Paper Trail: Working Papers and Recent Scholarship

Editor's Note: *This edition features two papers that assess Robert Pitofsky's volume of essays,* How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust*. Send suggestions for papers to review to: page@law.ufl.edu or jwoodbury@crai.com.*

—*William H. Page and John R. Woodbury*

Recent Papers

Joshua D. Wright, Overshot the Mark? A Simple Explanation of the Chicago School's Influence on Antitrust
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1370641

Daniel A. Crane, Chicago, Post-Chicago, and Neo-Chicago
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1375026

These two papers assess Robert Pitofsky's new volume of essays, *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust* (Oxford University Press 2008). As this title suggests, the essays in Pitofsky's book argue that the Chicago School provided a much-needed economic basis for antitrust policy, but has gone too far in inhibiting necessary interventions in the market.[1] Its pervasive influence in the courts and the agencies has enfeebled antitrust enforcement, at least in the United States.[2] The essays endorse the post-Chicago School, which uses sophisticated game-theoretic models that identify conditions under which such practices as predatory pricing, tying, and exclusive dealing can be anticompetitive.

The Wright and Crane reviews take different approaches, but both conclude that the book fails to make the case that the post-Chicago School should displace the Chicago School. The points of disagreement between the reviewers and the essayists are interesting in themselves. But they also give us a glimpse of what future debates over antitrust policy may look like because the reviewers, although already recognized scholars, are still in the first decade of their careers.

Wright challenges the book's repeated claims that the Chicago School's anti-interventionist policy program rests not on the best available economic theory or empirical studies, but on a conservative political ideology. While not denying the obvious ideological dimension in antitrust con-

1 Wright endorses the distinction between the Chicago School of industrial organization economics, which challenged the structure-conduct-performance paradigm of the 1960s, and the Chicago School of antitrust analysis, which challenged the prevailing view that certain practices, such as tying arrangements, were always anticompetitive. *See* Jonathan B. Baker & Timothy F. Bresnahan, Economic Evidence in Antitrust: Defining Markets and Measuring Market Power 23–26 (Stanford Law School, Working Paper No. 328, 2006).

2 For European perspectives, see Post-Chicago Developments in Antitrust Law (Antonio Cucinotta, Roberto Pardolesi & Roger van den Bergh eds., 2002).

troversies, Wright argues that the debates over the welfare effects of particular practices often can be resolved by data. The book's authors, he argues, ignore data that supports Chicago policy positions and oddly fail to offer data to support their arguments for expanded liability for such practices as resale price maintenance, exclusive dealing, and predatory pricing.

Wright notes that, from its inception, the Chicago School has emphasized the importance of empirical inquiry. Chicago School economists like Harold Demsetz relied on data to challenge the simplistic claims of the structure-conduct-performance paradigm that prevailed during the Warren Court years. George Stigler, the Nobel Prize-winning Chicago economist, measured the validity of theories by their empirical support. Wright also notes that the Chicago School was responsible for the error-cost framework that typically structures the consideration of evidence in modern antitrust cases.

Wright then turns to specific instances in which the available theory and empirical evidence support the Chicago approach. The first is resale price maintenance, or RPM. In *Leegin*,[3] the Supreme Court overturned the century-old rule of per se illegality for the practice, observing that the practice could enhance interbrand competition by, for example, controlling free riding by dealers on the sales efforts of other dealers. The book's authors argue that this ruling was incorrect, because manufacturers sometimes impose RPM even when there is no evidence of or prospect for free riding by dealers. Wright points out, however, that Ben Klein and Kevin Murphy, Chicago School economists, have noted this phenomenon, and have offered a convincing procompetitive explanation for it: the disparity in the profit margins of manufacturers and dealers on incremental retail sales.[4] Manufacturers have a higher profit margin on incremental sales of their differentiated profits than do their dealers; consequently, dealers, even in the absence of free riding, have an insufficient incentive to incur the costs of making manufacturer-specific sales efforts. Compounding the problem, a dealer's manufacturer-specific promotional efforts may increase sales of that manufacturer's goods at the expense of sales of other goods the retailer handles. The manufacture can profit by providing an incentive to dealers to provide those services. There are various ways to provide the appropriate incentive, but RPM may be the least costly.

Wright also directly disputes the claims of some of the essayists that there is little empirical evidence that RPM is procompetitive. There is evidence that RPM raises prices, but that is hardly surprising because the very reason for the practice is to provide dealers with higher margins, at least initially; the real issue is whether the price increase is accompanied by a reduction in welfare (as in the case of a dealer cartel) or an increase. Wright points to a substantial literature that suggests that, in the vast majority of instances of RPM, it benefits consumers by assuring that they receive services that they want.[5] The authors of the book, Wright notes, do not respond to this evidence.

Wright offers a similar critique of the essayists' treatment of exclusive dealing. Post-Chicago scholars have shown that exclusive contracts with dealers can be exclusionary if a manufacturer can sign up enough dealers to deny rivals the outlets they need to achieve minimum efficient scale. Wright provides a helpful review of the various models that show when market conditions make this sort of strategy possible in the face of its obvious problems—especially the incentive of dealers

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3 Leegin Creative Leather Prods., Inc v. PSKS, Inc., 551 U.S. 877 (2007).

4 Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L & Econ. 265 (1988).

5 *See, e.g.*, James C. Cooper, Luke M. Froeb, Dan O'Brien, & Michael G. Vita, *Vertical Antitrust Policy as a Problem of Inference*, 23 Int'l J. Indus. Org. 639 (2005); Francine Lafontaine & Margaret Slade, *Empirical Assessment of Exclusive Contracts*, *in* Handbook of Antitrust Economics (Paolo Buccirossi ed., 2008).

to avoid creating an upstream monopoly. In response to these possibility theorems, Wright points to the models of Klein and others that show the many ways in which exclusive dealing can be efficient. For example, a manufacturer may use the practice to assure that dealers will not simply pocket its payments or use them to promote rival products. Again, according to Wright, the available evidence, though limited, suggests that exclusive dealing is frequently output-enhancing.[6]

In a final section, Wright challenges the notion that the Chicago School's success in recent Supreme Court decisions is evidence of the overwhelming pernicious influence of what some essayists call conservative economics. He notes that the vast majority of the Supreme Court's recent antitrust decisions have been decided by supermajorities, a fact he attributes to the acceptance of Chicago School approach by both liberal and conservative justices. There is a real ideological divide in antitrust, but it only imperfectly reflects the conventional, broad-brush classifications of conservative and liberal on fiscal and social issues.[7]

Dan Crane makes some of the same points as Wright. He objects to the suggestion that the Chicago School is merely ideological. He particularly criticizes Pitofsky's chapter introductions as overstating the arguments of the essayists, most of which make more limited criticisms of particular Chicago positions. Like Wright, he criticizes the repeated characterizations of Chicago as lacking empirical foundation and notes that post-Chicago antitrust is, if anything, less empirical than Chicago. He suggests that, where there is no definitive evidence about the effects of a practice, the courts understandably prefer not to impose liability. He echoes Wright's point that "it takes a theory to beat a theory," observing that post-Chicago has failed thus far because "its major contribution has been to grouse about Chicago rather than to articulate a clear and appealing vision about what antitrust should do and why." (p.20)

He notes that the differences between the policy recommendations of the leaders of the two schools can be overstated. He rejects the claim that the mainstream of the Chicago School, represented by Richard Posner and William Baxter, is uniformly non-interventionist. He suggests also that much of the success of defendants in the Supreme Court can be laid at the feet of the Harvard School's emphasis on institutional competence in the exercise of the judicial function. As an illustration, he points to Herbert Hovenkamp, an early advocate of post-Chicago antitrust,[8] who has inherited the Areeda antitrust treatise, the great expression of Harvard School antitrust. Hovenkamp, he notes, despite his post-Chicago credentials, is one of the leading critics of *Kodak v. Image Technical Services*,[9] the Supreme Court's most clearly post-Chicago decision.

Despite his criticism of the broader claims of the book, Crane is impressed by the specific theoretical challenges that post-Chicago theorists have made to a range of Chicago positions. He suggests that the challenges warrant a renewed effort by Chicago scholars to reconstitute their approach as a Neo-Chicago school. A large part of this effort will be to improve the empirical basis of antitrust and to refocus attention on the capacities of courts to improve market outcomes.

In making his call for a Neo-Chicago School, Crane is on solid ground. Much work remains to be done within the traditional framework. Yet I believe he overstates the challenge ahead. He char-

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6 Jan B. Heide et al., *Exclusive Dealing and Business Efficiency: Evidence from Industry Practice*, 41 J.L. & Econ. 387 (1988); John Asker, Diagnosing Foreclosure Due to Exclusive Dealing (NYU Working Paper No. EC-04-36, 2005); Tim R. Sass, *The Competitive Effects of Exclusive Dealing: Evidence from the US Beer Industry*, 23 Int'l J. Indus. Org. 203 (2005).

7 William H. Page, *The Ideological Origins and Evolution of U.S. Antitrust Law*, 1 Issues in Competition Law and Policy 1 (ABA Section of Antitrust Law 2008).

8 Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 Mich. L. Rev. 213, 225 (1985).

9 Eastman Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 451 (1992).

acterizes post-Chicago as “lean, hungry, and spoiling for a fight,” (p.22) particularly with this new volume of essays as a manifesto. (He might have added that post-Chicago antitrust is dominant in Europe.) The Chicago School, in contrast, is moribund. Its “fire . . . has gone out,” (p.22) and its founders are “dead, bored with the field, or complacent.” (p.21) I hope this characterization is a bit of hyperbole to match that of the volume under review. While the founders may have moved on, there are others carrying the torch, not least the authors of these reviews. The Chicago School (or Neo-Chicago School) is in good hands. ●

—WHP