

Paper Trail: Working Papers and Recent Scholarship

This edition of the Paper Trail is a bit briefer than usual, but is, we hope, no less informative. The paper by Josh Lerner provides a sweeping empirical view of the benefits of patent protections. Dave Scheffman, Director of the FTC's Bureau of Economics, continues to use that position as a bully pulpit for deeper and different empirical analyses in merger investigations, an empirical enthusiasm that some find refreshing. His paper with Mary Coleman both provides further insights into how that front office views mergers, simulations, and empirical analyses and offers some previews of research to come from the Bureau. And we would be surprised if any antitrusteer has authored more serious papers on market definition than Greg Werden at the Justice Department. In the short paper discussed here, Werden advises practitioners on how to avoid incorrect inferences using critical loss/critical elasticity analysis, once again in the spotlight as a result of the FTC's cruise lines decision. In the final paper summarized in this edition, Cornell economist David Sally offers a theory of the role of sympathy in cartels.

As always, any suggestions for coverage in the Paper Trail are welcome. Please email Bill Page (page@law.ufl.edu) or John Woodbury (jrw@crai.com).

Papers and Summaries

Josh Lerner, Patent Protection and Innovation Over 150 Years, National Bureau of Economic Research Working Paper Series, Working Paper 8977 (June 2002), <http://papers.nber.org/papers/W8977>.

A key presumption in evaluating the antitrust implications of exclusionary conduct with regard to IP is that exclusion enhances incentives for innovation. (See the Point/Counterpoint exchange in the July issue of *The Antitrust Source*.) While not addressing exactly that question, a recent working paper by Josh Lerner empirically reviews the history of patent policy since 1850 in about 60 countries. The purpose of the paper is to determine whether changes in patent policy, particularly those that increase the extent of patent protection, have effects that one might expect, such as an increase in the number of patents. In the process, Lerner attempts to account for numerous other factors that might have affected the number of patents, including some that are not usually part of our ordinary antitrust control-variable tool-kit, such as wars, revolutions, and the extent of political stability. In fact, his data and analysis indicate that an increase in patent protection reduces the extent of patenting. To be sure, one could certainly (and likely correctly) be cautious about this result given the nature of the data (there are gaps in the 150-year history), including using patents as a measure of innovation. Nonetheless, it is disquieting that over the broad sweep of history, the value of patent protection cannot be identified.

—JRW

David T. Scheffman and Mary T. Coleman, Current Economic Issues at the FTC, *Review of Industrial Organization* (forthcoming), <http://www.ftc.gov/ftc/economic.htm>.

This short paper provides some insights into the current state of thought within the leadership of the FTC's Bureau of Economics (Scheffman is the Bureau Director and Coleman is the Deputy Director

for Antitrust) and offers some teasers about forthcoming BE efforts. At the outset, the paper seems to pan the use of Bertrand simulations using scanner-based demand estimates for a competitive effects analysis of horizontal mergers involving differentiated products. It's not always clear whether Scheffman is panning just simulations that rely on such demand estimates or whether he is just panning simulations. While I personally am of the view that these simulations are not the end of economic analysis of a differentiated product merger, they certainly can be useful at the least as a preliminary gauge of how much reliance must be placed on other factors (such as entry and repositioning) if the merger deal is to pass muster at the agencies. In any event, the paper reports that BE is analyzing the extent to which marketing documents specifically, and the marketing literature generally, can be used to estimate demand elasticities. Similarly, the paper alludes to examining the extent of competition between firms directly, but provides little in the way of guidance for practitioners. While continuing to promise the coordinated effects paper, this one offers a nice summary of the kind of empirical evidence helpful in merger analysis, suggesting new merger retrospectives (including health care mergers), possible policy developments in the IP/antitrust nexus, and a staff report on the state of the oil industry.

—JRW

Gregory J. Werden, *Beyond Critical Loss: Tailoring Applications of the Hypothetical Monopolist Paradigm*, EAG Discussion Paper EAG 02-9 (Aug. 2002).

In this short and accessible paper, Greg Werden discusses some common pitfalls in blindly applying the critical elasticity/critical loss approach to both market definition and competitive effects. In particular, he discusses how the critical elasticity/loss analysis can result in incorrect inferences when the elasticity composition of market demand, differing marginal costs across capacity units, and differing fixed costs across capacity units can lead to incorrect inferences about the scope of the market or the magnitude of the competitive effects. Fortunately for us, Werden explains how the analysis can be tweaked to account for these differences.

—JRW

David Sally, *Two Economic Applications of Sympathy*, *Journal of Law, Economics, and Organization* (2002).

This article is the latest in a series by Sally exploring the role of sympathy in economic relations. It should be interesting to antitrust lawyers because it offers a theory of why successful cartels typically involve strenuous efforts by their members to cultivate sympathy or fellow-feeling. Using a duopoly model, he shows that “[s]ympathy makes deeper cooperation possible,” because members of the cartel take account not only of their own gains and losses, but those of their “friends.” Sally’s model also identifies the sorts of problems that are likely to undermine cooperation. He points to accounts of several famous cartels, including the electrical equipment and lysine conspiracies, as evidence supporting importance of sympathy. He suggests, for example, that although ADM voiced the famous motto that “the competitor is my friend,” a lack of real sympathy undermined the cartel: “the salience of the social distance, both physical and psychological, between Decatur, Illinois, and Tokyo, may have created a low ceiling to sympathy . . . , preventing the bonds necessary for effective collusion.”

—WHP