Journal of Industrial Organization Education

Volume 5, Issue 1

2010

Article 6

Intentional and Evolutionary Visions of U.S. Antitrust Law

Subbu Kumarappan, *Michigan State University*

Recommended Citation:

Kumarappan, Subbu (2010) "Intentional and Evolutionary Visions of U.S. Antitrust Law,"
Journal of Industrial Organization Education: Vol. 5: Iss. 1, Article 6.

DOI: 10.2202/1935-5041.1027

Intentional and Evolutionary Visions of U.S. Antitrust Law

Subbu Kumarappan

Abstract

This teaching module shows how U.S. antitrust laws are affected by 'intentional' and 'evolutionary' visions of socio-economic market processes. The extent of government's role is studied to review whether the U.S. antitrust laws should be strengthened, reformed or repealed. The focus of Chicago (and Austrian) school is discussed: *'antitrust laws should promote and enhance the trio of -- consumer welfare, competition process, and dynamic (productive and allocative) efficiency.'*

The role of U.S. antitrust laws in a globalized world and the need for universal law are mentioned. The economic reasons used to rule in U.S. antitrust enforcement since the 1890s are provided in a tabular format for easy use in the classrooms. Teaching tips are provided on how to use the material in classroom discussion and assessments.

KEYWORDS: antitrust, globalization, intentional, evolutionary, vision, ideology, economics, law

Author Notes: I would like to thank Ivan Pongracic (Hillsdale College) for detailed comments on an earlier version of this draft.

Introduction

The US antitrust law has undergone tremendous changes in its interpretation and implementation over time. It has been used to indict companies for opposing reasons such as charging same prices (collusion), different prices (price discrimination), low prices (predatory behavior), high prices (monopoly) or the companies that fixed resale prices (vertical restraint, Armentano 1999, p 25) and its rulings have contradicted themselves over time. This teaching module aims to make these concepts accessible to students and help them understand *what are the elements of the alternative legal visions about markets and how the evolving interpretation of US antitrust laws has contributed to changes over time*. The economic and legal rationale based on two alternative legal visions termed as *intentional* and *evolutionary* paradigms are the focus of this presentation.

This module discusses the arguments for and against antitrust laws, and how economics and industrial organization have changed the antitrust law interpretation in the US. This presentation notes and the accompanying Slide slides are written up to answer questions such as:

- What are the alternative interpretations of economic arguments used to rule in antitrust cases?
- How the interpretation of antitrust laws has changed over time?
- Whether and how an industry's characteristics (structure-conduct-performance) contributed to radically opposing indictments under antitrust law?
- Whether the current interpretation is valid or will it change in the future?
- Will there be a new role for antitrust policies in a globalized world?

This lecture can ideally be covered by the end of the course as it revisits and discusses alternative viewpoints for common topics taught in an undergraduate IO class (economies of scale, industry structure, competition, welfare). The results of major economic principles and its implications for antitrust court rulings are explained with common graphs.

The teaching module is organized under three sections: Section 1 describes two alternative socio-economic visions (*intentional* vs. *evolutionary*) that affected the formation, implementation and interpretation of US antitrust laws (Page, 2008). The distinction between *intentional* and *evolutionary* visions was introduced by Page (1991, 1995, 2008; Page and Lopatka, 2007) enabling much of the discussion in this teaching module:

- (i) the *intentional* vision regards that markets can be swayed by powerful interests resulting in corrupt outcomes and a bigger role for government intervention is necessary to improve the economic welfare, thereby strengthening the need for government intervention institutions such as antitrust;

- (ii) the *evolutionary* vision limits the degree and extent of government intervention; in its purist form based on libertarian principles (the closest example would be Austrian economic thought), the *evolutionary* vision regards ‘free market’ processes to always result in morally good outcomes, hence with no role for government intervention.

From these radically opposing extremes, a middle ground approach with a reduced scope for government intervention has emerged (Bork, 1993). This middle ground approach suggests antitrust laws to focus on ‘hard core’ cartels and horizontal price fixing or mergers, but it reduces the scope of antitrust laws in other realms such as price discrimination, and vertical restraints. The economic rationale of this middle ground approach can be summarized as follows:

‘antitrust laws should promote and enhance the trio of – consumer welfare, competition process, and dynamic (productive and allocative) efficiency’ (Bork, 1993; Pitofsky, 2008).

Section 2 questions how the US antitrust laws are (not) tenable in a globalized world. The characteristics of European Union (EU) antitrust laws, and those of emerging economies (China and India) are discussed. The contrasting rulings by US and EU antitrust courts on major cases such as GE-Honeywell merger and Microsoft’s business practices are analyzed to show how similar economic principles can be interpreted and implemented differently by different antitrust regimes. Students have to be aware of the efforts to develop one international antitrust set up (or agency) with similar and comparable antitrust statutes.

Section 3 classifies the economic rationale used in US antitrust cases into ‘guilty’ and ‘not guilty’ verdicts; the connections between these verdicts and the alternative visions of US antitrust law are analyzed. Selected cases – under major categories such as market structure (monopoly, oligopoly), and conduct (pricing behavior) – are discussed to highlight how the *intentional* and *evolutionary* visions have affected antitrust rulings over time. The relevance of economic welfare, competition, efficiency, and innovation to economic analyses in antitrust cases are depicted using graphs.

Pedagogical focus: Industrial Organization students can gain an understanding of US antitrust law and how economic concepts have been used to answer some basic questions such as ‘what is market?’ and ‘what is competition in the market place?’ The arguments presented in section 3, used to rule in favor of plaintiff or defendant firm’s activities, can be valuable from an IO teaching perspective since almost all court rulings are based on the application of common economic concepts discussed in an IO course. Students may be encouraged to question or justify the economic rationale used in the past antitrust rulings. The focus of this teaching module is on alternative visions of antitrust laws which can

provide a basis for ‘thesis-antithesis’ discussion to synthesize student understanding of US antitrust (as in Hegelian dialectic). Students can be directed to defend the two opposing paradigms: *evolutionary* and *intentional* visions. They can also argue based on a hypothetical case or evaluate an actual case given in section 3.

This teaching module differs from traditional approach to teaching antitrust in IO courses by focusing on the contradictions and differences in antitrust rulings over time. It can broaden students’ understanding of antitrust by connecting economic principles with antitrust court rulings. The instructor can use sections 1 and 2 alone for an overview of antitrust cases, economic arguments commonly used and what does the future hold for antitrust law in the US and across the globe. Section 3 can be used as a stand-alone teaching module for an in-depth discussion of important antitrust cases and how they helped shape US antitrust laws. Teaching tips are provided for classroom assessments and to motivate discussion among students.

Slide #1

There are calls to implement antitrust laws more aggressively, others claim to reform the laws while a few others call for a total repeal of all antitrust laws – an understanding of these opposing views can provide a rich intellectual framework to understand how economic analyses are applied in legal areas and antitrust cases. The IO students will recognize the fundamental economic principles, viz. competition, welfare and efficiency, which should become the economic guiding principles to decide in antitrust cases.

Slide #2

The material is organized under three major sections: Section 1 provides a historical perspective of how the US antitrust laws have changed over time; the opposing views to *strengthen vs. reform vs. repeal* antitrust laws are motivated by a discussion of two contrasting visions viz. *Intentional and Evolutionary visions*. Section 2 evaluates the future role of US antitrust in the context of globalization. Sections 1 and 2 can be used to provide an overview of the ideological clashes existing in antitrust. Section 3 provides an outline of how antitrust case rulings have changed based on *intentional* and *evolutionary* visions in the US. The cases are arranged under two categories: reasons for ‘guilty’ and ‘not-guilty’ verdicts. The idea is to provide students with an understanding of what economic arguments were used and how were they applied to support (not-guilty verdict) or reject (guilty verdict) a particular business practice. This last section provides examples from actual US antitrust case rulings and how the *intentional* and *evolutionary* visions had impacted them over time. The implications of these opposing visions are depicted with graphs commonly used in IO courses. The last

section can provide a comprehensive summary to other concepts taught in a typical undergraduate IO course.

Slide #3

Antitrust – Historical Perspective and Alternative Ideologies

Slide #4

Antitrust laws are one type of government intervention in the markets. These laws were enacted in 1880s from the perspective that powerful interests are likely to manipulate and coerce the markets to their advantage. Hence, the market processes are regarded to almost always result in morally corrupt outcomes. So, the democratic intervention from the government is suggested to be necessary to improve aggregate welfare – this ideology corresponds to ‘corruption’ doctrine of the markets that was prevalent in the 19th and early 20th century. The opposite view is that unregulated market processes, characterized by free exchanges, will maximize social welfare. The resultant outcome is said to be better than the case where the government intervened – hence, this ideology corresponds to ‘goodness’ doctrine of the markets.

Antitrust laws are readily justifiable under corruption doctrine since it envisions a direct role for government and courts. The case against antitrust is propounded by the ‘goodness’ doctrine where market processes are regarded to outperform the government intervention. These opposing views have played a longstanding role in defining what antitrust laws should or should not do. These opposing viewpoints have also been key elements of many other processes and socio-economic spheres such as free markets, regulation, big business, socialism, distributive justice, and globalization (Kaiser, 2006).

Slide #5

Ideological differences: To *strengthen*, *reform* or *repeal* the antitrust laws?

This slide explores the differences between the two visions in more detail. Also see Page (1991, 1995, 2008) and Page and Lopatka (2007).

Intentional ideology: If the market processes are thought (expected) to generally result in corrupt outcomes, then powerful actors can manipulate, coerce and exploit the weaker agents in the economy – antitrust authorities often cite this reason as the basis for government intervention in the market process. In many cases, this view leads to prescription of a particular form of market structure (for instance, support for a market structure populated by numerous firms to replicate the text book style ‘perfectly competitive market’). Here, antitrust laws are used by the government and courts to review, and intervene in the market process to correct or steer in a different direction to obtain some ‘intended’ outcome. Hence

it is known as '*intentional*' ideology. This *intentional* view is used by the supporters of antitrust laws to *strengthen* the call for more vigorous implementation.

Evolutionary ideology: If the markets are expected to always result in morally good and just outcomes, then it means that the uncontrolled market processes are superior to alternative forms of government control such as regulation or antitrust. Markets can quickly evolve according to the consumer preferences and reflect their demand provided that the price signals are not distorted by intervention. This will also ensure that markets can attain both productive and allocative efficiency in the economy without having the government to intervene. From the purist standpoint of *evolutionary* ideologists (e.g. Austrian economists) there is no role for government at all, if the markets are allowed to function freely to attain competitive outcome, enhance consumer welfare and improve efficiency. The Austrian economists argue that no small group of economic agents could coerce the market system to their advantage, unless with the help of government rent seeking behavior, and government intervention is not necessary and even unconstitutional (Armentano, 1999; Connor and Foer, 2003). Any government intervention would only result in protecting selected groups of inefficient competitors rather than the competition process itself. The government intervention would worsen the problem since groups of privilege seeking competitors are likely to employ the antitrust mechanism to cover up their inefficiencies. This '*evolutionary*' view is akin to the libertarian and free market principles where the market mechanisms are the best means to achieve maximum welfare through free, legitimate and mutually beneficial exchanges and interactions among innumerable economic agents.

Under the purist form of *evolutionary* ideology (especially, Austrian economic thought), the antitrust laws are totally untenable since the antitrust laws limit, control or even cripple the free market processes - frequently acting in favor of some economic agents aiming at economic (or monopoly) profits. Moreover, the regulating authorities in government and antitrust do not have enough information or knowledge to make the best decisions for the entire market (or industry) comprised of numerous producers and consumers where demand and supply are constantly changing – this is the classical 'knowledge problem' (Hayek, 1945). In this purist form of *evolutionary* ideology, continued functioning of antitrust laws will reduce consumer welfare and affect competition for the above said reasons; this argument led to the call for *repeal* of all antitrust laws (Armentano, 1999). One major drawback with the purist *evolutionary* theorists is that they generally ignore the cases and conditions where government intervention can actually enhance consumer welfare.

There is also a moderate version of *evolutionary* view: according to this interpretation, the economic arguments for rulings in antitrust cases have changed (evolved) over time. Many support the moderate view of reforming antitrust laws. The focus of reform is suggested to be on certain business activities such as horizontal mergers that result in very large share of the markets or collusion activities restricting outputs with no gains in dynamic efficiency or consumer welfare. This moderate view supports the efforts to *reform* the antitrust laws (Bork, 1993).

Teaching tips: The students can be asked to take sides with any of the three viewpoints – *intentional* or purist *evolutionary* or moderate reformation. Taking a position and arguing for or against another will help them understand why the underlying ideology is important to comprehend the scope and implications of antitrust laws and court rulings. If possible, a clicker question can be used to analyze the distribution of students among these three categories – this can be compared with the distribution of professional economists that subscribe to these alternative viewpoints.

Slide #6, 7

These two slides provide a broader comparison of the two ideologies that have influenced and shaped the US antitrust laws and rulings. They provide a direct comparison of the two ideologies and how they differ from each other in terms of market doctrine, scope for governmental intervention, and how the economic agents might have different levels of power in these two schemes. These two slides expand on the definitions provided in Slide #5.

Slide #8

Antitrust laws can be readily justified under the *intentional* vision – where the intention might be to promote a certain structure within the industry (e.g. numerous small firms in stead of a few oligopolistic market structure). In practice, this could result in protecting few firms from their competitors. Enacting and implementing antitrust laws implicitly assumed that markets cannot bring about the most desirable outcomes and there is room for government to contribute and enhance the market outcomes – hinting at the roots of *intentional* vision.

This initial perspective later changed due to economic and legal analyses conducted in University of Chicago in 1970-80s; their analyses focused on the role of free markets in *promoting competition, improving efficiency and prioritizing consumer welfare* – this new focus was favored by many in the last three decades as it incorporated the dynamic changes, and stressed the role of innovation and technological changes in the market place. This also marked a significant shift from the *intentional* ideology that dominated till 1960s. Although

the term consumer welfare is used to refer to economic welfare, it actually refers to aggregate welfare that includes producer surplus and profits, since consumers (shareholders) own all companies in a free market economy.

Under the purist view of free market processes, there is no role for governmental intervention into a firm or industry's business practices. This is the extreme *evolutionary* view that calls for a total *repeal* of all antitrust laws (Armentano, 1999).

Teaching tips: Students may answer the question: 'What should be the basis for rulings on antitrust cases' – the instructor can use this question to introduce the concepts of *protecting competition, promoting efficiency and ensuring consumer (or aggregate) welfare*. Then the students can be introduced to Chicago school's contributions and motivate the idea of 'dynamic changes' at the market place; the type of knowledge problem that exists among antitrust authorities and how economic agents in the market place bring additional information and address the knowledge gap in the market place. Students have to recognize whether the *intentional* or *evolutionary* view would promote the development of these factors.

One of the most recent antitrust views is that Chicago school's economic insights developed during 1970s and 1980s may not be fully correct. In the context of this paper, this most recent insight can be interpreted as the middle ground between the two extremes of *intentional* and purist views (Pitofsky, 2008). The students may also discuss in what ways, the purist *evolutionary* view that calls for repeal of all antitrust laws could benefit or harm markets, industries and firms. The other discussion questions could be: should the ideology be same across all industries? Can the same ideology be applied in the same manner to both emerging industries (e.g. information technology) and established industries (e.g. fossil energy)? If the same ideology is applied differently for different industries, how to avoid arbitrariness in antitrust rulings?

Slide #9

Changes in US antitrust laws over time

This slide summarizes how the administration of US antitrust laws has changed over time. The table shows the paradigms (ideologies) that dominated the interpretation and implementation of US antitrust laws over the past 120 years. Understandably, the *intentional* vision was the predominant ideology in the beginning periods. Defining what constitutes *evolutionary* seems to be tricky: as Page (2008) points out, the institutionalizing of antitrust in late 19th century can itself be considered *evolutionary* since government did not interfere in the market processes to a large extent before 1890s – hence, expanding the government role in planning of the markets during the 19th century could be considered *evolutionary*. In the beginning (Sherman act, 1890), many antitrust cases were

dealt with severely, and many rulings were handed out on a *per se* violation basis (i.e. always wrong if there is evidence that such a business practice took place, irrespective of reasons or circumstances). This approach changed with the development of *Rule of Reason* principle in 1911 (e.g. *Standard Oil case*) – this could possibly be considered the beginning of *evolutionary* changes at a larger scale. There has been a combination of *evolutionary* approach (rule of reason) and *intentional* perspective that thrived together during the 20th century with the passage of new antitrust law statutes. The judges handing down the rulings also exercised considerable influence on what government could do in the markets. The students should understand that these judges might not necessarily have had a better economic understanding causing the ‘knowledge problem’ mentioned in Slide #5.

The Clayton act (1914), Robinson-Patman act (1936), Miller-Tydings Act (1937), and the merger guidelines (1968) and many other laws aimed at identifying an ideal form of market structure, and conduct. These laws claimed to improve competition and placed higher emphasis on text-book style perfect competition outcome by protecting many smaller inefficient producers with a view to reduce market concentration. These acts predominantly promoted small retail businesses and opposed large chain store market structure. Thus, it is clear that the focus and implementation of these acts in the first half of 20th century had a greater *intentional* focus.

In 1970s, the analyses by Chicago school economics and law faculty resulted in a change of interpreting antitrust laws; they advocated a modern interpretation of what antitrust laws should do. According to their (moderate) *evolutionary* vision, markets are dynamic and constantly evolving; the goal of antitrust laws should be (i) to protect competition (rather than the competitors), (ii) to increase efficiency and (iii) to improve consumer welfare in a dynamic sense. For the future, globalization has become a major reason to reconcile the alternative views of antitrust laws in the US, European Union (EU) and other countries. There is a need to develop a consistent set of principles at international level which will guide the implementation of antitrust statutes. These proposed changes will be based on new developments and altered significantly over time and hence can be classified under the *evolutionary* view.

Teaching tips: The ‘knowledge problem’ that arises in a dynamic sense (over time) can be stressed here. Even though the judges might rule on antitrust cases based on certain expected outcome, market behavior or price movements are not known with certainty ahead of time. Hence, any attempt to control the activities of firms today could become faulty move as the economic conditions change after a certain period of time. This has happened in the past, where the practices once prohibited by the *intentional* vision occurred or reappeared as genuine business

processes later and justified based on market conditions. The initial court rulings had in effect postponed such inevitable (possibly beneficial) changes, the consumer welfare were reduced due to intervention by the courts and government. The significance of Chicago school primarily comes from their insights on the above three aspects (competition, efficiency and consumer welfare) – the students may analyze how to identify and quantify them in a particular industry and whether the changes from *intentional* to (moderate) *evolutionary* vision has been for the better or worse.

Slide #10

Questions to consider

This slide presents a few more questions that can motivate student discussion.

Teaching tips: These questions can be framed as ‘is it possible to know the future demand and supply conditions, innovation and technological changes or the direction of future market conditions with certainty?’ If not, then governmental agencies should play only less of a role in the form of antitrust enforcement. Another question is whether markets result in inherently bad outcomes (corruption) or good outcomes. This question has philosophical roots behind it and students should recognize those philosophical implications of what markets are, how antitrust authorities and businesses view different practices. An answer to this question is fundamentally important because it will also help in answering the second question in this slide: should markets be coerced? Given a capitalistic market system in the US, what could be the political, economic and cultural motivations to enhance (or reduce) antitrust enforcement? The differences between various industries can be analyzed by exploring the conditions that warrant increased antitrust scrutiny.

Slide #11

Three common theoretical reasons are used to justify antitrust laws as economic theory (Armentano, 1999): antitrust as public interest, regulation or industrial policy – the students should explore the merits and problems associated with each of these theories or concepts. Antitrust as regulation or industrial policy may not be relevant in all countries especially that have adopted free markets and capitalism in theory as well as in practice.

Teaching tips: They should understand how the public choice theory relates to this problem: the politicians’ interests would not necessarily coincide with the market outcomes – hence an *intentional* approach would eventually favor the few who can wield its power which is ironic since the *intentional* vision was supposed to remove such selective influences. Students may explore whether antitrust can

be justified as an industrial policy in other countries characterized by bigger and centralized governments such as India. Students may discuss how the developing countries like India that adopt free-market principles should structure their antitrust policies and how the alternative ideologies can create problems.

Slide #12

This slide mentions some of the old economic theories whose results were once applied to rule in antitrust cases but have now been discarded. Replacing old views with new economic theories suggest the *evolutionary* nature of antitrust. If the old theories were not discarded, then it handicaps the antitrust mechanism – hence, literal interpretation of *intentional* ideologies can create problems in using antitrust to promote competition in the market place. Some discarded theories include shared monopoly (a form of oligopoly), entrenchment theory (where the merged entity can muscle out other competitors after merger) and use of predatory behavior as reasons to indict businesses (Bork, 1993; Padilla and Renda, 2008). The ‘incipiency’ argument used in *intentional* paradigm was also found to be faulty; according to this argument, a merger might be prohibited if the courts perceived a chance for larger market share, or monopolization in the future, even if not immediately possible.

Teaching tips: Students should recognize the faulty criteria in these discarded theories. The chances envisioned and outcomes perceived or predicted by the courts could be purely arbitrary and might not actually occur at all. Students may discuss how the business practices proscribed under these older theories may in fact enhance consumer welfare in the long run. One common theme among slides 9 through 12 is that markets are dynamic and changes in the market place cannot be known in advance showing the knowledge problem faced by the court or antitrust authorities who are not directly involved in production, marketing and other activities.

Slide #13

The previous slides discussed what theories were discarded; this slide presents what theories are predominantly used in early 21st century US antitrust laws. According to Meyer (2007), the current focus is on:

- Protection of competition in stead of competitors, i.e. the market process assumes importance over the market participants – protecting certain set of firms may lead to privilege seeking behavior among firms that are not necessarily competent; protecting competition is more likely to yield better goods and improved services helping enhance consumer welfare
- Less industry wide investigations – to prevent inefficient firms from misusing the antitrust system to fight its competitors

- Firm mergers are allowed if they ensure flow of resources into efficient managers' hands – this reiterates ensuring efficiency as a major goal of antitrust mechanism. The mergers are no longer regulated from the perspective of maintaining certain market structure; this is a radical shift from the earlier *intentional* vision of antitrust laws.
- Rule of Reasoning is widely used to differentiate among industries, situations and handled on a case-by-case basis.
- New antitrust laws aim to protect intellectual property rights. These laws have become more important with the developments in information and technology industries, suggesting that *evolutionary* vision of antitrust laws are more appropriate.

Slide #14

In recent times, there is increased attention in the US to control 'hardcore cartels,' which are formed purely to control and reduce output without improvements in market efficiency or changes in quality or service. European Union (EU) considers multi-national cartels a valid threat suggesting that there are some principles that are shared across political boundaries (James, 2002). While it may be obvious to control hardcore cartels from the *intentional* and moderate-*evolutionary* perspectives, the purist form of *evolutionary* theorists prohibit controlling even the hard core cartels. The students could analyze under what conditions an uncontrolled hardcore cartel would improve (or reduce) economic efficiency and consumer welfare in the long run (Bork, 1993; Connor and Foer, 2003). Students can be introduced to economic methodologies and econometric techniques used in measuring economic welfare in the context of cartels and other market forms (Whinston, 2006).

Slide #15, 16

In spite of the renewed focus in antitrust laws (Slides #13, 14), antitrust laws are plagued with many criticisms. These form the bases for purist *evolutionary* theorists that antitrust in any form is harmful for free market processes and all antitrust laws should be completely repealed.

- Arbitrariness – many cases use rule of reasoning approach; while it seems better than the *per se* approach, there are difficulties in applying it consistently. For instance, completely different rulings have been reached for similar cases (*Sylvania* and *Kodak*) plainly due to changes in courts and personnel. Whenever the courts found 'some' economic theory, antitrust laws give them the authority to wield them indiscriminately or in an inappropriate manner. This exemplifies the arbitrary nature of rulings in antitrust laws. Moreover, since such reasons and economic theories are constantly reinvented or reinterpreted (Slide #12), the laws are likely to

have different implications for different industries – this is also interpreted as arbitrary.

- Size – many firms come under antitrust investigation plainly due to their bigger size. The 1982 antitrust ruling on *AT&T* resulted in breaking up the big company into numerous subsidiaries (that included SBC); after two decades, market conditions forced AT&T to merge with SBC again (AT&T News Release, 2005). Students may discuss whether the antitrust courts had passed an erroneous judgment by breaking AT&T in 1982 where the market forces proved otherwise in 2005.

Similarly, General Motors (GM) and Du Pont were restricted from merging in the middle of 1950s (Dirlam and Stelzer, 1958). Fifty years later, GM struggles to survive due to falling market shares (Janofsky and Lange, 2008). Students may discuss whether GM would have benefited and changed its strategy, set-up and product quality under new management had the merger with DuPont gone through earlier. The salient questions are ‘did antitrust authorities inadvertently prevent a beneficial merger and stop the formation of a more efficient company?’ and ‘how much of benefits went unrealized due to the obstructed merger?’ A farcical account of investigating IBM and withdrawing investigations after fruitless investigations for 13 years also suggests how time, energy and resources could be wasted in antitrust investigations (Bork, 1993).

- Dynamic changes – the above examples show that antitrust authorities could not have known the ideal market structure or future outcomes. In stead of acknowledging the knowledge problem, if the antitrust laws are implemented arbitrarily (as with ‘rule of reasoning’), the antitrust institution may actually delay innovation and reduce consumer welfare over time.
- Certain market outcomes can be achieved by multiple methods – antitrust prohibits certain methods (e.g. price restrictions) while it allows some other methods (e.g. non-price restrictions, related to providing better service). This shows that firms can reach the same market shares or attain same amount of higher profits through certain methods that will not be instigate antitrust authorities. Those firms just only have to be creative to get around the antitrust issues. In a few other antitrust cases, the non-price restrictions have been cited to be anti-competitive. The students could discuss whether price and non-price restrictions should be treated in the same way or not. Since there are various options and interpretations under antitrust regimes, they create loopholes for either side (the plaintiff and defendant firm). All these legal complications affect the economic outcomes and market performance.

- In spite of a well-perceived violation, certain firms were not punished due to legal technicalities that come up with institutional bureaucracies.

Slide #17

Certain industries have been exempted from antitrust laws (Bohlman and Dundas, 2004) – students may discuss the reasons and aspects (structure, conduct and performance) of these industries that led to their exemption from antitrust. Another important question is whether exemption for these industries helped increase competition, consumer welfare and efficiency than other industries that are currently subject to antitrust laws and regulations. While all sports associations are subject to antitrust law regulations, baseball alone had been exempted since 1922 – even though there were some reasons for its exempt status, it is plainly more arbitrary to single out baseball sport alone (Griffith, 1993). Leaving out baseball did not enhance efficiency because the sport was still plagued with labor disputes (Kaiser, 2005). Even though baseball's exemption status was addressed in Curt Flood Act of 1998, its actual implementation has left much to be desired (Schwinger, 2007). Political backing and socio-economic climate weigh in more than the actual circumstances in any industry (Kaiser, 2005). The political drama behind revoking the antitrust exemption status of US insurance industry shows how antitrust may be used by the government to control industries or how the industry is still able to maintain its privileged status through lobbying and rent seeking efforts (Grim, 2009).

Teaching tips: Some relevant questions for class discussions and student understanding: if there are no superior efficiency gains or enhanced competition in the exempted industries, then should they be regulated by antitrust laws as well? Or should the laws be repealed fully because there is no difference even in industries that are regulated?

Slide #18

Section 2 – Antitrust in a globalized world

Previous Slides discussed the past and present approach to antitrust in the US. The next three Slide slides complement the discussion by looking ahead into the future.

Slide #19

International perspective

The role of antitrust law in the future globalized world could be very different from the past. When US have had a long antitrust tradition, many other countries do not have such antitrust enforcement (DOJ, 2009). This can potentially lead to relocating businesses from US (or other countries that follow strict antitrust

policies) to countries which do not enforce antitrust strictly. While this promotes global competition, the consumers in countries with strict antitrust laws may be harmed.

The adoption of antitrust laws in the European Union (EU) is becoming similar to that of the US (James, 2002). If such a process is repeated across the globe, a global 'one law' would emerge for all countries as proposed under 'one world' paradigm (Singer, 2002). Notwithstanding this uniformity, the cases that are found *not* to violate antitrust laws in the US have been found to be in violation in EU (Europa, 2009). Arbitrary or varied interpretation of same antitrust laws is more likely to happen in the international context.

Teaching tips: In popular media there are references to businesses moving from the US to Cuba to avoid antitrust scrutiny (Feature film: *The Godfather* part II – comment made by the character Hyman Roth to Michael Corleone in Cuba). Students may discuss the relevance of that comment and the impacts of US antitrust in locating multinational businesses. Other questions of interest include: should there be only one interpretation of antitrust laws across political boundaries or can there be more than one? Whether the countries would be open to adopting a universal law and what are the problems in implementing it in a similar manner across all countries?

Slide #20

Global antitrust law can be complicated due to varied socio-economic and political conditions in sovereign states. The emerging economies such as China and India have their own antitrust regimes (and problems). India's competition law today looks similar to that of the US laws in the early 20th century. The students should recognize that the impartiality and objectivity of antitrust laws will be lost if they are handled differently across countries/regimes. The industrial organization differs in many developing countries: many countries have public and private sector enterprises, government policies subsidize certain sectors or products (e.g. agriculture and food), and the attitude varies towards implementing intellectual property (IP) rights (Doyle, 2008; Sheth, 1997).

Slide #21

If a multi-national firm is subject to many antitrust law regimes where it operates, its transactions costs conforming will increase dramatically and reduce efficiency. As mentioned above, the practice allowed under one regime might not be allowed under the other; in some instances, antitrust investigation has crossed the traditional jurisdictional boundaries while investigating a firm's practices. There is some effort, though in its infancy, to bring uniformity among the interpretation of antitrust laws across the globe. The International Competition Network (ICN,

2006) is a step in that direction. As it stands now, it will take many more years to achieve any kind of uniformity in antitrust law implementation across the globe (James, 2001).

Certain countries may allow certain business practices, which are not allowed in other countries, purely to attract business investment. Defining consumer welfare has to address not only political and geographical boundaries but also address how to weight consumer welfare from different market segments across countries. Antitrust implementation has to be uniform in securing Intellectual Property (IP) rights; if not, there will be a loss in efficiency since businesses might not be willing to invest sufficient in research and development. The antitrust laws governing patent pooling becomes complicated with the growth in technology and different antitrust regimes are likely to view it differently. With many developing countries turning blind-eye to illegal copying (e.g. software piracy), global antitrust implementation will become a key feature in future international trade negotiations.

Teaching tips: Students may discuss the difficulties in defining consumer segments within a country versus across the globe. The evolution and changes in ‘competition, efficiency and consumer welfare’ concepts can be posed in the global context as well.

Slide #22

This slide provides two instances in which US and EU antitrust rulings conflicted with each other on the same case based on same facts. Microsoft’s practice of tying internet browser to its operating system was not dealt with severely in the US unlike EU (Europa, 2009). No punitive damages were levied on Microsoft for past violations, but EU fined Microsoft in excess of \$600 million in 2004. While both regimes found similar faults with Microsoft’s operations, the interpretation was more *evolutionary* in the US compared to that of EU antitrust regime.

The global merger between GE and Honeywell did not materialize because EU blocked it in Europe – US antitrust authorities were convinced that the merger will increase competition by reducing prices and improve consumer choice and force innovation by all competitors in the industry; EU used the same economic argument and suggested that some competitors (although inefficient) would be driven out of the market (Brock and Obst, 2007; Nalebuff, 2002; Page and Lopatka, 2007).

Teaching tips: The Slide #19 – 22 can be used to generate discussions on what should be the role of US antitrust in the future. The students can be assigned to find the differences in US and EU rulings given above and argue for either side.

The students can also be asked to evaluate what has happened to these companies and their industries since the antitrust case ruling.

If the instructor chooses to conclude with these first two sections, then Slide #43 provides concluding arguments.

Slide #23

Section 3 – Antitrust case rulings

This section provides a review of economic reasons that were used to convict (and restrict) or not convict a business practice in the US. It focuses on how economic arguments contradict each other showing the above discussed inconsistencies, arbitrariness, and difficulties associated with ruling antitrust lawsuits.

Note that the antitrust cases can either be civil or criminal. If it were a civil case, the case is ruled on the basis of ‘found for’ (plaintiff) or ‘found against;’ if it were a criminal case, the cases are ruled as either ‘guilty’ or ‘not guilty.’ The distinction between civil and criminal cases is not made explicit here for simplicity. In the following slides, selected antitrust case rulings are arranged under two categories: ‘Reasons for Not Guilty Verdict’ and ‘Reasons for Guilty Verdict.’ The former refers to economic reasons that allowed business practice to continue without incursion by an antitrust ruling while the latter refers to economic reasons that were used to restrict the business practice (in both civil and criminal cases). If the firm’s business practices were ruled with guilty verdicts, the ruling usually originates from the *intentional* vision of antitrust statutes; if those practices were not ruled with guilty verdicts, the ruling could originate from both *intentional* and *evolutionary* visions (more probably, the latter).

Slide #24

When an antitrust suit is brought against a firm, it employs certain economic rationale to justify its operations or business strategy. Some common defenses are given here (the list is not complete); these reasons are mentioned here so that the students are aware of these common defenses in addition to other economic rationale.

- Firms have claimed that market dynamics will make the concerned business practice necessary in the future
- Colgate doctrine – where one firm decided to act unilaterally and it happened to coincide with their competitors’ actions
- Firms also have claimed that they could not avoid their monopoly structure or practice since it naturally evolved due to market changes (also known as ‘thrust upon’)

Firms have generally claimed that the concerned business practices were necessary to safeguard the firm against bankruptcy in the future.

Slide #25

Many antitrust cases judged in the US can be classified under one of these four major categories: market structure related antitrust cases (monopoly/oligopoly cases), merger cases (horizontal, vertical and conglomerate), price fixing/market division cases and price discrimination cases. For the sake of clarity and conciseness, only selected cases are presented. The instructors can get few more cases (price exchange agreements, overt price fixing, related to professions or trade associations, patents, tying agreements, exclusive dealing, territorial and customer restrictions) and the related 'guilty' and 'not guilty' verdicts from the author. For additional classification of antitrust cases see (Becker, 2004).

Teaching tips: Students may read through economic arguments for rulings in these antitrust cases and try to identify the contradictions among antitrust rulings. Students may be asked to classify whether the case was ruled based on competition grounds, efficiency or economic welfare reasons. Instructor can select particular combination of cases and analyze the conditions that led to contradicting rulings. (Brock and Obst, 2007) could be a useful introductory reading.

Slide #26

There are two charts in this slide. The marginal costs (MC) are assumed to be constant in both cases. The left panel refers to Williamson's Tradeoff ("rectangles are bigger than triangles"); in the left panel, the industry is assumed to be at a perfectly competitive equilibrium, $P_c = \text{Marginal Revenue (MR)} = \text{MC}$. Assume that MC can fall substantially only if some firms exit and remaining firms merge into a monopoly or into a cartel that charges monopoly price. If that happens, the chart on the left shows a scenario where the gain in welfare (due to falling marginal costs) is higher than the welfare loss due to deadweight loss. This is used as one of the justification by the proponents of *evolutionary* view to allow market structures other than textbook style perfect competition. Also note that the resources freed up by exiting firms would in fact create additional economic activity in other sectors, thereby contributing to increased aggregate economic welfare.

The right panel corresponds to a situation where the market price starts higher than the MC (the markets are not perfectly competitive). In that case, if the market structure changes into a monopoly (or cartel), then the graphical depiction here shows welfare changes can be negative in the aggregate. The welfare loss (quadrilateral) can be larger than the welfare gain (rectangle) in the right panel. *Intentional* view identifies the latter case to be more common thus requiring antitrust laws to limit the formation of monopolies or cartel behavior even though

there are some associated benefits (such as reduction in marginal costs of production).

Teaching tips: Which of these panels is applicable depends on the context of the industry, market demand and supply conditions. Students can be asked to identify industries that fall under either panel or they can be given with numerical examples to estimate whether monopolization increases aggregate welfare (left panel) or not (right panel). They can also be asked to derive the conditions (parameter values or elasticities) under which monopolization could be beneficial or not. An exploration of those conditions can be part of a homework assignment.

Slide #27

This chart is similar to that of the left panel in Slide #26 except for the increasing marginal costs. When the marginal costs are increasing, the panel depicts a case where the welfare effects are unclear with the industry evolving into a monopoly.

Slide #28

The two charts depict how price fixing can change welfare when the market structure moves away from monopoly. The left panel suggests that if two firms are not allowed to communicate, then only one firm would operate as a monopoly. If both of those firms are allowed to communicate and coordinate, they might both be able to operate in the market (as a duopoly) that would increase aggregate welfare (right panel). For a numerical example, see (Whinston, 2006) page 17. Note that the welfare need not always increase due to increased coordination – that is why *intentional* theorists tend to discredit any beneficial outcomes that could arise from communication among firms, especially those firms with large market share. Even though the right panel corresponds to a cartel outcome, it is a move away from monopoly (possibly towards numerous producers as in perfectly competitive market) – which supports the fact that the number of firms in the market may be important as stressed by the *intentional* view of antitrust.

Slide #29

See the description for Slide #23. Most of the cases presented here come from Waldman and Jensen (2006).

Slide #30

Economic reasons for antitrust rulings – Monopoly and oligopoly cases

In the beginning days of antitrust, presence of high market share was sufficient enough to rule against a firm (*per se* rule) which is rooted in the *intentional* vision of ideal market structure populated by numerous smaller firms.

The bigger firms (such as IBM, AT&T – Slide #15) have been scrutinized merely for their bigger market share. Antitrust authorities have frequently considered breaking the bigger firms into smaller units. The earlier cases on *Standard Oil*, *American Tobacco*, and *Alcoa* were ruled on *intentional* vision that market share should not exceed certain (arbitrary) amount. This changed in 1980s with the *Du Pont* case where the courts stressed that superior skill and foresight – elements of efficiency – can yield a bigger market share (similar to that of a monopoly) and it should not be regulated under antitrust laws. Similar ruling happened with the widely known *Microsoft* case in 2000 as well – where Microsoft developed into a natural monopoly resulting due to structural factors in the industry.

The marked difference between *intentional* vision and *evolutionary* vision can be understood from these rulings on monopoly which focus on efficiency, superior skill and foresight that should be rewarded but not limited by antitrust laws. The controversial ‘guilty’ rulings on refusal to deal with a competitor (*Aspen Highlands* case) or retailers (*Kodak*) show the return of antitrust courts to its *intentional* vision on what the courts consider to be the proper form of market competition. This resurgence in *intentional* vision (and increased activism with antitrust) has been criticized by Bork (1993) and Armentano (1999) but supported by Pitofsky (2008). The guilty verdict in the *Aspen Highlands* case can be criticized on the following grounds: ex post, there have been numerous developments in Aspen area (Colorado) and both companies have merged into a single entity after many years which has changed the competitive landscape in that area. By forcing the dominant player to interact with the smaller company, the antitrust ruling might have delayed that progress and benefits that consumers could have received. Over time, this eventually reduced consumer welfare. See Teton Gravity (2003) for more details. Note that the structural monopoly condition with Microsoft in the US was not restricted – see Slide # 22 for the contradicting rulings across US and EU antitrust which is the reason for purist *evolutionary* theorists to argue for total repeal of antitrust laws (Armentano, 1999; Europa, 2009).

Teaching tips: Purist *evolutionary* theorists would argue even the attempts ‘to monopolize’ (prohibited under Sherman Act) the markets should be allowed – since any presence of economic profits would attract competition. Students may discuss whether their argument is valid, intuitive and pragmatic.

Slide #31

Dynamic changes and welfare

This slide suggests how the consumer welfare can change over time as the markets evolve dynamically over time. The blue lines correspond to supply of and

demand for product A. Assume that only one firm – i.e. monopoly – produces the product A. The corresponding consumer and producer surplus are given by the green triangle and blue rectangle. Assume the possibility that monopoly reinvests its profits into developing another product B whose supply and demand curves are given, in equivalents of A, by red colored lines.

For example, let B be the color television sets and A be the black & white television sets. Assume that the consumers value one color television set equivalent to two black-and-white sets, represented by $B = x.A$ where $x=2>1$, in this case. The consumer and producers welfare under the new situation with using color television sets is given by the pink colored triangle and red dotted rectangle respectively. Classroom discussion could center around how the welfare (area of triangles, rectangles) would differ between both cases. This can be used to give an intuitive explanation that controlling market structure is not always optimal

Teaching tips: Students should recognize that welfare could have increased with color television sets (as it did, in fact). If antitrust laws had banned monopoly, those profits would have never have been realized and reinvested in additional R&D. Students can also list the conditions under which the *intentional* view could have resulted in a better outcome (by banning monopoly). One of the key points is that antitrust laws should not stifle innovation and technological developments.

Slide #32

Merger and double marginalization

This slide provides a numerical example of how creation of a monopoly from two monopolies at retail and wholesale levels can increase aggregate social welfare. It uses a standard presentation used in explaining the problems with double marginalization. Although the entity is still a monopoly after the merger, the aggregate welfare has improved compared to the earlier case where retailers and wholesalers remain as two separate firms. Hence, having more number of firms or separate entities need not be the optimal way to increase consumer welfare. Students should recognize that efficiency improvements have to be studied as part of antitrust case rulings.

Slide #33

Horizontal mergers

The *intentional* vision that affected the horizontal mergers case could be exemplified by the ‘incipiency’ argument used in *Brown Shoe* case (1962) – the courts considered that even though the merged firm held less market share (5 per cent) at the time of merger, if there were potential for growing market power in the future then the merger should not be allowed to proceed (Armentano, 1999; Bork, 1993). This decision based on *intentional* vision had been widely criticized.

It was in fact based on an incorrect theorization (or perception) that increased market share would always lead to near-monopoly conditions in the future.

Whether big companies behave in an anti-competitive manner is an interesting question to consider (*Philadelphia National Bank* case in 1964). Toehold mergers (merging with a smaller competitor or having only smaller market shares after merger) was allowed in 1974 – this shows the general approach that mergers were refused under antitrust if a bigger market share could result. This *intentional* view that large scale horizontal mergers should be controlled reflects one of Bork's suggestions - see Slide #43. *Staples'* (1997) proposed merger with Office-Depot was refused on the grounds that in the absence of merger, the prices would decline even further improving the consumer welfare – especially in the rural areas. Students may discuss how this decision based on efficiency arguments may have changed with the increased competition from newer online competitors.

Teaching tips: Students should understand that if the market conditions favor a particular market structure (monopoly or oligopoly), then the courts should not intervene in that process – if the court rulings try to override those market forces, it will only delay the inevitable outcome, delaying consumer welfare over time. Alternatively, students may analyze the reasons to support the ruling in *Staples* case, where prices would decline further in the absence of a merger. Students can also be asked to state how sure they are about their assertions. This can show them the difficulty of making antitrust related decisions. By 1997, when the merger of Staples and Office-Depot was decided, online retail sales had started to flourish. Could the merged entity have really increased competition and compete with online discount stores is another interesting question for students to explore.

In addition, the students may discuss why horizontal mergers are the most scrutinized of all types of mergers. Students may discuss whether a provisional merger could be allowed between those companies – which will be subject to a later review to ensure that the efficiency claims (normally made in merger cases) did in fact occur and consumers were in fact benefited. Such provisional rulings are rare – but students can explore their applicability and associated challenges.

Slide #34

Vertical mergers

In case of vertical mergers, antitrust laws have focused on how the merged entity forecloses to many of its rivals along the supply chain. The guilty verdict in *Du Pont – GM* merger (1957) suggested that foreclosure to rivals based on anti-competitive reasons can be a basis for conviction, which is rooted in the *intentional* vision of antitrust laws. Even though the vertical merger was allowed in *Fruehauf* case (1989), the economic reasoning was not based on consumer

efficiency, competition or efficiency; this suggests that *evolutionary* vision ideas have not been used widely in vertical merger cases. In *Fruehauf* case, the merger was allowed because it would not have automatically occurred – students may analyze is it rational for the antitrust courts to review cases where the market forces favor the vertical merger, i.e. the merger would have occurred automatically based on market signals.

Teaching tips: Students may discuss the relevance of these statements: when two firms try to merge, have they identified some valid case for efficiency – otherwise, the two firms would not spend their resources towards merging. Should the courts be bothered about any above-normal economic profits or bother about entry barriers (that affect competition)? Students can be pointed with the higher prevalence of efficiency gains with vertical mergers compared to that of horizontal mergers.

Slide #35

Conglomerate mergers

The antitrust rulings have particularly avoided the mergers between large firms as part of conglomerate mergers. The merging with big firms (*P&G* merging with *Clorox* in 1967) has been ruled guilty but the merging with smaller firms (termed as toehold merger) has been allowed under antitrust laws. Such a tendency, rooted in *intentional* vision, could neglect the efficiency gains that are possible with the flow of funds into the hands of efficient managers in the larger firms. The tendency of antitrust laws has been to allow the merger only if it would ‘not’ have occurred as in *Tenneco* case in 1982. By promoting company mergers that – in the opinion of the courts – would not have merged on their own seems contradictory on two counts: first, the firms would not have initiated the merger unless there were some mutual benefits; so the merger would have occurred naturally; second, courts take the role of planning the industry structure by allowing certain mergers and not allowing others – this is in contradiction with allowing free markets to function independently. Hence antitrust courts’ agenda can be interpreted as the source of *intentional* views. As part of reforming the antitrust laws under *evolutionary* vision, Bork (1993) suggests to focus more on horizontal mergers but not bother about vertical or conglomerate mergers.

Teaching tips: Students may discuss the conditions that lead to (in)validity of toe-hold merger theory. They should understand the claim that firms that are restricted from merging lose some potential profits (producer surplus). What would be the impact of that unrealized profits (in the form of additional economic activity over time after the merger) and how consumers would have ultimately

benefited from those profits and vertical/conglomerate merger – are other questions for classroom discussion.

Slide #36

Price discrimination

As quoted in the introduction of these presentation notes, price discrimination is one fertile ground for antitrust lawsuits. The firms that charge same price, different prices, high prices, low prices have all been indicted (not necessarily convicted) under antitrust laws under different contexts. While the proponents of antitrust laws cite that the circumstances are different leading to contradicting rulings, the opponents of antitrust laws criticize the arbitrariness in interpreting those circumstances. The Robinson-Patman Act of 1950 has generally come to be known to protect the incompetent smaller businesses against the more efficient bigger businesses that are generally involved in price discrimination practices. There are two types of cases associated with price discrimination – primary line and secondary line cases. When the differential pricing decision of a firm affects its direct competitors, it is known as primary line case; if a firm's pricing decisions affects its buyer or supplier's competitors, it is known as secondary line case.

Slide #37

This is another standard graph that shows that aggregate economic welfare can increase with discriminating monopolist. The developments in IO models after 1970s have led law makers to realize that business actions related to pricing (price discrimination, resale price maintenance that establishes price floors) can be dealt with liberally, which is a notion from *evolutionary* perspective. This is one of the reasons for Bork's call to allow pricing agreements. Note that this is not the case in case of developing countries according to Sheth (1997).

Slide #38

Price discrimination – Primary line cases

The *intentional* vision of antitrust laws can be recognized from *Anheuser-Busch* case (1961) where the firm was investigated mainly for its market share and size. The case was ruled on the basis of 'rule-of-reason' (*evolutionary* view) since its market power was determined based on its ability to raise market prices. This shows that both *intentional* and *evolutionary* views have been used together to investigate and rule on antitrust cases.

In 1967, there were two rulings that contradicted each other – In *Borden* case, the ruling focused on consumer welfare (*evolutionary* vision), but in *Utah pie* case the ruling focused on protecting inefficient producers but not the interests of consumers. This shows the lack of consistency in the application of antitrust

laws. Such inconsistencies are usually the result of which viewpoints – *intentional* and *evolutionary* – assume a predominant position in any case. Anyhow, rivalry and competition had become the major focus in 1984 as seen with the *General Foods* case.

Teaching tips: The ruling of the court in Utah pie case – to avoid predatory price behavior – might not have been ruled so if the consumer welfare were to be taken into account, since consumers got the best out of lower prices. Students may discuss the circumstances and prices that could benefit or harm consumer welfare.

Slide #39

Secondary line cases

The recent rulings in secondary line price discrimination cases have mostly been guilty verdicts as in *Texaco*, *McCormick spices* and *Volvo* cases. These rulings and that of the earlier ones suggest that courts tend to think that they know what should be the ideal composition of prices, on top of demand and supply conditions in the market. Hence, the *intentional* ideology has remained dominant while ruling in the secondary line cases. Even though the courts based their decision on whether competition was secured, the rulings in secondary line price discrimination cases have resulted in different outcomes. Majority of these cases were ruled to be anti-competitive because the courts felt that price discrimination was not to meet the prices of competitors but to capture the higher value from consumers or retailers whenever possible. Since there is no rule that higher value could not be captured, the rulings in these cases show the courts' tendency (intention) to guide the markets. While the courts recognize the need to match competitor prices, they had generally ruled against it or ignored the need to discriminate and lower prices in the face of competition. This shows another type of contradiction in antitrust rulings.

Teaching tips: Students may discuss how to determine whether the competitors of buyers or suppliers were unlawfully affected by this price discrimination behavior. They can also discuss why the court verdicts may not always reflect the market direction – the answer centers around lack of knowledge and market fundamentals such as consumers demand and preferences.

Slide #40

Vertical restraints

Various vertical restraints along a supply chain had been challenged under antitrust. They generally fall under four sub-categories: tying, exclusive dealing, territorial/customer restrictions and resale price maintenance (RPM). The RPM

cases have gained more attention and are discussed below. Other cases pertaining to other sub-categories can be obtained directly from the author.

Slide #41

Exclusionary dealing

This chart shows one of the arguments proposed by the Chicago school to allow exclusionary dealing and other vertical restrictions (Whinston, 2006). Assume that an incumbent wholesaler is acting as a monopolist. There is an entrant who can enter the market only if the retailer does not sign the exclusive dealing contract with the incumbent wholesaler. The retailer buying from the wholesaler has to decide whether to deal with the incumbent exclusively by signing a contract or encourage competition from the entrant by not signing the contract.

If the retailer buys only from the incumbent, his welfare will be A; if the retailer buys from a duopoly market, his welfare will be A+B+C, provided the entrant prices his product at the marginal cost of $C_{\text{incumbent}}$ (assume Bertrand style price competition). If the incumbent wholesaler were to persuade the retailer to sign the exclusive dealing contract, he would have to compensate the retailer with an amount equivalent to B+C. But, the incumbent will not be able to transfer this much amount because his producer surplus (monopoly profits) is only B. Hence it is optimal for the retailer not to agree to exclusive dealing.

Chicago school uses this insight to explain why retailers decide to deal exclusively with a wholesaler and agree to RPM agreements. They argue that there are other factors that influence the retailer such as efficiency gains (increased sales) such as increase in retailer's welfare that exceed B+C which is possible only with signing the exclusive dealing contract. The rationale is that there are economic efficiencies that could be extracted from other sources in the form of improved product offerings or cost savings which the antitrust courts and lawyers may not readily recognize. Hence such exclusionary dealings are to be allowed and these non-tangible benefits could outweigh the benefits if the entrant is actually allowed to enter the market.

Slide #42

Resale price maintenance (RPM)

There is a clear shift from *per se* illegality ruling (*intentional* vision) in RPM cases to 'rule of reasoning' (moderate *evolutionary* vision). *Per se* rule originated with *Dr. Miles* case in 1911 consistent with the *intentional* vision. The *Colgate* doctrine (1919) recognized that unilateral moves by firms could be acceptable as valid restraints – it also set a longstanding precedent in antitrust rulings.

The elaborate arrangements to police RPM and explicit agreements were found to be the reasons for guilty verdict in 1920s. The *per se* illegality of 'maximum retail price fixing' became well publicized in 1968 with the *Albrecht*

vs. *Harold* case. Fixing maximum prices was ruled illegal openly suggesting that the courts' intention was to protect certain parties or firms.

Many fair trade laws passed to protect special interests were repealed in 1970s following the changes in market conditions. This shows that dynamic changes in the marketplace are more difficult to ascertain and the antitrust courts and laws may not necessarily incorporate all those future developments. More recently, with the *Leegin* case and *State Oil vs. Kahn* cases, the courts focused on whether the competition process was harmed due to those price maintenance agreements. The recent thrust has largely been *evolutionary*; only unreasonable attempts to maintain prices are ruled illegal now-a-days.

Slide #43

Future directions for antitrust laws

Based on the above discussion, there are three outcomes possible with US antitrust law implementation. The first is to *strengthen* antitrust laws, which is what the antitrust mechanism would promulgate since strengthening would obviously help its survival (Armentano, 1999; Pitofsky, 2008). The second is to reform the laws according to moderate *evolutionary* vision which requires new interpretation of antitrust laws but reduce subjectivity. The third is to *repeal* all antitrust laws which argues that the courts do not have all the necessary knowledge to decide what is good for the consumers, competition and efficiency.

The purist *evolutionary repeal* argument against antitrust laws would eliminate all inconsistencies and arbitrariness since it would abolish all such laws. But *repeal* of all laws is less likely since 'hard-core' cartels (Slide #14) seem to be a real problem. Repealing all antitrust laws also require that all firms behave in a competitive manner at all times with market forces being morally good at all times. Since this may not be always the case, the call to repeal antitrust is less likely to succeed.

The middle of the road approach would be to *reform* US antitrust laws as suggested by (Bork, 1993). His suggestions include a *reform* view that will (i) focus on consumer welfare maximization, (ii) protect competition and (iii) improve productive and allocative efficiency in the markets. According to him, antitrust laws should intervene in the market processes only in limited number of cases to fight horizontal agreements (hard core cartels), horizontal mergers that create large market shares, and deliberate predation activities. These are supposedly the activities that could seriously affect the benefits derived from competition, efficiency, consumer welfare. This is in fact an *evolutionary* approach since it reduces the scope of antitrust laws compared to what existed during the early 20th century. The moderate approach allows free operation of market forces. Bork seeks to allow various practices that were previously prohibited under antitrust laws: price agreements (such as RPM), refusal to deal

with competitors, various actions concerning rivalry, vertical and conglomerate mergers, vertical price maintenance, exclusive dealing, contracts and price discrimination.

References

- Armentano, D. 1999. *Antitrust - The case for repeal*: Ludwig von Mises Institute
- AT&T News Release. 2005. *New AT&T Launches*. Available at <http://www.att.com/gen/press-room?pid=4800&cdvn=news&newsarticleid=21906> (accessed February 2009)
- Becker, A. 2004. *The Antitrust Case Browser*. Available at <http://www.stolaf.edu/people/becker/antitrust/> (accessed December 2008)
- Bohlman, H. M., and M. J. Dundas. 2004. *Legal, Ethical, and International Environment of Business*. 6 ed: South-Western College/West
- Bork, R. 1993. *Antitrust Paradox – A policy at war with itself*: Free Press
- Brock, J. W., and N. P. Obst. 2007. "Market Concentration, Economic Welfare, and Antitrust Policy." *Journal of Industry, Competition and Trade* 9(2):65-75
- Connor, J. M., and A. A. Foer. 2003. *Cartel catalyst at work: A note on Holman Jenkins*. Available at <http://www.antitrustinstitute.org/Archives/268.ashx> (accessed January 2009)
- Dirlam, J. B., and I. M. Stelzer. 1958. "The "Du Pont-General Motors" Decision: In the Antitrust Grain." *Columbia Law Review* 58(1):24-43
- DOJ. 2009. *Other Antitrust Sites Worldwide*. Available at <http://www.justice.gov/atr/contact/otheratr.htm> (accessed September 2009)
- Doyle, R. 2008. *China's Anti-Monopoly Law*. Available at http://www.antitrustlawyerblog.com/2008/07/chinas_antimonopoly_law.html (accessed December 2009)
- Europa. 2009. *Antitrust: Commission confirms sending a Statement of Objections to Microsoft on the tying of Internet Explorer to Windows*. Available at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/15&format=HTML&aged=0&language=EN&guiLanguage=en> (accessed January 2009)
- Griffith, C. C. The New York Times. 1993. BACKTALK; Good Reason for Baseball's Antitrust Exemption January 17 1993; Available at <http://query.nytimes.com/gst/fullpage.html?res=9F0CEFD1E38F934A25752C0A965958260&sec=&spon=&pagewanted=all>

- Grim, R. Huffington Post. 2009. Insurance Industry Antitrust Fight Headed To Conference Committee 11-24-09; Available at http://www.huffingtonpost.com/2009/11/24/insurance-industry-antitr_n_369293.html
- Hayek, F. A. 1945. "The Use of Knowledge in Society." *American Economic Review* XXXV(4):519-30
- ICN. 2006. *International Competition Network*. Available at <http://www.internationalcompetitionnetwork.org/> (accessed November 2008)
- James, C. 2002. *Antitrust in the Early 21st Century: Core Values and Convergence* in (ed.) Program on Antitrust Policy in the 21st Century Brussels, Belgium Available at <http://www.usdoj.gov/atr/public/speeches/11148.htm> (accessed December 2008)
- James, C. A. 2001. *International Antitrust in the 21st Century: Cooperation and Convergence*. Available at <http://www.justice.gov/atr/public/speeches/9330.htm> (accessed October 2009)
- Janofsky, M., and A. Lange Bloomberg. 2008. GM Survival Questioned as SUV's End Chills Ohio Town (Update1) Available at <http://www.bloomberg.com/apps/news?pid=20601109&sid=aSDqsCl.7Ms0&refer=home>
- Kaiser, H. 2006. *Antitrust and Ideology: Moral Goodness or Corruption*. Available at <http://www.lawsocietyblog.com/archives/260> (accessed January 2009)
- Kaiser, L. L. 2005. "Revisiting the impact of the Curt Flood Act of 1998 on the bargaining relationship between players and management in major league baseball." *Journal of Sports Law & Contemporary Problems* 3(1):
- Nalebuff, B. 2002. *Bundling and the GE-Honeywell Merger*. Available at <http://ssrn.com/abstract=327380> (accessed November 2009)
- Padilla, A. J., and A. Renda. 2008. *Conglomerate mergers, consumer goods and the 'Efficiency Offense' doctrine - draft*. Available at <http://www.law-economics.net/public/221003%20Padilla-Renda%20efficiency%20offense%20in%20conglomerate%20mergers.pdf> (accessed January 2009)
- Page, W. H. 1991. "Ideological Conflict and the Origins of Antitrust Policy." *Tulane Law Review* 66(1):
- Page, W. H. 2008. "The Ideological Origins and Evolution of U.S. Antitrust Law " *Issues in competition law and policy - ABA Section of Antitrust Law* 1(1):17

- Page, W. H. 1995. "Legal Realism and the Shaping of Modern Antitrust." *Emory Law Journal* 1(3):
- Page, W. H., and J. E. Lopatka. 2007. *The Microsoft Case: Antitrust, High Technology, and Consumer Welfare*: The University of Chicago Press
- Pitofsky, R. 2008. *How the Chicago School overshot the mark : the effect of conservative economic analysis on U.S. antitrust*. Oxford ; New York: Oxford University Press
- Schwinger, R. A. 2007. *Will 'Leegin' Pave the Way for Ending Baseball's Antitrust Exemption?* Available at <http://www.law.com/jsp/llf/PubArticleLLF.jsp?id=1186477607823> (accessed February 2009)
- Sheth, M. M. 1997. "Formulating antitrust policy in emerging economies." *Georgetown Law Journal* 86(2):451
- Singer, P. 2002. *One World: The Ethics of Globalization*. New Haven: Yale University Press
- Teton Gravity. 2003. *Aspen Ski Company vs. Aspen Highlands Ski Corporation* Available at <http://www.tetongravity.com/forums/showthread.php?t=120701> (accessed January 2009)
- Waldman, D. E., and E. J. Jensen. 2006. *Industrial Organization: Theory and Practice*: Addison-Wesley
- Whinston, M. 2006. *Lectures on Antitrust Economics (Cairolis Lectures)*: The MIT Press