Comments Regarding Commission Issues for Study

Submitted by
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Submitted by E-mail to
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Antitrust Modernization Commission (AMC)
Attn: Public Comments
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Antitrust Modernization Commission

Dear Sirs,

I submit these seven issues for the Commission to consider. I submit these issues both as a concerned citizen and as a representative of my company's interests.

As background for the first issue, relative profit maximizing (RPM) incentives, I also submit a copy of my paper, "Using Relative Profit Incentives to Prevent Collusion," as a separate pdf file. The remaining issues should be self-explanatory. Further elaboration can be provided as needed.

Thank you for your consideration.

Sincerely,

Carl Lundgren
Economist and President
Relpromax Antitrust, Inc.

Issue 1. The AMC should consider the use of relative profit maximizing (RPM) incentives as a part of a comprehensive strategy to induce pro-competitive behavior and outcomes.

Relative profit maximizing (RPM) incentives are a new economic method for preventing oligopoly collusion and other forms of imperfect competition by oligopolies. The method can be applied either to the managers of business firms or to business firms as a whole. When applied to managers, the method eliminates incentives for collusion by making managerial compensation depend on relative profits rather than absolute profits. Relative profits are defined as profits of the firm relative to the profits of rival firms within the same market or industry. Absolute profits are simply profits as ordinarily defined.

In its most complete implementation, the RPM method sets up a zero-sum game among the firms in an industry, yielding the result that firms no longer have incentive to collude, either actually or tacitly, with regard to prices or outputs. In a zero-sum game, one firm can gain profit only if another firm loses profit; hence there is no longer an incentive for every firm to collude.

In a partial implementation, the RPM method is applied to only one firm, or to a few firms, in such a way that a zero-sum game is not created. In a partial implementation, the incentive to collude still exists, but is attenuated. A partial RPM implementation might be useful as a condition of merger, if a merger would otherwise be illegal under current antitrust laws. A partial RPM implementation is less beneficial to consumers than a complete RPM implementation.

The antitrust laws should be revised to allow complete implementation of the RPM method so that consumers can benefit fully from this economic innovation. The AMC should recommend broad use of the RPM method.

Issue 2. The AMC should investigate a structural and incentive approach to competition policy, in addition to the conduct approach of existing antitrust law.

Existing law looks primarily to ascertaining “bad conduct” as the source of anticompetitive outcomes in the marketplace. However, economic theory teaches that bad structure or bad incentives can also be a source of bad outcomes.

Antitrust law forbids bad conduct to acquire or maintain a monopoly, but does not forbid or remedy a monopoly that otherwise arises or exists. A monopoly is justifiable only if it is clearly a suitable reward for invention or innovation (e.g., patents) or is more efficient than alternatives (e.g., a “natural monopoly”). Natural monopolies are normally regulated as public utilities. Unjustifiable monopolies should either be broken up or regulated as public utilities. The conduct approach to antitrust attacks only half the problem of monopoly; the AMC needs to investigate and recommend action for the other half.

Antitrust law forbids mergers that substantially increase market concentration, but does not forbid or remedy an oligopoly market that is already too concentrated. Even though collusion is forbidden, oligopolies can often coordinate tacitly with little or no fear of being penalized. Even without collusion, oligopolies can be imperfectly competitive in other ways. One structural approach is divestiture: Break up the largest firm(s) into smaller firms. If there are significant economies of scale, divestiture may be productively inefficient and fail to benefit consumers. Another approach is to use relative profit maximizing (RPM) incentives to induce pro-competitive outcomes in oligopoly industries.

The AMC should investigate whether and in what manner the “cops and robbers” conduct approach to antitrust law should be supplemented or supplanted by a scientific approach that recommends changes in structure or incentives to overcome problems of monopoly and oligopoly.

Issue 3. An independent competition policy board (CPB) should be established to investigate, recommend, and order structural and incentive changes to industries that may be imperfectly competitive.

This independent CPB could be either a newly created agency or a sub-agency of the FTC. The main focus of the CPB would be to investigate and order structural changes, incentive changes, or new rules of conduct. The main focus of the DOJ would be to investigate and prosecute illegal conduct. To retain some competition between agencies, these two agencies would maintain overlapping jurisdictions. In cases successfully prosecuted by the DOJ, the CPB would normally be in charge of developing remedies. The CPB would take a broader view of competition, and would not primarily focus on illegal conduct.

The CPB would have little or no power to impose potentially anti-competitive measures, such as price ceilings or price floors, or restrictions on competitive entry. So as to avoid "capture" by a regulated industry, the CPB may recommend the regulation, by other agencies, of industries or businesses deemed to be natural monopolies. The CPB would normally conduct public hearings to which multiple parties and the public are invited. The CPB would apply scientific analysis, including cost-benefit analysis and distributional analysis, as appropriate.

Existing antitrust law presumes that most competition problems are due to the "bad conduct" of anti-competitive firms. However, economic science tells us that poor industry performance (e.g., high prices, low quantity or quality, etc.) can also be due to poor industry structure or poor industry incentives. Modernizing the antitrust laws requires recognition of these additional reasons for poorly competitive markets. Therefore, it would be a worthy reform to focus the efforts of at least one competition agency on these non-conduct aspects of the competition problem.

Issue 4. The economic goals of antitrust should be clarified. Does antitrust seek to maximize consumer surplus, total surplus, or something else?

The goals of antitrust are often described as "benefiting consumers" or "protecting competition, not competitors." The first goal is ambiguous, the second is a slogan. Neither statement clearly defines competition using economic terms. Possible goals, stated in economic terms, include maximizing consumer surplus or maximizing total surplus.

Arguably, it is only the welfare of consumers which requires government protection. Businesses, pursuing their self interests, can be relied upon to protect their profits. Hence, the goal of antitrust should be to maximize consumer surplus, subject to the constraint that businesses not be forced to incur losses. Under this goal, price rises after a merger cannot be justified by efficiencies if they are not needed to prevent business losses.

Contrariwise, it can be argued that shareholders are also consumers. Hence, the goal of antitrust should be to maximize total surplus, which is the sum of consumer surplus and producer surplus. Under this alternate goal, a price rise after merger can be justified, provided efficiencies cause profits to rise by more than the loss to consumers.

Still another approach looks to the legitimacy or illegitimacy of the source of profit. If a profit is derived from imperfectly competitive circumstances or conduct, it is illegitimate. If a profit is derived from competitive circumstances and conduct, it is legitimate. In that case the goal of antitrust should be to maximize the sum of consumer surplus and legitimate profit.

The AMC should attempt to clarify the economic standard(s) for measuring whether an antitrust reform is beneficial. This would be useful for both legislation and judicial reasoning, and may provide an analytical framework for the AMC's own deliberations.

Issue 5. The government should provide transparency in its economic modeling and analysis of antitrust cases.

The government should be required to divulge its economic models, analysis, and supporting data for antitrust cases, including cases that are not brought to trial (e.g., merger reviews). Transparency in government action is a democratic norm that helps to keep government accountable. The lack of disclosure harms the ability of the public to understand what the government is doing and how the government reasons. It also prevents outside parties from suggesting alternatives or improvements to the government's reasoning and proposed remedies.

The lack of transparency is evident even in Tunney Act settlements and fully tried cases. For example, one will look in vain for a good economic model of the PC operating system industry based on the Microsoft case. The claims by business for confidentiality of basic economic information are often overblown, as the Judge in the Oracle merger case noted.

As shown by the Microsoft Tunney Act settlement, the Tunney Act has become a farce. Appeals courts have diluted the Tunney Act and converted all district judges into rubber stamps who must ignore evidence of apparent corruption and who must avoid any genuine inquiry into whether an antitrust settlement truly meets antitrust goals. The Tunney Act disclosure requirements and public interest tests must be strengthened.

Substantially more information disclosure and economic analysis is required when the Executive Branch promulgates or rescinds any government regulation (Executive Order 12866). Why is there no similar disclosure of information and analysis in antitrust cases?

Issue 6. To encourage competitive innovation, trade secrecy should be scaled back and patents should be supplemented by a system of prizes.

The intersection of antitrust and intellectual property rights and its relationship to innovation will almost certainly be suggested as a topic for consideration by the AMC.

Patents grant a monopoly which can impose deadweight losses. Rewards to inventors can also be provided through a system of prizes. Prizes granted by the government, funded by government tax revenue, are likely to have less deadweight loss. Hence, supplementing a system of patents with a system of prizes may produce lower deadweight losses. Government should consider a system of buying out important patents, so that significant deadweight losses may be reduced. For example, the government could offer to buy out any inventions that appear to be worth more than $10 million.

Trade secrets may also confer a temporary monopoly that rewards innovation. However, because trade secrets are secret while patents are openly disclosed, patents should be encouraged and trade secrecy discouraged. Trade secrecy should be restricted to no more than five years, while patents confer a significantly longer monopoly. This would encourage companies to choose patents rather than trade secrecy. For innovations that do not merit a patent, the limitation on trade secrecy is equitable because it limits the rewards of monopoly for inferior innovations to less than what a patent could give. The reduction in trade secrecy also reduces the resource waste of competitors trying to duplicate secret innovations.

Currently, software code can be protected by any combination of patents, copyrights, and trade secrecy. The same software code should not be simultaneously protected by both copyright and trade secrecy. Such simultaneous protection discourages openness and has provided an unwarranted legal foundation for certain software monopolies.

Issue 7. The government should collect cost, revenue, and profit data for lines of business in large firms.

Information about which lines of business are profitable or unprofitable is necessary for the correct allocation of capital. This information is often obscured when large businesses with several products or services combine their accounting information across broad categories. If potential competitors do not know which lines of business are most profitable, sufficient entry is not attracted. If potential competitors do not know which lines of business are least profitable, too much entry may be attracted into unprofitable endeavors. In any event, the uncertainty created by obscured information increases the risk for all business entry, thus ensuring less competition overall.

The secrecy of economic data is not needed to protect innovation. Mere cost or revenue data, by itself, does not disclose trade secrets concerning the nature of any innovation which might produce such data. Hence, this type of secrecy is not needed to provide incentives for innovation.

Public disclosure of such economic data, conceivably, might aid actual or tacit collusive agreements, but only if the disclosures occurred fairly immediately. Hence, the government might reasonably impose a delay before public release of such economic information. For example, such delay might be on the order of three years. Researchers who wished to analyze the data even sooner could sign confidentiality agreements.

I believe the FTC had a program in the 1970s to require such data, but the program lasted only five years, presumably because of business opposition. Such data would be useful to economists, legislators, and others who wish to analyze or estimate the extent of the antitrust problem and the usefulness of various possible correctives. Such data and analysis can only contribute to economic knowledge and perhaps lead to better economic policies.