

EXTERNALITIES IN OPEN ECONOMY ANTITRUST AND THEIR IMPLICATIONS FOR INTERNATIONAL COMPETITION POLICY

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Competition policy has become the subject of increasing international attention, and members of the World Trade Organization ("WTO") continue to wrangle over whether to launch formal negotiations on competition policy under WTO auspices. In this paper, I address the wisdom of such negotiations and offer some preliminary thoughts about possible approaches to an international agreement.

The theoretical case for international cooperation is a powerful one and rests on the existence of substantial external effects from national antitrust policies in an open economy—an economy with international trade. It is difficult to imagine a mechanism short of international cooperation that could adequately address these important externalities, but it is also clear that international consensus on "optimal" antitrust policy is lacking in many particulars. Accordingly, I argue for a modest initial agreement aimed at encouraging all nations to formulate policy with reference to global rather than national welfare concerns where the two conflict. The legal principles most pertinent to that task would include non-discrimination, transparency, and due process requirements.

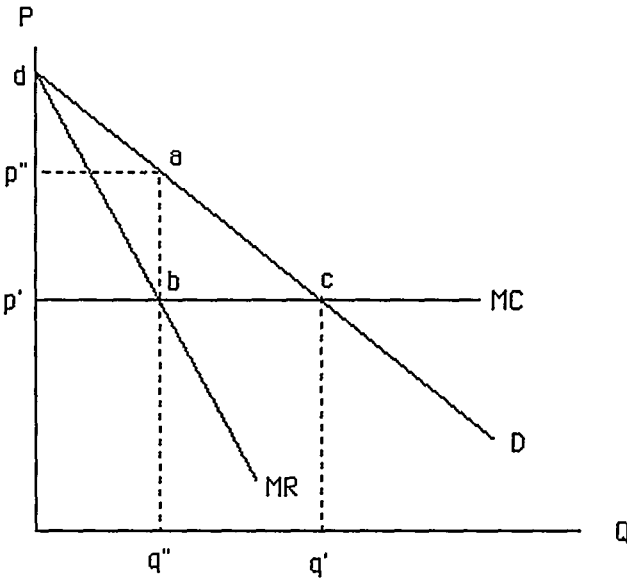
I. NATIONAL ANTITRUST POLICY WITH INTERNATIONAL TRADE

Every basic microeconomics course teaches the evils of monopoly, using a diagram such as Figure I. The standard exposition runs as follows.

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Under conditions of competition, an industry will produce to the point where the marginal cost curve (MC) intersects the demand curve (D), for that is the point at which price just covers the marginal cost of an additional unit of output. The quantity produced is q' at price p' , and "consumer surplus" is measured by the area dcp' . With single-price monopoly,¹ by contrast, the monopolist appreciates that all customers will enjoy any reduction in price. Its "marginal revenue" from an additional sale is thus less than the price received for that particular sale because of the price reduction that other buyers will enjoy. The monopolist will maximize profits by expanding to the point where marginal revenue just equals the cost of the marginal sales—to the point where MR intersects MC. At that level of output, q'' , the market clearing price is p'' . Consumer surplus is now dap'' , monopoly profit is $p''abp'$, and total surplus in the market is the sum of those two areas.

FIGURE 1



1. Alternatively, the monopolist may have the capacity to price discriminate among customers. With perfect price discrimination, price and output will be the same as under competition. With imperfect price discrimination, monopoly will still reduce output and raise price, though rather differently than described in the text.

The loss of social welfare relative to competition is then given by the "deadweight loss triangle" abc . This area represents a loss of consumer surplus to individuals priced out of the market by the monopolist. The further loss of consumer surplus, p^*abp' , is not a social loss but is a "transfer" to the monopolist who captures this amount as profit. If the monopolist expends resources in pursuit of the monopoly, however, it may dissipate some of its profit and the social welfare loss will be greater than just area abc . In any event, monopoly is demonstrably inferior to competition in this framework from the standpoint of economic efficiency, and it is on this basis that economists have long condemned it.

A moment's reflection will establish that this analysis of how monopoly affects social welfare rests on the implicit assumption that the welfare of the monopolist and the consumers in the market "counts" equally, so that a dollar transfer from consumers to the monopolist is a wash in the welfare calculus. Put differently, the analysis presupposes that "social welfare" is captured by the conventional measure of economic efficiency and does not depend on distribution.

This implicit assumption is open to challenge. Scholars have debated for years whether American antitrust policy should pursue economic efficiency single-mindedly or should instead pursue other goals that in some way take account of distribution.² And a lively debate exists regarding the intentions of Congress in enacting antitrust legislation.³

For the most part, however, the parties to this debate consider only antitrust policy in a *closed economy*, by which I mean an economy in which all consumers and producers are domestic citizens. Under such circumstances, one can plausibly argue that the surplus of all citizens counts equally and that aggregate efficiency should guide antitrust policy without regard to distribution—especially if superior policy

2. For excerpts from this debate, see chapter one of MILTON HANDLER ET AL., *TRADE REGULATION* (4th ed. 1997). The classic argument for an efficiency benchmark in antitrust is that of ROBERT BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* (2d ed. 1993). I offer a brief survey of the legislative history of American antitrust in Alan Sykes, *Antidumping and Antitrust: What Problems Does Each Address?*, 1998 BROOKINGS TRADE F. 1.

3. See *supra* sources cited note 2.

instruments exist to address distributional concerns.

But let us instead consider an *open economy*, in which goods and services may be traded internationally and producers and consumers may be of different nationalities. Does the efficiency argument against monopoly still hold? The answer is, "it depends," and it will turn on whose welfare "counts" in the formulation of policy. If "global welfare" is the proper criterion for implementing policy, then the analysis does not change at all, for the net gains and losses globally are as described in the discussion of Figure I. But if nations look to the welfare of their own citizens primarily or exclusively—the "national welfare" criterion—their view of monopoly may change dramatically.

For example, suppose that producers are foreign and that consumers are domestic. Then, the national welfare loss from monopoly is not simply the deadweight loss triangle abc —plus any dissipation of monopoly profit by the monopolist in securing the monopoly—but rather the full area p^*acp' . From the national perspective, monopoly is far more harmful when the monopolist is a foreigner (as the United States discovered during the heyday of OPEC). Alternatively, suppose that the monopolist is domestic and the consumers are foreign. Then, from the national perspective, the increase in profit to the monopolist is a national gain, and the harm to consumers is of no concern.⁴

I will skirt the normative question of whose welfare "ought" to count in the formulation of national policy and simply observe that, from a positive perspective, it is exceptionally unlikely that the welfare of foreign citizens will be weighted equally with the welfare of domestic citizens in the domestic political process. Foreign citizens do not vote in domestic elections, they cannot be taxed, they generally do not donate money to foreign politicians, and so on. Consequently, it will certainly be the rare case in which their interests are taken into account by domestic policymakers to the same degree as the

4. To be sure, the world may be more subtle—shareholders in the monopolist may be of many nationalities, for example, so the physical location of the monopolist's production facilities is not determinative of whose citizens earn the monopoly profit. Moreover, the monopolist may sell to consumers both domestically and abroad. Such observations, however, merely complicate matters without changing the basic point that, from the national welfare perspective, the welfare effects of monopoly may differ dramatically between the closed economy case and the open economy case.

interests of domestic constituents. This claim is not mere theoretical speculation, as we see innumerable manifestations of it in practice. Indeed, examples can be found in the antitrust statutes themselves. For instance, the Webb-Pomerene Act creates an exemption from the Sherman Act for cartels that operate exclusively in export markets.⁵

The implications of these observations are clear: not only will national antitrust policies have significant external effects in an open economy, but there is little reason to believe that national policymakers, acting on their own, will give much systematic weight to those external consequences in deciding how to behave. Accordingly, national governments acting on their own may tend to make decisions that promote the national interest—or at least the interests of their well-organized domestic constituents—at the expense of the global interest.

I have already offered the Webb-Pomerene Act's exemption for export cartels as an illustration of this problem, but it is important to recognize that it may surface in a variety of other, and typically less transparent, policy decisions. For example, a horizontal merger between two domestic companies that export extensively might reduce global welfare because of its tendency to produce higher prices, yet it may appear attractive to the government because the injured consumers are largely foreign. Similarly, if the same horizontal merger were efficient from a global perspective of economies made possible by the merger, foreign jurisdictions might nonetheless object to it because their consumers bear any rise in prices and do not realize any of the profits from cost savings in the merged company. One can develop numerous other illustrations.⁶

5. See 15 U.S.C. §§ 61-65 (1994).

6. See, e.g., Janusz A. Ordover & Alan O. Sykes, *The Antitrust Guidelines for International Operations: An Economic Critique*, 1988 FORDHAM CORP. L. INST. 4-1.

I wish to be clear that I am not claiming that national antitrust policy decisions are *in fact* made systematically on the basis of careful national welfare calculations. Many antitrust policies rest on no discernible welfare criterion, and indeed Janusz Ordover and I have argued that the U.S. Antitrust Guidelines for International Operations in particular cannot be understood with reference to either a global or a national welfare criterion. See *id.* Likewise, the tendency of the Antitrust Division of the U.S. Department of Justice to initiate cases against major exporters like IBM and Microsoft suggests that leniency toward national champions with the capacity to earn monopoly profits abroad is by no means systematic. Yet, there are enough examples of self-interested national policies and decisions (such as the Webb-Pomerene Act, Federal Trade Commission approval of the Boeing/McDonnell-Douglas merger, and the

The potential benefits of international cooperation in the face of this problem are obvious, and indeed one can conceptualize the situation as a classic Prisoner's Dilemma. Nations acting on their own will tend to pursue the national interest at the expense of the global interest, but if they could cooperate and credibly promise not to behave in that fashion, all nations would benefit on average. Thus, we can make out a case, at least in theory, for an international agreement committing its signatories in some fashion to pursue global welfare rather than national welfare.

II. WHAT LEGAL OBLIGATIONS ARE APPROPRIATE?

The task of structuring a useful international competition policy agreement is not a trivial one. I do not imagine for an instant that a treaty of the form "we promise to use global welfare as a touchstone for policy" would accomplish much or would be politically attractive to national officials. Rather, the task is to fashion an agreement that would promote that general objective, yet stand on much more precise and concrete obligations.

I cannot in this short piece hope to elaborate all the details and options for such an agreement,⁷ but I will suggest a few particulars. A central principle should be the "national treatment principle," which is simply a rule of non-discrimination. Here, it would require that nations not discriminate in their competition policy rules or enforcement actions according to the nationality of producers or consumers affected by them.

This principle has a number of immediate corollaries. For example, the Webb-Pomerene exemption for export cartels expressly discriminates in favor of cartels that burden foreign consumers only and could not survive under the national treatment principle. Likewise, a merger review policy that was more lenient toward mergers of firms that export a great deal would violate the national treatment obligation. A national

European Community challenge to it) to suggest that national policymakers do give more weight to domestic interests than to foreign interests, and indeed it would be surprising were it otherwise.

7. There is a large amount of literature on these issues. See, e.g., Eleanor Fox, *Competition Policy and the Millennium Round*, 2 J. INT'L ECON. L. (forthcoming Dec. 1999).

treatment obligation would also require nations to grant private rights of action to foreign nationals injured by anticompetitive conduct within the jurisdiction just as it does to domestic nationals.

A substantive commitment to national treatment is worthless unless deviations from that commitment can be detected. Accordingly, a useful agreement must embody certain "transparency" requirements, such as a requirement for the publication of decisions accompanied by a statement of reasons and a requirement that decisions be based on information in a public record. Such requirements make it harder for nations to violate their obligations without somehow signaling their wrongdoing. Related "due process" requirements, such as a requirement that all interested parties be given notice of proceedings and an opportunity to be heard, are useful to ensure that competition policy authorities and courts take account of the effects of their decisions on foreign nationals.

Finally, a dispute resolution system is required to afford some avenue for nations to enforce their rights under the agreement. One can readily imagine such a system modeled on that of the WTO, where international bodies of experts can review national decisions for compliance with WTO obligations.

Indeed, the WTO is probably the logical umbrella entity for the agreement, in part because of a fairly well-functioning dispute resolution system that is already in place. Further, by locating the agreement within the WTO, an opportunity for side payments arises that may sway nations otherwise reluctant to sign the agreement. Some nations may be hesitant to make commitments on competition policy because they may benefit on balance from opportunities to pursue national interests at the expense of global interests. Such nations can be "bribed" within the WTO by giving them concessions on market access issues involving trade in goods and services.

The framework outlined here, to be sure, will not resolve all issues, and some must no doubt remain unresolved for the time being. For example, there is no global consensus on the proper antitrust treatment of vertical restraints or on tight criteria for the treatment of horizontal mergers. Substantive differences in policy on these and other subjects will persist, and are, of

course, permitted under an agreement that merely requires non-discrimination, transparency, and due process.

Is an agreement along the lines sketched here realistic as a political matter? I do not know the answer to this question, and I certainly do not want to suggest that the United States should accede to whatever agreement might be put forward by others regardless of its terms. I suggest only that significant gains from cooperation on antitrust policy are possible in principle and that simple commitments on non-discrimination, transparency, and due process could realize some of them. Formal competition policy negotiations under WTO auspices would permit the trading community to determine whether such commitments are attainable in the near term.