

Andrew J. Heimert

Subject: Aai- consumer welfare

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From: Bert Foer

To: Andrew Heimert, Executive Director, Antitrust Modernization Commission

Cc: [REDACTED]

Conversation: Aai- consumer welfare

Category: Experts

Dear Andrew:

During the hearings on mergers, there was a good bit of discussion of whether total surplus or consumer surplus should be the goal of antitrust. Please include in the record my essay on this subject, which is AAI Working Paper No. 05-09, The Goals of Antitrust: Thoughts on Consumer Welfare in the U.S. This paper, when edited, will appear in Handbook of Research in Trans-Atlantic Antitrust, (P. Marsden ed) (Edward Elgar: Cheltenham: 2006). This paper reviews the literature, including views not presented to the AMC, and concludes that we should not commit ourselves to a single goal.

Thank you.

Bert Foer

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ABSTRACT

The Goals of Antitrust: Thoughts on Consumer Welfare in the U.S.

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This paper considers three types of goals that have been advocated for antitrust: political goals; static efficiency goals; and dynamic efficiency goals. It argues that, despite declarations that everyone now supports the goal of “consumer welfare,” there is currently no clear consensus as to whether all or some of the various goals are mutually compatible, whether one goal should prevail, or, if one should prevail, how it should be defined in the particulars. Nor are clear rules likely for the integration of multiple goals. How, then, should antitrust decisions be made? The author concludes that human judgment will simply have to sort things out on a less-than-scientific case-by-case basis, dependent upon the strength of the evidence that happens to be available, and informed by the best economic analyses and legal argumentation of the day.

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The Goals of Antitrust: Thoughts on Consumer Welfare in the U.S.

Albert A. Foer¹

In that each nation with a formal competition policy sooner or later must attempt to define the objectives of its policy, it is useful to make several observations about the course of U.S. antitrust that will establish the framework for this chapter.

First, there is currently no clear consensus as to whether all or some of the various goals that have been advanced for antitrust in the U.S. are mutually compatible, whether one goal should prevail, or, if one should prevail, how it should be defined in the particulars.

Second, over time, three distinctly different types of goals for antitrust have been advanced, which I will categorize as (1) making economics work for the electorate (political goals); (2) making the most of what we have (productive efficiency) and distributing it optimally (allocative efficiency) (together, static efficiency goals); and (3) making the pie grow larger (dynamic efficiency goals).

Third, establishing a goal or the priority of multiple goals is not a once-for-all-time decision, but rather reflects a temporary consensus that is likely to morph over time to accord with changing political and economic realities, advancing knowledge, and general fashions in political and economic thought. It is, in short, not merely a product of economic theorizing, but of political economy.

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In the opening part of the chapter, I will comment on how the U.S. came to the seeming anointment of one particular goal, allocative efficiency (sometimes called “consumer welfare”), as *the* dominant or even exclusive goal of antitrust; and then I will show that the declaration of victory by the Chicago School is premature. Next I will describe the three principal categories of goals that have been advanced for antitrust, will criticize each in turn and will conclude that, despite the fact that a still-vague concept of consumer welfare dominates antitrust thinking in the U.S. today, there is actually no consensus on the meaning of consumer welfare and no adherence to a single goal. Finally, I will address some questions presented by the absence of a single goal.

I. The Movement toward a Single Goal of Antitrust.

A. From Populism to Consumer Welfare

The Chicago School, which has dominated antitrust enforcement since the election of Ronald Reagan in 1980, contends that there is now a single goal of antitrust: namely, “consumer welfare”. The march toward the story that there is a single goal is fairly familiar,² but it is worth pointing to some of the key features.

From its earliest days, antitrust interpretation naturally enough concerned itself with ascertaining and executing the intent of the antitrust laws. Although Marshall’s *Principles of Economics* was published in the same year that the Sherman Act passed, it is fair to say that Congress was neither steeped in economic philosophy nor greatly assisted by economists. Political sensitivities dominated the debates in 1890³ and again in

² See, e.g., Marc Allen Eisner, *Antitrust and the Triumph of Economics* (U. N.C. Press, 1991); Rudolph J.R. Peritz, *Competition Policy in America: History, Rhetoric, Law* (Oxford U. Press, 2000, revised edition).

³ A famous quote from the time was Senator Sherman’s declaration, “If we will not endure a king as a political power, we should not endure a king over the production, transportation and sale of any of the necessaries of life.” Quoted in A.D. Neale, *The Antitrust Laws of the U.S.A.* (Cambridge Univ. Press, 1966) at 25.

1912-14, as the Clayton and FTC Acts were being debated. There was great worry about the powerful new institution of trusts, about preserving the role of small producers, and about precluding transfers of wealth from consumers to monopolists.

A neopopulist attitude, defining competition largely in terms of atomized markets, dominated antitrust from the years after the end of World War II into the 1970's. What political scientist Marc Allen Eisner calls in his book of that title, "The Triumph of Economics," was to a large degree a matter of occupational sociology. Antitrust enforcement had been dominated from the beginning by attorneys. Economists often played a role both in the formulation of policy and in litigation support, but they were clearly subservient to the attorneys. (People with business backgrounds or MBA's rarely played a role and still play only a very small role.) During the 1970's, the role of economists in the federal antitrust agencies underwent a dramatic growth in importance. All by itself, this portended a shift in emphasis away from matters of legislative intent and due process toward economic theories of industrial organization.

Changes were also occurring within industrial organization economics. What had been considered something of a backwater in the economics profession became a hot bed of creative thought and ideological debate as neoclassical economists imbued with price theory turned their attention to an antitrust field that had been accustomed to thinking about a structure-behavior-performance paradigm. It is important to note that the battle within the antitrust agencies and the academic antitrust community was not merely between lawyers and economists; it was also between economists of different schools and lawyers with different political philosophies. The "new thinking" rejected competition as something that required a particular form of industrial organization such as atomized markets in favor of a focus on the expected fruits of an efficient economy.⁴

Even before Ronald Reagan was elected President in 1980, a bipartisan movement away from neopopulism could be seen in several key appellate and Supreme Court

⁴ See George E. Garvey and Gerald J. Garvey, *Economic Law and Economic Growth* (Praeger, 1990), 4-6.

decisions and in the beginnings of the deregulation movement. When Reagan assumed office, however, the price theorists came into executive power. The appointment as Chairman of the Federal Trade Commission of James Miller, a conservative academic economist, symbolized the ascendancy of Chicago. Reagan's first Assistant Attorney General for Antitrust, William Baxter, a law professor soaked in neoclassical economics, announced, "The only goal of antitrust is economic efficiency."⁵

More generally, the law-and-economics vision of leading University of Chicago professors applied neoclassical analyses to a wide swath of the law, embedding the antitrust revolution within a larger movement that had global ramifications. Deregulation, the expansion of international trade, and the international application of what Joseph Stiglitz called "the Washington consensus,"⁶ and the explosive growth of free markets and competition policy laws were parallel and interrelated developments.

Two names associated with the University of Chicago, Robert Bork and Richard Posner, stand out in these developments. Bork published *The Antitrust Paradox*, in 1978 and it became the handbook of neoclassical antitrust. Bork compared a producer welfare goal (i.e., the producer's natural goal is to be able to charge a monopoly price) with a consumer welfare goal (the consumer would want a competitive price). He offered five reasons why the consumer welfare goal is superior.⁷ "A multiple-goal approach," he proclaimed, "can achieve none of these things."⁸

⁵ Taylor, A Talk with Antitrust Chief William Baxter, *Wall St. J.*, Mar. 4, 1982, at 28, col. 3.

⁶ Joseph E. Stiglitz, *Globalization and Its Discontents* (W.W. Norton, 2002).

⁷ The consumer welfare goal (1) gives fair warning, (2) places intensely political and legislative decisions in Congress instead of the courts, (3) maintains the integrity of the legislative process, (4) requires real rather than unreal economic distinctions, and (5) avoids arbitrary or anticonsumer rules. Bork, *The Antitrust Paradox* (Basic Books, 1978) 81-89.

⁸ *Id.*, 81.

By these words, Bork undoubtedly dismisses the possibility that antitrust is intended to protect businesses against competition, but what does he mean by consumer welfare? His answer constitutes one of the great acts of academic legerdemain:

Consumer welfare is greatest when society's economic resources are allocated so that consumers are able to satisfy their wants as fully as technological constraints permit. Consumer welfare, in this sense, is merely another term for the wealth of the nation."⁹

In other words, consumer welfare, to Bork, is what others call "total welfare," not the welfare of real live consumers of the type who walk into the drugstore and make purchases.¹⁰ By capturing the symbol of consumerism in this way, Bork pulled off a major public relations coup for laissez faire, but he also created confusion for public discussion that still continues. We will avoid this confusion by identifying consumer welfare with policies that are of direct or indirect benefit to citizens who make purchases of the product or service in question and by identifying total welfare with policies that are intended to benefit the entire society by creating greater overall wealth.

To show that consumer welfare and total welfare are not necessarily the same, consider a merger which produces a net increase in efficiency but also leads to a significantly higher price for consumers for a significant period of time.¹¹ A total welfare approach would approve the merger; a consumer welfare approach might not.

⁹ Id., 90.

¹⁰ Professor Lande says, "Bork used 'consumer welfare' as an Orwellian term of art that has little or nothing to do with the welfare of true consumers." Robert H. Lande, *The Rise and (Coming) Fall of Efficiency as the Ruler of Antitrust*, 33 *The Antitrust Bulletin* 429, 436 (1988). Also see footnote 11 of John B. Kirkwood's article, *Consumers, Economics, and Antitrust* in John B. Kirkwood (ed.), *Antitrust Law and Economics* 21 *Res. J.L. & Econ.* 1 (2004), in which Kirkwood debates with himself but concludes that it is fair to call Bork "sly" when he calls the traditional measure of economic efficiency "consumer welfare."

¹¹ Timothy Muris, later the Chairman of the FTC under George W. Bush, argued that such a merger should be approved. See Muris, *The Efficiency Defense Under Section 7 of the Clayton Act*, 30 *CASE W. RES. L. REV.* 381, 393-402 (1980). This was refuted in Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 *HASTINGS L.J.* 65 (1982).

In conflating consumers with the national society, Bork not only positioned neoclassical economics as pro-consumer; he also avoided a more natural way of contemplating society in a democracy, namely that it is made up of citizens whose majority votes ultimately determine what is in the interest of the whole society. Instead, the consumer is viewed as sovereign and his or her vote occurs in the commercial context. Politics, which is the traditional nest for the authoritative promulgation of laws, becomes separated from and in a certain respect subservient to economics.

Richard Posner was a principal developer and popularizer of the law-and-economics movement which advocates neoclassical economics as the standard for evaluating, interpreting, and ultimately passing laws. His book, *Antitrust Law: An Economic Perspective*, was first published in 1976. A second edition (now simply titled *Antitrust Law*) was published in 2001. In the more recent edition, he provides this unilateral declaration of victory for “economic welfare” which appears to be the same as total welfare:

“Almost everyone professionally involved in antitrust today – whether as litigator, prosecutor, judge, academic, or informed observer—not only agrees that the only goal of the antitrust laws should be to promote economic welfare, but also agrees on the essential tenets of economic theory that should be used to determine the consistency of specific business practices with that goal. Agrees, that is, that economic welfare should be understood in terms of the economist’s concept of efficiency; that business firms should be assumed to be rational profit maximizers, so that the issue in evaluating the antitrust significance of a particular business practice should be whether it is a means by which a rational profit maximizer can increase its profits at the expense of efficiency; and that the design of antitrust rules should take into account the costs and benefits of individualized assessment

Also see Alan A. Fisher, Frederick I. Johnson, and Robert H. Lande, *Price Effects of Horizontal Mergers*, 77 Cal. L. Rev. 777 (1988).

of challenged practices relative to the costs and benefits of rule-of-thumb prohibitions, notably the per se rules of antitrust illegality.”¹²

B. But the Declaration of Victory Is Premature.

Posner’s declaration of victory for Chicago is premature. While the contributions of Chicago have been persuasive in many ways, there remain other important threads in the antitrust story and proponents of alternative goals have neither surrendered nor are likely to do so. Posner himself continues to grow as an academic and as a judge, for example, by stretching out neoclassical analysis to incorporate strategic behavior, even though he is reluctant to credit post-Chicago game theorists with much of a contribution.¹³ In addition to game theory, with its emphasis on the strategic behavior of firms, what are the other threads that challenge the Chicago School?

On the far right, some in the libertarian movement reject antitrust more or less entirely, considering antitrust intervention to be a form of theft. The introduction to a recent collection of essays titled “The Abolition of Antitrust” begins:

Most Americans believe that the antitrust laws preserve our free market system, protect consumers from rapacious corporations, and ensure fair competition in the marketplace. However, the reverse is true. Antitrust is based on bad economics and on a false interpretation of the history of American business. It violates the sanctity of contract and abrogates a businessman’s moral right to produce, trade, and profit.”¹⁴

¹² Richard A. Posner, *Antitrust Law* (Univ. of Chicago Press, second edition, 2001) at ix.

¹³ Posner’s second edition (but not the first edition) notes that game theory models have refined oligopoly theory in recent years, but “the models do not yet yield implications that differ from those of non-game-theoretic approaches. . . . Long before game theory was a part of most economists’ tool kits, they were well aware of the strategic character of competition in markets that had only a few sellers.” (Op. cit. at 59-60.)

¹⁴ Gary Hull (ed.), *The Abolition of Antitrust* (Transaction Publishers, 2005) at ix. This book presents essays from the “objectivist” perspective and is replete with quotes from Ayn Rand and sentences like this

What drives this particular critique is an extreme individualistic perspective that finds immoral the standard used by modern antitrust. That standard was set out by University of Chicago economist Frank Knight who in 1921 described the neoclassical assumption of perfect competition as follows: “Under perfect competition he [the entrepreneur] would of course be completely helpless, a mere automatic registrar of the choices of consumers.”¹⁵ To Knight and later economists, this was a model of how capitalism works. The libertarian problem with this, according to John Ridpath, is that “Businessmen are being persecuted for not being sufficiently identityless, passive, altruistic servants of consumers... [This provides] the foundations for modern antitrust’s assault on the most productive system man has ever known—capitalism—and on the most productive individuals in human history—the industrialists.”¹⁶ In the battle between consumers and producers, this viewpoint sides completely with the strongest producers, recognizing no legitimate role for antitrust as a restraining factor.

A slightly less absolutist strand of libertarianism focuses not on the immorality of interfering with entrepreneurs (the “objectivist” position quoted above) but on the inability of government to provide rules that give definitive guidance or to administer in the public interest. The influential Cato Institute, for example, says, “Antitrust laws that allow the federal government to second-guess markets and hold up or prohibit sound business practices have no valid place in a market economy.”¹⁷ Some who describe themselves as libertarians would continue the policy of outlawing cartels, where it is clearly understood what actions are illegal.

one: “The antitrust laws of the United States are an obscene violation of individual rights that have thrown American business into a no-man’s land of non-objective law.” (John Ridpath, at 17.)

¹⁵ Quoted in John Ridpath, *The Philosophic Origins of Antitrust*, in Gary Hull (ed.), *op. cit.*, at 25.

¹⁶ *Id.*

¹⁷ See the Cato Handbook for Congress, available at <http://www.cato.org/pubs/handbook/hb105-39.html>.

Congenial with a minimal-intervention attitude, the public choice school carries the rational profit maximizer theorem into the realm of public institutions and concludes (with great logic but faulty premises) that since civil servants (like the economists' economic man generally) act in their own self-interest, there can be no such thing as the public interest. Therefore, antitrust, controlled by the self-interest of the law enforcers, cannot serve a *public* interest.¹⁸ This chain of thought, which is associated with the political right, is related to the "capture theory" that government regulators are typically captured by the industry they regulate – a perspective that has proponents at both ends of the political spectrum, but has been to a large degree discredited because of its weakness as a predictor of when capture might occur.¹⁹

The Chicago School, which is often tinged with libertarian and public choice ideology, might be thought to find a comfortable home in the nation's business schools. After all, Chicago advocates a minimal degree of intrusion into the affairs of business based on a profound respect for the rationality of business decisions. A review of what the business schools actually teach, however, found something different in two of the three separate business school faculty groups that are concerned with the nature of competition. In the economics courses taught by economists, the instruction generally mirrored that which is taught in graduate economics departments.²⁰ No surprise there. However, the marketing faculties and the strategic management faculties tended to work from assumptions that are significantly different from those taught by the Chicago School.²¹

¹⁸Generally, see Fred S. McChesney and William F. Shughart, *The Causes and Consequences of Antitrust, The Public-Choice Perspective* (Univ. of Chicago Press, 1995). Compare, Herbert Hovenkamp, *Legislation, Well-Being, and Public Choice*, 57 U. Chi. L. Rev. 63 (1990). For a critique of an extreme application of public choice analysis to antitrust, see Albert A. Foer, *The Politics of Antitrust in the United States: Public Choice and Public Choices*, 62 U. Pitt. L. Rev. 475 (2001).

¹⁹ See Stephen J. K. Walters, *Enterprise Government, and the Public* (McGraw-Hill, 1993), chapter 4.

²⁰ Lawrence J. White, *Microeconomics and Antitrust in MBA Programs: What's Thought, What's Taught*, 47 N.Y.L.S.L. Rev. 87 (2003).

²¹ See the articles in the first three parts of 47 N.Y.L.S.L.Rev. (2003). It appears that most business students are exposed to marketing and strategic management courses, but relatively few take industrial organization economics, even though it is offered.

Although most strategic management texts pay scant attention to antitrust,²² many discuss the relationship of strategic management to profit maximization. The Chicago School assumption from price theory is that businesses rationally seek to maximize profits. Bork considered the profit maximization assumption “crucial.”²³ But when Professor Norman Hawker reviewed the academic literature, this antitrust expert who teaches strategic management in a business school found only one text that specifically suggests that businesses actually seek to maximize profits, and this text acknowledged that this point of view is the subject of some dispute.²⁴ None of the texts denigrates the importance of profitability, but profitability is not the same as profit maximization, and the texts tend to say that there are multiple motivators at work, that it is in practice impossible to determine when firms are maximizing profit, that corporations exist to satisfy an array of stakeholders (and not merely stockholders), and that the point of strategic management is more generally presented as sustainable competitive advantage, rather than profit maximization.²⁵ While one might argue that nothing here is inconsistent with maximizing the discounted present value of profits in an environment of uncertainty by an institution that must overcome a range of principal-agent problems, it suggests that the Chicago School assumption needs considerable relaxation and that management has a range of discretion that is not strictly limited by the rule of profit maximization.

Similarly, whereas the Chicago School assumes that firms go about maximizing profit in a rational way, a division exists between those that share the assumption of rational behavior and those behavioralist-influenced texts which assume that the behavior of firms depends at least in part on emotional and psychological factors.²⁶ Behavioral

²² Norman Hawker, *Antitrust Insights from Strategic Management*, 47 N.Y.L.S.L.Rev. 67, 73.

²³ Bork, *op. cit.*, 119.

²⁴ Hawker, *op. cit.* note 21 *supra*, at 74-75.

²⁵ *Id.* at 75-78.

²⁶ *Id.* at 78-9. For a trenchant analysis of markets applying behavioralist insights, see John Kay, *Culture and Prosperity* (Harper Business, 2004). An application of behavioral insights to a specific antitrust issue,

economics is still in an early stage and has infrequently been applied to antitrust analysis. There is a good chance, however, that this field will grow rapidly and will contribute further to the critique of fundamental Chicago School assumptions.

When Hawker surveyed business school curricula, he found that the structure-conduct-performance concepts that long dominated antitrust analysis were still alive and well in most strategic management text books. He found “surprising” the extent to which “virtually all the textbooks rely on the Michael Porter model for competitive analysis.”²⁷ Porter, originally trained as an industrial organization economist but influenced by his extensive studies of corporate strategy and consulting experience, does not focus on price theory and downplays standard antitrust categories such as market definition and concentration. Instead, he argues that the state of competition in an industry depends on five basic forces: the threat of new entrants into the market; bargaining power of suppliers; bargaining power of buyers; the threat of substitute products; and rivalry among existing firms.²⁸ The objective of strategic management becomes an effort to defend against the five forces or influence them in the firm’s favor.²⁹

Academic consideration of strategic behavior has given rise to many critiques of the Chicago School. For example, the team of Patrick Bolton (a professor of finance and economics), Joseph Brodley (a professor of antitrust law), and Michael Riordan (a professor of finance and economics) wrote this in their magisterial treatment of predatory pricing in 2000:

A powerful tension has arisen between the foundations of current legal policy and modern economic theory. The courts adhere to a static, non-strategic view of

market entry, can be found in Avishalom Tor, *The Fable of Entry: Bounded Rationality and the Efficacy of Competition*, 101 Mich. L. Rev. 482 (2002).

²⁷ Hawker, *op. cit.* at 80.

²⁸ Michael E. Porter, *Competitive Strategy* (,1980) at 3.

²⁹ *Id.*, at 7.

predatory pricing, believing this view to be an economic consensus. This consensus, however, is one most economists no longer accept.³⁰

The influence of Michael Porter in the business schools has been mentioned. Porter's contribution to the debate over the goals of antitrust takes him back to a fundamental question: what is it we want from the economy? His answer is growth.³¹ It is only when the economy grows that everyone can be better off. And productivity growth, he argues, "is the missing, unstated link between competition and national standard of living. This provides the soundest explanation for why antitrust must protect competition: it is the key to a nation's economic prosperity."³² Porter rejects the Chicago School's commitment to efficiency in favor of growth and innovation.³³ He advocates a hierarchy of goals with growth and inflation followed by productive (static) efficiency followed by keeping price close to costs (allocative efficiency).

Porter is heavily influenced by his own research on how competition works in many different countries.³⁴ International specialists such as Robert Gilpin³⁵ who have observed the "Washington consensus" applied in other nations have brought a focus on the institutions that differ from nation to nation and have concluded that political

³⁰ Patrick Bolton, Joseph F. Brodley, and Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 *Geo. L. J.* 2239, 2242 (2000).

³¹ Compare Joseph Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare and Technological Progress*, 62 *N.Y.U. L. Rev.* 1020 (1987), in which it is urged that the economic goals of antitrust are innovation, productive efficiency, and allocative efficiency, in that order. Brodley argues that antitrust has a preferred mechanism to achieve its economic goals – competitive process. Moreover, the economic goals of antitrust, properly defined, can be connected with political and social goals, which Brodley calls the animating spirit of antitrust.

³² Michael E. Porter, in Charles D. Weller (ed.), *Unique Value* (manuscript, 2004) at 158.

³³ This is not to suggest that current antitrust policy ignores the importance of innovation and productivity. Chicagoists would argue that their focus on output increases subsumes dynamic considerations. In fact, the attention of enforcers, courts, and commentators given to innovation has increased considerably in the past fifteen years. In the Chicago theology, however, the emphasis is clearly on static efficiencies. Innovation fits in awkwardly at best.

³⁴ See, e.g., Michael E. Porter, *The Competitive Advantage of Nations* (Free Press, 1990).

³⁵ Robert Gilpin, *Global Political Economy* (Princeton Univ. Press, 2001).

economy, not neo-classical economics, is the field that best explains what is observed.³⁶ Some economists such as Britain's John Kay have applied this institutional insight and concluded that the neoclassical antitrust goals should be amended by inclusion of "disciplined pluralism," which he defines as "the process of perpetual experiment in market economies, in which most experiments fail and are terminated, but the few that succeed are quickly imitated."³⁷ Like Porter, Kay gives priority to the goal of dynamic efficiency.³⁸

Posner is correct to the extent that most people professionally involved with antitrust in the U.S. today believe that antitrust ought to be disciplined by economic thinking and that it ought generally to be utilized on behalf of the largest element within the population, namely consumers. Beyond this, however, it is impossible to conclude that everyone in the antitrust community agrees on a single goal with a single meaning. The neoclassical model of economics, with its emphasis on static efficiency, is in fact under rather severe challenge from a variety of directions, including teachers of strategic management, advocates of dynamic economics focused on growth and innovation, behavioral economists, and political economists, not to mention anti-government libertarians. Posner's declaration of victory, therefore, is either premature or his definition of efficiency must be sufficiently elastic to encompass a great deal more than was originally intended by the Chicago School.

Finally, within the U.S., the American Antitrust Institute³⁹ has emerged since 1998 as a recognized organization of post-Chicago antitrust experts who are

³⁶ Gilpin writes, "Economics and political economy differ significantly in their view of the market in economic affairs and of the relationship of the market to other aspects of society. Whereas neoclassical economists believe that the market is autonomous, self-regulating, and governed by its own laws, almost all political economists assume that markets are embedded in larger sociopolitical structures that determine to a considerable extent the role and functioning of markets in social and political affairs and that the social, political, and cultural environment significantly influences the purpose of economic activities and determines the boundaries within which markets necessarily must function." At 74-5.

³⁷ John Kay, *Culture and Prosperity* (HarperBusiness, 2004) at 18.

³⁸ A classic in this field is Burton Klein, *Dynamic Economics* (Harvard Univ. Press, 1977).

³⁹ See www.antitrustinstitute.org.

fundamentally market-oriented but nevertheless skeptical about concentrated economic power, believe that markets fail more than rarely, and that government is capable of intervening positively on behalf of, yes, the public interest, which it generally identifies with the interest of consumers. Many within the AAI believe that choice and innovation can be at least as important as price, and that distributional fairness is an appropriate goal of antitrust.

II. What Should Be the Goal of Antitrust?

A. A Variety of Goals Have Been Advanced.

In this section, the first part sets out three categories of antitrust goals that have been advanced. The second part criticizes each of these as singular goals.

1. Making Economics Work for the Electorate.

At various times, it has been suggested that antitrust is a fundamentally political policy and that this should be explicitly recognized by shaping antitrust policies for politically determined ends.⁴⁰

What are these ends? Typically, they may be categorized as decentralization of economic power, freedom, fair distribution of wealth, maintenance of a level playing field, and other ‘public interest’ goals.

The goal of decentralization of economic power rests on the perception that concentrated economic power is generally accompanied by centralized political power, which is seen as dangerous to a democratic polity. Thus, antitrust is viewed as a semi-

⁴⁰ An example of a populist approach to antitrust is reflected in the Antitrust Law and Economics Review, available at <http://www.metrolink.net/~cmueller/default.html>? Approaches that I would designate as populist tend to be more explicit in their political intent than purely economic approaches, although I argue that economic approaches also contain a political program.

constitutional tool for maintaining a certain vision of democracy, akin to the fundamental political concepts of separation of powers, checks-and-balances, and federalism. Just as Americans have traditionally feared and resisted too much political power (whether in one person, one party, one economic class, or one part of the government), they fear that private entities with “too much” economic power will be able to buy their way into too much political power. Antitrust is viewed by many as one of the few policies available for imposing a degree of popular control over centralized economic power.

This political perception of antitrust tends to support strong policies against unregulated monopolies or tight oligopolies. Sometimes it goes further and advocates protection of small and medium size businesses without regard to their efficiency, on Jeffersonian grounds based in the assumed moral superiority of rural life and small scale institutions. Stephen F. Ross has argued that an appropriate goal, which he calls “Jacksonian,” is equal economic opportunity.⁴¹ The spirit of this latter concept may be found in the popular phrase, “level playing field.”⁴²

Another type of political perception is that antitrust is part of the universal search for freedom,⁴³ so that consumers are free to make choices⁴⁴ and producers are free to

⁴¹ In an e-mail to the author, Ross usefully distinguishes between Jeffersonian antitrust (protecting small business for its own sake in spite of efficiency costs) and Jacksonian antitrust (giving equally efficient competitors a level chance but not permitting less efficient small firms to remain in business for Jeffersonian reasons). See Stephen F. Ross, *Network Economic Effects and the Limits of GTE Sylvania's Efficiency Analysis*, University of Illinois College of Law Law and Economics Working Papers Series, Working Paper No. 00-13, September, 2000, available at http://papers.ssrn.com/pape.tar?abstract_id, later published in 68 *Antitrust L.J.* 945 (2000). This Jacksonian goal was not included as among the top three non-economic goals enunciated by Robert Pitofsky in *The Political Content of Antitrust*, 127 *U. Pa. L. Rev.* 1051 (1979) (identifying as political goals of antitrust the inhibition of antidemocratic political pressure caused by excessive economic concentration; maximization of individual and business discretion; and avoidance of concentrations of power that inevitably lead to increased government intervention in the economy).

⁴² See Albert A. Foer, *American Idealism: Level Playing Fields*, 96 *Bus. & Soc. Rev.* 27 (1996).

⁴³ See Thomas B. Leary, *Freedom as the Core Value of Antitrust in the New Millennium*, 68 *Antitrust L. J.* 545 (2000).

⁴⁴ See Robert H. Lande, *Consumer Choice as the Ultimate Goal of Antitrust*, 62 *U. Pitt. L.Rev.* (2001). Also see Thomas B. Leary, *The Significance of Variety in Antitrust Analysis*, 67 *Antitrust L. J.* 1007 (2001) (“If it is true that matters other than price are of prime importance to consumers, in ever-growing sectors of the economy, an intelligent antitrust policy should respond accordingly.” 1021.)

enter a market and compete without undue restraints. Although these political goals are rarely discussed by U.S. enforcers or courts today, the older court opinions mentioning them, like *Brown Shoe*⁴⁵, have never been explicitly overruled.

Some see antitrust as a mechanism for avoiding unfair transfers of wealth. This takes several forms. In terms of political analysis, the question is whether antitrust should serve the interests of a particular class, which could be consumers generally, producers generally, or some subclass of either group such as lower-income consumers or small businesses. In terms of political philosophy, the question might be put as to who has the primary right to the fruits of capitalism: much of the legislative history of the Sherman Act, for instance, suggests that Congress intended to award the property right we call “consumer surplus” to consumers, and that any actions (such as a cartel’s raising of prices above the competitive level) that take this property away from consumers without adequate compensation is immoral and illegal.⁴⁶ In terms of classroom economics, the argument comes down to whether antitrust should be concerned only with the dead weight loss caused by monopoly or also with the reallocation of income from consumers to monopolists (and their shareholders), made possible when monopoly rents are created.⁴⁷

Public interest goals typically refer to policy issues raised in antitrust cases, where values other than competition may be at stake. An example would be the National

⁴⁵ *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962).

⁴⁶ I thank Robert Lande for making this point, which is supported by numerous quotes from the legislative debates. See Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 *Hastings L.J.* 65 (1982).

⁴⁷ The familiar model for this is drawn, e.g., in Robert Bork, *The Antitrust Paradox*, chapter 5, comparing (a) the amount above costs that consumers would be willing to pay for the lost output (dead-weight loss) to (b) the gain to all consumers of cost reductions resulting from a merger (cost savings). Bork says, “This diagram can be used to illustrate all antitrust problems, since it shows the relationship of the only two factors involved, allocative inefficiency and productive efficiency. The existence of these two elements and their respective amounts are the real issues in every properly decided antitrust case.” 108.

Society of Professional Engineers case,⁴⁸ where the Society's professional ethics were called into question by the Department of Justice and a defense was offered that, in effect, if engineers do not observe "ethical" constraints on price competition, bridges and other structures will fall down, because price competition leads to reduced professional time applied to the engineering problem. The holding, still the law, was that such public interest values as these are irrelevant in an antitrust analysis, which can only be concerned with the competitive effects. Public interest goals also often appear in the context of regulatory proceedings, where the statute requires consideration of the public interest which may be interpreted to include but not be coextensive with competition.

2. Making the Most of What We Have.

The goal of antitrust according to the Chicago School is efficiency. The idea is that society's resources are limited and therefore it is in society's interest if these limited resources are utilized in the most efficient manner. The two components of efficiency are allocational efficiency and productive efficiency.⁴⁹ By minimizing waste and maximizing productivity, there will be more for everyone. Competition is seen as the mechanism whereby the most efficient use of existing resources will be made on the basis of voluntary exchange, necessitating relatively little government involvement.

⁴⁸ U.S. v. National Society of Professional Engineers, 435 U.S. 679 (1978). Another example is the Ivy League financing case in which nine schools were charged by the Antitrust Division with conspiring to restrain price competition for students receiving financial aid.⁴⁸ The defense was that such an agreement was necessary in order to achieve the social objective of increasing the scholarship money available for needy students. The fact that Congress killed the case raises the whole issue of the political dimension of antitrust. See, e.g., Gustavo E. Bamberger and Dennis W. Carlton, "Antitrust and Higher Education: MIT Financial Aid," in Kwoka & White (4th ed.), 188-210.

⁴⁹ Bork, The Antitrust Paradox, chapter 4. Bork says that productive efficiency should be understood as "offering anything...that consumers are willing to pay for." "The relative efficiency of firms is therefore measured by their relative success in the market." 105. Much of the Chicago logic follows from this. Any [legal] activity that increases profitability is necessarily efficient. Rational profit maximizers therefore seek to become more efficient; hence the voluntary decisions of business leaders must be seen as efficiency-seeking. Since efficiency is what is best for society, government should keep its hands off.

The concept of total surplus emerges as one measure of social welfare. By total surplus, economists mean the aggregate of consumer surplus and producer surplus created by a transaction. In the case of consumers, the surplus is the amount they would have been willing to pay for something, less what they actually had to pay in the marketplace. In general, the more competitive the market, the closer the price of a good to the producer's cost, the more consumers who desire the good will purchase it, and the greater the consumer surplus. In the case of producers, the surplus is the value of what they produced less the cost of producing it. Producer surplus is, roughly speaking, profits. From surplus must be subtracted the "deadweight loss" caused by any prices that exceed the competitive level, since these higher prices would preclude some consumers who would have made a purchase at the competitive price. This potential output is absolutely lost to society.

A transaction that increases the total surplus is said by neoclassical economists to be efficient and therefore desirable.

It is important to distinguish between what maximizes wealth for the society and what maximizes wealth for particular members of the society. A transaction such as a merger that increases the total surplus but does not significantly increase consumer surplus, would be considered allocatively efficient, but might not satisfy most consumers, if they find that they have to pay more as a result of the transaction.⁵⁰

It is possible to have a compromise between total surplus and consumer surplus approaches by saying that a transaction will meet the efficiency goal of antitrust if it both

⁵⁰ See Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 *Hastings L.J.* 65 (1982). The battle as to whether consumer welfare should mean consumer surplus or total welfare, often captured as a dispute between Robert Lande and Robert Bork, is described in John B. Kirkwood, *Consumers, Economics, and Antitrust* in John B. Kirkwood (ed.), *Antitrust Law and Economics*, 21 *Res. J.L. & Econ.* 1 (2004). Kirkwood says that Lande is winning in the courts but Bork is winning among economists. Compare *Reiter v. Sonotone*, 442 U.S. 330, 343 (1979) (stating that the legislative record "suggest[s] that Congress designed the Sherman Act as a 'consumer welfare prescription.'") with *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 360 (1990) ("The Court, in its haste to excuse illegal behavior in the name of efficiency, has cast aside a century of understanding that our antitrust laws are designed to safeguard more than efficiency and consumer welfare...") (footnotes omitted) (Stevens, J., dissenting).

creates a total surplus and achieves some economic benefits for actual consumers (i.e., people who purchase the product as opposed to “the nation as a whole”). The fact that this somewhat sloppy and poorly defined compromise describes the way antitrust generally operates in the U.S. today⁵¹ merits two additional comments.

First, in the majority of instances, it is probably true that the consumer surplus standard usually correlates with the total surplus standard. That is, competition makes consumers better off and at the same time makes the society as a whole better off. While there may be occasions where this is not true, they do not seem to arise particularly often.

Second, the fact that the two standards so often work in the same direction may have interesting political consequences. Clearly there are ideological reasons available for supporting one standard or the other; that they so infrequently actually collide may reduce the play of this potentially divisive ideological factor, thereby facilitating political support for the antitrust enterprise. We will return to this toward the end of the chapter.

3. Making the Pie Larger.

The goal of efficiency, that is, of making the most of our existing limited resources, is considered a static goal, because it takes as given the resources that are

⁵¹ The differences between total welfare and consumer surplus approaches to a merger are starkly presented by the Canadian case of Superior Propane. If the facts were found correctly, this was a merger that would harm consumers in the relevant market by raising prices, but would benefit consumers elsewhere in the economy (e.g., stockholders of the merging companies) by saving resources. The outcome was to permit the merger. A legislative effort to overcome the decision failed. This case represents the rare instance in which a merger was approved by antitrust authorities on the basis of an efficiencies defense. Compare the discussions by Brian A. Facey, Dany H. Assaf, and Russell Cohen (*The Canadian Competition Tribunal Gets It Right*) and Alan A. Fisher, Robert H. Lande, and Stephen F. Ross (*The Canadian Competition Tribunal Gets It Wrong*) in *Antitrust Magazine* (fall, 2000). Also see Stephen F. Ross, *The Political Economy of the Efficiency Defence*, 21 *Canadian Competition Record* 89 (2003) and Richard O. Zerbe, Jr. and Sunny Knott, *An Economic Justification for a Price Standard in Merger Policy: The Merger of Superior Propane and ICG Propane*, in John B. Kirkwood (ed.), *Antitrust Law and Economics, Research in Law and Economics Volume 21* (Elsevier 2004). An excellent review of issues relating to the role of efficiencies in competition policy may be found in Canadian Competition Bureau, *Consultation Paper, Consultations on the Treatment of Efficiencies under the Competition Act* (Sept. 24, 2004), available at <http://strategis.ic.gc.ca/epic/internet/inch-bc.nsf/en/ct02951e.html>.

already available. A different goal is dynamic efficiency⁵², which seeks to use competition as a tool for generating innovations that will expand the economic pie. It is usually understood that dynamic efficiency can have a far more dramatic effect on the economy than static efficiency, and this can be visualized by comparing the overall impact of improving the manufacturing process of a buggy whip to inventing the reciprocating engine.

Michael Porter has argued that growth of the economy should be the primary goal of antitrust.⁵³ “Since the role of competition,” he says, “is to increase a nation’s standard of living and long term consumer welfare via rising productivity growth, *the new standard for antitrust should be productivity growth*, rather than price/cost margins or profitability.”⁵⁴ Porter continues, “All combinations or practices scrutinized in antitrust should be subjected to the following question: how will they affect productivity growth?”⁵⁵

Porter does not deny a place for additional goals, but rather posits a hierarchy in which productivity growth comes first, with technical (static) efficiency the second most important goal, interpreted in a more subtle way to incorporate improvements in product quality, features, and services, as well as product or service value measured by price. For Porter, the third goal in importance would be limiting short-term price/cost margins or profitability. But he considers this – today’s predominant goal in the U.S.—as a dubious goal for antitrust because it fails to measure true consumer welfare by ignoring product

⁵² See Burton Klein, *Dynamic Economics* (Harvard U. Press, 1977). Bork considered “progressiveness” to be a component of consumer welfare, and not a separate goal. Bork, *op. cit.* at 132. It is not clear how the short-term static efficiency upon which Bork’s system rests is intended to be reconciled with long-term dynamic efficiency. E.g., a monopolist may provide the utmost in static efficiency, while at the same time blocking or channeling innovation to serve its own interests in preserving the monopoly status. Interestingly (and to his credit), Bork sided with the opponents of Microsoft during the landmark computer litigation.

⁵³ Michael Porter, *Competition and Antitrust: A Productivity-Based Approach* in Charles E. Weller (ed.), *Unique Value: Competition Based on Innovation Creating Unique Value* (manuscript, 2004). This is a later version of a paper that appears in ABA, *Report of the Task Force on Fundamental Theory* (July, 2001).

⁵⁴ *Id.* At 165 [italics are Porter’s].

⁵⁵ *Id.*

value and because we care much more about the long-term trajectory of value, prices, and costs than we do about consumer welfare in the short run.⁵⁶

Note that Porter has turned the current priorities of antitrust on their head: the traditional view (to the extent that a traditional view exists) ranks goals in the order of: profitability/price-cost margins (i.e., allocative efficiency), followed by cost (static efficiency), followed by innovation (dynamic efficiency). Porter's alternative approach ranks innovation (dynamic efficiency) highest, followed by value improvement (static productivity), followed by profitability/price-cost margins (allocative efficiency).

If Porter's hierarchy were to replace current priorities, large elements of accepted antitrust analysis would have to be supplemented or replaced. Porter himself advocates not worrying about market definition, but rather utilizing what he calls the "five forces framework" and the "diamond framework."⁵⁷ Applying his priorities to merger analysis, he doubts that mergers will be efficient and profitable just because companies propose it, and advocates a much more restrictive enforcement policy for mergers of leading firms.⁵⁸

To recapitulate, there are three types of antitrust goals that have often been advocated. None of these stands unchallenged in today's thinking. In the next section, we present the major criticisms of each goal.

B. Each of These Goals Rightly Has Been Criticized.

1. Political Goals.

⁵⁶ Id, 167.

⁵⁷ These are set forth in Porter's major books, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (1980) and *The Competitive Advantage of Nations* 133 (1990).

⁵⁸ Op. Cit., note 53 supra, *Unique Value*, 173-4.

Explicitly attributing political goals to everyday antitrust decisions may have a number of drawbacks.

Political goals tend to be subjective rather than objective. As such, they may invite law enforcers and judges to reach personal decisions of great economic importance. In addition to making prediction difficult, this opens the door to abuse, ranging from partisan decisions to outright bribery. It may enhance the ability of some industries with political power to “capture” antitrust enforcement. Maintaining a professional objectivity within the antitrust enforcement agencies needs to be a high priority, because the financial stakes in policy decisions are sufficiently high to make corruption a distinct possibility. (One of the great and unremarked achievements of American antitrust is that it has been tainted by so little evidence of corruption over its long history.⁵⁹)

Political goals do not offer clear direction. From where would the direction arise? The public is not at all well-educated on antitrust issues and is almost never offered options on antitrust during elections.⁶⁰ At best, presidential elections provide some direction along the lines of “more regulation or less governmental regulation” of the economy. At this level of generality, there is no popular guidance to a decision-maker.

Moreover, what is popular enough at one time to be considered a majority view may be a minority view after the next election. There is a danger in having economic policies, including antitrust, swing wildly from administration to administration, with reversals taking a toll in the inability of businesses to plan for the future. While change of direction as a result of election politics is legitimate, it is arguably better for the antitrust system if change takes place more incrementally.

⁵⁹ For a look at some of the more scandalous tidbits in U.S. antitrust history, see Charles R. Geisst, *Monopolies in America* (Oxford, 2000).

⁶⁰ But see James Chace, 1912 (Simon & Schuster, 2004), the one campaign when antitrust policy was a major issue in an unusual presidential election.

Let us take a specific example of the difficulty in operationalizing a political goal. A case can be made that freedom is the basis of overall antitrust policy, as Commissioner Thomas Leary of the FTC has argued.⁶¹ Freedom might imply, among other things, that consumers should have a range of choices when they go into the market place. But how many choices? If a merger in a five-company industry is about to leave four companies standing, how do we know if this will allow consumers an appropriate range of choices? And what does freedom mean if we are offered the choice of a small company having the freedom to compete on the merits or a large company having the freedom to drive the smaller one out of business by extreme aggressive tactics? If two successive administrations could each formally adopt an abstraction such as freedom as the goal of antitrust, but reach very different decisions when faced with real cases, then freedom may be a background value, but is too abstract to serve as a directive-giving goal. (I would not expect Commissioner Leary to disagree.)

There is today (and indeed, there probably always has been) general agreement that antitrust policy should, to at least some important degree, be about the efficient operation of markets. Political goals may import considerations such as environmental policy or health policy that have little to do with the functioning of markets. If we import these kinds of goals that do not relate to competition into antitrust, such a mismatch would make antitrust decisions much more difficult to predict. All things being equal, predictability is a desirable feature because of its impact on investment decisions. Arguably, if non-economic goals play a significant role in antitrust decisions, the economy will become less and less efficient, which in the end will be harmful to consumers. Such an outcome might benefit certain limited interests, but it would not benefit the overall interest of the community.

It is also argued that many of the political goals of antitrust can in theory be accomplished by other policies. For example, wealth distribution can be accomplished by tax policy; environmental protection by environment laws; encouragement of small businesses by special subsidies; honest governance by the securities laws, and so on. The

⁶¹ Op. cit., note 43 supra.

argument is that day-to-day antitrust should be founded on objective, staple criteria, and that political goals should be left to other venues. Part of the influence of this argument rests on an assessment of the likelihood that alternative solutions will be produced by the political system in a timely and case-appropriate way; and part rests on the assumption that the economic efficiency alternative is scientific and objective. Commenting on the former condition is beyond the scope of this essay.

2. Static Efficiency Goals.

The leading candidate for an objective, logical – indeed, scientific-- alternative to political goals is neoclassical economic analysis. Yet, adoption of neoclassical economics as the sole determinant of antitrust policy is itself be a political decision, if only because it displaces decisions made over a long period of time by the Congress and the courts.

A quick overview of neoclassical economics is in order. The underlying value is voluntary exchange in a market place where the interplay of supply and demand sets the price of a transaction. A system is considered optimal when no further exchanges can be made that will make a person better off without harming another. In the strong form of Pareto optimality, a commercial transaction should be allowed if someone benefits and no one is harmed. This makes intuitive sense. It helps us define efficiency as that state of affairs where no further exchanges will make the society better off.

Lurking in this concept, however, are the questions that Harold Lasswell long ago used to define the nature of politics: who gets what, when, how?⁶² Somewhere along the line, neoclassical economists recognized that it is too difficult to find real life Pareto optimal situations, because in real life people are always getting harmed without compensation as a result of apparently voluntary exchanges. Consequently, a weaker, more easily identifiable version of Pareto optimality—potential Pareto-- became accepted

⁶² Harold Lasswell, *Politics: Who Gets What When How?* (World Publishing, 1958).

by many economists, including the Chicago contingent. In this weaker version, it is not necessary that no one *actually* be harmed; it is only necessary that *in theory* no one would be harmed.⁶³

For example, suppose a merger in which the merging parties will become more efficient such that they would have the ability to reduce both their costs and their prices. If the reduced prices were to be passed on to consumers, no one would be injured, thus it is theoretically possible to achieve strong Pareto optimality. But what if the merged company, now facing reduced competition, actually raises its prices and passes on the increased profits to its shareholders in the form of dividends rather than to consumers in the form of lower prices? Consumers *could have been* made better off (so the weakened version of optimality would be satisfied) but they were not in fact made better off. Indeed, if prices are increased, they are made worse off. On the other hand, if the increased profits are passed on to shareholders and shareholders spend more money in the economy and invest in enterprises that create new jobs, there will presumably be an eventual trickle down benefit to the general population including the class of consumers. (We will not discuss what discount rate should be applied when the quantity and timing of “trickle down” is so thoroughly unpredictable.)

The switch to a weaker version of optimality means that the consumers who are injured by the merger may not be the same ones who will presumably benefit at a later date from the trickle down benefits to the whole society. The point is that the objective aspect of Pareto optimality, upon which the neoclassical efficiency goal rests, has been undermined by a problem of fairness, which means that political considerations have been admitted into the game in a fundamental way. Let’s be blunt: the innocuous little

⁶³ Posner argues “[T]hat economic theory provides a solid basis for the belief that monopoly pricing, which results when firms create an artificial scarcity of their product and thereby drive price above its level under competition, is presumptively inefficient in the sense most commonly used by economists in discussing issues of monopoly and competition (the Kaldor-Hicks, or potential Pareto, sense of efficiency).” Richard A. Posner, *Antitrust Law* (second edition, Univ. of Chicago Press) at 2. See W. Kip Viscusi, John M. Vernon, and Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust* (MIT Press, 2d ed., 1995), 74 (problem with Pareto criterion is that “in most cases in the real world, at least some people will be harmed”). For a discussion of the failure of Kaldor-Hicks to capture significant aspects of social utility, see Herbert Hovenkamp, *Legislation, Well-Being, and Public Choice*, 57 U. Chi. L. Rev. 63 (1990).

shift by certain economists from strong Pareto to potential Pareto optimality amounts to a political decision that current stockholders should be allowed to benefit from a merger at the expense of the class of consumers who will purchase the merged firm's products.

Several other questions arise from the neoclassical assumptions about what constitutes efficiency. First, although strong Pareto optimality makes intuitive sense with respect to the participants in the exchange, what about others who are affected by the exchange but are not themselves participants? A voluntary exchange that benefits both the parties may be harmful to those who are not parties unless such externalities are made part of the consideration. For example, a merger that enhances the efficiency of the surviving company and does not raise prices for the company's products may also result in the closing down of a corporate headquarters, costing the headquarters' city a loss of tax revenues, jobs, and philanthropy; these externalities are not currently taken into account. There thus seems to be something extraordinarily arbitrary about concluding that a transaction is efficient even though all the costs are not taken into account.⁶⁴

Also questioned is why competition policy should focus exclusively on prices. The microeconomic focus on price is the result of a definition of efficiency that is based on exchange, in that exchange is carried out by a universal medium of value, i.e. monetary price. Price is the one value that can easily be quantified, hence made susceptible to scientific measurement and manipulation. When you ask consumers why they want competition to play a large role in the economy, it is true that they will likely point to competitive prices as being advantageous. (It is also possible that they will say that competition is desirable because it drives out waste.) But, if they take a moment to think about it, they will likely mention other effects that they desire from competition: a reasonably wide range of products and services to choose from (and the empowerment of leverage that this suggests) and the progressivity and growth of a system that encourages improvements and innovations. Competition that brings low prices will often also

⁶⁴ Of course every model is a simplification of reality, which means that certain factors, deemed insufficiently relevant, will be excluded from the model. In antitrust, there is also a weighty argument about how already-complex cases can be tried if virtually everything that might be relevant is considered fair game in the litigation. Nonetheless, it seems strained to justify a merger as efficient when major elements of cost are disregarded.

engender the other desiderata of variety and innovation. But not always. If a competitive system that delivers only competitive prices is not likely to be entirely satisfactory, why should we accept price as if it were a proxy for all the desiderata?

Isn't there a confusion of goal and byproduct? A telling criticism of the efficiency standard, therefore, is that efficiency should not be conceived as the primary goal of antitrust so much as an important desired output of a competitive system. The system itself might better be conceived as the goal.

Static efficiency as a goal has the benefit of sounding scientific and quantifiable. We should in theory be able to place a dollar value on efficiency gains. Assuming we can, however, antitrust inevitably places us in the situation of having to weigh putative efficiency gains against putative competition losses. While some of the gains and some of the losses may be measured in terms of prices, this precision is lost if what is perceived to be at stake includes more than prices (e.g., a reduction in the number of competitors, reduction in choices, reduction in future innovations). These incommensurables undermine the claims of objective science put forward by over-emphasis on microeconomic price theory.

Perhaps the largest problem is that a static efficiency gain must sometimes be compared to a dynamic efficiency loss. If, as I pronounced earlier but will not document here, dynamic efficiencies are often far more important than allocative efficiency gains, it would seem that static efficiency should not always be the singular or even the highest-ranking goal of antitrust.

3. Dynamic Efficiency.

If political goals are too subjective and too changeable and static efficiency goals are too narrow, can dynamic goals provide the direction that antitrust needs?

There are several drawbacks to this idea, as well.

First, there are many antitrust situations in which dynamic efficiency is not particularly relevant. As a recent book on dynamic competition concluded, “Dynamic analysis would probably do little to alter antitrust decisions in markets that already appear competitive in a traditional, static sense, because the structure of such markets – the presence of numerous actual competitors or low barriers to entry—already makes antitrust action unlikely to improve consumer welfare.”⁶⁵ Porter may handle this by saying there is a hierarchy of goals: if innovation is irrelevant, then we should turn to the static efficiency price/cost goals. What is unclear, however, is how to weigh the goals against each other when two or all three are relevant and they do not point in the same direction.⁶⁶

Second, while we can agree on the importance of growth, we have a limited understanding of how to generate innovation. In particular, we can only be very vague about what types of market structure or incentives are most likely to lead to innovation. F.M. Scherer and David Ross concluded their extensive review of the industrial organization literature with the observation that “What is needed for rapid technological progress is a subtle blend of competition and monopoly, with more emphasis in general on the former than the latter, and with the role of monopolistic elements diminishing when rich technological opportunities exist.”⁶⁷ This being approximately the best that can

⁶⁵ Jerry Ellig (ed.), *Dynamic Competition Policy and Public Policy: Technology, Innovation, and Antitrust Issues* (Cambridge Univ. Press, 2001), concluding chapter.

⁶⁶ Burton Klein wrote, “Economists have long assumed that the only kind of efficiency is static efficiency. But Schumpeter not only recognized that an economic system can be characterized by a higher or a lower degree of dynamic efficiency, but acknowledged that it cannot achieve a high degree of static and dynamic efficiency simultaneously.” *Dynamic Economics*, 35, quoting Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy* (Harper & Brothers, 1942) at 83. Also see William J. Baumol, *The Free-Market Innovation Machine: Analyzing the Growth Miracle of Capitalism* (Princeton Univ. Press, 2002) (“*[I]nnovation has replaced price as the name of the game in a number of important industries.*” at 4).

⁶⁷ F.M. Scherer and David Ross, *Industrial Market Structure and Economic Performance* (third ed., Houghton Mifflin, 1990) 660. Also see William M. Landes and Richard A. Posner, *The Economic Structure of Intellectual Property Law* (Harvard Univ. Press, 2003), 385 (“[A]fter many years of study, it remains completely uncertain in both theoretical and empirical analysis whether concentration promotes, reduces, or does not affect innovation. So effect on innovation is probably something that should be ignored in the administration of merger law.”)

be said, it is fair to conclude that we do not currently know how to operationalize dynamic efficiency within an antitrust context. Porter, unfortunately, provides very little help in this.

Economist Jerry Ellig says that, although he can see where dynamic analysis can offer insights to antitrust enforcers,

Intellectually, dynamic competition makes antitrust enforcement even more difficult than it already was. Instead of simply defining product markets and hunting for evidence of market power, antitrust officials must assess which firms are capable of innovating in various areas. To avoid artificially restricting the breadth of the innovation market, officials must assess the innovative capabilities of firms that may not even compete with each other in a product market...A skeptic would be justified in asking why and how enforcement officials would have the knowledge to make such assessments.⁶⁸

Third, a risk of focusing only on innovation is that it could lead to the absence of competition, at least if the focus is only on achieving innovation in the short term. Schumpeter, for example, extolled monopoly as being a necessary condition for innovation. Under our patent system, we award a “temporary” monopoly as an incentive to innovate. Although we do not know how much incentive is enough to generate optimal innovation, our copyright protections are subject to political forces that continually extend their duration. The conundrum of intellectual property is that there may be such a thing as too much protection. The problem can be that monopolies gained through innovation, once empowered and in the absence of antitrust constraints, may not roll over to make way for the next innovators. This is what the Microsoft case was all about.⁶⁹

⁶⁸ Ellig, *op. cit.*, 265-7.

⁶⁹ For a useful perspective on the Microsoft litigation, see Bruce Abramson, *Digital Phoenix* (MIT Press, 2005).

III. Choosing Among the Multiple Goals of Antitrust

To recapitulate, although Robert Bork teaches that there can only be one goal for antitrust, namely his conception of consumer welfare, there are in fact a number of other goals that have been posited: some are political, some involve the search for static efficiency, and some relate to growth. How is a nation to decide which goals to follow?

There is indeed a yearning to find one goal, the single goal, because then one could design a system of antitrust that would appear to be scientific, objective, safe from the prejudices introduced by such human factors as politics. When multiple goals are acknowledged, logic is likely to suffer. Tradeoffs will have to be made. Discretion and hence politics will enter into the process. Compromise is messy. Outcomes are not necessarily predictable, although rules can be invoked to reduce this problem. Nonetheless, none of the proffered goals of antitrust, taken alone, withstands criticism or provides a singularly satisfactory standard. Is some sort of multiple-goaled system therefore a necessity?

Porter and others, notably Joseph Brodley, have suggested one approach, which is a hierarchy of goals: dynamic efficiency, productive efficiency, and allocative efficiency, in that order of importance. As noted, however, we do not have a way of knowing when or how to mix these various goals. For instance, if the innovation goal were given priority, would strong evidence in favor of a small dynamic gain outweigh weak evidence of a large productive efficiency gain? Perhaps one could construct a matrix to cover most situations. But how should one compare mathematically calculated evidence of a deadweight loss against a prediction that a company will successfully bring to market a drug that is only now in an R&D phase? When is a bird in the hand worth two in the bush?

An alternative to a hierarchy might be to assign a primary goal which is to be supplemented by other goals. Ellig has suggested that dynamic competition analysis

might be deemed an “additional factor” that supplements the primary goal of static efficiency analysis.⁷⁰ This could lead to such rules as, e.g., where substantial market power exists but the potential for innovation is high, “[T]here is a strong argument for refraining from antitrust action.”⁷¹ Ellig also sees a trickier decision in those markets where a high degree of market power may be accompanied by a low potential for innovation, and notes that in borderline cases, more complicated trade-offs will be needed. The overall consideration would be how long consumers would be left exposed to monopolistic exploitation.

Similar to an “additional factor” would be a “tie-breaker function” for certain clearly articulated goals. Here, the additional factor is not merely something to be considered, but is a definitive trump card. This may be a useful rhetorical device, but unless there is a scientific method for first determining a “tie,” invocation of the tie-breaker is ultimately someone’s discretionary act.

Thus, we have at least three models to consider: a single goal, a hierarchy of goals, and a primary goal supplemented by additional factors that may have specified or unspecified weights. Each has drawbacks. None of the single goals that have been put forward draws universal acceptance. Even most neoclassical economists recognize that innovation needs to be considered in some manner within a solid antitrust analysis. Other types of goals we have examined do not by themselves offer sufficient guidance for policy decisions. A hierarchy of multiple goals offers some prioritization of values and is helpful to that extent. However, this approach requires weighing the various goals and assigning rules for when and how they are to be combined. The additional factor approach offers assurance that relevant goals will not be ignored, but, again, it does not tell us how to weigh any additional factors in an analysis. Ellig has given an indication of how researchers might develop rules for adding dynamic considerations to traditional static analyses, but these are still at an early stage of formulation and further elaboration is likely to prove difficult. Moreover, there are more “additional factors”, such as various

⁷⁰ Ellig, *op. cit.*, at 264.

⁷¹ *Id.* at 265.

goals like choice and diversity that have been advanced. If we move beyond one-goal antitrust analysis, we still need to determine which goals will have to be considered as legitimate and how the various goals can be operationalized.

At this point, we need to retreat to fundamentals. The first and foremost question is, what economic end should the antitrust system serve? Porter argues that growth of the economy is the proper end, so that all in the society can have more, and therefore antitrust's role should be to contribute to that growth by encouraging innovation. Bork argues that the proper end is allocative efficiency, so that current resources can be maximized for the good of all. It would seem that in many cases there is no conflict between these goals. Static efficiency is a reasonable goal, since in principle nobody favors unnecessary waste, but as we have seen, efficiency means different things to different people. Growth is also a reasonable goal, since everyone potentially benefits if the pie gets larger. But both efficiency and growth depend for their support on unspoken questions of distribution. Who gains and who loses? Who should gain and who should lose? While economics can help us answer the first, empirical, question, the normative "should" question is political. Political issues are unavoidable. There is no a priori reason why different political systems should be expected to come to the same answers or why the same political system should not alter its answers over time.

Take this basic question: Should the antitrust system favor consumers or producers? An interesting answer was recently recommended by Jonathan Baker, who has the advantage (or curse) of being both an economist and a lawyer.⁷² Baker tells "a story" of a kind of social contract between producers and consumers, two broadly defined coalitions, which could have been worked out through experience in the context of American history. Baker argues the case for a political compromise, in which neither producers nor consumers definitively win out. His compromise is that when consumer and producer welfare clash, both should get a piece of the action. To give an example, if there is a proposed merger that may have anticompetitive effects but will produce

⁷² Jonathan B. Baker, *Competition as a Political Bargain*, forthcoming in the *Antitrust L. J.*, available as an AAI Working Paper at <http://www.antitrustinstitute.org/recent2/382.pdf>.

efficiency gains, then the merger would be allowed, provided that *some* of the gains be passed through to consumers-- not to the nation in general (which in the first instance would mean the stockholders of the merging companies), but to consumers who purchase the products of the merged firm, receiving a share of the new efficiencies in the form of lower prices. This solution, Baker argues, is roughly the one that exists today in the U.S., although it is rarely stated explicitly outside of the merger context.⁷³

Baker's story is interesting, perhaps compelling. But as he clearly understands, the "story" is a myth, much like Rousseau's social contract or Rawls' veil of ignorance. It has the value of seeming to provide a solution to the question of what to do about the three surpluses: total surplus, consumer surplus, and producer surplus: namely, we should take them all into account. There should be no clear winner. This will disappoint not only advocates of each of the three surpluses, but advocates of a thoroughly objective approach to antitrust. It leaves it to the black box of law enforcement and judicial administration to determine in specific cases to make a judgmental balance and declare a winner.

Helpful as it is in explaining how political issues might be understood to have brought us to a narrowing of the principal economic questions that antitrust must address, this is not a solution to the question of what should be the goal or goals of antitrust. First, it does not attempt to suggest how the tradeoff should be made within the black box. What constitutes a fair, appropriate, or politically adequate distribution of the gains? Second, it does not deal with the other "additional factors" such as innovation or the desire for diversity (e.g., choice, variety, freedom) that have so often been voiced. Where were these values when the storied compromise was reached? It is easy enough to imagine a profit-enhancing merger that creates a monopoly, in which the shareholders

⁷³ In many areas of antitrust enforcement (e.g., cartels), differences between consumer welfare and producer welfare are not important. Baker identifies four settings in which application of the two standards can lead to different conclusions: an agreement among rivals leading to more efficiency and also higher prices; exclusionary conduct that can harm rivals and lead to lower prices; agreement among consumers to use monopsony power to reduce prices in an input market; and price discrimination that can raise aggregate welfare while reducing consumer surplus. *Id.*, at 45-7. Also see Joseph Brodley, *Proof of Efficiencies in Mergers and Joint Ventures*, 64 *Antitrust L.J.* 576 (1996) (all savings do not have to be passed on to consumers, but they should get some benefit).

will absorb half of the cost savings in the form of dividends and consumers will absorb half in the form of reduced prices; but at the same time, it is reasonably predicted that the new monopoly power will be used in ways that will convince investors not to invest in new ideas or companies that will challenge the monopolist. In this, the public should have not only a large interest, but arguably an interest that is weightier than either the shareholders or those who will be consumers.

CONCLUSION

My own approach would be somewhat different. I think that much of the debate described in this chapter conflates primary and secondary goals. I would say that there is only one primary goal of antitrust, namely a market-based economic system in which competition should be the ruling principle so long as it creates a reasonable balance of certain specified outcomes, which constitute the secondary goals: stimulation and opportunity for innovation and growth; efficient production and allocation of resources; competition-determined prices for consumers; a reasonable range of choices for all participants in the market; and a set of guiding rules and practices that provide reasonable predictability for those who have to make decisions within the system. I would admit that sometimes these desired outcomes will clash and that there are no lasting algorithms for setting priorities in such instances. Human judgment (primarily that of law enforcers and courts, egged on by the critiques of learned commentators) will simply have to sort things out on a case-by-case basis, dependent upon the strength of the evidence that happens to be available, and informed by the best economic analyses and legal argumentation of the day. A science? No. More of an art form that goes by the name, common law.