damages from a conspiracy, it cannot countersue its co-conspirators.

In suits involving multiple defendants, each defendant is thus potentially liable for *all* the damages alleged to have resulted from the entire conspiracy. Not surprisingly, this figure —or even each defendant's arithmetic share of

Subscribers and other readers of *Regulation* magazine will want to join the staff of the American Enterprise Institute in acknowledging with great appreciation the magazine's chief editors, Anne E. Brunsdale and Walter Olson, as they depart for new positions.

Anne Brunsdale, the managing editor and an AEI senior fellow, helped to launch *Regulation* in 1977. She has been nominated by President Reagan to serve on the U.S. International Trade Commission. With her recent confirmation by the Senate, she has begun a term that will expire in 1993. Under Brunsdale's direction the magazine gained a reputation for reliability and analytical rigor, qualities not always found in a journal as highly praised for its readability as *Regulation*.

Walter Olson, associate editor since 1980, has maintained these high standards both in his editing and in his writing. He has accepted a position with the Manhattan Institute, in New York City, as vice president for research.

The special niche that *Regulation* occupies in the national policy community is a tribute to the expert guidance of these two editors. We wish them well in their new endeavors.

it—often exceeds the net worth of many small, and sometimes not-so-small, defendants. S. 1300 would limit any single firm's liability in such cases to the (treble) damages *attributable to its own sales or purchases*, except for portions of the total damages attributable to firms that are bankrupt or beyond the jurisdiction of American courts.

The existing combination of joint and several liability, treble damages, and the payment of attorneys' fees to winning plaintiffs (but not defendants) creates perverse incentives for both sides in antitrust litigation. The huge potential losses to individual defendants encourage marginal or even "strike" suits filed in hope of squeezing settlements from defendants. Many managements are understandably reluctant to bet their firms by contesting such suits, even if they believe the grounds to be meritless, on the expectation that a jury will properly assess the complex evidence involved.

Once the suit is filed, the present liability rules, especially joint and several liability, create a dangerous litigation dynamic. When one alleged conspirator settles, it can dramatically increase the potential liability of the others. Only the amount for which the defendant settles, not its proportionate share of the damages, gets subtracted from the remaining liability. For example, with ten defendants and $1 billion in potential damages, each defendant has an average expected maximum liability of $100 million. (It is, of course, in the plaintiff's interest to announce that he will be utterly arbitrary in apportioning damages, so that each defendant must contemplate the prospect of getting stuck with the full bill. A very small chance of corporate obliteration can weigh quite heavily at settlement conferences.) But if five defendants settle for $10 million each, the five remaining defendants face exposure of $950 million, or $190 million apiece, nearly double the original amount. And if nine defendants settle at $10 million each, the lone remaining defendant can be left holding a $910 million bag.

The result can be virtually irresistible pressure to settle even a frivolous lawsuit so long as the potential exposure is great enough. The first defendants to settle—not improbably, the guiltiest among them—will bail out at bargain rates, leaving the remaining defendants, the ones more inclined to fight the charge, in a steadily worsening bargaining position—unless they join the race to surrender. The effect is to create what the American Bar Association's Antitrust Section has called "a litigation posture that precludes the assertion of innocence."

Such problems can arise even in cases where the potential damages are relatively small (although multi-billion-dollar damage projections are becoming almost routine in major cases). The critical figure, from a psychological if not fiscal standpoint, may not be so much the total dollar amount of exposure as the ratio of that exposure to a firm's net worth. A small firm roped in as a defendant in an antitrust conspiracy almost surely faces potential bankruptcy if it fights alone and loses, perhaps just from the legal fees. Indeed, it can be wiped out by the legal fees even if it wins. The mere pendency of a killer suit can thus have a devastating impact on a firm's credit rating.

The preamble to the bill says that its point is "to assure fairness in the allocation and award of antitrust damages." One body that does not feel swayed by that argument is the Justice Department, which testified in opposition to the bill. Charles Rule, then acting assistant attorney general for the Justice Department's antitrust division, memorably explained why: "it is difficult to quantify the benefits to society from being 'fair' to antitrust felons."

"Antitrust defendants who truly deserve to be treated 'fairly,'" Rule said—"persons engaged in procompetitive or competitively ambiguous conduct—would seldom be able to invoke S. 1300." Instead, the administration testified, the beneficiaries of the bill "would be that class of antitrust defendants who least engage our sympathy: those *accused* of horizontal conspiracies affecting price. These *violations* are clearly anticompetitive, intentionally committed, and criminal in nature" [emphasis added].

Although the notion that the scope of punishment raises no issues of fairness is a provocative one, the deftest part of this logic is surely its leap from allegation to proof. Perhaps we now know who planted the idea with the attorney general that all suspects are guilty.

Conspicuously absent from the administration's testimony is any acknowledgment of the problems of harassment and strike suits. The effects of S. 1300 would be principally felt not after a trial and verdict of guilty, but at the pretrial stage, when corporate officers decide whether to fight or settle. While it may be too much to expect the ABA's Antitrust Section to tackle the problem of excessive lawyering, one is surprised to see the Reagan administration Justice Department ignoring the tactical implications of giving nuclear weapons to the plaintiffs' bar.

The administration's general antitrust reform package contains some balm for defendants. For example, the elimination of treble damages in many actions (though not price-fixing suits) would go far toward removing some of the perverse litigation incentives that now exist. More important is the administration's proposal on claim reduction: when one defendant settles, that defendant's share of the originally sought damages is deducted from the remaining total. The pressure on remaining defendants to settle would thus be substantially lessened, though far from eliminated.

If the administration's package is not the last word in antitrust reform, neither is S. 1300. The bill limits a defendant's liability to damages attributable to its "purchases or sales," which, as the administration pointed out, would exempt from liability participants in bid-rigging conspiracies who purchase or sell nothing, but merely agree not to bid. As written, the bill would deny victorious plaintiffs recovery of their costs and attorneys' fees, though one can argue about whether this is really a problem for anyone outside the legal profession. Finally, it would not apply to vertical "conspiracies," which by now most antitrust scholars as well as the administration view as frequently procompetitive.

The Glacial Water Project

Unlike Solomon Grundy, born on Monday and deceased by Sunday next, many public works projects seem to have unnaturally protracted life histories. One such is the Garrison Diversion project, a scheme dreamed up back in the 1940s to spend $1.2 billion irrigating North Dakota farmland. In 1965 Dakota politicians finally got Congress to authorize the project, but lawmakers have never been able to reach agreement on whether to go ahead and finish it, though the Bureau of Reclamation has spent $213 million building preliminary canals and other structures. Faced with continued political stalemate, Congress in 1984 created a blue-ribbon commission to review the project's future, its twelve members appointed by Interior Secretary William Clark.

Appointed commissioners, no matter what the color of their ribbons, are subject to the same interest-group pressures as mortal legislators. In December 1984 the Garrison commission came out with recommendations that could serve as a model of the typical outcome of such pressures. The commission recommended a compromise plan that on the one hand would scale back the project, but on the other hand would spend so much to buy off the political opposition that it would save little or no money.

The Garrison Diversion project is a massive webbing of canals, reservoirs, and dams to supply North Dakota farmland with water diverted from the Missouri River, which runs through the middle of the state. North Dakota politicians aver that in 1944, when the government built Garrison Dam on the Missouri as part of the Pick-Sloan power project, Congress promised to build the diversion project to "make up for" having flooded thousands of acres with the dam. No such promise is recorded in the legislative history of the Pick-Sloan project, nor would one seem to be called for by ordinary standards of compensation, since the acreage flooded was first duly purchased from its owners, and since those owners are in any case not the same people who would be helped by the diversion scheme. A "sense of the Congress" resolution passed in 1984, however, insisted that a moral commitment had been made.

The Bureau of Reclamation's cost-benefit studies leading to authorization in 1965 and updated since then have always been favorable, and financial studies have shown that the project's beneficiaries, the landowners whose properties would be irrigated, would reap enough profit that they could afford to repay the project's operating as well as some of its capital costs. The investigating commission found that view far too optimistic: the beneficiaries would be unlikely to be able to repay even their operating costs. The bureau's favorable findings to the contrary, commission hearings revealed, had been based on extremely unrealistic assumptions. It was assumed, for example, that half of one district would be planted in pota-

In Brief–

Update: No Extra Cancer in TMI's Wake. A study by the Pennsylvania Department of Health has found no evidence that the Three Mile Island nuclear accident led to any increase in cancer incidence among its neighbors. The department found that, for the area within a ten-mile radius of the TMI plant, there have been 2,892 deaths from cancer since 1979, slightly fewer than the 2,909 that would be statistically expected. The death rate was also within the expected range in a larger radius of twenty miles from the plant, as well as in a smaller group of "downwind communities" immediately adjacent to the plant.

The word on new cases of cancer diagnosed since the accident, as distinct from deaths, was also reassuring. There were twelve more new cancer cases in the downwind areas between July 1982 and June 1984 than would have been expected (133 instead of 121.4), but the difference is not statistically significant, and the dozen "extra" cases do not fall into any category associated with TMI. "While Newberry Township appeared to have ten more cases than might have been expected," said state health secretary Dr. H. Arnold Muller, "virtually all of the discrepancy (nine of the ten) involved non-radiogenic cancers, or those not generally associated with radiation."

Residents had been alarmed by an earlier survey conducted by a local couple that purported to find a dramatic rise in cancer deaths "clearly tied to the TMI-2 accident." According to the state researchers, the earlier survey attributed to TMI the deaths of people who had been diagnosed with cancer before the accident, people who were mistakenly counted as residents of the survey area, and long-term heavy smokers who died of lung cancer. The earlier survey was also found to have been biased in its selection methods: in one neighborhood of fourteen streets, it had canvassed each of four streets where a cancer death had occurred, skipping each of the ten where none was found.

Specials of the Day: Bean Pilaf and Cod Sushi. For some time there have been proliferating in the fifty state capitals not only "buy-American" but also "buy-in-state" laws. The latter direct state agencies and contractors to retaliate against the predatory and unconscionable trade practices of the Outer Forty-Nine. It is usually futile to complain about these trade-barriers-by-any-other-name, because jobs are thought to be involved, and anyway a state's inherent right to erect such barriers is what the Constitution (well, all right, the Articles of Confederation) is all about.

One of the odder buy-in-state campaigns is currently under way in Massachusetts. Local activists have long been alarmed that their heavily urbanized and poor-in-topsoil state falls far short of agricultural self-sufficiency, as if the state were likely to fall victim to an Organization of Potato Exporting Countries led by Maine and Idaho. Now they have convinced the state government to do something about it. The state Department of Agriculture is passing out subsidies to bring fresh local tomatoes to market, organizing taste-ins to promote local apple wines, and even giving restaurants grants to redo menus using local products. Director Gus Schumacher refuses to attend dinners or events where the food is not largely locally grown.

Even if this campaign succeeds in pulling a Silicon-Valley-in-reverse by replacing the state's numerous electronics plants with orchards, there are no grounds for expecting anyone to be satisfied. After all, as Iowa farmers could tell them, being self-sufficient in food is no guarantee of prosperity.

Coercion in Canada. Critics of the U.S. medical system often complain that doctors are "maldistributed," with too many choosing to practice in suburbs and downtowns while too few practice in slums and rural areas. Various levels of government have set up incentive schemes to lure physicians to areas deemed "underserved," but there have often been hints of sticks that might be used some time in the future should the carrots prove insufficient.

In Canada, the future has arrived. The province of British Columbia is now telling doctors where they may and may not set up practice, according to a report in the *Wall Street Journal*. The enforcement mechanism is simple enough. The provincial government health insurance scheme merely refuses to issue billing authorization to doctors opening new practices in the forbidden zone, which includes Vancouver and other popular areas. With the only big city in the province off-limits, that means new doctors must inevitably locate in the cold and remote hinterlands. "It ties us to the soil like serfs," complains an official of the doctors' association.

The medical group has challenged the new law in court on the grounds that the constitution protects the right to live and work where one wishes. Not that the doctors are any paragons of libertarian principle: according to the *Journal* report, they propose as an alternative that the government restrict medical students while leaving existing doctors alone.

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toes, while the commission concluded that in fact only 5 to 6 percent of the acreage in question might economically produce that crop.

A whole book could be written about the fanciful interest rates assumed when public works projects are put through putative cost-benefit analyses. In this case, even assuming a rock-bottom 3⅛ percent nominal rate of interest, the commission concluded that every dollar of expenditure on the original irrigation project would yield back merely twenty-nine cents in benefits.

Nonetheless, the commission proposed not to abandon the project but to build a smaller alternative that would irrigate 114,000 acres instead of 250,000. The junior-sized version would serve 400 farms of about 300 acres each at a capital cost of $5,414 per acre or $1.65 million per farm. (Subsequent recalculations by the Bureau of Reclamation have cast doubt on these cost estimates, forecasting a cost overrun of $262 million above the authorized ceiling of $1.1 billion. The projected annual benefit would amount to $23,600 per farm, which works out to a nominal annual rate of return of just under 1.5 percent.

The recipient farmers would pay almost none of the project's total cost. Under the commission's plan, 99 percent of it would be paid by customers of the Pick-Sloan power project. These customers would lose in another way, because taking water flow out of the power system for purposes of irrigation would reduce the hydroelectric power available for Pick-Sloan users. The market value of that power is at least $30,000 per year for each newly irrigated farm, a cost that itself exceeds the project's benefit to farmers, but that the commission did not consider.

To compensate the state of North Dakota for the loss of the extra irrigation, the commission also proposed spending $400 million to bring improved water supplies to 150,000 families in and around 130 widely scattered small towns in the state. Interestingly, the relevant federal guidelines allow planners to skip benefit-cost analyses for projects bringing domestic water to communities of fewer than 10,000 persons; in those cases, planners may simply assume that benefits equal costs. Needless to say, the Garrison commission took full advantage of this provision.

And a good thing too. Again assuming the scanty 3⅛ percent rate of interest, each family would have to pay $45 a month to reimburse the $400 million in capital and operating costs. Since a study by the state of North Dakota found that comparable farm families can pay no more than $15 per month to switch from wells to centralized water supplies, there is no reason to expect this part of the outlay to be paid back either. Furthermore, the state of North Dakota has already come up with a cheaper proposal for supplying many rural families with domestic water. In short, both North Dakota and the rest of us might be better off if the state were simply given $300 or $400 million with no strings attached to buy off its demands. When bargains are made with water as the currency, however, no substitutes will apparently be tolerated; it is water or nothing.

The domestic water quid pro quo raises other serious issues too. Under a 1958 law municipal and industrial users, unlike agricultural users, have always been charged rates high enough to pay back water subsidies with interest on capital expenditures, reckoned at the Treasury's long-term bond rate (currently above 10 percent) as well as operating and maintenance costs.

The commission got around this obstacle by recommending that users pay only 10 percent of the cost of providing the household water supplies. The remainder would be made up by tapping revenues from power provided by the Pick-Sloan project, which currently are scheduled to repay Garrison construction costs. The Office of Management and Budget says that to do this will mean raising rates to Pick-Sloan users. The commission also recommended that interest charges on the domestic water project be set at the same fictitious 3⅛ percent rate as the irrigation project—an unprecedented boon for a nonagricultural water project. This would leave U.S. taxpayers to bear a $100 million interest subsidy.

While the commission recommended building a less ambitious irrigation system, it shied away from the unpleasant task of proposing that the remainder of the original plan actually be dropped from the authorization. Instead, it would leave the unfunded portions—some $533 million worth—on the statute books where they could be funded by some future Congress.

The Garrison commission is being suggested as a model for resolving stalemates on other water projects. Presumably future commissions will operate within the same constraints, such as the notion—borne out in the cases of Tennessee-Tombigbee and Tellico, as well as Garrison—that once authorized, a water project should be considered a moral commitment, never to be surrendered but for the ransoms of Araby.

The major pressure against these projects, which is environmental rather than financial, is at best sporadic. Environmental organizations have their own interests to pursue, and are not reliable opponents of the pork barrel as such. The Audubon Society is fighting one aspect of the compromise settlement, the continued authorization of the full project. But it reportedly approves of the costly domestic water plan as a way to muster the political support to preserve wetlands by scaling back the scope of the project.

Even this flurry of compromise may not be enough, it turns out, to get Garrison finished. The states that now benefit from Pick-Sloan power may object to having to make up their losses, and Congress still has to authorize any scheme to reallocate power revenues. Whatever the reason, more than a year after the commission's work the political glacier has not melted and Garrison's future remains unresolved.

Nature's Own Subsidies?

Most economists, whatever their other differences, agree that the cornerstone of the international trading system is the idea of comparative advantage. To the economic mind the majestic fjords of Norway, the verdant meadows of New Zealand, and the exotic avian fauna of the Galápagos are mere instances of unequal factor endowments, leading inevitably to surpluses of hydropower, mutton, and guano suitable for trading. Were such endowments not unequal, there would be little point to trading anything: we might as well resign ourselves to self-sufficiency.

It is therefore of particular interest that the latest protectionist initiative on Capitol Hill inadvertently threatens to define comparative advantage itself as an unfair trade practice. A group of bills headed by H.R. 2451 (Rep. Gibbons, Democrat, Florida) and H.R. 1950 (Rep. Guarini, Democrat, New Jersey) would expand the Tariff Act of 1930 to require the Department of Commerce to levy countervailing duties against "natural resource subsidies" by foreign governments. Such subsidies would exist whenever a foreign government sold a natural resource product to its own citizens at a price below "fair market value," unless it also offered the product to U.S. firms on the same terms.

The most often cited example of such a resource is Canadian timberlands. Now, anyone who has ever visited Canada, especially its western provinces, will remember seeing—well, a lot of trees. One might even observe that, when it comes to lumber, Canada has a comparative advantage over other countries. This may help explain why the Canadian government lets its citizens (though not foreigners) chop down trees on public lands for a very low price—conduct that could be stigmatized as illegal under the proposed bills.

Of course, just as even paranoids may have real enemies, so even a country with naturally cheap raw materials may be going out of its way to make them even cheaper. Prohibitions on the export of raw materials and "two-tier" price schemes with preferences for certain industries may confer artificial advantages on a country's export of manufactures, advantages that are in fact regarded as outright subsidies.

The countervailing-duty policies of this country, however, never have attempted to trace and cancel out all foreign subsidies; that would require trying to estimate the net impact of hundreds of general government policies on an exporter, comparing them with a mythical undistorted equilibrium. Instead the United States, in coordination with most other developed nations, has mainly gone for a quick kill of obvious subsidies, in particular those that directly benefit exports, at the cost of letting some subtler but real subsidies go uncountervailed. The process has surely been influenced by the fact that, in the view of many respectable observers, it is not always in our best interest to retaliate against subsidies in the first place, whether direct or indirect. It is probably influenced even more strongly by the fact that the United States itself carries on virtually every sort of indirect subsidy that one can name. It uses cheap water and research to subsidize farm exports; it has embargoed the sale of various raw materials, including logs from public lands, in order to help processors; and, like most other countries, it restricts mining by foreigners on public lands.

Up to now, the United States has followed the general rule of imposing countervailing duties only on practices that confer a special advantage on a specific industry or group of industries or that directly benefit exports. The distinction is best understood in the negative: a bounty or grant that is available to all is not

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counteravailable. If the Canadian government wishes to establish roads, schools, or investment tax credits that are available to all, it may, even if one or another industry derives unusual benefit from those expenditures.

The Commerce Department is already embroiled in difficulties in determining even this level of subsidy. It would really be in the soup if it also had to determine the "fair market value" of the inputs foreign companies use. Under the proposed legislation, the department would have to take into account a long list of factors in assessing this fair market value, of which comparative advantage is supposed to be one (though only one). This raises the prospect of a trading world in which foreign exporters can go on selling at low prices only if a squad of Washington functionaries is convinced that Nature, and not a government, is at the root of their economical production.

The U.S. Court of International Trade, which regularly second-guesses the Commerce Department on these matters, has already stepped into the arena of natural resource subsidies. It recently held that Pemex, the Mexican national oil company, was unfairly subsidizing certain Mexican manufacturers when it provided them with petroleum byproducts at cut rates.

The current U.S. policy of attacking only certain kinds of subsidies conforms to the rules of the General Agreement on Tariffs and Trade, and in particular the Subsidies Code agreed to at the Tokyo Round of trade negotiations. The proposed bills are almost certainly subject to successful challenge under GATT. If that happens, our trading partners would be authorized to retaliate against U.S. exports, especially, of course, the exports that are traceable to our own bounteous natural resources, which could be hit with countervailing duties. We know this sort of retaliation to be effective because we have invoked such measures ourselves: American gourmets are currently paying an additional 40 percent duty on imported pasta because the European Economic Community restricts imports of U.S. citrus and walnuts. As it turns out, Canada is the best market for U.S. exports —which suggests another reason for U.S. policy makers to exercise caution.