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COMPETITION & FREEDOM:

THE VIEW FROM ANTITRUST

Today I want to talk about the free market and unfettered competition, and hope you know the basic theme -- that free and unfettered competition maximizes consumers' economic welfare; that government interference with the market, by regulations or otherwise, tends to reduce consumers' economic welfare; that antitrust policy should be based upon sound economic analysis; and that many features of past antitrust enforcement policy caused serious competitive harm, and therefore substantially reduced consumers' economic welfare, because they were not founded upon sound economic analysis.

Today I'd also like to talk about competition and freedom, viewed from the perspective of antitrust.

Man does not live by bread alone, and the free market does not relate to economic welfare alone. Twenty-four years ago, in Capitalism and Freedom, Milton Friedman eloquently described "the role of competitive capitalism -- the organization of the bulk of economic activity through private enterprise operating in a free market -- as a system of economic freedom and a necessary condition for political freedom." Professor Friedman asked, rhetorically, "can a free market in ideas long be maintained if a free market in goods and services is destroyed?" The answer is clear: it cannot.

But Professor Friedman was not by any means the first to recognize the interrelationship of economic freedom and political freedom. We shall celebrate next year the 200th anniversary of the most profound charter of political freedom ever written by Man: the Constitution of the United States. Do you recall that Article I, Section 10 of that incredible document prohibits the states from passing any law impairing the obligation of contracts? And the Fifth Amendment, of course, provides that no person shall be deprived of life, liberty, or property without due process of law, and that private property shall not be taken

for public use, without just compensation. In short, our Founding Fathers understood well that economic freedoms -- freedom to contract, freedom to hold and dispose of property, without undue interference of the state -- are fundamental rights of a free people.

Economic rights, like the other rights guaranteed by the Constitution, are not absolute. The right to freedom of speech does not include the right to shout "fire" in a crowded room. The right to freedom of contract may similarly be limited. Unfortunately, however, although most people in government are usually sensitive to any intrusion on freedom of speech, for too long they have been all but oblivious to denials of economic rights. Antitrust enforcement, by definition, involves interference with freedom of contract. As the government must demonstrate a clear public interest before it interferes with our political rights, it should also have to establish a clear public interest before it interferes with our economic rights. Interference with economic rights is interference with the political rights. This is the understanding I intend to apply as Chairman of the Federal Trade Commission.

What are the implications of this approach for day-to-day antitrust enforcement? First and foremost, it means that before we initiate any enforcement action -- in other words, before we undertake to infringe any person's or any organization's freedom -- we ought to be quite certain that the public interest in free and unfettered competition will, in fact, be served by our action. And this requires that we subject any enforcement action we contemplate to searching economic analysis of its competitive implications.

It should not surprise you to be told that the basis for Commission actions now is principally economic. Indeed, this basis is no longer even radical. The FTC's Bureau of Economics has been part of our organization for a long time. Some notion of economic policy, often explicit, has been part of Commission decisionmaking for generations. The great crusade against the suspected evils of industrial concentration that occupied so much of our resources during the 1960's and 1970's can be traced ultimately to a Depression-era organization called the Temporary National Economic Committee. Thus, it is consistent with tradition and established principle to assert that Commission decisions should be based on economic analysis. We must work to ensure that Commission cases make economic as well as legal sense.

Fairness requires me to note that economics has been involved in antitrust enforcement for a long time; honesty requires me to add that a lot of things were done that do not make economic sense. Some actions were taken in spite of economic advice, because the rules being implemented were thought

to be, somehow, "fair," despite their economic irrationality. Others were taken because the enforcers could score a quick victory, regardless of the wider consequences. Other actions were taken based on the then-best economic advice, advice that over the years has proven to have been misguided.

We have, over the last few years, begun to replace what had become a kind of quasi-economic mythology with a more sophisticated, hard-headed economic analysis. More than a generation has passed since the studies appeared in the 1950's linking concentration and monopoly profits. Further study has cast great doubt on those simple correlations. It has revealed instead that high market shares are often correlated, not with monopoly, but efficiency. Additional study has led to reconsideration of other traditional concerns, such as tying, exclusive dealing, vertical distribution arrangements, and even some kinds of horizontal agreements.

You experts who deal with this every day have watched this process unfold over the last few years even in luncheon speeches. I will not repeat what has become commonplace. The kind of policy-making based on economics that you have seen over the last several years from the FTC will continue through this Administration, and, I believe, well beyond.

I think it is fair to say that much progress has been made during the Reagan years. But much remains to be done. We need to make every effort to rectify and neutralize the mistakes of the past. I hope we will also adopt measures to avoid their repetition in the future. We must be willing to eliminate old orders that are clogging competition for no defensible reason. I would go further, and would vacate any existing order after a reasonable period of time unless there is an affirmative reason to keep it in effect. We should also consider adopting a policy of sunsetting new orders, so that our mistakes are not visited on our grandchildren.

Another contribution of the Reagan years has been the revision of the merger guidelines and the Commission's policy statement on horizontal mergers. Analyzing a case according to the guidelines is now a standard operating procedure at the enforcement agencies, as I am sure it is for you in your offices as well. The various guidelines have established a common framework for all of us.

The guidelines have not, however, made merger analysis an exact numerical science. The ultimate question, all should remember, is whether the transaction violates Section 7 of the Clayton Act, not whether the HHI increases by over 100 points. To focus solely on the HHI thresholds is to perpetuate the market share fallacy, that legality can be determined solely by a statistical proxy for the real world. Concentrating on the HHI

levels substitutes one incomplete inquiry for another. The key word is "incomplete." Concentration, and changes in it, can tell us something about a market, but cannot tell us everything necessary to justify a restraint on freedom of contract. More needs to be known before enforcement decisions can be made intelligently.

We define the market -- and that's no easy task. We look at entry barriers. We consider efficiencies -- but know that's a tricky business. We calculate the effects of "small but significant and non-transitory" price changes -- but know that our calculations are speculative. We talk to people and gather evidence. But sometimes the people we talk to say they'd never switch products for a ten percent price change -- unaware they've already done as much in response to an equivalent change in transportation costs, tariffs, taxes, or exchange rates. Sometimes the evidence we seek regarding possible price changes simply isn't kept in the ordinary course of business.

Please don't think I'm trashing the guidelines. I'm not. I'm simply pointing out that they may seem to promise more concreteness than they can deliver. The question is still: does the transaction violate Section 7, not "what do the guidelines say?" Properly understood, the guidelines should be very useful.

For example, the guidelines do make it clear that we consider international trade in defining the market.

The notion of a global economy is becoming commonplace. Increasing economic internationalization is a boon to consumers. It multiplies product choices, stimulates aggressive competition, and, through intensified competition, lowers prices.

The Commission is thoroughly adapted to such a global outlook. Whether the market for a product is international is something that can only be determined by looking at the facts. The simple fact that there is significant international trade for a product often shows that there is an international market for it. Indeed, there may be an international market, for purposes of antitrust analysis, even if there is no international trade. If foreign producers could enter the market in response to an unjustifiable price increase, we would generally consider those foreign producers to be in the market. Sometimes, though, foreign producers cannot realistically be expected to respond to developments in this country's economy. Transportation costs may be too high, national tastes or technologies may be incompatible, or exchange rates may be too volatile to justify investment or other marketing decisions. That is, after a second look, we may find that the economic markets for some products are not truly international after all.

More often, unfortunately, we find that even where the

economic markets should be international, foreign producers are not allowed to respond competitively in this country. They are barred by artificial, government-imposed barriers to free, competitive, international trade. These protectionist barriers, which include tariffs, quotas, antidumping duties, and the like, give an unnatural definition to international markets.

Government interventions -- closing markets, favoring domestic producers, penalizing imports -- are a serious restraint on free markets. Efforts to bar "unfair" imports are frequently efforts by domestic special interests to protect domestic producers from legitimate competition, and thus to deprive U.S. consumers of the benefits of that competition.

These efforts result in, essentially, government-sponsored cartels.

The seemingly perpetual quotas on textile imports have reduced the supply and increased the prices of low-cost clothing, while transferring wealth from the pockets of consumers to the domestic apparel industry. It is common to assume that domestic firms protected by quotas must be on the brink of collapse, but the U.S. apparel industry have in recent years been doing very nicely.

The five-year old "voluntary" restraints on imports of Japanese automobiles constitute, effectively, a collusive market-dividing scheme. The VRA's have had the predictable -- and predicted -- effects: fewer cars than consumers wanted, at higher prices than they would have had to pay. Most of the benefits, in the form of economic rents due to the quotas, went to Japan. Domestic producers, shielded from their most serious competition, raised their prices as well. No wonder they're called "voluntary" restraints.

Now, incredibly, we are about to commit the same folly in an industry this country pioneered. Computer chips are now the subject of a market-division scheme, suggested by this country, and agreed to by the Japanese government. The industry knows what is going on; an executive is quoted in the press as calling the agreement "a new era of cooperation." That is, cooperation instead of competition. The agreement guarantees market shares and provides a bureaucratic monitoring of costs and prices, to be sure the companies are playing "fair." It would even try to control competition in third countries. The immediate losers are already the American companies that will have to pay more for chips, and their customers who will have to pay more for their products. The <u>Wall Street Journal</u> calls this arrangement a cartel; the <u>Journal</u> is right.

A common justification for trade restraints is predation and its supposed consequences: the foreigners are deliberately

trying to destroy the American industry, and after they succeed they will monopolize the market and raise their prices. This is the same claim that we hear often in the domestic antitrust context. It is almost always implausible -- true predatory pricing is about as rare as a trustworthy Soviet -- and we have learned to be very skeptical of both. The Supreme Court observed just this year, in the Zenith-Matsushita case involving claims of import predation, that such schemes are "rarely tried and even more rarely successful." The alleged predation is most often found to be aggressive competition, which should be promoted, not prohibited.

Adopting anti-competitive measures in this country, in retaliation or defense against claims of market closure elsewhere, is a misguided policy. It invites a race to the bottom. If the foreign country is really limiting competition there, it is hurting its own consumers in the process. If we then cut off imports here, we merely do the same thing to ourselves.

The Commission is very concerned about efforts to restrict the operation of free international markets. One of the Commission's major efforts is its "consumer advocacy" program. We try to show when the international trade laws can be applied consistently with the pro-consumer purposes of the antitrust laws. We have urged that the trade agencies apply an understanding of competitive processes, rather than artificial rules of thumb, in determining whether there have been trade law violations. Even when violations have been found, we have tried to show how relief can be structured in the most pro-competitive way, to protect domestic industry from unfair injury while minimizing the injury to American consumers.

We have appeared before the International Trade Commission but we are not always welcomed, at least not by the parties seeking special interest relief from stiff competition. That is not surprising: people everywhere seek to manipulate government to their own advantage. Their successes in those endeavors come at the expense of the consumers -- the general public. The consumers' best interest lies in a free economy, not a protected economy, where the consumers foot the bill for the protection. Tariffs, quotas, legislation exempting cartels from the antitrust laws -- those are all devices for shielding old firms from new ones and from the rigors of the marketplace. We lawyers, especially those who are antitrust practitioners, should understand that point better than most.

Import restraints like these have cost the American consumer far more than private price-fixing has. Our economists have estimated that the restraints imposed by the government on the steel, sugar, textiles, and auto industries resulted in consumer losses of $3.3 billion in 1983. By contrast, the total sales in

all the industries subject to price-fixing prosecutions in that year were only $779 million. If the conspirators in those industries had been able to raise prices as much as 25 percent, that would work out to consumer losses of about 200 million from prosecuted private price-fixers -- less than one tenth the costs of just four government-imposed cartels.

Let me reemphasize here the connection between economic liberty and political freedom. Look back at our Declaration of Independence. Among the "Facts . . . submitted to a candid world" to prove that the King of Great Britain sought to establish "an absolute Tyranny over these States" was his "giving . . . Assent to . . . acts of pretended Legislation . . . for cutting off our Trade with all parts of the world." We should be equally outraged today whenever the government interferes with our international trade.

There is something inherently contradictory in being in favor of antitrust laws, and also in favor of tariffs, quotas, rent control, market orders -- the millions of ways the government interferes with competition. In the case of antitrust laws, the economic freedom of people in their business capacity is curtailed for the benefit of consumers. In the case of tariffs and other anti-competitive legislation, the economic freedom of consumers is curtailed for the benefit of certain businesses. We should make up our mind which is the proper policy. I think it should be the policy most consistent with freedom for the consumers -- the policy of competition and capitalism.

Not that competition and capitalism are always pretty. Capitalism and competition often result in blood being spilled all over the floor. We care only if it is consumers' blood.

The economist Joseph Schumpeter described the salient feature of capitalism as the disintegration of some businesses -- caused by their competitors. A process, in other words: of creative destruction, of growth and decay. It is only natural that those businesses in decay should seek our protection against the forces that are causing their demise. They want protection against their competitors' lower prices, or more efficient techniques, or his methods of telling consumers about his product. You and I -- but most especially legislators -- must resist being enlisted on the side of modern-day buggy manufacturers or whale oil producers.

I once suggested -- facetiously? -- that a prize be given to the largest company to go bankrupt each year: not because we encourage business failure, but to make the point that we don't condemn it. Bankruptcy is not an entry barrier to Heaven.

Failure is part of our system. It reflects the voice of the

consumers speaking -- democratically, if you will -- in a million elections (commercial transactions) across the country, every day.

Most regulation tends to impair competition -- and tends therefore to lessen the voice, and the vote, of the consumers. Let us be careful in rigging -- er, I mean in regulating -- those elections, those commercial transactions, as we would be in interfering in a political election.

I ask you, as fellow members of the Bar, many with specialized knowledge of competition, to join me in speaking up for the free market. And in advocating competition. I think that's what antitrust law is all about. The intellectual high ground is ours. Let us hold it for the sake of consumers -- for the sake of both their economic welfare and their political freedom. Consumers know, better than all the regulators in the world, what is best for them.

Thank you so much for inviting me to speak to you. I am greatly honored. It is always a pleasure to be in Texas -- the home of that great Senator, a free-market colleague of mine, one of the sanest men in Washington, Phil Gramm.

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