

ANTITRUST IN AN ERA OF MARKET FAILURE

ALAN DEVLIN*

This is an unsettling time for those who support rigorous economic analysis in antitrust cases. Over the past four decades, numerous assumptions underlying the operation of free markets had developed to the point of being virtually unassailable. Rational profit-maximizing behavior on the part of many leads to optimal, self-sustaining equilibria. Markets self-correct, such that many (indeed most) distortions will be ephemeral. Financial markets are efficient, which means that even large-scale entry in capital intensive markets can safely be presumed where supracompetitive prices await. In cases of uncertainty, enforcers should err on the side of false negatives by presuming the existence of competitive markets. In short, the free market works. Certain of these assumptions now lie in ruins. For the antitrust proponent who developed his thinking based on such principles, the global market meltdown poses an unprecedented predicament.

Yet, when all the dust has settled, it is not clear what the objective lessons of the crisis will be for competition policy. The global recession certainly teaches that assumptions of efficiency are misplaced where systemic risk and uncertainty pervade the marketplace. It questions the wisdom of a financial system that becomes concentrated to a point where the failure of one key player triggers the collapse of others. It reveals that monetary policy alone cannot control all macroeconomic fluctuations. It raises fundamental questions about the role of regulation, not just in terms of domestic scope, but in efficacy and global reach too. But for all this, it does not say much about antitrust analysis.

Many have missed this point, and missed badly. Competition enforcers, politicians, and commentators are falling prey to an alluring, yet simplistic and myopic view. They posit that the economic dogma that ushered in today's extraordinary global recession is inextricably linked to the tenets of price theory that inform antitrust doctrine. They are mistaken.

* Law Clerk to the Honorable Richard D. Cudahy, U.S. Court of Appeals for the Seventh Circuit; University College Dublin, B.B.L. (Int'l), 2004; University of Chicago, LL.M., 2005; University of Chicago, J.S.D., 2006; Stanford Law School, J.D., 2007.

This Article explores the normative repercussions of the global recession for competition policy and explains that minimal readjustment is counseled under the rubric of economics. Nevertheless, past shifts in substantive policy have coincided with larger changes in political thinking. The crisis has undermined U.S. faith in the free market, a development that portends a deviation from the law's cautious approach to economic conduct of indeterminate long-run competitive effect. Such a shift is difficult to justify, but is likely inevitable.

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INTRODUCTION

The collapse of the global financial system in 2008 and the ensuing recession through 2009 raise fundamental questions about the future of free-market economics. Although macroeconomic policy and regulation of the financial sector are the most obvious candidates for revision in light of the meltdown, antitrust law—given its explicit reliance on price theory—may also be implicated. This Article surveys the worst recession in a generation and explores the normative insights the crisis provides for proper competition policy.

The market meltdown that began in the U.S. housing sector and tore through the world economy has laid bare a number of economic principles. In particular, the deregulatory movement that swept through myriad industries was premised on the notion that market forces produce results superior to government intervention. This movement relied on the assumption that rational choice theory fairly encapsulates real-world behavior, such that companies and consumers act in their best interests. So informed, this theory suggested that markets self-correct, economic distortions are ephemeral, and rational behavior produces desirable outcomes. In light of the calamitous global recession, certain of these assumptions were obviously misplaced.

Assumptions of capital-market efficiency, rational behavior, and market self-correction play at least as central a role in antitrust jurisprudence as they played in regulatory policy toward financial markets. If these assumptions have been at least partially discredited in the latter setting, what does that say about the former?

Despite a common reliance on free-market forces, the principles of economics that underlie competition law are highly distinct from the norms that justified deregulation in the financial sector. Antitrust law understands the market to self-correct where monopoly conditions attract capital, thus yielding competition, lower prices, and greater social welfare.¹ In contrast, in the financial sector, the incentive to maximize profits spurs excessive leverage, creating systemic risk, which triggers the need

1. Cognizant of this restorative process, the law seeks to facilitate entry and to avoid mistaken findings that might insulate undesirable behavior from free-market forces. Obedience toward the curative powers of the market has led U.S. law to adopt an agnostic approach to economic conduct of indeterminate long-run effect.

for regulation. Thus, the market failure in the banking industry need not reveal an intellectual frailty underlying antitrust jurisprudence. Were one to infer, however, that the market failure associated with the credit crisis has normative repercussions for the faith properly placed in capitalist forces generally, one might reasonably revisit substantive antitrust doctrine. This Article explores whether we should in fact interpret the recession in this manner.

Over the past several decades, competition regimes of ever-growing sophistication have played an important role in the regulation of Western economies.² In the United States, the Chicago and post-Chicago Schools of thought have placed price theory at the heart of substantive policy.³ U.S. courts and enforcement agencies have developed an intricate body of jurisprudence that arguably renders the United States the world's most mature antitrust jurisdiction.⁴ The European Union has slowly, but inexorably, followed suit, adopting the consumer welfare paradigm and implementing rules of growing economic sophistication.⁵ Substantive interjurisdictional differences remain, of course, especially with respect to the question of the proper level of constraints to be placed on dominant

2. See Bruce M. Owen et al., *China's Competition Policy Reforms: The Anti-Monopoly Law and Beyond*, 75 ANTITRUST L.J. 231, 231 (2008) (explaining the myriad benefits competition policy has bestowed upon Western economies).

3. See Jonathan B. Baker, *Recent Developments in Economics that Challenge Chicago School Views*, 58 ANTITRUST L.J. 645, 646 (1989); Herbert Hovenkamp, *Post-Chicago Antitrust: A Review and Critique*, 2001 COLUM. BUS. L. REV. 257, 258; Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925 (1979).

4. See Siddharth Fernandes, *F. Hoffmann-LaRoche, Ltd. v. Empagran and the Extraterritorial Limits of United States Antitrust Jurisdiction: Where Comity and Deterrence Collide*, 20 CONN. J. INT'L L. 267, 268 (2005) (noting that the "United States has what is considered the world's most advanced and extensive antitrust regime" (footnote omitted)); Thomas A. Lambert, *Tweaking Antitrust's Business Model*, 85 TEX. L. REV. 153, 153-54 (2006) (reviewing HERBERT HOVENKAMP, *THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION* (2005)).

5. See Neelie Kroes, *Why Microsoft Was Wrong*, WALL ST. J. EUR., Sept. 26, 2007, at 13 ("U.S. and EU antitrust laws agree on most things, not least the objective of benefiting consumers."); Mario Monti, Comm'r for Competition: European Comm'n, *Comments and Concluding Remarks, Conference on Professional Regulation* 16 (Oct. 28, 2003), available at http://ec.europa.eu/comm/competition/speeches/text/sp2003_028_en.pdf (referring to the goal of making "the EU the most competitive and dynamic economy in the world by 2010").

firms.⁶ Despite these differences, a belief in the power of economic analysis has largely transcended national borders.⁷

Although the global financial meltdown demonstrates that unqualified support for the free market was dogmatic,⁸ it has revealed no systemic market failure that suggests or supports a shift in substantive antitrust policy. Competition law is concerned with the tendency of capital to flow to its highest-value uses. This phenomenon emanates from firms' incentive to maximize profits. If the banking crisis has taught us anything, it is that financial actors are myopic in their avid pursuit of short-run gains. This practice highlights the presence of incentives that justify the pre-crisis approach to competition law.

Unfortunately, it seems clear that the U.S. and EU authorities are using the crisis as a launching pad for far more aggressive enforcement against unilateral behavior and merger activity.⁹ Coupled with the possible expansion of Section 5 beyond the traditional scope of antitrust law,¹⁰ it appears that the United States is headed on an interventionist path more akin to Brussels than Chicago.¹¹

America's two enforcement agencies have gone so far as to speak of market concentration itself as an appropriate object of antitrust condemnation, even absent price effects.¹² This view,

6. See Deborah A. Garza, *Transatlantic Antitrust: Convergence or Divergence*, 16 ANTITRUST 5, 5 (2001); Ken Heyer, *A World of Uncertainty: Economics and the Globalization of Antitrust*, 72 ANTITRUST L.J. 375, 403 (2005); Charles W. Smitherman III, *The Future of Global Competition Governance: Lessons from the Transatlantic*, 19 AM. U. INT'L L. REV. 769, 821–25 (2004).

7. See, e.g., GIORGIO MONTI, EC COMPETITION LAW 73–82 (2007) (comparing and contrasting the role of economic analysis in U.S. and EC competition law).

8. See Henry Kaufman, *How Libertarian Dogma Led the Fed Astray*, FT.COM, Apr. 27, 2009, http://www.ft.com/cms/s/0/705574f2-3356-11de-8f1b-00144feabdc0,s01=1.html?nckick_check=1.

9. See *infra* Part II.B; see also Tamara Lytle, *Obama's New Antitrust Rules Have Big, Powerful Companies Sweating: The monopoly policy is a reversal of a Bush administration rule*, U.S. NEWS & WORLD REP., May 20, 2009, <http://www.usnews.com/articles/news/national/2009/05/20/obamas-new-antitrust-rules-have-big-powerful-companies-sweating.html>.

10. See, e.g., Robert H. Lande, *Revitalizing Section 5 of the FTC Act Using 'Consumer Choice' Analysis*, ANTITRUST SOURCE, Feb. 2009; Thomas B. Leary, *A Suggestion for the Revival of Section 5*, ANTITRUST SOURCE, Feb. 2009.

11. See DoJ, *EU Actions Suggest Tougher Antitrust Enforcement*, TELECOMM. REP., June 1, 2009, at 43.

12. See Mark D. Whitener, *Interview with J. Thomas Rosch, Commissioner, Federal Trade Commission*, 23 ANTITRUST 32, 41 (2009) ("A . . . possibility is that the agencies will be taking a closer look to see whether or not the merger will result in a post-

most prevalent during the Warren Court era, has been resoundingly rejected by U.S. courts for more than thirty years.¹³ Long-run efficiency is the exclusive goal of modern competition enforcement.¹⁴ Without the guiding norm of efficiency, antitrust policy would become untethered from any cognizable policy foundation.¹⁵ It would become a malleable tool subject to the idiosyncratic whim of whoever wished to enforce it.¹⁶ Courts would lack a well-defined standard by which to judge challenged conduct.

This Article explores the events leading up to the global recession, construing them in light of the revolutionary political and economic factors that yielded dramatic historical change in antitrust doctrine. It also explains the specific lessons of the crisis for modern principles of competition law. Clearly, the global recession has created a challenge for antitrust policy, but a critical inquiry into the genuine lessons of the global credit crisis reveals that little alteration is needed. An economically informed body of law focused purely on maximizing dynamic

transaction firm that is too big to fail"); see also Jim Puzzanghera, *Antitrust Enforcer Vows Tough Stance*, L.A. TIMES, May 12, 2009, at B1 (noting Christine Varney's question of whether antitrust has failed if companies get too big to fail and observation that "[c]onsumers have been waiting for the markets to correct themselves, but the financial crisis has shown they haven't").

13. See, e.g., *United States v. Syufy Enters.*, 903 F.2d 659, 668–69 (9th Cir. 1990).

14. See *N.C.A.A. v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 107 (1984) ("Congress designed the Sherman Act as a 'consumer welfare prescription.'" (quoting *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979)); *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 57–59 (1977); Joseph F. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 N.Y.U. L. REV. 1020, 1025–27 (1987); William J. Kolasky, *Conglomerate Mergers and Range Effects: It's a Long Way from Chicago to Brussels*, 10 GEO. MASON L. REV. 533, 533–34 (2002); Robert H. Lande, *Commentary: Implications of Professor Scherer's Research for the Future of Antitrust*, 29 WASHBURN L.J. 256, 258 (1990) ("[T]he dominant paradigm today is that the only goal of the existing antitrust laws is to increase economic efficiency"); Timothy J. Muris, *GTE Sylvania and the Empirical Foundations of Antitrust*, 68 ANTITRUST L.J. 899, 900 (2001) (interpreting *GTE Sylvania* as "a ringing endorsement of the economic approach to antitrust"). But see John B. Kirkwood & Robert H. Lande, *The Fundamental Goal of Antitrust: Protecting Consumers, Not Increasing Efficiency*, 84 NOTRE DAME L. REV. 191 (2008).

15. See Douglas H. Ginsburg, *Synthetic Competition*, 16 MEDIA L. & POL'Y 1, 7–10 (2006) (observing the vast range of ends to which antitrust laws have historically been applied, noting that the "varied goals endorsed by the Supreme Court were . . . divisive and contradictory," and observing that the Supreme Court's decision in *GTE Sylvania* "largely ended the confusion . . . [and] made the maximization of consumer welfare, or allocative efficiency, the chief consideration when applying the antitrust laws").

16. It would, as Judge Robert Bork characterized it, be like "playing tennis with the net down." Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7, 10 (1966).

and allocative efficiency is necessary to help propel the economy back into recovery and sustainable growth.

The global crisis, properly construed, does have significant repercussions for the larger political landscape within which competition law is defined and informed. Revolutionary moments in the development of this area of law have been characterized by a broader socioeconomic context that predisposes the courts, the public, and academics toward adopting an alternative view. From the 1940s through the 1960s, for instance, the global marketplace was characterized by relatively weak competition, which surely tempered the need for the U.S. economy to emphasize efficiency. Instead, U.S. competition law reflected populist goals that included the dispersion of economic power and the protection of commercial liberty. In the 1980s, when the law evolved to reflect principles of economic efficiency, the global economy had become far more competitive. In this setting, an efficiency-based approach to antitrust policy made far more sense. More important still, the limitations of non-capitalist systems of creating and distributing wealth had become painfully apparent.¹⁷ Faith in the free market, especially in the United States, became deep-rooted, which facilitated an antitrust regime that reflected these principles.¹⁸

We now face another juncture—one that has the potential to be equally revolutionary. Rightly or wrongly, many consider capitalism to have failed, and the public may now perceive negatively even sound tenets of price theory. Although we should meet claims that dominant firms have engaged in unilateral misconduct with skepticism,¹⁹ political and legal sympathy for monopoly will probably diminish. Certain fundamentals will remain unchanged, such as the prosecution of cartels

17. See Jonathan R. Macey & Geoffrey P. Miller, *The End of History and the New World Order: The Triumph of Capitalism and the Competition Between Liberalism and Democracy*, 25 CORNELL INT'L L.J. 277, 283 (1992).

18. See Timothy J. Brennan, *Essential Facilities and Trinko: Should Antitrust and Regulation Be Combined?*, 61 FED. COMM. L.J. 133, 147 (2008); Thomas E. Kauper, *The Report of the Attorney General's National Committee to Study the Antitrust Laws: A Retrospective*, 100 MICH. L. REV. 1867, 1870 (2002) ("American antitrust rests heavily on what in the end is an act of faith, faith that markets work and are in large part self-correcting.").

19. See Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 18 (1984) ("When a business rival brings suit, it is often safe to infer that the arrangement is beneficial to consumers.").

and the prohibition of mergers to monopoly, but large swathes of doctrine are vulnerable to readjustment.

As a positive matter, such evolution appears inevitable. What remains to be seen is the scale of the departure from prior precedent. In justifying a new approach to controversial policy areas, policymakers must tie their reasons for change to justifiable economic theory. Unfortunately, the Federal Trade Commission (FTC), Justice Department, and others have already grounded their policy alterations in the supposed teachings of the financial crisis. This is obtuse at best, insincere at worst.

Part I of this Article explains the roles of economic analysis and political context in the historical development of antitrust policy. Part II explores the economic policy that led up to the financial catastrophe, and explains how the global recession debunks numerous assumptions often associated with the Chicago School. It reveals the lessons that we should draw from the credit crisis, but those lessons do not include meaningful contributions to proper antitrust policy. Commentators' reaction to the crisis, partial denunciation of competition policy in Europe, and aggressively enhanced U.S. enforcement actions against unilateral behavior of uncertain long-run harm bode ill for the future. Enforcers' uncritical words threaten to cause a reversal of the otherwise steady evolution of antitrust law toward greater economic sophistication. This Article explains that the better course would be to allow the recession to have little, if any, normative effect on the future direction of competition law.²⁰ A brief conclusion follows.

20. Before proceeding further, a word on interpretation is needed. Specificity is the key to reasoned debate about the crisis. Sweeping references to "the market," "deregulation," "capitalism," "Chicago," and other broad terms are not likely to yield meaningful conclusions. Deregulation of industry segments that do not display natural monopoly characteristics is distinct from deregulation of banking activities predisposed to excessive leverage. "The market" performs a different role in antitrust analysis than it does when uncritically used to support wholesale deregulation. Each industry and every market must be subject to particularized analysis—conclusions about the perceived failure of capitalism in one context may have legitimate normative consequences in one setting and yet none in another.

I. FREE-MARKET ECONOMICS AND THE EVOLUTION OF
MODERN ANTITRUST DOCTRINE

A. *Antitrust Without Economics? The Sherman Act from
Inception to the Warren Court*

In modern times, and at least until the onset of the global market crisis, U.S. antitrust law promoted a narrow but well-defined goal—namely, long-run efficiency.²¹ This objective, defined by microeconomic theory, requires that competition policy condemn conduct likely to result in diminished industrial output and increased market prices.²² Antitrust law could conceivably forward a wide variety of alternative ends, but courts have rejected them. Populism would object to business conduct that carries the potential to interfere with individual liberty or to concentrate economic power, irrespective of price effects; yet this view carries no contemporary force.²³ Only actions that threaten dynamic or static efficiency implicate modern competition law.²⁴ It was not always so.

The Sherman Act, or the “Magna Carta of free enterprise,”²⁵ passed into law in 1890.²⁶ As a common law statute, it leaves

21. See Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7, 7 (1966); Michael S. Jacobs, *An Essay on the Normative Foundations of Antitrust Economics*, 74 N.C. L. REV. 219, 226–27 (1995). There is an important distinction between short-run static efficiency, in which a market displays allocative efficiency with zero deadweight loss, and long-run dynamic efficiency, in which markets may be subject to ephemeral bouts of monopoly that fuel ongoing innovation. In some information markets, often referred to collectively as the “new economy,” there is a tension between static and dynamic efficiency, with the latter goal being by far the more important. See Thomas O. Barnett, *Interoperability Between Antitrust and Intellectual Property*, 14 GEO. MASON L. REV. 859, 860 (2007). It is for this reason that society bestows certain inventors and artists with limited exclusivity under the intellectual property laws. The key point to remember is that although efficiency is indeed the goal of contemporary antitrust policy, the particular form of efficiency mandated by theory differs depending on the particular market.

22. See DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 631 (2005).

23. See, e.g., Alan J. Meese, *Liberty and Antitrust in the Formative Era*, 79 B.U. L. REV. 1, 4–5 (1999).

24. See Eleanor M. Fox, *What Is Harm to Competition? Exclusionary Practices and Anti-competitive Effect*, 70 ANTI-TRUST L.J. 371, 379 (2002).

25. *United States v. Topco Assocs.*, 405 U.S. 596, 610 (1972).

26. Sherman Act, ch. 647, 26 Stat. 209 (1890) (codified as amended at 15 U.S.C. §§ 1–7 (2006)).

the judiciary to determine substantive law.²⁷ Earlier courts interpreted the goals of antitrust broadly and sought to preserve an unhindered competitive process, particularly by ensuring the liberty of commercial actors.²⁸ Judges emphasized individual freedom and the decentralization of economic power.²⁹ Throughout this era, it was clear that ultimate downstream price effects were not the sole concern of the competition laws. Courts condemned numerous exclusionary practices, regardless of their impact on consumers.³⁰

An aversion to undue concentration featured prominently in U.S. antitrust policy until the 1970s, most notably throughout the Warren Court era. Perhaps the best-known example emanated from Judge Learned Hand in the famous 1945 case, *Alcoa*:

We have been speaking only of the economic reasons which forbid monopoly; but, as we have already implied, there are others, based upon the belief that great industrial consolidations are inherently undesirable, regardless of their economic results Throughout the history of these statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other.³¹

27. See RICHARD A. POSNER, *HOW JUDGES THINK* 48 (2008). Notably, Senator Sherman commented on a related draft that the act “does not announce a new principle of law, but applies old and well recognized principles of the common law.” John C. Peppin, *Price-Fixing Agreements Under the Sherman Anti-Trust Law*, 28 CAL. L. REV. 297, 306 n.29 (1940) (quoting 21 CONG. REC. 2456 (1890)). The Supreme Court has explicitly recognized this, noting that the “vagueness of [the Sherman Act’s] language” left it to the courts to give “content to the statute.” *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 489 (1940).

28. See *United States v. Aluminum Co. of America (Alcoa)*, 148 F.2d 416, 428–29 (2d Cir. 1945) (describing the “helplessness of the individual” before “great aggregations of capital” as an object of concern for antitrust).

29. See Harlan M. Blake & William K. Jones, *Toward a Three-Dimensional Antitrust Policy*, 65 COLUM. L. REV. 422, 422–23 (1965); see also Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1053–57 (1979).

30. See Daniel A. Crane, *Rules Versus Standards in Antitrust Adjudication*, 64 WASH. & LEE L. REV. 49, 102–03 (2007) (noting that “[a]ntitrust opposition to mergers, collaborative restraints of trade, and exclusionary practices reached its zenith under the Warren Court’s rule-based approach which restricted concentrations of industrial power and favored non-economic values and small business interests”); Robert A. Skitol, *The Shifting Sands of Antitrust Policy: Where It Has Been, Where It Is Now, Where It Will Be in its Third Century*, 9 CORNELL J.L. PUB. POL’Y 239, 245 (1999).

31. *Alcoa*, 148 F.2d at 428–29.

Judge Hand's comments made clear that the maintenance of an unconcentrated market structure was a legitimate goal in itself, even if the price of that goal was higher cost and inefficiency.³² The Supreme Court infamously made this policy explicit in the 1962 case, *Brown Shoe*.³³ There, the Court held that "Congress appreciated that occasional high costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization."³⁴

This perspective pervaded the Supreme Court's pre-Chicago jurisprudence.³⁵ Notwithstanding the efficiency and competition-enhancing virtues of a joint venture amongst fringe firms, the Supreme Court found such arrangements per se unlawful.³⁶ The Court reached this decision purely because the venture limited the freedom of traders.³⁷ Product tying, in which a vendor refuses to sell a good unless the buyer also purchases another product, was found to be a per se violation of the antitrust laws.³⁸ Bundling and requirements contracts were condemned without further inquiry because they took away consumers' purchasing freedom and deprived potential sellers of the tied product of access to customers.³⁹ It did not matter that concerns of economic efficiency typically underlie tie-ins, or that they are ubiquitous in even the most competitive markets.⁴⁰ Conglomerate mergers that involve economically distinct markets were found objectionable on the basis of size and scale, rather than on the basis of price effects.⁴¹ Vertically imposed maximum resale prices were found to be illegal not be-

32. *See id.*

33. *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962).

34. *Id.*

35. *See* RICHARD A. POSNER, *ANTITRUST LAW* 28–29 (2001).

36. *See United States v. Topco Assocs.*, 405 U.S. 596, 609–11 (1972).

37. *Id.*

38. *See Fortner Enters. v. U.S. Steel Corp.*, 394 U.S. 495, 503 (1969) (holding that tie-ins "generally serve no legitimate business purpose that cannot be achieved in some less restrictive way").

39. *See, e.g., N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 6 (1958).

40. *See* David S. Evans & Michael Salinger, *Why Do Firms Bundle and Tie? Evidence from Competitive Markets and Implications for Tying Law*, 22 *YALE J. ON REG.* 37, 38–39 (2005).

41. *See, e.g., United States v. Marine Bancorp., Inc.*, 418 U.S. 602 (1974); *FTC v. Procter & Gamble Co.*, 386 U.S. 568 (1967); *United States v. Phila. Nat'l Bank*, 374 U.S. 321 (1963).

cause of negative downstream price effects, but because they interfered with traders' liberty to set prices as they saw fit.⁴²

Although modern price theory flatly contradicts much doctrine throughout this era,⁴³ condemning the courts for abandoning economic theory might be going too far. Economists at the time largely agreed on the now-discredited "Structure-Conduct-Performance" paradigm, which erroneously predicted that less concentrated markets were more competitive and produced better results than markets in which there was considerable accumulation of economic power.⁴⁴ This body of economics (often associated with the Harvard School) was given perhaps its definitive expression in the 1967 Neal Report, which ironically issued at the very end of the S-C-P model's influence.⁴⁵ Adherents of the Harvard School correctly observed a relationship between industry concentration and profits, but erroneously inferred that those profits were the result of artificial market power.⁴⁶ Joseph Bain, an economist whose work was very influential throughout the period, aggravated the mistake.⁴⁷ He suggested that entry barriers were pervasive, and found that necessary up-front capital expenditures, incumbent efficiency, and other difficulties frustrated entry into concentrated markets and perpetuated market power.⁴⁸ Combined, these factors contributed to a significant disdain for dominance. The judiciary and enforcement agencies actively sought to promote a dispersed industry structure through anti-trust policy that inhibited growth.

The Warren Court embraced the theory that market structure plays a crucial role in fostering an effective and desirable com-

42. See *Albrecht v. Herald Co.*, 390 U.S. 145, 153 (1968).

43. See Christopher M. Grengs, *Verizon v. Trinko: From Post-Chicago Antitrust to Resource-Advantage Competition*, 2 J.L. ECON. & POL'Y 105, 126–27 (2006); Timothy J. Muris, *Improving the Economic Foundations of Competition Policy*, 12 GEO. MASON L. REV. 1, 9–10 (2003).

44. Muris, *supra* note 43.

45. See Herbert J. Hovenkamp, *The Neal Report and the Crisis in Antitrust* (Working Paper, Feb. 24, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1348707.

46. See Shubha Ghosh, *The Market as Instrument: A Response to Professor Harrison*, 52 SMU L. REV. 1717, 1721–23 (1999); William E. Kovacic & Carl Shapiro, *Antitrust Policy: A Century of Economic and Legal Thinking*, 14 J. ECON. PERSP. 43, 52 (2000).

47. JOE S. BAIN, *BARRIERS TO NEW COMPETITION: THEIR CHARACTER AND CONSEQUENCES IN MANUFACTURING INDUSTRIES* 144–66 (1956).

48. *Id.*

petitive process.⁴⁹ Nevertheless, it would be incorrect to infer that economic theory alone explains the modern Supreme Court's quite radical departure from the previous Warren Court era. Both the Warren Court and earlier courts had explicitly noted that the artificial dispersion of economic power would carry efficiency losses.⁵⁰ Clearly then, the judiciary knew of the economic costs associated with a diffusion of power. Although the Chicago and post-Chicago Schools certainly convinced the Court of the importance of efficiency concerns—largely by highlighting the enormity of the losses associated with the S-C-P approach—the ultimate explanatory factor was a shift in political ideology. This shift, in turn, came from the public's changing attitude toward industry structure and free market processes.⁵¹

B. *A Price-Theoretic Approach to Competition Law*

The Warren Court's populist interpretation of the Sherman Act proved ephemeral. Beginning in the late 1960s, a group of economists and legal academics at the University of Chicago began to subject leading antitrust doctrine to rigorous micro-economic scrutiny.⁵² It quickly became apparent that the Supreme Court had misinterpreted business conduct, using impressionistic and economically ill-informed theories of harm.⁵³ Vast swathes of commercial activity that the Court condemned as exclusionary were found to have beneficial effects on consumer prices, industrial output, and innovation.⁵⁴ Some of the

49. See Spencer Weber Waller, *The Language of Law and the Language of Business*, 52 CASE W. RES. L. REV. 283, 297 (2001) (describing the rise of the Structure-Conduct-Performance paradigm in antitrust enforcement).

50. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962); *United States v. Aluminum Co. of America (Alcoa)*, 148 F.2d 416, 428 (2d Cir. 1945).

51. See Edward A. Purcell, Jr., *The Class Action Fairness Act in Perspective: The Old and the New in Federal Jurisdiction Reform*, 156 U. PA. L. REV. 1823, 1916–17 (2007) (“Milton Friedman attributed the recent dominance of the ‘Chicago school’ to the economic crises of the 1970s and early 1980s and to the subsequent collapse of Communism and the Soviet Union. ‘It wasn’t my talking that caused people to embrace these ideas, just as the rooster doesn’t make the sun rise,’ [Friedman] explained. ‘Collectivism was an impossible way to run an economy. What has brought about the change is reality, fact—and what Marx called the inevitable forces of history.’” (citations omitted)); see also NAOMI KLEIN, *THE SHOCK DOCTRINE: THE RISE OF DISASTER CAPITALISM* (2007).

52. See Posner, *supra* note 3, at 925–33.

53. See POSNER, *supra* note 35, at 261; Bork, *supra* note 16, at 9; Robert H. Bork & Ward S. Bowman, Jr., *The Crisis in Antitrust*, 65 COLUM. L. REV. 363, 375–76 (1965).

54. See Posner, *supra* note 3, at 926–28.

Chicago School's adherents even counseled wholesale abandonment of the antitrust laws, believing that the free market would generate better outcomes than government intervention.⁵⁵ This group went so far as to oppose the prosecution of cartels, believing that such entities would invite prompt entry and would naturally collapse.⁵⁶ The more reasonable (and influential) members of the School, however, counseled an agnostic approach to competition policy. Cartels and mergers to monopoly should be prohibited, but claims of unilateral misconduct and challenges to concerted actions of indeterminate economic effect should be approached cautiously.⁵⁷ As Judge Posner, one of the key proponents of this school of thought, put it:

The Chicago School's approach is skeptical . . . about the gravity of the danger to competition posed by unilateral firm action The approach emphasizes both the difficulty of squashing competition by such means and the danger that heavy-handed antitrust enforcement may suppress a practice that seems anticompetitive but actually is efficient.⁵⁸

Although an exhaustive analysis of the School's findings is beyond this Article's scope, some of the central contributions are worth mentioning. It debunked the assumption that entry barriers are pervasive, demonstrated that concentration and high profits are at least as likely to signal efficiency as market power, proved that vertical restraints a manufacturer imposes on its distributors are highly unlikely to be anticompetitive,

55. See, e.g., D.T. ARMENTANO, *ANTITRUST POLICY: THE CASE FOR REPEAL* (1986). At this juncture, it is crucial to draw a distinction between the "Chicago School"—broadly defined, but referring in particular to macroeconomic policy—and the approach to competition policy dictated by both that School and the post-Chicago literature. See William E. Kovacic, *The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago/Harvard Double Helix*, 2007 COLUM. BUS. L. REV. 1, 21–29. The latter occupies a distinct position, and assumed a role of transformational importance in causing U.S. antitrust law to evolve beyond the Warren Court jurisprudence.

56. See, e.g., Maurice E. Stucke, *Should the Government Prosecute Monopolies?*, 2009 U. ILL. L. REV. 497, 506–07.

57. See Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696, 1701 (1986) (discussing the Workable Antitrust Policy School, which advocates a "profoundly skeptical program" that would consist of "little other than prosecuting plain vanilla cartels and mergers to monopoly").

58. POSNER, *supra* note 35, at 251; see also Richard A. Posner, *Keynote Address: Vertical Restrictions and "Fragile" Monopoly*, 50 ANTITRUST BULL. 499, 500 (2005) ("[E]ven the early versions of Chicago school thinking recognized that there could be cases in which single-firm abuses would give rise to a serious antitrust concern.").

and explained that a wide variety of unilateral practices by dominant firms—including predatory pricing, product tying, exclusive contracting, and price squeezing—are unlikely to injure consumers in the long run.⁵⁹

The post-Chicago School has refined these findings by introducing dynamic models that use modern game theory.⁶⁰ Some of the Chicago School's more extreme conclusions, such as Robert Bork's suggestions that entry barriers do not exist and that unilateral behavior cannot exclude equally or more efficient competitors,⁶¹ have been shown to be dogmatic.⁶² As a result, the post-Chicago School generally counsels a reserved approach that entails a rule-of-reason inquiry.⁶³

The Chicago School's contributions were not limited to economic theory alone. Rather, the movement sought to establish efficiency as the exclusive political goal of competition policy.⁶⁴ It was remarkably successful in doing so, in part due to the intellectual incoherence of the Warren Court and preceding eras.⁶⁵ Chicago scholars demonstrated that the cost of the Court's jurisprudence was higher market prices at the expense of consumers.⁶⁶

It is clear that the Chicago School succeeded in convincing the Supreme Court of a number of issues. Ultimately, the Court accepted Robert Bork's contention that the Sherman Act serves as a

59. See Bork, *supra* note 16 (explaining these points in detail); Posner, *supra* note 3, at 925–33 (same).

60. See Jacobs, *supra* note 21, at 240–50.

61. See ROBERT H. BORK, *THE ANTITRUST PARADOX* 310 (1978).

62. See Hovenkamp, *supra* note 3, at 278; Steven C. Salop, *Economic Analysis of Exclusionary Vertical Conduct: Where Chicago Has Overshot the Mark*, in *HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST* (Robert Pitofsky ed., 2008); Lawrence A. Sullivan, *Post-Chicago Economics: Economists, Lawyers, Judges, and Enforcement Officials in a Less Determinate Theoretical World*, 63 *ANTITRUST L.J.* 669, 672 (1995).

63. See Hovenkamp, *supra* note 3, at 258, 279; Keith N. Hylton & Michael Salinger, *Tying Law and Policy: A Decision-Theoretic Approach*, 69 *ANTITRUST L.J.* 469, 497 (“[T]he post-Chicago literature arose in response to the Chicago School's implication that tying should be legal per se. The post-Chicago models indicate that tying can be anticompetitive, not that it must be anticompetitive or that it is likely to be anticompetitive. Indeed, the models cannot tell us even that anticompetitive tying is more than a remote possibility.”).

64. See Jacobs, *supra* note 21, at 219.

65. See POSNER, *supra* note 35, at viii (characterizing the pre-Chicago School body of antitrust doctrine as an “intellectual disgrace”).

66. See BORK, *supra* note 61, at 4.

“consumer welfare prescription.”⁶⁷ This statement had the great benefit of pushing the importance of price effects toward the fore of antitrust analysis and served as the bedrock of several revolutionary decisions that overruled prior cases.⁶⁸ The Court also put a premium on price competition and has explicitly linked that form of rivalry with consumer welfare.⁶⁹ Moreover, the Court has displayed sensitivity to concerns of aggregate welfare, most obviously with respect to monopsonistic conduct.⁷⁰ Perhaps most importantly, several influential courts have defined consumer welfare as coterminous with allocative efficiency.⁷¹

The glaring distinction between the present and the past is political.⁷² Whereas the concentration of economic power and

67. See *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) (quoting BORK, *supra* note 61, at 66); see also *NCAA v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 107 (1984).

68. See *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007) (overruling its 1911 *Dr. Miles* decision, which had held that vertical minimum price fixing is illegal per se); *Ill. Tool Works, Inc. v. Indep. Ink*, 547 U.S. 28 (2006) (overruling presumption that patents confer market power for the purposes of the antitrust laws); *State Oil Co. v. Kahn*, 522 U.S. 3 (1997) (overruling its 1968 *Albrecht* decision, which had held that vertical maximum price fixing was a per se antitrust violation); *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) (requiring that an antitrust plaintiff who alleges predatory pricing establish a dangerous probability of recoupment); *Cont'l T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (advocating the abandonment of per se rules that are inconsistent with prevailing economic theory and analyzing vertically-imposed nonprice constraints under the rule of reason).

69. See *Brooke Group*, 509 U.S. at 223.

70. See Nickolai G. Levin, *Weyerhaeuser's Implications for Future Antitrust Disputes*, 4 N.Y.U. J.L. & BUS. 343, 352–53 (2007).

71. See *Rebel Oil Co. v. Atl. Richfield Co.*, 51 F.3d 1421, 1433, 1444 n.15 (9th Cir. 1995); see also *MetroNet Servs. Corp. v. U.S. West Commc'ns*, 329 F.3d 986, 1006 (9th Cir. 2003).

72. Of course, it is not possible to delineate politics and economics into two distinct and mutually exclusive disciplines. The teachings of each influence the other. Nevertheless, they are not coterminous. Fundamentally, price theory provides the policymaker with a means by which to ascertain the economic consequences, both positive and negative, of a particular course of action. That theory does not dictate a single right approach, however. Society can, and often does, pursue policies that are inconsistent with aggregate welfare. One need only think of minimum wage laws. Economics teaches that such laws will prevent certain labor markets from clearing at optimal levels, with ensuing deadweight loss. This loss takes the form of jobs that would have existed, but for the government policy. While those who receive jobs gain from these laws, economics predicts on the whole that workers are made worse off. Mindful of this theory, society nevertheless concludes that certain political factors—the belief that an individual's effort has to be worth at least a certain amount, the concern that employers may force wages to suboptimal levels due to the homogeneity of the workforce, and others—are of sufficient value that the laws are nonetheless justified. The case is no different with antitrust economics, which approximate the impact of challenged business conduct on allocative efficiency. An electorate can choose to adopt this

obstacles to economic freedom were once viewed as antithetical to a “healthy and unimpaired competitive process,” courts no longer view these factors as inconsistent.⁷³ This evolution in the law is surely a result of the U.S. experience with free markets over the last three decades, which have yielded great levels of innovation and consumer benefit, even in cases of quite extreme concentration.⁷⁴ Such gains have been most evident in the new economy where society has reaped vast long-run gains by foreclosing short-run access to markets and facilitated ephemeral monopoly power via the intellectual property laws.⁷⁵ An obvious tension exists between the goal of free access to markets and dispersion of economic power, on the one hand, and the pursuit of social wealth, on the other.⁷⁶ It is now clear that adhering to the former often forecloses the latter, with serious economic repercussions.⁷⁷

Although the tradeoff between dynamic and static efficiency is a fundamental principle of modern economics, the ultimate question involves a policy choice. A suitably minded electorate could legitimately favor populist goals of diversified economic power and unconcentrated markets, but it would have to pay a high price. Clearly, in modern times, society has deemed this price not worth paying. Such has been the recent U.S. experience with dominance that the Supreme Court saw fit to describe monopoly conditions in laudatory terms in *Trinko*.⁷⁸ Such a result would have been unthinkable during the Warren Court era.⁷⁹

As Part II explores, however, this political calculus may have changed. The credit crunch that brought the global economy to

measure of efficiency as its sole normative metric, or it can elect to take such efficiency into account as a relevant factor amongst several.

73. The most dramatic example is the Supreme Court’s decision in *Trinko*. There, the Court opined that “[t]he opportunity to charge monopoly prices—at least for a short period—is what attracts ‘business acumen’ in the first place; it induces risk taking that produces innovation and economic growth.” *Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004).

74. See Reed Hundt, *The Future of the Net—Comments on Lawrence Lessig’s Code and Other Laws of Cyberspace and The Future of Ideas*, 68 BROOK. L. REV. 289, 293 (2002).

75. See Mark A. Lemley, *The Economics of Improvement in Intellectual Property Law*, 75 TEX. L. REV. 989, 994–95 (1997); Richard A. Posner, *Antitrust in the New Economy*, 68 ANTITRUST L.J. 925, 930 (2001).

76. See Barnett, *supra* note 21, at 865.

77. See *id.*

78. See *Trinko*, 540 U.S. at 407.

79. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962).

a standstill has fundamentally altered the way that many view dominance, market concentration, the diffusion of economic power, and the equity and efficacy of the free market process.⁸⁰ Antitrust commentators have reacted viscerally, framing the recession as a refutation of Chicago School economics.⁸¹ They argue that continuing faith in the market is ill-placed and that substantive competition policy must change as a result.⁸²

This Pavlovian response is misplaced. As this Article explains, the lessons of the credit crisis for antitrust law are not economic. The tenets of price theory that indicate a close relationship between efficiency and concentration remain, as do the associated inferences that suggest the primacy of allocative efficiency as the proper inquiry under the Sherman Act. It remains true that the “primary concern of the antitrust laws is the corruption of the competitive process.”⁸³ Business practices that price theory deemed likely to corrupt the competitive process before the crisis will surely remain likely to corrupt it after. Certain changes in policy will be necessary throughout the credit crunch, of course, most notably with respect to the prospect of entry into capital-intensive markets.⁸⁴ But such alterations in policy will prove fleeting and will disappear as the flow of credit returns.

The real result is political. Those who were opposed to the largely laissez-faire rules suggested by rigorous economic analysis (and decision theory in cases of uncertainty) are now optimally placed to promote their alternative perspectives. To the extent such efforts might result in the repeal of policies that are

80. Illustratively, Albert Foer, president of the American Antitrust Institute, has opined that the crisis will cause the public mood to shift “from worship of big corporations to skepticism of the role they play.” David R. Francis, *How Obama could prevent firms from becoming ‘too big to fail’*, CHRISTIAN SCI. MONITOR, Apr. 26 2009, at 32.

81. See *supra* note 11.

82. See *infra* Part II.B.

83. *Tal v. Hogan*, 453 F.3d 1244, 1258 (10th Cir. 2006).

84. For an example of a position that would not be appropriate in current market conditions, see Deborah Platt Majoras, Deputy Ass’t Att’y Gen., Antitrust Div., U.S. Dep’t of Justice, GE-Honeywell: The U.S. Decision, Remarks Before the Antitrust Law Section, State Bar of Georgia 8 (Nov. 29, 2001) (opining that the capital requirements for entry into a market should not be construed as an entry barrier because “[c]apital markets generally work very efficiently and there is no obvious reason . . . why [an incumbent’s] cost of capital for a particular project should be any lower than that of its rivals”).

likely to promote long-run efficiency, they should be resisted. Paramount amongst these is the suggestion that antitrust law again forecloses scale- and scope-based market concentration.

Other, less dramatic but nevertheless politically motivated moves have also resulted. Given the divisive nature of the George W. Bush Administration's Section 2 Report,⁸⁵ it is not surprising that the Obama Administration has revoked it.⁸⁶ It has done so, of course, under the rubric that free-market presumptions can no longer be relied upon in formulating enforcement policy.⁸⁷ Price theory—even in light of the crisis—dictates no such result. Given the indeterminate nature of some unilateral conduct by the dominant firm, economics does not necessarily mandate adherence to the status quo either, but it is intellectually dishonest to frame the revocation in economic terms and to suggest that it is compelled by the global recession.

Before proceeding, it is necessary to address the broader role of Chicago School economics. The School's intimate reliance on neoclassical price theory and support of libertarianism had revolutionary repercussions beyond antitrust policy. Unlike its more narrow influence on competition law, the legitimacy of the School's contribution to regulatory policy has been validly called into question by the present crisis. This policy—like Chicago's approach to antitrust—places great weight on the efficacy of free-market forces.

C. *Chicago and the Deregulatory Movement*

Although Chicago's influence on U.S. antitrust policy has been profound, its promotion of capitalist, free-market, and libertarian principles found a warm political welcome throughout U.S. policy.⁸⁸ The School's ascension, which coincided with

85. U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT (2008) [hereinafter COMPETITION AND MONOPOLY].

86. See Stephen Labaton, *Administration Plans to Strengthen Antitrust Rules*, N.Y. TIMES, May 11, 2009, at A1. One questioning the existence of this controversy need merely read the FTC's reaction to the report. See Press Release, Fed. Trade Comm., FTC Commissioners React to Department of Justice Report, "Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act" (Sept. 8, 2008), available at <http://www.ftc.gov/opa/2008/09/section2.shtm>.

87. See Puzzanghera, *supra* note 12.

88. This Part is intentionally concise because an exhaustive treatment of Chicago's influence on macroeconomic and regulatory policy would demand a book in itself.

a rise of conservatism in the United States and United Kingdom throughout the 1980s, ushered in an era of deregulation and non-interventionist economic policies.⁸⁹ Chicago-oriented principles place deep-rooted faith in the ability of unbridled free-market forces to yield efficient outcomes.⁹⁰ This conviction promoted not only a non-interventionist and inherently skeptical approach to competition policy, but underlay the normative case for removing certain sectors of the economy from government control.⁹¹ This Part provides some brief background on the Chicago School's larger effect on regulatory policy, which, unlike antitrust law, may be subject to some criticism.

Before the 1970s, large swathes of the airline, electricity, and telecommunications industries were thought to display characteristics of natural monopolies such as diminishing long-run average cost.⁹² This trait does not suggest (as many mistakenly believe) that the market will bear only a single firm, but indicates that the optimal market structure from the view of productive efficiency is monopoly.⁹³ The ensuing company sets monopoly prices, which cause allocative inefficiency. In re-

The purpose here is to provide the reader with sufficient knowledge about the School's broader role in the deregulatory movement that swept across some Western economies from the 1980s on.

89. See Kovacic, *supra* note 55, at 25 n.71 (quoting various authorities for the proposition that Ronald Regan's acceptance of Chicago School theories informed the deregulatory movement in the 1980s).

90. An exception to the Chicago School's free-market approach lay in its promotion of government-controlled monetary policy. Milton Friedman's revolutionary work on monetarism, which rejected the prevailing Keynesian and post-Keynesian theories of the day to focus on money supply, grew in influence throughout the 1970s. The body of thought, perhaps best summarized by the conclusion that "inflation is always and everywhere a monetary phenomenon," typically regarded markets as inherently stable. As a result, monetarist thought concludes that governments need merely control the money supply and need not employ the fiscal policies associated with Keynes. Alan Greenspan, Chairman of the Federal Reserve from 1987 to 2006, largely adhered to monetarist policy.

91. See Ashutosh Bhagwat, *Unnatural Competition?: Applying the New Antitrust Learning to Foster Competition in the Local Exchange*, 50 HASTINGS L.J. 1479, 1485-86 (1999) (observing that "[t]he impact of the Chicago School on regulatory policy is less obvious than on antitrust policy, but is almost certainly reflected in the massive wave of deregulation and unbundling that has swept through regulated industries in the past two decades").

92. See RICHARD J. PIERCE, JR. & ERNEST GELLHORN, *REGULATED INDUSTRIES* 348 (4th ed. 1999).

93. See Richard A. Posner, *The Effects of Deregulation on Competition: The Experience of the United States*, 23 FORDHAM INT'L L.J. S7, S12 (2000); Richard A. Posner, *Natural Monopoly and Its Regulation*, 21 STAN. L. REV. 548, 548 (1969).

sponse, the government regulates those prices and attempts to constrain them to competitive levels.⁹⁴

Such regulation is subject to numerous systemic flaws. For one, it is notoriously difficult to subject an entity to effective price regulation. Companies react to constraints in a variety of unanticipated ways. The classic form of regulation—rate-of-return constraints that allow the regulated entity to charge a price no higher than a specified percentage of its costs—is ineffective.⁹⁵ An entity subject to such a constraint has little to no incentive to operate efficiently or to minimize costs—goals that firms facing open competition must strive to meet if they are to survive.⁹⁶ Moreover, a company subject to a rate of return limitation will rationally “gold plate” its facilities by creating a system of greater quality than would be justified on a cost-benefit basis.⁹⁷

Given the severe limitations associated with this form of price constraint, it eventually gave way to incentive-based approaches, exemplified by price-cap regulation.⁹⁸ This system establishes an upper boundary on the price set by the regulated entity. So constrained, the company has strong incentives to

94. See 2 ALFRED E. KAHN, *THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS* 123 (1971).

95. See James Walter Grudus, *Local Broadband Networks: A New Regulatory Philosophy*, 10 YALE J. ON REG. 89, 114 (1993); Richard A. Posner, *Taxation by Regulation*, 2 BELL J. ECON. & MGMT. SCI. 22 (1971); Win Whittaker, *A Price-Level (Incentive) Regulation Proposal for Oil Pipelines*, 46 OKLA. L. REV. 415, 417 (1993) (noting that “the failure of traditional cost-of-service regulation to achieve its primary objective—the replication of competitive results in terms of return levels, resource utilization, and efficiencies—is dramatic and well documented”); Herbert Hovenkamp, *The Takings Clause and Improvident Regulatory Bargains*, 108 YALE L.J. 801, 825 (1999) (reviewing J. GREGORY SIDA & DANIEL F. SPULBER, *DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES* (1997)).

96. See *In re Policy and Rules Concerning Rates for Dominant Carriers*, 4 F.C.C.R. 2873, 2878 (F.C.C. 1989). What little incentive such a regulated entity may have to limit costs emanates from the phenomenon of regulatory lag. See Stephen F. Williams, *Deregulatory Takings and Breach of Regulatory Contract: A Comment*, 71 N.Y.U. L. REV. 1000, 1001 (1996).

97. See Alfred E. Kahn & William B. Shew, *Current Issues in Telecommunications Regulation: Pricing*, 4 YALE J. ON REG. 191, 227 n.87, 240 (1987); Gregory J. Vogt, *Cap-Sized: How the Promise of the Price Cap Voyage to Competition Was Lost in a Sea of Good Intentions*, 51 FED. COMM. L.J. 349, 360–61 (1999).

98. See Ronald R. Braeutigam & John C. Panzar, *Effects of the Change from Rate-Of-Return to Price-Cap Regulation*, 83 AM. ECON. REV. 191, 193 (1993).

lower costs and thus to generate an economic profit.⁹⁹ As the regulated entity succeeds in cutting costs (via the “X-Factor”),¹⁰⁰ the regulator can then lower the cap, thus transferring some of the efficiency savings onto consumers.¹⁰¹ While unquestionably more effective than rate-of-return regulation,¹⁰² price caps are themselves subject to numerous frailties.¹⁰³ First, they are not, and can never be, superior to market processes in yielding cost-cutting.¹⁰⁴ Second, to even attempt this form of regulation, one must identify an appropriate metric of cost by which to judge an optimal price. This is also problematic. In the economics literature, a key figure is the marginal cost of a firm’s production, which will equal price under perfect competition.¹⁰⁵ Unfortunately, marginal cost—being a theoretical construct—is notoriously difficult to estimate in practice.¹⁰⁶ Even if a suitable proxy is employed—most often average variable cost¹⁰⁷—few regulated industries can be subjected to marginal-cost pricing, as it would lead to insolvency in the presence of any fixed costs.¹⁰⁸ How great a mark-up to allow proves to be a troublesome question in practice. Third, it is difficult for a regulator credibly to commit to not increasing the cap if the monopolist fails to lower costs sufficiently to achieve profitabil-

99. See Jeffrey I. Bernstein & David E.M. Sappington, *Setting the X Factor in Price-Cap Regulation Plans*, 16 J. REG. ECON. 5, 5–6 (1999).

100. See Jim Chen, *The Nature of the Public Utility: Infrastructure, the Market, and the Law*, 98 NW. U. L. REV. 1617, 1672 (2004) (reviewing JOSÉ A. GÓMEZ-IBÁÑEZ, *REGULATING INFRASTRUCTURE: MONOPOLY, CONTRACTS, AND DISCRETION* (2003)).

101. See STUART M. BENJAMIN ET AL., *TELECOMMUNICATIONS LAW AND POLICY* 427 (2001).

102. See Jerry Ellig, *Costs and Consequences of Federal Telecommunications Regulations*, 58 FED. COMM. L.J. 37, 42–43 (2006); Damien Geradin & Robert O’Donoghue, *The Concurrent Application of Competition Law and Regulation: The Case of Margin Squeeze Abuses in the Telecommunications Sector*, 1 J. COMPETITION L. & ECON. 355, 377 (2005).

103. See Vogt, *supra* note 97, at 360–61.

104. Howard A. Shelanski, *Adjusting Regulation to Competition: Toward a New Model for U.S. Telecommunications Policy*, 24 YALE J. ON REG. 55, 80 (2007).

105. See CARLTON & PERLOFF, *supra* note 22, at 89.

106. See Dennis W. Carlton, *Market Definition: Use and Abuse*, 3 COMPETITION POL’Y INT’L 1, 7 (2007); David Genesove & Wallace P. Mullin, *Testing Static Oligopoly Models: Conduct and Cost in the Sugar Industry, 1890–1914*, 29 RAND. J. ECON. 355, 355 (1998).

107. See, e.g., *United States v. AMR Corp.*, 335 F.3d 1109, 1116 (10th Cir. 2003); RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 311–12 (6th ed. 2003).

108. See Lawrence H. Summers, *Competition Policy in the New Economy*, 69 ANTI-TRUST L.J. 353, 355–56 (2001).

ity. Political factors would make it difficult for such a regulator to perpetuate a system that appears on course to cause the regulated company's insolvency.

Adherents to the Chicago School successfully exposed these shortcomings.¹⁰⁹ In addition to demonstrating the inefficacious nature of price regulation, they questioned the actual scope of natural monopoly¹¹⁰ and pointed to empirical evidence of regulation's ineffectiveness.¹¹¹ In doing so, they convinced the government that many aspects of the so-called regulated industries were not subject to diminishing long-run average cost. They also emphasized that certain portions of industry that were characterized by natural monopoly conditions could be left regulated, while the rest of the market could be opened up.¹¹² The result was revolutionary. Vast swathes of the economy that had never before been subject to free-market forces were exposed to competition. Government regulation of the airline, trucking, energy, telecommunications, securities exchanges, and commercial banking industries was scaled back considerably in the 1970s and 1980s.¹¹³

109. More controversially, the Chicago School also alleged the existence of a phenomenon it labeled "regulatory capture," which described regulators' tendency to become influenced by, and ultimately serve the interests of, those they sought to constrain. See Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q. J. ECON. 371 (1983); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971).

110. See Harold Demsetz, *Why Regulate Utilities?*, 11 J.L. & ECON. 55 (1968); Richard A. Posner, *Taxation by Regulation*, 2 BELL J. ECON. & MGMT. SCI. 22, 38 (1971) (observing that "many regulated industries are not monopolistic in structure"); George J. Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961); George J. Stigler, *Public Regulation of the Securities Markets*, 19 BUS. LAW. 721, 721 (1964); George J. Stigler & Clair Friedland, *What Can Regulators Regulate? The Case of Electricity*, 5 J.L. & ECON. 1 (1962).

111. See PIERCE & GELLHORN, *supra* note 92, at 343–44; Hovenkamp, *supra* note 95, at 825.

112. See Gerald R. Faulhaber, *Will Access Regulation Work?*, 61 FED. COMM. L.J. 37, 38 (2008).

113. See PIERCE & GELLHORN, *supra* note 92, at 343–78; Posting of Gary Becker to The Becker-Posner Blog, *Greater Regulation of Financial Markets?*, <http://www.becker-posner-blog.com/> (Apr. 28, 2008, 19:37 EDT). The results were largely satisfactory, even if all were not convinced. Even before the onset of the current crisis, which itself strongly suggests that unbridled deregulation can produce far from desirable results, some were skeptical of the curative powers of deregulation. See, e.g., Richard D. Cudahy, *The Folklore of Deregulation (with Apologies to Thurman Arnold)*, 15 YALE J. ON REG. 427 (1998).

Much of this deregulation has yielded great benefits for consumers, and the current economic crisis should not compel a drastic reversal in the deregulatory movement generally. But deregulation that led to the withdrawal of government oversight from vast swathes of the financial sector was a mistaken approach—the uncritical result of an ideology taken too far.¹¹⁴

There is a fundamental distinction between industries like transportation and energy, on the one hand, and financial institutions on the other: The latter are not regulated on the basis of natural-monopoly conditions. Instead, banks are subjected to myriad rules that are designed to prevent excessive leverage, to ensure adequate capitalization, and to facilitate the dissemination of accurate information to the market. Such regulation creates stability. Banks are unusually vulnerable to market shocks. Because they mostly lend borrowed money, changes in market conditions that result in seemingly modest increases in default rates can render banks insolvent—a risk that can be greatly exacerbated by runs. In times of economic growth, banks also have strong incentives to enhance profitability by increasing leverage (the ratio of borrowed to owned assets). Because the interest that banks pay on borrowed money is independent of the return those funds are used to obtain, favorable economic conditions make increased leverage highly attractive. Yet, this same fact portends disaster in the event of a downturn, as leverage magnifies losses as much as it does gains. Banks' myopic pursuit of profits in booms can therefore lead to mass bankruptcy in less-favorable economic conditions.

These factors suggest that banks are unusually likely to fall prey to their own actions, but this fact alone does not present a strong case for regulation. After all, it is a fundamental principle of free-market economics that losers should perish. The internalization of this expected cost will cause managers' decision making to mirror the social optimum. But the prospective loss of shareholder value does not remotely encapsulate the social cost of a large bank's failure. Banks are regulated because, in providing critically important liquidity, they occupy a position of unique importance within the economy. If a bank's role within the economy is systemic, then the cascade effect of its

114. See RICHARD A. POSNER, *A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DECENT INTO DEPRESSION* (2009).

failure will greatly exceed the cost of rescuing it. This connection is especially strong in a recession, where such a failure could significantly exacerbate a grave economic situation. To prevent such an outcome, the government regulates banking activities to ensure adequate capitalization and a sufficient equity cushion.

Although the Chicago School's critique of price regulation in many industries is well taken, its promotion of deregulation is less well suited to certain aspects of the financial sector. The industries formerly regarded as natural monopolies are relatively enclosed, such that their fate is largely independent of the rest of the economy. Banks' activities, in contrast, pervade the entire economy—providing liquidity and facilitating maturity transformation. Notwithstanding the great need to regulate banking activities, large parts of the financial system were removed from, or never subjected to, stringent oversight.

II. CHICAGO AND THE GLOBAL FINANCIAL CRISIS

A. *Chicago as a False Ideology?*

“One thing is clear to me: the orthodox and unvarnished Chicago School of economic theory is on life support, if it is not dead.”¹¹⁵ This view, expressed by Commissioner Rosch, is certainly no outlier.¹¹⁶ Real-world collapse has, in the most compelling way possible, eviscerated the notion that markets operate with such efficiency that regulation is unnecessary. Alan Greenspan, a prominent and highly influential disciple of free-market economics, characterized himself as being in a “state of shocked disbelief” as he watched the free market that had been built on an edifice of rational behavior collapse around him.¹¹⁷ How did it all happen? And what will be the policy ramifications of the recession? This Part seeks to provide an answer to

115. J. Thomas Rosch, Commissioner, Fed. Trade Comm'n, Remarks to the New York Bar Association Annual Dinner: Implications of the Financial Melt-down for the FTC 2 (Jan. 29, 2009), available at www2.ftc.gov/speeches/rosch/090129financialcrisisnybarspeech.pdf.

116. See PITOFSKY, *supra* note 62, at 7 (discussing various economists' growing “unease” with Chicago School analysis).

117. Edmund L. Andrews, *Greenspan Concedes Error on Regulation*, N.Y. TIMES, Oct. 24, 2008, at B1.

these crucial questions.¹¹⁸ In short, the crisis cannot be explained on economic grounds that are attributable to antitrust policy.

The 2008 economic crisis, the worst since the Great Depression,¹¹⁹ began in the summer of 2007. A large housing bubble had developed within the U.S. economy, accompanied by unprecedented levels of consumer debt,¹²⁰ which ultimately burst in 2007 with devastating economic effect.¹²¹ Financial institutions that had accumulated vast quantities of vulnerable asset-backed securities suffered massive losses,¹²² which they were required to recognize immediately under mark-to-market accounting rules.¹²³ The ensuing write-downs threatened the solvency of many leading institutions, which portended a catastrophic cascade effect in the event of a critical bankruptcy. This perilous prospect required the U.S. government to rescue Fannie Mae and Freddie Mac at enormous expense to taxpayers.¹²⁴ In what was widely, though not unanimously, considered a mistake, the Federal Reserve (“the Fed”) decided that Lehman Brothers, a venerable investment bank, was not so critical to the economy that it had to be saved.¹²⁵ As a result, Lehman filed for bankruptcy in mid-September 2008,¹²⁶ which, at over \$600 billion, was the largest filing in the history of the United States.¹²⁷ The event significantly exacerbated the crisis.¹²⁸ In the same month, Bank of America acquired Merrill Lynch, and the

118. For a consideration of the normative conclusions to be drawn from the recession, see *infra* Part II.B.

119. See POSNER, *supra* note 114, at vii.

120. See *id.* at 31–34 (noting the vast increase in consumer debt and further observing that “in the years leading up to the current depression, the personal savings rate of Americans had plummeted”).

121. See *id.* at vii–xi.

122. See *id.* at 66–68.

123. See *id.* at 68.

124. See *id.* at 209.

125. See *id.* at 133, 274 (characterizing the decision “to allow Lehman Brothers to slip into bankruptcy . . . as the single biggest blunder to date in the response to the gathering storm”).

126. See *What Next?*, ECONOMIST, Sept. 20, 2008, at 19–20 (surveying the week’s events, opining that “[i]t is no hyperbole to say that for an inkling of what is at stake, you have only to study the 1930s,” and concluding that it had been “a black week”).

127. See Yalman Onaran & Christopher Scinta, *Lehman Files Biggest Bankruptcy Case as Suits Balk*, BLOOMBERG.COM, Sept. 15, 2008, <http://www.bloomberg.com/apps/news?sid=awh5hRyXkvs4&pid=20601087>.

128. See POSNER, *supra* note 114, at 274; *Accelerating Downhill*, ECONOMIST, Jan. 17, 2009, at 13–14.

U.S. government nationalized American International Group (AIG).¹²⁹ Serious questions began to arise regarding the solvency of the U.S. financial system.¹³⁰

Crippled by large amounts of toxic securities tied to falling house prices and short of capital from the ensuing losses, banks began hoarding cash.¹³¹ Credit markets froze,¹³² the issuance of commercial paper ceased,¹³³ and, lacking the ability to borrow, companies were unable to conduct business as usual. Housing prices began to drop sharply. Consumer spending, which had depended in significant part on credit, fell as refinancing became more difficult.¹³⁴ The U.S. economy was officially in recession since December 2007.¹³⁵ Stocks plummeted;¹³⁶ \$30 trillion in global stock market value was lost in 2008.¹³⁷ Although at first the world economy appeared sheltered from these effects by continuing growth in developing economies, these, too, suffered catastrophic effects as the crisis went global.¹³⁸ One Western country, Iceland, went bankrupt, resulting in significant popular unrest and the collapse of its government.¹³⁹

In an attempt to stem the tide, the U.S. government passed the \$700 billion Emergency Economic Stabilization Act in October 2008, which created the Troubled Assets Relief Program (TARP)¹⁴⁰ to rescue banks from what was erroneously considered to be a liquidity problem.¹⁴¹ This action was followed by the \$787 billion American Recovery and Reinvestment Act on February 17, 2009 to counter the economic downturn and lead

129. See POSNER, *supra* note 114, at viii.

130. See *I Want Your Money*, ECONOMIST, Sept. 27, 2008, at 17.

131. See *All You Need Is Cash*, ECONOMIST, Nov. 22, 2008, at 17.

132. See *World on the Edge*, ECONOMIST, Oct. 4, 2008, at 11–12.

133. See POSNER, *supra* note 114, at 275.

134. See *The End of the Affair*, ECONOMIST, Nov. 22, 2008, at 39–40; *When the Golden Eggs Run Out*, ECONOMIST, Dec. 6, 2008, at 95–97.

135. See Chris Isidore, *It's Official: Recession Since Dec. '07*, CNN MONEY.COM, Dec. 1, 2008, <http://money.cnn.com/2008/12/01/news/economy/recession/index.htm>.

136. See *Where Have All Your Savings Gone?*, ECONOMIST, Dec. 6, 2008, at 13.

137. See Alan Greenspan, *Banks Need More Capital*, ECONOMIST, Dec. 18, 2008, at 122.

138. See *Decoupling 2.0*, ECONOMIST, May 23, 2009, at 14.

139. See Judy Dempsey, *Iceland's Government Collapses*, N.Y. TIMES, Jan. 27, 2009, at A8; Eric Pfanner, *Iceland Is All But Officially Bankrupt*, N.Y. TIMES, Oct. 9, 2008, at B1.

140. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765.

141. In fact, it was a solvency problem. See POSNER, *supra* note 114, at 64–74.

the U.S. economy back to growth.¹⁴² The latter legislation allocated \$499 billion for federal spending programs, designed to compensate for the decrease in spending from the private sector, and \$288 billion in tax relief to spur consumer spending.¹⁴³

The U.S. economy has largely stabilized and has returned to a modest level of growth.¹⁴⁴ Nevertheless, the long-term economic outlook remains worrisome.¹⁴⁵ Unemployment remains stuck at an unwelcome 9.7%,¹⁴⁶ which understates matters when one considers people who are working part time or not in their preferred line of work. Including the stimulus package, total U.S. financial commitments aimed at tackling the crisis have neared \$13 trillion—a figure that approaches the U.S.’s annual GDP.¹⁴⁷ U.S. public debt now exceeds sixty percent of GDP. The risk of inflation looms, especially given the Federal Reserve’s share of the liability.¹⁴⁸ In this event, policymakers will be faced with a decidedly unpleasant set of choices—pay for government debt through inflation or induce a recession, either by dramatically hiking taxes or by having the Fed increase interest rates significantly and take cash out of the system.¹⁴⁹

142. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115.

143. Recovery.gov, The Act, http://www.recovery.gov/About/Pages/The_Act.aspx (last visited Mar. 27, 2010).

144. See Press Release, U.S. Dep’t of Commerce, Bureau of Econ. Analysis, Gross Domestic Product: Fourth Quarter 2009 (Jan. 29, 2010), available at <http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm> (reporting that GDP rose at an annual rate of 5.4% in the fourth quarter of 2009); see also Justin Fox, *Is the Economy Starting to Recover? Or Just Less Bad?*, TIME.COM, Mar. 26, 2009, <http://www.time.com/time/business/article/0,8599,1887684,00.html>; Carlo Piovano, *World Stocks Rally on Hopes for Economic Recovery*, ABCNEWS, May 19, 2009, <http://abcnews.go.com/Business/wireStory?id=7620953>.

145. See Annys Shin, *Federal Reserve Leaders See Economic Progress*, WASH. POST, May 21, 2009, at A15.

146. See Patrice Hill, *Unemployment Rate Stays at 9.7%; 36K Jobs Lost*, WASH. TIMES, Mar. 5, 2010, available at <http://www.washingtontimes.com/news/2010/mar/05/unemployment-held-steady-97-percent-february/>.

147. Richard A. Posner, http://www.theatlantic.com/richard_a_posner (May 20, 2009, 9:59 EDT).

148. *Id.*; see also POSNER, *supra* note 114, at 273.

149. Posner, *supra* note 147.

How did this economic catastrophe occur?¹⁵⁰ The explanation is of the utmost importance for regulatory policy, macroeconomics, and antitrust law. Although policy experts will debate how we can prevent a similar crisis in the future, most people will agree that a number of major institutional weaknesses must be addressed. These include asymmetric regulatory policy, which leaves a truly global financial system subject to national control with limited international harmonization; gaps in regulatory oversight, including hedge and private equity funds; the inadequate performance of credit rating agencies; and the lack of proper enforcement of adequate capitalization requirements.¹⁵¹ The pressing question for this Article is what guidance the recession provides for future competition policy—an issue that the following Part addresses in detail. Despite the Justice Department's and FTC officials' pronouncements to the contrary, the crisis has scant relation to the economic principles that inform competition policy.

*B. The Causes of the Crisis Have Little to Do with
Price Theory in Antitrust Markets*

A dispassionate inquiry into the crisis reveals remarkably little about the specific assumptions that underlie antitrust theory. Notwithstanding this fact, many employ the global recession to justify an aggressive expansion in antitrust enforcement, particularly against unilateral conduct and merger activity. The head of the Justice Department's Antitrust Division, Christine Varney, has opined that "[c]onsumers have been waiting for the markets to correct themselves, but the financial crisis has shown they haven't."¹⁵² She has promised that the DOJ will

150. Although this Part seeks to provide a reasonably detailed explanation of how and why the economic crisis occurred, such that the reader can properly interpret the consequences of the global recession for macroeconomic and, more importantly for this Article, antitrust policy, a full and authoritative treatment of the subject would require space far in excess of what is feasible for an article. Readers who seek a more detailed treatment of the crisis should look to any of a number of excellent books. *See, e.g.,* POSNER, *supra* note 114; JOHN B. TAYLOR, *GETTING OFF TRACK: HOW GOVERNMENT ACTIONS AND INTERVENTIONS CAUSED, PROLONGED, AND WORSENERED THE FINANCIAL CRISIS* (2009); MARK ZANDI, *FINANCIAL SHOCK: A 360° LOOK AT THE SUBPRIME MORTGAGE IMPLOSION, AND HOW TO AVOID THE NEXT FINANCIAL CRISIS* (2008).

151. Notably, some weaknesses are already being resolved. For example, the market for credit-default swaps has transformed itself in the short time since the onset of the crisis.

152. Puzzanghera, *supra* note 12.

engage in a far more interventionist policy than it did during the Bush administration.¹⁵³ She even suggested that lax anti-trust enforcement permitted companies to grow so big that their looming failure fueled the crisis.¹⁵⁴ The reasons behind the recession do not support these positions.

An impressionistic appraisal of the credit crisis might lead an antitrust activist to spout platitudes about capitalism having failed, free markets being defective, and economic theory having been undermined. These assertions, however, are uncritical. Free-market ideology indeed pervades modern antitrust jurisprudence, at least in the United States.¹⁵⁵ At first glance, one might draw the casual inference that a systemic failure in the financial markets undermines assumptions governing free-market processes in other contexts. But this inference is far too general to yield reliable conclusions.

Markets are said to self-correct for antitrust purposes when supracompetitive returns spur entry that is sufficient to restore market output to optimal levels.¹⁵⁶ The tendency of capital to move toward markets bearing the highest return is a critical component of the restorative process. This trait, long considered to be a definitive characteristic of free markets, is driven by the incentive to maximize profits. In the process, it spurs a variety of socially desirable phenomena such as innovation, risk-taking, and price-cutting.

The ensuing flow of capital creates a self-restoring process of competition. In assessing the commercial impact of a challenged practice, antitrust enforcers place great—often dispositive—weight on the ability of the market to correct any distortions created by the behavior under scrutiny. Often, there will be some uncertainty as to whether an anticompetitive effect exists. In such cases, U.S. law typically errs on the side of underenforcement, trusting the process of entry, incumbent output expansion, and competition to produce optimal outcomes.

Thus, antitrust law is not a system of direct government regulation. Rather, it is a policy tool designed to protect the function-

153. *Id.*

154. *Id.*

155. See, e.g., Brennan, *supra* note 18, at 147; Herbert Hovenkamp, *The Monopolization Offense*, 61 OHIO ST. L.J. 1035, 1049 (2000); Kauper, *supra* note 18, at 1870.

156. See FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, HORIZONTAL MERGER GUIDELINES §§ 3.0–3.4 (1997).

ing of the free market.¹⁵⁷ The law presumes that an unhindered competitive process allows capital to flow to its highest value uses, thus ensuring that allocative and dynamic efficiency will follow. A company may legally set monopoly prices,¹⁵⁸ injure and destroy its rivals on the basis of innate superiority,¹⁵⁹ and engage in almost any conduct that results in only fleeting power over price.¹⁶⁰ Only “where a firm with monopoly power interfere[s] with natural economic forces which would otherwise dissipate its monopoly” will antitrust law be implicated.¹⁶¹

In short, market forces tend to erode anticompetitive effects. U.S. law places considerable faith in the ability of the market to have this effect, but this trust in market forces is far from absolute. Instead, regulators make case-by-case inquiries into the nature of specific industries to judge the likelihood, speed, and efficacy of entry in response to supracompetitive prices. Free-market economics as applied to contemporary antitrust policy is not an ideology; it is a nuanced tool. Faith in the market becomes most obvious—and controversial—when it is employed to produce policy conclusions to empirically and theoretically indeterminate problems. Dominant-firm misconduct, which produces short-run harm, but possibly overrides long-run gains, is the paradigmatic example. But the role of the market in macroeconomics is quite different, as is the need for government intervention. Government action is central to macroeconomic policy; few have suggested that market forces alone produce optimal long-run growth and stability. The definition

157. See *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 902–03 (9th Cir. 2008) (“One of the challenges of interpreting and enforcing the amorphous prohibitions of §§ 1 and 2 of the Sherman Act is ensuring that the antitrust laws do not punish economic behavior that benefits consumers and will not cause long-run injury to the competitive process.”).

158. *Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004).

159. See Frank H. Easterbrook, *The Chicago School and Exclusionary Conduct*, 31 HARV. J.L. & PUB. POL’Y 439, 440 (2008) (noting that “[a]ntitrust law and bankruptcy law go hand in hand”).

160. See *Colorado Interstate Gas Co. v. Natural Gas Pipeline Co.*, 885 F.2d 683, 695–96 (10th Cir. 1989); *Williamsburg Wax Museum, Inc. v. Historic Figures, Inc.*, 810 F.2d 243, 252 (D.C. Cir. 1987); *Dimmitt Agri Indus., Inc. v. CPC Int’l, Inc.*, 679 F.2d 516, 530 (5th Cir. 1982); see also William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 959 (1981). The only exception relates to per se illegal conduct, such as naked price-fixing and market allocation.

161. *In re Borden, Inc.*, 92 F.T.C. 669, 795 (1978).

of market self-correction in antitrust law (monopoly profits attract entry) obviously is quite different from self-correction in the macro-economy (recovery from recession, deflation, excessive inflation, or the myriad other conditions that can afflict an economy). Although the macro-economy tends to reach equilibrium, various shocks can upset that balance in a way that capitalist forces will not self-correct.¹⁶²

One such shock involves deflation brought about by recession, which creates a particularly dangerous downward spiral.¹⁶³ As the value of money increases, consumers' savings increase in real value, and if they are acting rationally, consumers will cease spending. This results in a drop in industry demand, which requires companies to cut output and lower prices further, in part by reducing wages and laying off workers. This, in turn, steepens the increase in the value of money and accentuates the deflation. The market cannot rescue itself in these circumstances. The government will need to act by implementing a significant monetary or fiscal measure, or both.¹⁶⁴ The response of the United States to the current crisis has focused precisely on such corrective action, in an enormously costly—though apparently successful—attempt to stave off a ruinous downward spiral of deflation.¹⁶⁵

The crucial distinction between the relevance of free-market forces to antitrust and to macroeconomics is that competition law is just a single, limited tool that can prevent market failures at the micro level. The law seeks to prevent failures by ensuring a robust, dynamic, and competitive market process. If failures distinct from company-level misconduct arise, antitrust law has nothing to say. Market failures in the macro context require urgent government intervention. But the cause, and hence normative consequences, of these macro failures may be entirely irrelevant to the factors of concern at the antitrust level.

With respect to financial-sector policy, the role of the market is again distinct. The incentive to maximize profits, which fuels the self-correcting nature of the market in antitrust cases,

162. See POSNER, *supra* note 114, at 5–7.

163. See Ben S. Bernanke, Remarks Before the National Economists Club: Deflation: Making Sure "It" Doesn't Happen Here (Nov. 21, 2002), available at <http://www.federalreserve.gov/BOARDDOCS/SPEECHES/2002/20021121/default.htm>.

164. See POSNER, *supra* note 114, at 7–8.

165. *Id.*

causes problems in the banking industry. Here, faith in the market is in many ways reversed. Antitrust is not concerned with the larger functioning of the economy; it is concerned only with the distortion-creating activities of firms with market power. Bank regulation is concerned with, and certainly implicates, the economy as a whole, but profit maximization—a phenomenon that induces trust in the market from a competition standpoint—also counsels limits on faith in the market for larger regulatory purposes. The pursuit of ever-greater profits in the banking sector, which is magnified by risk-taking incentives in the form of FDIC insurance, securitization, and high discount rates, will not yield a desirable and stable equilibrium. Profit maximization in an entirely unregulated banking environment will yield successive boom and bust cycles.

The preceding discussion illustrates some of the major distinctions between the principles of regulation and the far narrower area of antitrust economics. This Part proceeds by considering in greater detail three particular areas of competitive concern: concerted conduct, mergers, and unilateral behavior. The Article considers the impact of the crisis on the economic theory applicable to each area, and concludes that few substantive alterations are necessary. The approach of the United States to antitrust law—long dominated by price theory and economic conservatism—is likely to coalesce to a significant degree with the jurisdiction whose competition policy it has long criticized, the EU.¹⁶⁶

1. *Concerted Conduct*

The instructive power of economics provides the most assured normative guidance in the area of concerted conduct, which involves various forms of collaborative arrangement be-

166. See Michael Elliott, *The Anatomy of the GE-Honeywell Disaster*, TIME.COM, July 8, 2001, <http://www.time.com/time/business/article/0,8599,166732-2,00.html> (quoting Treasury Secretary Paul O'Neill as denouncing the European Commission's veto of the GE-Honeywell merger for being "off the wall"); Press Release, Thomas O. Barnett, Assistant Att'y. Gen. for Antitrust, Dep't of Justice, Statement on European Microsoft Decision (Sept. 17, 2007), available at http://www.usdoj.gov/atr/public/press_releases/2007/226070.htm (criticizing a decision of the Court of First Instance of the European Communities, which affirmed a decision of the EC, because "rather than helping consumers, [it] may have the unfortunate consequence of harming consumers by chilling innovation and discouraging competition").

tween entities that share a horizontal or vertical relationship. Economic theory is sufficiently definite within this field that the economic crisis could not conceivably justify any substantive alteration. Price theory illustrates the evil of monopoly and explains why cartels should be prosecuted on all possible bases.¹⁶⁷ Game theory demonstrates the circumstances in which communication among competitors threatens to act as a facilitative component of tacit collusion in a concentrated market.

So informed by economics, the law has developed a rich set of principles for facilitating the efficient flow of information through trade associations and similar vehicles, but also for prohibiting such interchanges as might prove conducive to nefarious outcomes.¹⁶⁸ Similarly, the economics of joint ventures indicate that fringe rivals acting in concert to exclude others may prove to be highly competitive, as they compete with an otherwise more efficient, dominant company.¹⁶⁹

Section 1 enforcement will remain largely untouched by the crisis because the economic analysis at issue generally does not entail the balancing of indeterminate and incalculable long-term effects with immediate and observable results. Cartels restrict output, causing harm in the short run, without yielding a concomitant, offsetting positive effect in the future.¹⁷⁰ They can therefore be summarily condemned. Similarly, economic theory is sufficiently robust that the exchange of much information, including cost and price specifics, will likely yield greater competition in unconcentrated market structures.¹⁷¹ These principles are widely accepted and largely uncontroversial.

The meltdown of the financial markets has revealed many weaknesses in macroeconomic and regulatory policy, but it has not demonstrated any weaknesses in the long-established rules that govern conduct and communication between horizontal competitors. Neither U.S. nor EU enforcement agencies have

167. See POSNER, *supra* note 35, at 9–32.

168. See FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, *ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS* 2–3 (2000).

169. See *generally id.* at 1; POSNER, *supra* note 35, at 136–40.

170. In some circumstances, however, cartels will not have long-run anticompetitive effect, as the increase in price to supracompetitive levels will spur rapid entry. See Roger D. Blair, James Mak & Carl Bonham, *Collusive Duopoly: The Economic Effects of the Aloha and Hawaiian Airlines' Agreement to Reduce Capacity*, 74 *ANTITRUST L.J.* 409, 436 (2007).

171. See POSNER, *supra* note 35, at 136–40.

advocated a shift in ideology other than to maximize the number of cases brought against cartels.¹⁷² This is precisely the appropriate approach, especially in a time of economic contraction, because cartels depress output and therefore exacerbate recessions.¹⁷³ One who doubts this point need only look at the consequences of President Roosevelt's decision to suspend the antitrust laws at the onset of the Great Depression.¹⁷⁴

2. Merger Policy

Merger enforcement is a more contentious area of antitrust concern. It tends to implicate political biases concerning the appropriate size and scope of merging entities,¹⁷⁵ as well as the proper frequency of merger challenge.¹⁷⁶ Nevertheless, the underlying economics are clear and the only major debate within contemporary academic discourse is whether to derive sanction decisions from consumer or aggregate-welfare models.¹⁷⁷ Sophisticated empirical techniques often allow the government to ascertain the degree of price competition in specific geographic markets between two merging entities.¹⁷⁸ These tools

172. See Whitener, *supra* note 12; Puzanghera, *supra* note 12.

173. See John D. Harkrider, *Lessons from the Great Depression*, 23 ANTITRUST 6, 9 (2009).

174. See *id.*

175. One need merely observe the debate leading up to the XM-Sirius merger, which largely divided along party lines. For a discussion of the economics applicable to that merger, see J. Gregory Sidak & Hal J. Singer, *Evaluating Market Power with Two-Sided Demand and Preemptive Offers to Dissipate Monopoly Rent: Lessons for High-Technology Industries from the Antitrust Division's Approval of the XM-Sirius Satellite Radio Merger*, 4 J. COMPETITION L. & ECON. 697 (2008).

176. Democratic administrations are likely to be significantly tougher on merger enforcement than their Republican counterparts are. See Julie Johnsson et al., *346 Days: With less than a year left in the Bush administration's tenure, some see an urgency to push through mergers in a pro-business climate*, CHI. TRIB., Feb. 8, 2008, at 1.

177. Aggregate-welfare models place as much relevance on producer-side cost savings as they do on merger-specific consumers' benefits. Oliver Williamson famously demonstrated that output-restricting mergers, which increase prices for consumers, may be socially desirable if even a relatively small productive efficiency gain is achieved. See Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Trade-offs*, 58 AM. ECON. REV. 18 (1968). At present, so-called "Williamson mergers" are not allowed in the United States. Debate on whether this prohibition is appropriate continues. See Alan Devlin & Bruno Peixoto, *Reformulating Antitrust Rules to Safeguard Societal Wealth*, 13 STAN. J.L. BUS. & FIN. 225, 231-32 (2007) (making the case for an aggregate-welfare approach to antitrust policy).

178. The classic example is *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997). See POSNER, *supra* note 35, at 157-58 (explaining the econometric techniques employed in

have enabled the government to make unlawful any acquisition that might result in a substantial lessening of competition.¹⁷⁹

These tenets of modern merger analysis remain undisturbed. In light of the crisis, then, one must ask: Apart from the changes in the political climate, what applicable rules of economics have been called into question? The only conceivable answer is that assumptions of prompt entry into some markets may need to be revisited throughout the credit crisis.¹⁸⁰ Lending has yet to return to pre-crisis levels, though the government has succeeded in loosening the credit markets.¹⁸¹ Although the Chicago School has debunked the prior assumption that capital requirements constitute barriers to entry, the cost of capital is unquestionably an entry barrier when it is higher for an entrant than it is for an incumbent.¹⁸² In situations where prompt entry is a condition for post-merger competition, or in conglomerate mergers where rivals' access to capital is an important consideration in analyzing the danger of cross-subsidization, a dearth of credit may be highly relevant to the decision to sanction.¹⁸³

the case and concluding that “[e]conomic analysis of mergers had come of age”). These empirical tools have also been employed in consummated mergers to prove actual anticompetitive effects. See *In re Evanston Nw. Healthcare Corp.*, F.T.C. No. 9315 (Aug. 6, 2007).

179. See 15 U.S.C. § 18 (2006).

180. The feasibility, likelihood, and effect of post-merger entry arguably play the most important role in the merger assessment process after market definition. See FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, HORIZONTAL MERGER GUIDELINES §§ 3.0–3.4 (1997). Indeed, U.S. courts have previously chastised the enforcement agencies for seeking to enjoin combinations when post-merger entry is likely. Perhaps the most important case under this heading is *United States v. Syufy Enters.*, 903 F.2d 659 (9th Cir. 1990).

181. See *Decoupling 2.0*, *supra* note 138, at 14; *Economists: Recession to End in 2009*, CNN MONEY, May 27, 2009, http://money.cnn.com/2009/05/27/news/economy/NABE_recovery_outlook/index.htm.

182. See POSNER, *supra* note 35, at 115.

183. For example, the U.S. Justice Department approved a controversial merger between General Electric and Honeywell that was subsequently blocked by the European Commission. The Commission was concerned, in part, by GE's large capital reserves, which GE-Honeywell would be able to use to fund its activities in various markets. GE-Honeywell's competitors, by contrast, would not have access to such funds. The Justice Department rejected this contention, reasoning that “[c]apital markets generally work very efficiently and there is no obvious reason, absent some clearly defined market imperfection, why GE's cost of capital for a particular project should be any lower than that of its rivals.” Majoras, *supra* note 84, at 8. Such a conclusion might lie on shakier foundation were it reached in the present, credit-deprived economy.

How much weight should we put on this concern? Not much. If credit seizes up, the assumption that prompt entry will occur—financed by the capital markets—may need to be revisited. But this is likely to be an ephemeral concern. Once the financial industry sufficiently deleverages and markets stabilize, the flow of credit is likely to resume once more. Thus, the dearth of lending itself reveals no systemic, long-term weakness that requires us to revisit a priori assumptions governing the expectation of market entry. Indeed, no such controlling assumption exists, as inquiries into the speed, efficacy, and likelihood of entry are necessarily conducted on a case- and market-specific basis.¹⁸⁴ Ultimately, capital will resume flowing to markets where supracompetitive profits prevail.

In lieu of any sweeping or substantive alteration to current merger doctrine, the better course in close cases is to consider enhanced use of Section 7 to challenge consummated mergers once anticompetitive effect has in fact been demonstrated. This approach would have significant advantages. First, it shifts the challenge decision from an information-deprived *ex ante* setting to a fully informed *ex post* context, where actual direct effects can be measured.¹⁸⁵ Second, the threat of *ex post* attack may powerfully inhibit the decision of a newly merged entity to restrict output and raise price, knowing that such actions could draw the wrath of enforcement agencies. The downside lies in the relative legal uncertainty from the perspective of the merging entities, though this should not be exaggerated, given that the risk of *ex post* challenge has always been a factor for companies that are considering a merger.

The more fundamental issue relates to the systemic tension between concentration, efficiency, and stability. Because the prohibition on entities carrying out both investment and commercial banking activities was lifted, global financial markets have been increasingly dominated by a small number of enormous institutions.¹⁸⁶ This concentration is driven by innate

184. See *Reazin v. Blue Cross & Blue Shield of Kan., Inc.*, 899 F.2d 951, 968 (10th Cir. 1990).

185. See, e.g., *Evanston Nw. Healthcare Corp.*, F.T.C. No. 9315, 2007 WL 2286195 (Aug. 6, 2007) (noting that, in a consummated merger, “our analysis is a retrospective inquiry based on empirical evidence” of competitive effects).

186. See HOWARD DAVIES & DAVID GREEN, *GLOBAL FINANCIAL REGULATION* 8–9 (2008).

characteristics of the market, including certain “winner-takes-all” traits.¹⁸⁷ Such outcomes arise in markets that display diminishing long-run average cost over a significant range of output—a phenomenon known as subadditivity.¹⁸⁸ But this alone cannot be the full story. Given the conglomerate nature of the markets involved, such that these huge banks provide a vast array of different services, significant economies of scope must be at play.¹⁸⁹ Unfortunately, quantifying these gains seems impossible, though one might reasonably infer that a forced reduction in scale and scope would be enormously costly if conducted on a large scale.

As noted, however, this efficiency-driven consolidation has a serious downside. The failure of banks carries huge externalities because of the unique position banks occupy in financial markets by providing liquidity and facilitating maturity transformation.¹⁹⁰ Certain banks, given their size and the volume of commerce they affect, may be so important to the economy that their failure would be devastating.¹⁹¹ In such circumstances, the social cost of rescuing the relevant institutions will be less than the ruinous cascade effects that may surge through the financial sector. This is the state of being “too big to fail,” which both the FTC and Justice Department have identified as an outcome that antitrust law can and should prevent.¹⁹²

This concern is legitimate. The crisis has revealed unacceptable systemic weaknesses in the financial sector, frailties that required the U.S. government’s urgent—some would say frantic¹⁹³—bailout of numerous key banks lest their failure lead to the collapse of the broader economy. If these traits are the result of efficiency gains, then a very real cost-benefit analysis

187. *Id.* at 9.

188. See T. Randolph Beard, Robert B. Ekelund Jr., & George S. Ford, *The Law and Economics of Unbundling and Impairment*, 2003 U. ILL. J.L. TECH. & POLY 475, 476 n.3; Douglas Gegax & Kenneth Nowotny, *Competition and the Electric Utility Industry: An Evaluation*, 10 YALE J. ON REG. 63, 67–68 (1993).

189. See, e.g., Oliver Budzinski & Katharina Wacker, *The Prohibition of the Proposed Springer-Prosiebensat.1 Merger: How much Economics in German Merger Control?*, 3 J. COMPETITION L. & ECON. 281, 286 (2007).

190. For the classic discussion of this point, see WALTER BAGEHOT, *LOMBARD STREET: A DESCRIPTION OF THE MONEY MARKET* (2005).

191. See DAVIES & GREEN, *supra* note 186, at 16–17.

192. See Whitener, *supra* note 12; Puzanghera, *supra* note 12.

193. See POSNER, *supra* note 114, at ix.

must be undertaken. To prevent this phenomenon, however, regulators would have to restructure the existing market radically. Banks would have to be broken up and their various constituent parts divested. All associated economies would be lost.

Even if it were justified—and this is the key point—there is no basis in contemporary antitrust doctrine for such a course of action.¹⁹⁴ Competition enforcers have no mandate to engage in such interventionist conduct. As the Seventh Circuit has observed, “the antitrust laws do not deputize district judges as one-man regulatory agencies.”¹⁹⁵ Presumably, neither Commissioner Rosch nor Ms. Varney had in mind the idea of active reorganization of the market. Instead, they surely meant to signal an end to merger clearance that would facilitate further concentration within the market. Of course, if such mergers were expected to yield negative price effects, they would be prohibited under today’s guidelines. But should the agencies seek to enjoin combinations that result in greater size, but not higher prices?

At first glance, one might think so, but prohibiting mergers that will not result in price increases would require the rewriting of over three decades of antitrust jurisprudence.¹⁹⁶ Conglomerate mergers, which are combinations of firms that are neither vertically nor horizontally related, do not bear the potential for unilateral or coordinated price effects and have not been an object of U.S. antitrust concern in this generation.¹⁹⁷

194. As the Seventh Circuit classically explained, “[n]o court has yet said that the accumulation and use of great power is unlawful per se. Bigness is no crime” *United States v. N.Y. Great Atl. & Pac. Tea Co.*, 173 F.2d 79, 87 (7th Cir. 1949); accord *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 274 (2d Cir. 1979) (distinguishing mere size from market power); *Bailey’s Bakery, Ltd. v. Cont’l Baking Co.*, 235 F. Supp. 705, 718 (D. Haw. 1964), *aff’d*, 401 F.2d 182 (9th Cir. 1968) (“Mere size, nor continued exercise of lawful powers by even a monopolist, is not illegal . . .”).

195. *Chi. Prof’l Sports, Ltd. v. Nat’l Basketball Ass’n*, 95 F.3d 593, 597 (7th Cir. 1996).

196. *Alcoa*, the landmark case that stood for the proposition that a company can violate the antitrust laws by monopolizing a market on the sole basis of efficiency, has been characterized as “discredited,” “defunct,” and “no longer the law.” J. Gregory Sidak, *Abolishing the Price Squeeze as a Theory of Antitrust Liability*, 4 J. COMPETITION L. & ECON. 279, 304 (2008) (quoting POSNER, *supra* note 35, at 103, 196, 250, 263).

197. See Kolasky, *supra* note 14, at 533. See generally Joseph P. Bauer, *Government Enforcement Policy of Section 7 of the Clayton Act: Carte Blanche for Conglomerate Mergers?*, 71 CAL. L. REV. 348 (1983).

The economic literature suggests that conglomerate mergers do not result in the direct acquisition of monopoly power and therefore are least likely to be worthy objects of antitrust concern.¹⁹⁸ This is especially true where antitrust is applied in favor of allocative efficiency.¹⁹⁹ Debate continues regarding the possible anticompetitive consequences of conglomerate mergers, including raising rivals' costs through cross-subsidization, bundling, tie-in, range effects, and control of potential upstream and downstream channels of commerce.²⁰⁰ The Chicago School has found such claims to be attenuated and unworthy of attention and has been successful in persuading the U.S. courts and enforcement agencies to adopt its view.²⁰¹ For jurisdictions whose sociopolitical climates are adverse to sheer size and to efficiency that threatens to yield a long-run monopoly, however, the approach is quite different.²⁰² The European Commission and courts have been actively hostile toward conglomerate mergers that yield scope efficiencies and large entities that threaten the viability of incumbent, less efficient competitors.²⁰³

If the FTC and the Justice Department wish to prevent companies from growing too big to fail, they will have to reorient antitrust policy away from concerns of efficiency. Since the 1960s, courts have rejected the view that antitrust can prevent a com-

198. See Alan A. Fisher & Robert H. Lande, *Efficiency Considerations in Merger Enforcement*, 71 CAL. L. REV. 1580, 1603 n.101 (1983); Donald F. Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 HARV. L. REV. 1313, 1321–22 (1965).

199. See Edmund H. Mantell, *Conglomerate Mergers, Allocative Efficiency, and Section 7 of the Clayton Act*, 56 TEX. L. REV. 207, 208 (1978).

200. Compare James Cooper, Luke Froeb, Daniel O'Brien & Michael Vita, *A Critique of Professor Church's Report on the Impact of Vertical and Conglomerate Mergers on Competition*, 1 J. COMPETITION L. & ECON. 785 (2005), with Jeffrey Church, *The Church Report's Analysis of Vertical and Conglomerate Mergers: A Reply to Cooper, Froeb, O'Brien, and Vita*, 1 J. COMPETITION L. & ECON. 797 (2005).

201. See BORK, *supra* note 61, at 257; POSNER, *supra* note 35, at 131 n.30; George Stephanov Georgiev, Recent Development, *Bridging the Divide? The European Court of First Instance Judgment in GE/Honeywell*, 31 YALE J. INT'L L. 518, 519 (2006).

202. This includes the Warren Court era in the United States where antitrust largely reflected populist principles. For a contemporaneous articulation of the view at that time, see Harlan M. Blake, *Conglomerate Mergers and the Antitrust Laws*, 73 COLUM. L. REV. 555, 586 (1973).

203. See Ilene Knable Gotts et al., *Nature vs. Nurture and Reaching the Age of Reason: The U.S./E.U. Treatment of Transatlantic Mergers*, 61 N.Y.U. ANN. SURV. AM. L. 453, 473–74 (2005).

pany from growing too large in size.²⁰⁴ The Chicago School demonstrated that industry concentration and increasing profits are more likely to reflect enhanced efficiency than market power.²⁰⁵ If one constrains the efficiency-enhancing growth of a company, both consumers and the economy will pay a price.²⁰⁶ Judge Learned Hand's implicit suggestion in *Alcoa* that a company can violate Section 2 merely by being efficient²⁰⁷ "has been questioned by just about everyone who has taken a close look at it."²⁰⁸

Of course, such criticism of *Alcoa* and its progeny was based on the premise that the efficiency benefits associated with scale and scope are not associated with larger social costs, such as the potential for cataclysmic market instability. From the wider perspective of public policy, Ms. Varney's and Commissioner Rosch's concern with concentration is understandable. It is precisely the degree of scale and scope, combined with the interconnected nature of modern global finance, that made the crisis so dangerous as to require such urgent intervention.

Nevertheless, if the interconnected nature and increasing concentration of the financial system are problematic, it is not at all clear that the solution lies with competition policy. The closing of regulatory loopholes, proper application of existing securities laws, oversight of previously unregulated activities, international cooperation by financial services authorities, and stringent enforcement of capitalization rules should stabilize the financial system. But if society prohibits growing concentration, which is mandated by Coasian theories of internal efficiency,²⁰⁹ whatever gain in stability that might thereby be attained may be outweighed by the associated efficiency losses.

204. See, e.g., *United States v. Aluminum Co. of America (Alcoa)*, 148 F.2d 416, 421, 429–30 (2d Cir. 1945).

205. See Jacobs, *supra* note 21, at 228; Herbert J. Hovenkamp, *The Neal Report and the Crisis in Antitrust* (March 2009) (unpublished manuscript), available at <http://ssrn.com/abstract=1348707>.

206. See *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004).

207. *Alcoa*, 148 F.2d at 430–32.

208. *United States v. Syufy Enters.*, 903 F.2d 659, 668 (9th Cir. 1990) (citations omitted).

209. See Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386, 388 (1937) (explaining that firms exist and grow in response to the transaction cost-savings made possible by internal production and coordination).

Two further factors suggest that the FTC and the Justice Department's desire to challenge size-increasing mergers is ill-placed. First, there is tremendous benefit to tying competition doctrine to a specific, identifiable goal. Of course, antitrust law is a manifestation of public policy. On that basis, one could quite reasonably posit that public policy rues the presence of companies whose economic power is such that their failure threatens the larger economy. But competition law is not well-placed to incorporate such a principle in addition to efficiency. Self-contradictory and incongruous principles do not lend themselves to harmonious application. One need merely observe the Sisyphean efforts of the Warren Court in attempting to reconcile economics, populism, and constrained protectionism in its jurisprudence. The result has been characterized in variously colorful terms, perhaps most poignantly by Judge Posner as an "intellectual disgrace."²¹⁰

There is a second, likely fatal, objection to the enforcement agencies' plan to prevent further concentration within the financial markets. If strong economies of scale and scope are indeed present in this industry, then concentration is inevitable irrespective of merger policy. Companies can achieve precisely the same result by merger as they can through internal growth—a process with which antitrust law is much less concerned. If efficiencies are indeed at play, then the banking industry will remain concentrated and Ms. Varney's and Commissioner Rosch's efforts will prove futile. The only "solution" in this eventuality—a notably inferior one to adopting a proper system of regulation—would be to introduce legislation akin to the now-repealed Glass-Steagall Act.²¹¹

3. *Unilateral Behavior by the Dominant Firm*

The constraints properly brought to bear on dominant-firm behavior likely make up the most contentious, divisive, and uncertain area of competition policy. The difficulty arises from the epistemological limitations inherent in economic analysis of such conduct. The regulation of unilateral behavior raises a variety of difficult issues. Most important is that imposing behav-

210. POSNER, *supra* note 35, at viii.

211. Pub. L. No. 73-66, 48 Stat. 162 (1933) (repealed 1999) (separating investment and commercial-banking activities).

ioral limitations on monopolists invariably reduces their profits, thus diminishing the incentive to succeed in the first place. Yet, much conduct by a dominant firm carries potential exclusionary effect, which restricts the ability of rival firms to compete, with negative consequences for short-term consumer welfare. To complicate matters, short-term exclusivity and anticompetitive effect can be potent fuel for dynamic innovation and long-term consumer welfare. A wide variety of unilateral conduct—including bundling, requirements contracting, refusals to supply rivals, and refusals to cooperate with rivals—implicates both short- and long-term effects. The immediate economic effects are often negative, but these may mask offsetting future gains. Economists currently lack the ability to ascertain and quantify the consequences of this conduct. Thus, cost-benefit analyses cannot be performed, resulting in a critical knowledge deficit and leaving policymakers in a difficult position.

Interpreting these factors, U.S. antitrust law has developed a body of jurisprudence based largely on the teachings of decision theory.²¹² Adopting Judge Easterbrook's contention that antitrust should err on the side of avoiding Type I errors²¹³ because Type II errors²¹⁴ will be corrected by free-market forces, the law has approached claims of dominant firm misconduct with skepticism.²¹⁵ This agnosticism reached its zenith in the Justice Department's September 2008 Guidelines on Section 2 enforcement, which counseled challenging unilateral conduct only where "its anticompetitive effects are shown to be substantially disproportionate to any associated procompetitive effects."²¹⁶

The new Justice Department Antitrust Division has dismissed this approach because, in light of the global recession, "we can no longer rely upon the marketplace alone to ensure that competition and consumers will be protected."²¹⁷ Ms.

212. Decision theory is the branch of economics concerned with decision making under conditions of uncertainty. Uncertainty is to be distinguished from risk, which is quantifiable. See POSNER, *supra* note 35, at 60.

213. Type I errors involve erroneous conclusions of anticompetitive conduct.

214. Type II errors involve mistaken determinations that conduct is procompetitive.

215. See Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 3 (1984).

216. COMPETITION AND MONOPOLY, *supra* note 85, at ix.

217. Press Release, Dep't of Justice, Justice Department Withdraws Report on Antitrust Monopoly Law: Antitrust Divisions to Apply More Rigorous Standard With Focus on the Impact of Exclusionary Conduct on Consumers (May 11, 2009), *avail-*

Varney's conclusion would be justified if the crisis revealed a failure of rationality. But the crisis has revealed no such thing.²¹⁸ The primary assumption underlying antitrust economics—that commercial entities will seek to maximize profits—remains unscathed. Indeed, if the crisis has taught anything, it is that corporate entities have been myopic in their pursuit of short-run profits. Although this inadequately constrained conduct proved costly to the financial system as a whole, such behavior is precisely what spurs entry into monopolized markets. The former result of unconstrained profit-maximization can and should be subject to regulatory constraints that prevent excessive externalities. But the broad expectation that firms will act in their best financial interests, at least in the short run, is not undermined by the crisis.

One prominent enforcer appears to have reached an opposing conclusion. Surveying the economic crisis, Commissioner Rosch suggested that antitrust enforcers might benefit by looking to the literature on behavioral economics.²¹⁹ This discipline incorporates insights from psychology to enrich economics with a more realistic set of assumptions.²²⁰ The independent relevance of this branch of economics continues to be controversial, with some leading commentators positing that the accuracy of predictions is far more important than the realism of assumptions.²²¹ But its invocation by Commissioner Rosch can be explained only on the basis that he sees some assumptions underlying antitrust law as either unrealistic or undermined by the global recession.

Given that the only assumption that underlies all modern economic analysis applied to antitrust is profit maximization, one can surmise that this assumption is what Commissioner Rosch questions. But the concept of rational choice, much derided in some

able at http://www.justice.gov/atr/public/press_releases/2009/245710.htm. Commissioner Rosch has expressed a similar sentiment. See Whitener, *supra* note 12, at 40–41.

218. See POSNER, *supra* note 114, at 82–85.

219. See Whitener, *supra* note 12, at 40–41.

220. For an excellent compilation of leading works in this area, see ADVANCES IN BEHAVIORAL ECONOMICS (Colin F. Camerer, George Loewenstein & Matthew Rabin eds., 2004).

221. Compare Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998), with Richard A. Posner, *Rational Choice, Behavioral Economics, and the Law*, 50 STAN. L. REV. 1551 (1998).

fields of its purported application,²²² would seem to be a reasonably accurate depiction of real-world corporate behavior.²²³ Of course, it is an imperfect assumption, given the well-known asymmetry between shareholders' interests and direct management. And the global recession has demonstrated that rationality is indeed bounded in that firms do not seem to internalize the small risk of a financial crisis in their decision making.²²⁴ But directors who repeatedly lead their company away from profit-maximizing practices are certain to face resistance and, ultimately, replacement. More fundamentally still, in a vibrant economy where competition demands efficiency for a company to survive, irrational firms are likely to fail. Unsurprisingly, then, the Supreme Court has embraced this assumption, requiring that antitrust plaintiffs' theories make "economic sense."²²⁵ Indeed, the accuracy of profit-maximization as a normative tool for guiding antitrust policy has been so influential that behavioral economists have paid virtually no attention to the field.²²⁶

Commissioner Rosch's promotion of behavioral economics within the field of antitrust would not only be unprecedented, but it would also fly in the face of prevailing opinion. This objection is by no means fatal, but one would expect some basis for abandoning the edifice of rational choice upon which virtually all antitrust doctrine is built. Instead, all we are left with is a broad assertion that markets have been shown not to work efficiently.

The sole exception, as in merger analysis, is a symptom of the recession, not an inherent trait of the free market. It is neither a harbinger nor a cause of the crisis. This exception, of course, is the freezing in the credit markets that reached a peak in October 10, 2008 when the LIBOR/Overnight Index Swap spread (a proxy for bank solvency and hence the need for capital) hit 364 basis points, up from an established ten before the

222. See Claire A. Hill, *The Rationality of Preference Construction (and the Irrationality of Rational Choice)*, 9 MINN. J.L. SCI. & TECH. 689, 701–02 (2008).

223. See POSNER, *supra* note 35, at ix. *But see* Note, *Organizational Irrationality and Corporate Human Rights Violations*, 122 HARV. L. REV. 1931, 1932–33 (2009).

224. See POSNER, *supra* note 114, at 79.

225. See *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986).

226. For an exception, see Maurice E. Stucke, *Behavioral Economists at the Gate: Antitrust in the Twenty-First Century*, 38 LOY. U. CHI. L.J. 513, 525 (2006) (advocating the use of behavioral economics in market analysis).

crisis.²²⁷ Although the passage of gargantuan stimulus packages, including the \$700 billion TARP, has eased the dearth of lending, credit remains more costly than before the onset of the recession.²²⁸ This phenomenon unquestionably implicates the ability of the market to respond to artificial distortions created by dominant-firm behavior. It limits the ability of markets to self-correct, and legitimately calls into question the exclusionary conduct of incumbent firms. Nevertheless, as noted above, the credit crisis will not last forever; already credit markets have sputtered back to life. As the flow of credit resumes, this factor will become defunct.

In sum, dominant-firm misconduct is a divisive area of antitrust policy and will continue to be so in light of the crisis. Nevertheless, the various causes of the recession—government distortions in the form of low interest rates and quasi-guarantees of mortgage providers, an influx of foreign capital, swathes of commercial activity not subject to regulatory oversight, the excessive complexity of financial derivatives that made them impossible to value, concentration and interdependence within the financial sector, and mark-to-market accounting rules—say nothing about the specific policies underlying Section 2 enforcement. The inability of the macroeconomy to self-correct, as explained above, emanates from a downward spiral in the event of deflationary pressures, and has little relation to the process by which antitrust markets self-correct by spurring entry.

Of course, given the indeterminism that characterizes the business phenomena at issue in abuse-of-dominance cases, the Justice Department acted reasonably in advocating more interventionist antitrust policy against monopoly and in withdrawing the prior administration's Section 2 report. Nevertheless, the proclaimed justification for the move—that the market will no longer self-correct—is either an obtuse or intellectually dishonest reading of the crisis.

227. Alan Greenspan, *Economic Focus: Banks Need More Capital*, *ECONOMIST*, Dec. 20, 2008, at 122.

228. *See id.*

4. *Political Repercussions*

Because nothing in the global market crisis necessarily seems to implicate microeconomic theory, at least insofar as distinguished from the embrace of political ideology, the only remaining question is whether political theory itself has been affected by the crisis. No doubt it has, although the precise long-run shift in ideology remains to be seen. Prior revolutions in competition policy have taken place amid larger sociopolitical changes. Faith in the free market—a critical feature of the post-Warren Court era—has unquestionably been undermined, with the result that the public, and hence politicians, are likely to become less accepting of dominance. Antitrust condemnation of potentially abusive monopoly behavior will surely intensify. In this political respect—and in this respect only—the agnosticism of the Chicago School may indeed be mortally wounded.

U.S. enforcement agencies have long spoken of a serious transatlantic asymmetry concerning the degree of faith properly placed in the market to yield desirable outcomes and the relative ability of regulators to remedy imperfections before the market can do so.²²⁹ Yet, there is already much talk of the U.S. antitrust regime becoming more harmonious with EU competition law. The shift in ideology brought about or facilitated by the crisis is, apparently, significant.

Although political reaction to the recession is worrisome in the United States, it is far worse in Europe—a jurisdiction that was likely predisposed against the free market principles that have long pervaded U.S. politics even before the crisis. In 2007, French President Nicolas Sarkozy succeeded in removing from the European treaty the explicit objective that the “Union shall offer its citizens . . . an internal market where competition is

229. See Kolasky, *supra* note 14, at 537 (“In the U.S., we have very little confidence in the ability of regulators to make these judgments, which would necessarily involve predictions far out into the future. U.S. antitrust agencies believe, in the immortal words of my favorite golfer, Tin Cup McAvoy, that they need to ‘be humble.’ The agencies also have more confidence in the self-correcting nature of markets. This confidence is especially strong when the markets are populated by strong rivals and strong buyers, who will usually find ways to protect themselves from an aspiring monopolist. This strong belief in markets and humility in their predictive abilities lead U.S. authorities to be skeptical of claims by rivals that a merger will lead to their ultimate demise and to demand strong empirical proof before we will accept such claims.” (footnotes omitted)).

free and undistorted.”²³⁰ An objective that the “Union shall establish an internal market” is all that is left in its place. This coup served as an effective backdrop to the ensuing crisis. Mr. Sarkozy has made clear that his rejection of Chicago principles is absolute, asserting that “[l]aissez-faire is finished. The all-powerful market that is always right is finished.”²³¹

The removal of the explicit free-market objective is a serious loss for EU competition policy, and for the European Commission in particular, whose efforts to combat member states’ promotion of state champions and attempts to bypass competition rules have been most valiant. As the global crisis lends substantive support to Sarkozy’s and others’ rejection of free-market competition, the myriad fruits of a dynamic single market will be diluted. Now, more than ever, U.S. promotion of free competition and the economic policy that supports it is needed.

CONCLUSION

The global credit crisis counsels a new direction to antitrust enforcement only if one engages in obtuse reasoning. Assertions that the market and capitalism have failed may be justified in the context of macroeconomic and regulatory policy, and certainly appeal to the populace, but they have no relevance to competition policy. The fundamental tenets of microeconomics that underlie modern U.S. antitrust jurisprudence remain unscathed.

The key to construing antitrust law in light of the crisis is to focus on the distinct role the market plays within this area of the law. Markets self-correct for antitrust purposes when monopoly conditions attract entry. The inability of the macroeconomy to self-correct promptly without government intervention following the 2008 crisis has nothing to do with entry into monopolized markets. It has to do with the urgent need for deleveraging, widespread uncertainty, and the well-understood inability of the market to recover independently from severe deflationary pressures. Though the economy has stabilized and will rebound modestly once the financial sector has sufficiently deleveraged, such recovery is also unrelated to

230. See *Lessons from a Crisis*, *ECONOMIST*, Oct. 4, 2008, at 55.

231. *Id.*

the idiosyncratic meaning of self-correction for purposes of competition law. Similarly, the market failure that gave rise to the crisis emanated from a wide variety of phenomena—none of which seems to implicate competition policy. Only if one defines “the market” in a wholly overbroad manner can the crisis be read as disproving the restorative nature of markets at the microeconomic level.

When one dissects the crisis with sufficient specificity, it becomes clear that minimal adjustment in competition doctrine is necessary under the rubric of economics. Obviously, the recession has no impact on the theory underlying the rules that currently govern concerted conduct. Cartels restrict output and create deadweight loss—effects that mirror and exacerbate the symptoms of a recession. Enforcers on both sides of the Atlantic have correctly vowed to condemn all instances of improper collaboration between rivals.

The more interesting issue concerns rules that should apply to merger clearance and unilateral conduct. In both fields, antitrust doctrine puts considerable faith in the market. Notwithstanding this fact, however, the market failure associated with the recession has no normative consequence for the antitrust assumption that monopoly conditions attract entry. The financial market meltdown has revealed that commercial actors avidly pursue courses of action that increase profit, at least in the short run. This phenomenon magnifies, rather than dilutes, the economic theory that informs contemporary antitrust rules. The only factor that supports more scrutinizing antitrust standards—the dearth of lending activity—is merely a short-lived symptom, rather than a cause, of the recession. If credit markets freeze, assumptions of entry into capital-intensive industries should be made with some caution.

Thus, enforcers’ denunciation of antitrust policy founded on free market ideals is misplaced. Although there are few, if any, normative insights to draw from the crisis as far as antitrust is concerned, the positive effect of the recession is apt to be far greater. Antitrust law, as a tool of public policy, inevitably will reflect the sociopolitical mood of the day. The free market principles of modern antitrust law may be anathema to those who have tired of unbridled capitalism. Nuanced arguments in defense of the status quo may fall on deaf ears. For those who advocate a more interventionist competition regime, the financial crisis provides the perfect backdrop for promoting an agenda

of aggressive enforcement. The new Justice Department and certain FTC commissioners seem to be making use of the opportunity. Of course, the crisis provides a false foundation for such enforcers to reverse course on precedent. Illustratively, the new Justice Department's rejection of the 2008 Section 2 guidelines cannot be tied to any specific teachings of the crisis, but merely to political interpretation. This rejection seems to mark the beginning of a larger movement toward a more intrusive antitrust policy, which is an unfortunate consequence of a crisis that requires no such result.