Tweaking, Instead of an Overhaul

Reviewed by Richard L. Gordon

THE ANTITRUST ENTERPRISE: Principle and Execution
By Herbert Hovenkamp
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In *The Antitrust Enterprise,* University of Iowa law professor Herbert Hovenkamp undertakes an overview of antitrust explicitly designed to update Robert Bork's 1978 antitrust review, *The Antitrust Paradox: A Policy at War with Itself*. Hovenkamp's outlook is very different from Bork's. Bork saw antitrust as so dysfunctional that radical reorientation was needed. Hovenkamp sees substantial judicial response to Bork's admonitions that antitrust should consider only the effects on economic efficiency. Therefore, Hovenkamp's reform advice involves tweaking antitrust to complete the implementation of an efficiency-based approach.

The result is an intricate combination of loosening and tightening that often is difficult to follow. This difficulty is aggravated by Hovenkamp's tendency to assume the reader is familiar with antitrust laws and their enforcement history, and by his many dizzying, unexplained moves from one topic to another. Hovenkamp presents multiple discussions of several antitrust cases that he feels were improperly decided, without making sufficiently clear what generalizations are indicated. More fundamentally, he presents the drawbacks of antitrust but often plunges ahead advocating extensions that others, including me, would argue are precisely what the limits preclude.

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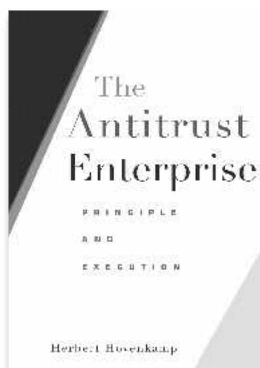
Those of us who are skeptical of antitrust argue that courts are incapable of accurately assessing the efficiency of alternative market situations. In addition, competitive forces almost always recognize and eliminate inefficiency more rapidly than do antitrust enforcers. Hovenkamp's nod to the existence of calls for repeal comes in the form of endnote citations without comment.

As he recognizes, the debate involves differing views of the initial bases for antitrust, what its goals should be, how extensive the problems are, how well government agencies and the courts can appraise the specific cases undertaken, and whether satisfactory remedies are available. Hovenkamp's book is full of warnings of the inability of judges and juries to evaluate the economics properly. It is unclear, however, whether he adequately considers the impact of those deficiencies on the ability to implement his proposals.



THE PURPOSE OF ANTITRUST

The key question about the creation of antitrust is whether its purpose was enhancing economic efficiency or preserving existing—and in most cases inefficient—firms. Hovenkamp takes the position that the goal of those who sponsored the law was indeed sheltering old firms from competition, but the language of the laws allowed shifting focus to efficiency.

The case for the efficiency focus is that it is the only justifiable option among the two logically possible goals of increased efficiency and improved distribution. While distribution goals have a few advocates, justified skepticism is more prevalent. The nature and size of the distributional effects producible by antitrust are unclear, probably small, and almost certainly perverse. A key is the disparity between firm size and the affluence of the owners. Large corporations are typically widely held, with pension funds and mutual funds as substantial owners. Small firms are typically closely held. While many small businesses provide low incomes, others—including the most influential—are often the basis of substantial fortunes. Consider such legislative favorites as local banks, local car dealers, local newspapers, and small producers and refiners of petroleum. Moreover, as Hovenkamp observes, the costs of preserving old firms is so high that, at best, limited aid can be given. Similarly, the non-market effects of industry organization are too vague. Such considerations are not just undefended, but never extensively discussed.

Thus, the efficiency goal is left. Even with it, problems arise. Fifty years ago, Richard Lipsey and Kelvin Lancaster produced a much-cited but little-employed second-best argument that what is desirable when one inefficiency prevails may prove undesirable when other inefficiencies arise. A more clear-cut reason for concern is that economic analysis verified by antitrust experience indicates that authenticating the existence of inefficiency is very difficult and, some argue, impossible. However, eliminating inefficiency is still the least undesirable alternative.

INTELLECTUAL HISTORY

Hovenkamp is searching for a next step in the long effort by economists and lawyers to place antitrust on a sound basis. The effort is usually and properly said to begin with the efforts of Edward S. Mason at Harvard. Mason was appalled by the incoherence of arguments employed in the New Deal's shift from planning to antitrust enforcement. Mason encouraged graduate students to write theses using sound economics to evaluate antitrust cases. The result was a series of landmark studies and the training of economists who went on to careers as professors at several leading universities. In practice, these students adopted many different positions on the issues.

Notoriously, Joe E. Bain and Carl Kaysen (in collaboration with Donald F. Turner) concluded that it was correct for the ad hoc commentators of the 1930s to advocate breaking up large companies. This was not the only position taken by Mason's students and, indeed, not what Mason argued. M. A. Adelman, for example, focused on the tendency of antitrust and other public policies to concentrate on damages to competitors even when such harm arose because the damaged firms were less efficient. Adelman started with retail trade, specifically the case against the A&P grocery store chain—a record well worth returning to because of the almost identical present-day attacks on Wal-Mart. Adelman then turned to similar errors in oil. In short, the Harvard response was more diverse and scattered than many commentators, following the guidance of Richard Posner, indicate. Posner's article postulating a Harvard/Chicago distinction suffers from pasting together a vision of Harvard. Posner selected from among diverse views of specific commentators with Harvard associations those that differed from Chicago positions. Thus, both Posner and Hovenkamp ignore important differences and nuances.

CHICAGO After World War II, a remarkable group of economists and lawyers at the University of Chicago began a more extensive, more concentrated, skeptical analysis of antitrust. Two main themes prevailed. First, the defects of the Bain and the Kaysen and Turner calls for breakup of large firms were explored by such "Chicago" participants as Harold Demsetz, John McGee, Robert Landes, and Posner. (The first two made their main contributions after moving on from Chicago.) Second, many of the supposedly anticompetitive tactics of large firms were examined and found of dubious relevance. McGee was critical here. In a 1958 article, predation was deemed improbable in theory and not present in its most celebrated alleged occurrence, Standard Oil. This effort produced many responses. Some believe McGee's conclusions were undermined; others disagree. Other areas considered included vertical relations, resale price maintenance, and tying.

In any case, the effort led to books by Posner and Bork summarizing the position and using it to advocate shifting antitrust toward stress on efficiency. With the rise of the Reagan administration, those concepts began to influence policy. Concern arose and persists that the change went too far—or not far enough.

POST-CHICAGO By the late 1970s, something sometimes termed the new industrial economics emerged. Theoretically inclined economists moved to developing new, more formal analyses of the issue of market power and the tactics that produced it. Around 1990, several syntheses emerged. The implications of this work are vigorously debated even by those who produced the new analyses.

Hovenkamp wants more stringency than the Chicago position but less than the post-Chicago theorists propose.

The problem is that the theories typically indicate that the tactics considered may or may not work and, if they work, may or may not be inefficient. Thus, inefficiency must be verified empirically; however, the available techniques are unable to provide definitive appraisals. Nevertheless, some of the developers believe their theories can be tested in practice, advocate changing antitrust to incorporate their concepts, and proclaim that they have produced a "post-Chicago" improvement in antitrust. In 1985, Hovenkamp argued that despite its problems, post-Chicago theory should be applied. In this book and a 2001 article, he now argues that implementation is unfeasible.

This leaves him without a coherent basis for his suggestions. He now wants more stringency than the Chicago position but less than post-Chicago theorists propose. Nevertheless, he claims that this produces a "new Harvard tradition" that realistically modifies the Chicago position. (Hovenkamp neither studied at nor was a faculty member at Harvard, but two of the antitrust works that he maintains were started by Harvard Law School professors.)

SYNOPSIS

Hovenkamp divides his book into three parts. The first begins with an examination of antitrust basics and concludes with a chapter each on private antitrust and expert witnesses. The second part deals with the five traditional concerns of antitrust: unreasonable exercises of market power, combinations, dominant firms and their exclusionary practices, distribution (of products, not income), and mergers. As he does not make clear, the market-power chapter presents general principles applicable to the rest of the book's second part. In the third part, he turns to the relationship of antitrust to other public policies that affect competition. These are regulation and deregulation, intellectual property, and network industries.

PART I The starting chapter is tedious because of widely different assumptions about readers' preexisting knowledge. A fairly leisurely traversal of an Economics 101 theory of monopoly is combined with terse, cryptic discussions of antitrust law. Since Hovenkamp later gives brief descriptions of the provisions of the law, presenting them early would not have expanded the book and would have helped the reader. Another problem is a treatment of supposedly undesirable competitive tactics that seems to suggest great concern, but later chapters stress that most of these tactics are not important policy issues.

In contrast, Chapter 2 nicely shows why efficiency, if not the goal of antitrust's framers, is properly the one the courts adopted. As is standard in the antitrust literature, he ignores the often hinted but never articulated view that important non-market impacts are critical to antitrust enforcement. This chapter also presents his case that a modified Chicago approach is better than post-Chicago.

In Chapter 3, Hovenkamp describes arguments applicable to all antitrust of the limitations of judges and juries in interpreting economic arguments and the difficulties of adopting satisfactory remedies.

On private antitrust itself, he notes the basic problems of the incentives of competitors to use the law to thwart competition that may come from more efficient firms and the temptations created by the statutory provision of requiring repayment of triple the damage. (See "The Perverse Effects of Predatory Pricing Laws," Winter 2005–2006.) Final consumers or resellers have better motives but lesser competence to evaluate the situation. Hovenkamp limits proposals for change to better recognizing and adjusting for anticompetitive problems. He later calls for lesser use of the triple damage option.

In treating the use of expert witnesses, Hovenkamp concentrates on questionable statistical analyses accepted in a specific antitrust suit. The more fundamental problem of recognizing and refuting unsound economic reasoning is mentioned too casually. He suggests more care and reliance upon court-appointed experts.

PART II Hovenkamp's treatment of "unreasonable exercises of market power" covers several key general issues. He begins with a solid discussion of determining market power. He recognizes that market shares are problematic as measures of market power, although his critique is not as forceful as those in the material that he cites. Just as he reaches a point where summarization is needed, he moves (without adding even a subtitle) to criticize a decision that Eastman Kodak restricted customers of its copiers to Kodak-made parts because its parts were not interchangeable with parts for other manufacturers. The decision is seen as setting a fortunately-not-followed precedent for limiting requirements on franchises, including those that preserve the franchise's identity. He returns to this issue in several later chapters.

An undesirably brief discussion of barriers to entry follows, and then Hovenkamp turns to the meat of the chapter. First, he outlines broad principles about large correctable harms that should be used in evaluating a case. He then grapples with the proper applicability of the two established principles: the rule of reason that requires evaluation of the circumstances in the case under consideration, and per se precedents by which some practices are automatically illegal without considering their impact in the case. Hovenkamp uses a 1918 quote by Justice Brandeis as the illustration of calls for overly broad rule-of-reason inquiries as the lead into another of his checklists of relevant considerations. In this and the other cases, the list is a solid presentation of what good economics requires. Before turning to per se rules, he reiterates the familiar proposition that actions involving cooperation of separate firms are of more concern than the isolated actions of a single firm. The latter can affect economies absent from arm's-length dealings of multiple firms and are harder to change than an accord.

The treatment of when per se rules should apply is based on a distinction between "naked" restrictions that only lessen competition and ancillary ones that have desirable effects. In the process, he discusses the need to retreat from decisions making per se illegal business practices that Chicago work showed were pro-competitive. In harmony with the recent confirmation hearings of Chief Justice John Roberts and Associate Justice Samuel Alito, Hovenkamp discusses why *stare decisis* (respect for precedent) does not preclude the proposed changes.

The chapter on combinations then deals with two aspects of identifying naked restriction. The first issue is whether firms attaining output restriction without any formal agreements should be prosecuted under the antitrust laws. Economic theories of oligopoly indicate that under favorable conditions, joint–profit maximizing can arise from independent output decisions and independent reactions to them. Following suggestions in Posner's treatise on antitrust, Hovenkamp proposes another rule for prosecuting such informal output restriction. The rules are designed to determine whether market conditions are conducive to such tacit collusion. When the criteria are met, Posner and Hovenkamp want antitrust action. Despite Posner's support, the argument ignores the Chicago concerns over the importance of such collusion and the uncertain ability of courts to implement the law properly. Indeed, whether Posner's original list of screening criteria or Hovenkamp's simplification is used, the result might be elimination of every situation considered.

The treatment of joint ventures in the remainder of the chapter is, in contrast, a solid statement of the issues with joint ventures. Such ventures need not, but sometimes do, involve restricting competition. Hovenkamp believes the difference can feasibly be distinguished in antitrust cases.

Chapter 7 on exclusionary practices starts by arguing that only monopolists that attained their position by uncompetitive behavior should be prosecuted. Hovenkamp then moves on to present familiar arguments why often-cited examples, such as predatory pricing, of such behavior are unlikely to occur. The chapter also covers various discounts for volume purchase and "torts" (harmful acts) as possible uncompetitive behavior; later chapters cover further examples.

In turning to antitrust and distribution, Hovenkamp largely presents Chicago arguments why most practices denounced by antitrust law are, in fact, often or even usually benign. The issues considered include efforts by manufacturers to control retail prices of their product and the various restriction franchisers or manufacturers place on retailers. He is aware that such restrictions on price can be anticompetitive but feels the difference can be distinguished. In the middle of his review, he turns to the now 70-year old Robinson-Patman Act. The act was another ill-conceived Depression-era effort that sought to protect small-scale retailers from the chains by depriving the latter of the quantity discounts justified by the economies of scale. Hovenkamp notes and endorses the longstanding attacks on the act. He notes that it too could be reinterpreted as favoring competition but agrees repeal is better.

His treatment of mergers opens by reiterating the standard view that many actions in the 1950s and 1960s prevented desirable mergers. He proceeds to suggest how harmful mergers can be distinguished. Again, this involves undue optimism about the abilities of antitrust agencies.

PART III The first of Hovenkamp's reviews of interactions between antitrust and other policies is a necessarily summary review of the relation to regulation.

He starts with an effort to summarize the overriding principles. He tends to understate the agreements and overstate the disagreements among economists. He presents an unsatisfactorily note of the tendency of political attitudes toward regulation to fluctuate. This is a critical example of his neglect of those who consider antitrust irredeemably flawed. Since concepts of sound economics are stable, the inability to count on continued adherence to sound economics is a limitation of politics, not economics.

He notes approvingly that courts are reluctant to subject federal, state, or local regulation to the antitrust laws; he correctly argues that antitrust is not the appropriate tool to reform ill-advised regulation. He then moves to an overview of deregulation and the economic work that supported it. He properly credits public choice economics for undermining faith in regulation. However, the text stresses the general, overly abstract work of such writers as James Buchanan and relegates to endnotes the more cogent work of the Chicago school, particularly George Stigler and Posner. He similarly credits newer, more optimistic analysis of competition that again stresses an abstract approach over more regulation-related Chicago work. He concludes with a well done but overly specific discussion of the rules relating to what local phone companies must charge long-distance carriers for connections to local subscribers; these are considered too low.

The chapter on intellectual property begins with acceptance of criticism of the law as overly protective. He sensibly argues that it is not the role of antitrust to offset the deficiencies of other legislation. He then moves to arguing that purported conflicts over antitrust arise mainly from misunderstanding. One area of error is pushing copyright or patent rights too far and trying to use them to justify control of the price patent-holders charge for products using the patent. Another is undue concern over tactics such as tying.

The treatment of networks turns out to be largely an argument that the modifications of the Microsoft case made during appeal and retrial were undesirable. Such a move into specificity was unexpected and disappointing. At a purely mechanical level, Hovenkamp inadequately cites the vast literature on networks in general and the Microsoft case in particular. More critically, the result is acceptance of dubious arguments. Those deficiencies merit review because they are graphic examples of the disparity between Hovenkamp's basic arguments and his specific proposals.

Press reports of the initial district court Microsoft decision made me skeptical and inspired looking further. Viewing the trial transcripts and supporting material made available on the Internet, I found an appalling situation: The written statements and oral testimony of the government's two expert economists fail to present a coherent, well documented argument of the case. The government's premise is that Microsoft possessed an impregnable Windows monopoly that was misused to displace the Netscape Navigator Internet browser. The government's own epitomizations are slightly better on the monopoly but worse on its abuse. The arguments are attempts to elevate post-Chicago concepts over Chicago ones. However, the relevant post-Chicago theory is repeatedly mentioned without ever being explained.

The government's two expert witnesses in the *Microsoft* case failed to present a coherent, documented argument.

What probably won the case for the government was shrewd use of seemingly damning statements by Microsoft officials. Except for one statement produced in oral testimony by an Intel executive, these phrases came from internal memoranda uncovered in the government's sweep of Microsoft records. The phrases seem to have produced indignation in the government's expert economists, several outside observers of the case, and, most critically, the judge presiding over the trial. Examination of them in context suggests the phrases at worst are exaggerations to stimulate interest in otherwise innocuous proposals to compete more vigorously. The quote from the Intel executive was that Microsoft's provision of a free browser forced Netscape to stop charging and thus cut off Netscape's air supply. Even leaving aside that the cited Microsoft executive denied making the statement, it was unwarranted bragging. It was unclear that Netscape was raising much revenue from selling Navigator and quite clear, as Chicago theory indicates, that the many participants in microcomputing could (and AOL ultimately did) provide financing to assure that Netscape could withstand competition from Microsoft.

While a valid case is not easily constructed, both sides agree that Microsoft tried vigorously to displace Netscape Navigator with Microsoft's Internet Explorer. The Microsoft actions amount to buying greater access for Explorer. The issue then is the motivation. The government claimed that Microsoft was frightened by boasting by Netscape's chief designer that by using Java, a computer language developed by Sun Microsystems, he could transform Navigator into a platform on which computer programs could be written, thus displacing Microsoft's Windows operating system. Under cross-examination, the CEO of Netscape, in fact, dismissed the ambitions as fanciful. Microsoft contended that it simply saw that a good browser had to be part of an operating system.

The record suggests that Microsoft did initiate browser inclusion before it was aware of the Netscape threat, that platform creation was a fantasy, that indeed many more serious threats to Windows existed, and that Explorer ultimately became superior. Thus, the Microsoft claim of a fair fight in the browser area is more plausible than the government's Windows' monopoly-preservation contention. Hovenkamp misses all of this in his comments in the case. Moreover, an article on Supreme Court guidelines on expert witnesses by two Federal Trade Commission economists cited the more important government expert witness, Franklin Fisher of MIT, as an example of unacceptable testimony. In addition to the lack of economic substance already noted, the testimony showed acceptance of post-Chicago theories that Fisher has severely criticized in professional writings.

Hovenkamp, however, accepts the government's contention that including Explorer in Windows was tying that prevented the use of Navigator. He presents this argument in prior chapters as well as in his treatment of the case. However, the assertion reflects an erroneous view of microcomputers. Disk size had increased greatly so that adding Navigator was, contrary to the court's assertion, no burden. Even if the court's dubious assumption that downloading was too difficult is accepted, it was in the interest of computer manufacturers and allowable under their agreements with Microsoft to install Navigator if it were the superior browser. (At the time I wrote my book on Microsoft, I had the Macintosh versions of Explorer and Navigator on my hard drive; today these are joined by the browser Apple ties to its operating system and two other browsers.)

Having decried the ultimate disposal, he admits that standard antitrust remedies are unlikely to produce desirable outcomes. He suggests that the government encourage competition by requiring use of rival operating systems. This presumes that Microsoft exercises monopoly power with Windows. Microsoft's expert at the original trial argued that the existence of technically competent, well-financed firms in the computer industry restrained Microsoft and caused it to sell Windows at a price well below the monopoly optimum.

The book concludes with eight sensible suggestions to improve antitrust. These all are drawn from the prior chapters. The broadest call for further retreat from per se rules and clearer guidelines for rule-of-reason inquiries.

CONCLUSION

Given Hovenkamp's role as a leading writer on antitrust, his views will receive much attention. Therefore, the book's deficiencies are unfortunate. The essence of his argument is that the move to stressing efficiency has gone far but needs further tweaking. Even if we accept his premise that in theory antitrust can be made a more effective program to promote efficiency, would not public choice limitations of actual governments preclude success? R

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