

AMERICAN ENTERPRISE INSTITUTE

THE NEW ANTITRUST PARADOX:
POLICY PROLIFERATION IN THE GLOBAL ECONOMY

PANEL III: CENTRAL REGIMES AND LOCAL MONOPOLIES

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ANDREW GUZMAN: It is not clear to me why a bad competition policy has any negative effect on innovation. With an open economy and a locally protectionist policy, the firm, it seems to me, is still competing with foreign rivals. Competition policy that generates too few rivals clearly will stifle innovation. But in order to achieve the result you're arguing for—a result which does not rely on cooperation—your model needs to be a localized one in which foreign states are not engaged in the same game. And so there's still going to be competition, it seems to me, which undermines the claim that there's a cost of innovation because the firm is still faced with the same incentives.

PAUL STEPHAN: Well, if I understand your critique, it is that a country that is locally protectionist but -- that is to say as to local industry -- but invites foreign producers in, will be subject to foreign competitive pressures. I think that such a country suffers a cost in the lack of development of local competitors to the international producers. I think in the developing world, this is in fact a very serious problem, and a local policy that encourages foreign traders and doesn't enable domestic producers to compete effectively with foreign traders suffers a cost.

PARTICIPANT: I met with Bill Baxter many years ago, and we were talking about a trip he had taken to China as an advisor to discuss what antitrust policy they should have. I said, "well, what did you advise?" And he said none at all, let's have free trade. And I think the argument that you're making, that the trading regime disciplines, to a large extent, the antitrust regime, is right. The question, however, is whether the WTO is as benevolent an organization as you suggest. TRIPS turned WTO, which was arguably a positive-positive game for everyone, into a positive-negative game and changed the whole calculus of the negotiating.

You suggested there would be no John Marshall at the WTO, and yet wouldn't you at least entertain the possibility that the TRIPS Turtle decision created a very dramatic shift in the way trade policy would be made, reading sustainable development in as a criteria to trump national law, the process-procedures methods? Maybe anarchy or, as I would say, spontaneous order might be better even than that WTO.

PAUL STEPHAN: There actually were a series of cases, one under the GATT, one under the WTO. TRIPS Turtle is the most recent, and it dealt with the legality under the WTO agreements of U.S. regulation of shrimp-catching devices—regulation intended to protect either, depending on your perspective, endangered sea turtles, or U.S. manufacturers of shrimp-catching equipment. The appellate body concluded that the U.S. approach violated various WTO provisions, but that in principle, this kind of ecological trumping of free trade could be done. The U.S. didn't change its law, but it repudiated the Federal circuit's interpretation of its law, and that was good enough for the WTO.

A nation that has John Marshall in its culture is prepared to interpret appellate body decisions in a way that can have quite troubling extensions. I do not believe that that instinct is in the WTO culture itself. Given the way we interpret court decisions and our

inclination to look at appellate body decisions as if they were court decisions, we are prepared to see implications and extensions that are not likely within the WTO system itself. There will be modest changes, and the principles they articulate can be seized upon and used in ideological or cultural contexts, but I do not think there will be a profound impact on WTO appellate body decision-making.

WOLFGANG KERBER: University of Marburg in Germany. I very much like your reluctance to accept harmonization, but I am a bit more skeptical about your anarchy model. Anarchy is one type of competition, of which there are many. The possibility exists that an anarchic form of competition would lead to an improvement of competition laws, but it is also possible that other strategic competition policies—such as the creation of safe havens for cartels, or the promotion of merger-friendly policies—would attract firms and investments, and increase productivity.

I'm also skeptical in regard to another problem. If firms decide on their locations, there are many factors in those decisions. It may be that competition laws play only a very small role in the decision of whether to move from one country to another, and it might be that the incentives of governments for changing competition laws for attracting investments are also very small.

PAUL STEPHAN: One of the advantages I have is that I'm firmly embedded in the academy. I have no policy functions, and I am comfortable throwing ideas out for consideration and testing and development. If I were actually in the government, my advice would be far more cautious. This paper is meant to be a thought experiment to stake out some ideas that I haven't seen elsewhere developed in the literature, and to open up some possibilities.

I firmly believe that the validity remains very much a matter of empirical testing, and that the alternatives you suggest of races to the bottom, of rent-seeking on the part of firms, is a possible part of the environment.

The move I'm trying to make is from a strictly static analysis, in which the presence of externalities is clear, to a dynamic analysis. But there is, as of yet, no consensus about any particular dynamic, and therefore my proffered analysis is necessarily speculative. I just think it's worth trying, at least as an academic matter.

FRED SMITH: Bruce, you suggested externalities as a test for keeping state antitrust and national antitrust separate, and you used migratory birds as an example. If you kill off all the birds going through a state, there won't be any in the rest of the country. But, if you've been following environmental literature, the going theory is that everything is connected to everything. All the world is an externality. How do you discipline that process to ensure that competitive federalism actually does discipline the excess reach of state imperialism?

BRUCE JOHNSEN: In applying the antitrust merger guidelines, the DOJ and the FTC have thresholds that they believe are plausible reflections of market power in particular

cases. We believe that our geographic market power test can be used to erect essentially the same set of presumptions. There must be some activity that is sufficiently local that any claim of externalities beyond the state is just bunk. But can we draw some a line? The line might not have to be the same for every type of trade restraint. Probably for pricing restraints you'd want the line to be smaller and more narrow than for vertical integration or something along those lines. But those are things that can be tinkered with over time as the judiciary's understanding evolves.

MOIN YAHYA: The antitrust apparatus that aims to capture these externalities already exists. What we are suggesting with our geographic market model is that it is possible and helpful to superimpose the geographic market map over the map of state boundaries. If there is a state line going between our concentric circles, we have identified the spillover, because that's where the impact of a hypothetical monopolist would be felt. If there's no state line going across those geographic markets, as defined using the FTC merger guidelines, then we have cabined the externality.

RICHARD EPSTEIN: I can't resist answering your question. I would answer it in a slightly different way. When you start dealing with the question of environmental issue and why it is that E stands for everything and externality simultaneously, one of the techniques that links you into that particular conclusion is that of contingent valuation. We ask the question of whether knowing that someone is about to destroy Big Sur makes me feel happy or sad. And to the extent that you're doing this, it's not even a national market, it's an international market that you can create.

There are a lot of difficulties with contingent valuation. It turns out that nobody seems to have a positive contingent value for a ski resort—just for the natural resource that it has replaced.

I don't think there is any serious argument with respect to the fruit stand on the corner or the lemonade stand, that you want to deal with externalities in the world of contingent valuation. I mean it just doesn't seem to me that we want to ask the question in antitrust, “do you feel better living there in Oklahoma, knowing that there is a kid on a street corner fixing prices with some other kid on a street corner in Minnesota?” The set of effects that you're trying to define in the antitrust universe is smaller, so the willingness to take larger units with respect to the evaluation, is going to be much less.

In effect, you can draw the separation if you care about drawing the separation. Whether you care about drawing the separation is an act of political will rather than a question of technique, I think.

BRUCE JOHNSEN: That may be true at the moment in the United States. In the first place, there's a tremendous nostalgia appeal for the small businessman, the fruit stand on the corner, and in Europe, as you undoubtedly know, the indigenous way of the peasants in the village has become now enshrined. So I think once you have let contingent valuation out of the box, I agree with you that, at the moment, small business doesn't

have the same political clout as does Big Sur. But the desire to maintain a way of life in the indigenous small business, mom-and-pop farm style is always lurking.

RICHARD EPSTEIN: But if it's a question of local maintenance of local small business, that's not going to expand the scope of the geographic market very much, even if it's going to change the way in which you argue the cases within it.

BRUCE JOHNSEN: Incidentally, the Office of Information and Regulatory Affairs has now vindicated contingent valuation in their proposed report to Congress. So, as bad as this methodology is, we're about to see it legitimated.

PAUL STEPHAN: In the environmental area, we have the traditional, liberal position—as Francis Thompson wrote in “The Mistress of Vision [\[link to http://www.bartleby.com/236/240.html\]](http://www.bartleby.com/236/240.html),” “Thou canst not stir a flower/Without troubling of a star.” Economists in the area of antitrust policy seem to be a good bit more reasonable than that. We believe that we can overcome these externality problems.

MOIN YAHYA: Under our system, if indeed the economy is local and there really is clout, the state under its own antitrust policy can address small businessman problems. As long as the geographic market stays within the boundaries of that state, that is the state's domain. Once that geographic market spans more than one state, it becomes exclusively federal jurisdiction.

Of course, this small business person might try to expand the scope of the market. If he or she is successful, the market share of the defendant is diminished, and the claim is defeated on the merits. You can't have it both ways.

RICHARD EPSTEIN: I have the following question about some of the jurisprudential issues that were raised in this case. Citing Frank Easterbrook, you mentioned the argument that Sherman Act-era legislators could not have foreseen the developments that have taken place inside our economy, and that therefore their legislative intent could not have reached these new issues.

I regard that as one of the classic red herrings with respect to international trade or Commerce Clause jurisprudence. Let's suppose that in 1789 no one foresaw a railroad. As you have a sensible test about interpretation across state lines, the railroad is fine. There are also local railroads. Nobody foresaw the walkie-talkie, which is used within states.

What is important is a sensible test for what is local and what is interstate jurisdiction. I think *Gibbons v. Ogden* did a pretty good—not a perfect—job on that distinction. And if technology changes so that there are more interstate transactions, then the federal jurisdiction expands, but if the evolution of technology creates a lot of local niches, then local jurisdiction expands. So, just as technology transforms the interstate markets, it could also transform the local markets. It doesn't necessarily lead to the obliteration of the latter in favor of the former.

I don't understand why the *Gibbons v. Ogden* line doesn't work as well today? Sticking strictly to trade, I don't see any changed circumstance that matters in the slightest with respect to the distribution of power between the two spheres. A static model seems to be the correct one.

BRUCE JOHNSEN: Starting with the trade issue, Easterbrook actually proposed his argument in a *Journal of Law and Economics* article in 1981, where he talks about state action. I raised his point in an effort to anticipate one kind of argument that could be made against our paper.

There was a time when economists could stand up and say, “externality,” and that was the end of the discussion. Now everybody is finding externalities everywhere. You wear a blue shirt, I wear a green shirt, and you're imposing an externality on me. Where does it stop?

We have the responsibility of sitting down and making empirical arguments about where the externalities are, and that's a doable thing. There are certain presumptions and thresholds that we can put in place.

I think *Gibbons* certainly started down the road. I actually think *Cooley v. Board of Wardens* took an even better step toward essentially saying that there are some things that are inherently local and some things that are inherently national.

RICHARD EPSTEIN: You're one of these people who got slickered by *Cooley v. Board of Wardens*. For the non-lawyers in the room, this was a case involving dangerous shoals in the Port of Philadelphia. By law, ships entering or leaving the port were required to hire a local pilot to navigate through these dangerous waters. The question was whether or not the requirement to use the local fellow was in fact legitimate, notwithstanding *Gibbons v. Ogden*.

The kicker in that case was that ships could pay 50 percent of the pilotage fee to the local fund, and get out from underneath the regulation. So at heart, the case is purely about trade, and has nothing to do with safety—otherwise the state would never allow ships to buy their way out of the requirement. The Court was slickered into seeing the case as one of safety and not extortion.

BRUCE JOHNSEN: I certainly agree with and defer to your interpretation of the facts, but I still think that the general rule the Court was trying to put forth, was that some things are inherently local.

PARTICIPANT: This is for Paul Stephan. To what degree have you thought of and to what degree would your analysis and your ideas about the virtues of anarchy go beyond competition policy in terms of the other areas that are being pushed on the WTO agenda? For instance, in investment or some sort of social charter, labor rights or whatever.

And then let me turn that back. To what degree would it have an impact on, let's say, things that are already inside the WTO but we have not had a lot of litigation yet, in terms of services, which are really litigation about competing regulatory systems, or the TRIPS, which was mentioned? Does your model or your analysis go to other areas beyond competition?

PAUL STEPHAN: The anarchy model is something that people have talked about in the context of intellectual property, securities regulation, and bankruptcy as well as corporate governance. I have written about it and I believe that this is analysis that is helpful in understanding intellectual property law. I actually came to where I am right now on antitrust out of looking at competition among definitions of intellectual property. My critique of TRIPS is that it tries to forestall that competition.

In terms of other things, focusing on the WTO raises another whole set of issues. I think GATT has done some great things. I won't be quite so bold as to say that there was a fall in 1994 and that it's been all perdition since then, but I think that the history of the WTO has demonstrated that as an institution it deals best with very transparent restrictions that violate core principles. As it moves away from transparent restrictions to ones that are much more ambiguous, it has great trouble.

The example I cite in my paper with respect to competition law involves two WTO disputes: one, the Fuji-Kodak dispute, where the United States complained that Japanese marketing practices were a de facto barrier to imports; and the other, a dispute over the Antidumping Act of 1916, which has never been enforced in the United States, but if read independent of any judicial gloss looks like a trade barrier.

The WTO solution is that the 1916 law is a trade barrier because only the text matters; judicial gloss is irrelevant. On the other hand, the WTO had a lot of trouble seeing what the problem was in the Fuji-Kodak case. Maybe there really was no problem there—I want to hold that out as a possibility. But it is also possible that the WTO is incapable of getting at problems that are not written down, but are instead matters of institutional practice. I think that that perspective is built into the institutional design of the WTO, and we don't want to give it the kind of discretion and authority that it would have to have to solve those kinds of problems.

PARTICIPANT: If you assume, just for the sake of the argument, assume that there would be a tradeoff between competition in the goods market and institutional competition or jurisdictional competition on the other side, and you can only have one, so that if you have jurisdictional competition it would go at the expense of goods competition, just as an assumption, as a thought experiment, what would you prefer to have? And why?

PAUL STEPHAN: This is very unsatisfactory, I'm afraid, but it depends. I think with both the U.S. and the EU, jurisdiction competition is at least as important as content of the law, because there are a range of transactions which, to achieve the benefits that can

be achieved, have to be implemented in both the U.S. and Europe. Whether you're shut out of Brazil is important, but not as important as being shut out of the U.S. or Europe. And I want to reserve the issue of how Canada fits in there, as well. So I can imagine that the jurisdictional issue can be more troubling.

FRED SMITH: Paul, you mentioned you had some reservations about TRIPS, and yet you are obviously pro-trade, and you are pro-antitrust, I take it—

PAUL STEPHAN: Pro-competition. I have my doubts about the Sherman Act.

FRED SMITH: You realize that during the early period the United States had no copyright treaty with Britain, and instead we rewarded artists by arranging for the publishers to create a cartel. It was effectively a cartelized way of enforcing intellectual property protection.

Now, of course, that scheme would be eliminated by a competition policy. How do you see those two tradeoffs of trying to reward innovative talent with something like the U.S. publishing agreement, or enforcing a competition policy which would outlaw that and favor something like TRIPS in its place?

PAUL STEPHAN: My position is one of strong agnosticism as to where the optimal tradeoff is, and my argument for jurisdictional competition is that it is satisfying for an agnostic like me to have jurisdictions fight it out, and perhaps we'll learn something by the combat. So that's my position.