Book Review

Imported Antitrust


Bruce M. Owen†

Background

Professor Gal, who teaches at the University of Haifa, has produced a delightfully clear and remarkably sensible book devoted to the problems of formulating competition policy, or antitrust law, in such small economies as Israel. Appreciating her contribution requires some background, which I will sketch out before describing the book in greater detail. Also, because Professor Gal has chosen to apply herself in this book to a problem of sharply limited scope, I will attempt to generalize some of her insights.

Market reforms are popular around the world now that communism is defunct. But markets do not work well if they are not competitive. Recent work by Wallsten and others, for example, demonstrates a striking cross-country difference in the performance of privatized firms, depending on whether they face competition; it appears that privatization alone accomplishes little. Antitrust law is regarded as necessary, therefore, to support such market reforms as privatization. Many countries have now adopted American-style competition policy, or its close European cousin, at least partly because there are few other models.

Although Professor Gal limits her focus solely to competition policy, and largely to countries with well-established and functional legal systems, the issues she addresses exemplify a broader class of difficulties associated with recent attempts to export Western legal systems to "transitional" (formerly Communist) or developing (formerly Third World) countries. Widespread agreement that the "rule of law" is an important economic goal for any country is based on influential analyses suggesting an

† The author is the Gordon Cain Senior Fellow in Stanford University’s Institute for Economic Policy Research. He was formerly chief economist of the Antitrust Division of the U.S. Department of Justice and has consulted with the World Bank and several developing nations on competition policy issues.


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important connection between economic success and legal structure, such as those associated with the economic historian Douglass North.\textsuperscript{2} Law that supports a productive and growing market economy is like the hidden steel scaffolding that supports a building. The design of the scaffolding is no less important to the size and stability of the building than the strength of the steel. In particular, the design must interactively support the building's other functional systems. In an economy, the link between the structure of law and the efficiency of economic activity is one of incentives that are based on expectations of what courts—or, more accurately, the legal system as a whole—will do in various contingencies.

An obvious example, coming back to antitrust, is price fixing. Antitrust law deters some price fixing by creating an expectation among sellers that collusion will be, with some probability, detected and penalized by fines and private damage liability. This reduces ex ante the expected profitability of price fixing. The optimal amount of undetected price fixing activity is not zero, however. Detection and punishment are costly and must be weighed against their social benefits. Also, there are trade-offs to be made between the severity of punishments and investment in detection. Most important, the costs of inadvertently deterring beneficial economic behavior that may be mistaken for price fixing, and other costly unintended consequences, must be considered. Both the substance of the law and the outcomes of particular cases matter economically because, and only because, of their effects on the incentives, mediated by expectations, of future economic actors. Clearly, designing a price fixing law and the associated enforcement regime that most nearly optimizes the incentives of economic actors is a technically challenging, fact-specific task. The result will be different from one context and country to another. The same considerations apply to laws on monopolization, mergers, and other restraints of trade.

From this it follows that there are three serious problems with the widespread importation of U.S.-style antitrust law.

\textbf{Problem T: Tailoring.} U.S. antitrust law and enforcement standards may be inappropriate in other economies with different business and economic environments. One example is merger policy in small and isolated economies where demand is insufficient to support multiple suppliers operating at efficient scales. Such problems are most serious in an economy isolated, by distance or otherwise, from trade—in other words, from foreign suppliers. This is the focus of Professor Gal's book. Nevertheless, transitional and developing economies present similar issues.

\textsuperscript{2} See \textit{DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE} (1990) [hereinafter NORTH, INSTITUTIONS]; \textit{DOUGLASS C. NORTH, STRUCTURE AND CHANGE IN ECONOMIC HISTORY} (1981).
Problem G: Geography. Sound antitrust analysis and enforcement must always focus on markets. Countries, economies and jurisdictions are not the same as markets. There is, for example, a world market for certain kinds of steel, while markets for ready-mix concrete are regional; neither corresponds to a jurisdiction. Very seldom do “relevant antitrust markets” correspond closely with jurisdictional boundaries. This creates technical problems in gathering information, threatens overlapping and potentially conflicting enforcement, and severely limits potential remedies. Far worse, it facilitates policy enforcement that promotes intra-jurisdictional economic welfare at the expense of extra-jurisdictional consumers. This problem worsens as globalization expands markets throughout the world. It takes an act of faith to conclude that antitrust enforcement within jurisdictional bounds is an improvement in global economic welfare. Yet international coordination and cooperation in competition policy is, essentially, nonexistent.

Problem L: Law. In any country, antitrust law must operate chiefly through its effects on the expectations and incentives of economic actors rather than through the direct regulation of each transaction. Therefore, the economic effects of antitrust policy are mediated by the legal system and other determinants of economic actors’ expectations. National legal systems are unique, both in substance and procedure, as are the economic and political histories that influence expectations. It follows that, even if they are “correct” for the United States or the European Union, standard antitrust policies are very unlikely to produce optimal results elsewhere.

Professor Gal quite explicitly devotes her book chiefly to problem T, as advertised, and does a nice job of it within the confines of “small economies,” as she defines them. She recognizes but does little to confront problem G, which is not surprising because problem G is likely to be intractable. Problem L is analytically interesting, important in legal reform generally, and probably tractable. However, she has almost entirely neglected problem L, a significant shortcoming in a book about antitrust policy. In deciding not to treat this crucial issue, unfortunately, Professor Gal is in the mainstream of antitrust commentary.

Problem T: The Need To Tailor Antitrust

Antitrust or competition policy is now de rigueur everywhere in the world. According to Professor Gal, roughly 100 nations already have, or are in the process of adopting, antitrust laws. These include countries as

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3 The process of defining the relevant market is a crucial first step in most antitrust cases. See, e.g., U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, HORIZONTAL MERGER GUIDELINES § 1 (1992, revised 1997) [hereinafter MERGER GUIDELINES].

large as China\(^5\) and as small as Trinidad and Tobago.\(^6\) The popularity of antitrust laws reflects the recent trend of market reforms and trade liberalization. In developing countries and former Soviet republics the establishment of competition enforcement policy has been successfully urged by the various multilateral development organizations.\(^7\) The United States Department of Justice and other U.S. agencies provide training programs and other assistance for the professionals in charge of establishing and enforcing these new laws.\(^8\) The E.U. competition authority also has advisory and technical assistance programs for developing countries.\(^9\)

The United States, by reason of having started earlier,\(^10\) has by far the most experience with and knowledge of competition policy, including a vast scholarly literature\(^11\) and many hundreds of reported cases. Not surprisingly, U.S. competition enforcement policies and the theories behind them have been widely adopted in other countries. This is not mere form. The professional staffs of most antitrust agencies have been trained in U.S. universities or by U.S. antitrust lawyers and economists. If one reads the reports of antitrust proceedings in, say, Costa Rica,\(^12\) one would be pressed to distinguish either the substance or the quality of the analysis

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7  In Argentina, for example, the World Bank insisted that the Executive Authority propose an antitrust law to the legislature as the condition for a loan to facilitate privatization of the steel industry. For the result, see ECONOMISTS INC., REPORT OF THE ADVISORY TEAM ON COMPETITION POLICY AND CONSUMER PROTECTION IN ARGENTINA (1992). The recommendations were enacted in 1999 but are now under review. See Law No. 25156, Aug. 15, 1999, [29233] B.O. 5. (Arg.).


11  The leading treatise is PHILLIP E. AREEDA & HERBERT J. HOVENKAMP, ANTITRUST LAW (rev ed. 1995).

12  TRIPARTITE COMM., ORG. OF AM. STATES, REPORT ON DEVELOPMENT AND ENFORCEMENT OF COMPETITION POLICY AND LAWS IN THE WESTERN HEMISPHERE 76-83 (2003).

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from that of analogous proceedings in the United States or the European Union.  

Professor Gal addresses Problem T chiefly in the context of “small [developed] economies,” as distinct from poor or transitional economies. She has written a timely and readable book explaining why the competition policies that have been adopted in smaller economies, based on the standard U.S. and E.U. models, may not be as welfare-enhancing as they could be. Her basic point is that U.S. antitrust law, and especially its enforcement standards, reflects policy choices appropriate for a very large domestic market in which economies of scale do not severely limit the number of competitive alternatives available to most buyers. The reverse of these conditions is found in smaller economies, developed or not, unless they are open to trade with close neighbors. Competition policy based on U.S. conditions may not be perfectly applicable to small economies in which domestic competition in goods and services is heavily constrained by production non-convexities and limited demand. In such economies, the chief source of competitive market discipline, actual or potential, is trade.

But Professor Gal is particularly interested in countries that are somewhat isolated from trade by boycotts, such as Israel, or by distance, such as New Zealand. In such economies, some product markets simply may not exist, and in others competition will not be attainable. On the other hand, small economies with free trade, such as Belgium, are only distinguishable from large economies by problem G, as discussed below.

Professor Gal offers a menu of alternatives to the potentially inappropriate application of U.S. or E.U. antitrust standards and policies.  

For example:

"Trade policy is one of the most effective tools available to small economies for dealing with the consequences of their small size."

"Small economies should strive to achieve economic efficiency as their main goal because they cannot afford a competition policy that is prepared to sacrifice economic efficiency for broader policy objectives."

"[S]tructural remedies to lower seller concentration should be limited when scale economies are significant."


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14 Much is made, by some, of substantive differences in the details of enforcement standards of U.S. and E.U. competition authorities. But these agencies, under pressure from unified academic economic opinion, have essentially similar approaches.
15 GAL, supra note 4, at 35.
16 Id. at 48.
17 Id. at 53.
strict policy . . . toward exclusionary practices” are beneficial. 18
“[S]implistic rules” such as reliance on competitive forces alone, are potentially mischievous. 19

This is good advice, of course, not only in small economies but in large ones as well. One of Professor Gal’s contributions lies in observing that, while a large or rich economy may be able to afford inferior competition policies, perhaps in exchange for other political goals, such policies may be less affordable in small or poor economies. Acknowledgement of this difference may help policy-makers in small economies assess the implications of adopting the policies of large economies.

Competition rules are often based on generalizations and legal presumptions. Such legal presumptions arise from limited enforcement budgets and the need to set clear guiding principles that go beyond the microeconomic theory on which all competition laws are now based. It is precisely this fact that underscores the need for different rules for small and large economies. The marginal cases of large economies are often, according to Professor Gal, the main cases of small economies, and thus different presumptions should drive the law.

The heart of Professor Gal’s book is three long chapters devoted, respectively, to monopolies and essential facilities, collusive behavior, and merger control. In these chapters, Professor Gal uses cases from the U.S., Europe, Israel, New Zealand, and other mostly developed jurisdictions to illustrate basic antitrust principles and policies. None of these chapters breaks new ground, but each addresses standard competition policy problems in ways that are especially sensitive to the constraints not only of markets with limited demand relative to the scale of efficient productive units but also of jurisdictions with limited enforcement resources. What is new here, essentially, is the application of accepted principles to the special circumstances of small economies. Specifically, Gal argues that in small economies greater weight should be given to economies of scale and other efficiency defenses, and that regulation, rather than antitrust, be used to control monopolies.

This material will be useful to antitrust enforcers anywhere, including in the United States, that want a careful and middle-of-the-road review of modern antitrust economics illustrated with real-world cases. It will be especially useful to newer antitrust enforcement regimes because it does not rely solely or uncritically on U.S. cases or U.S. policy preferences when it comes to enforcement standards. Indeed, one must ask whether this book is really about antitrust in “small economies,” as advertised, or

18 Id. at 54.
19 Id. at 55.
about antitrust analysis that is reasonably sensitive both to modern competition theory and to the conditions and characteristics of the individual product and geographic markets to which it is applied. While Professor Gal clearly has countries like Israel in mind, almost all of her prescriptions are as applicable to transitional and developing economies as to small, developed economies. In this respect, the book’s title is, perhaps, too modest. In fact, for reasons that will become clearer below, Professor Gal’s approach is no less useful even in large economies that contain within them markets of limited geographic size.

Professor Gal’s message in the end is clear enough: Competition policy in any country must be sensitive to the economic character of the particular product and geographic market in question. This message is not likely to come as a surprise to the lawyers and economists who staff the new antitrust agencies around the globe, but it needs to be understood by the law makers and political leaders to whom they report.

Problem G: Geography

In discussing “small economies,” Professor Gal, as noted above, chiefly means countries like Israel and New Zealand—that is, geographically small countries that are nevertheless part of the developed world. But small economies, in the sense relevant to Professor Gal’s book, are not limited to small countries. Indeed, Professor Gal’s use of the term “economy” is potentially misleading, and not merely because the word has no clear definition. Even the largest developed countries have small regional economies within them—areas within which the extent of the market for particular non-tradable goods and services is too small, relative to the minimum efficient scale of production, to allow much competition. (A non-tradable good or service cannot be supplied by firms located outside the market. Retail services provide an example.) This issue arises, of course, in product dimensions other than the geographic, but it is perhaps only geography that is relevant here. By the same token, there are many markets in tradable goods that are larger than the largest national economy. Automobiles and steel are examples. In these markets, domestic producers and their workers seek protection from imports at the expense of

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20 Contrast rural areas of the United States, where consumers have relatively limited selections of retail outlets, with urban areas.

21 Every market has a geographic dimension, defined by using the hypothetical monopolist paradigm with respect to location and transport costs. MERGER GUIDELINES, supra note 3, § 1.2. Most markets involve products differentiated by physical as well as geographic characteristics, and the extent of competition among them is limited in characteristic space, as it is in geographic space, by the density of consumer demand for the relevant characteristics in relationship to the location and scale of efficient production units. The analogy in characteristic space of geographic legal jurisdiction is the substantive jurisdiction of regulatory agencies, such as public utility commissions.
domestic consumers. Countries or jurisdictions are well-defined entities, and in antitrust analysis relevant markets are also well-defined.\(^{22}\) Any jurisdiction can be said to have an economy, but only an economy that is largely isolated is a coherent entity by itself, and even then only for geographic markets that extend no further than the country's borders.

Countries are jurisdictions within which antitrust enforcers have power over economic actors. Antitrust markets are composed of the alternatives available to consumers of a given product or service at a particular location plus the alternatives that would become available if current suppliers of existing alternatives were to raise their prices. Professor Gal rightly notes, of course, that market boundaries may coincide with political borders when those borders demarcate language or cultural preferences, as well as trade barriers.\(^{23}\) What political boundaries do usually determine, though not inevitably, is jurisdiction, so jurisdictions and antitrust markets may not line up, especially for small economies. Large markets may not be susceptible to effective national competition policy, and smaller ones are in danger of neglect or, perhaps worse, dual national and local jurisdiction. In an era of globalization, markets that are larger than jurisdictions are a growing problem.

Wherever jurisdiction to investigate possible competition problems may be assigned, it makes no sense to limit the analysis to part of the market or to ignore welfare effects that fall outside the market, as Professor Gal recognizes. Thus, essentially the same economic arguments that support trade liberalization also support international jurisdiction over competition problems whose effects are inter-jurisdictional. But achieving such an outcome is even more difficult than trade liberalization. Inefficient domestic producers and trade unions resist trade liberalization. Loss of domestic sovereignty over antitrust enforcement adds resistance from those who believe that antitrust law is, or ought to be, a bulwark against the specter of foreign neo-imperialism in the guise of globalization.

There is only one logical answer to the mismatch between relevant antitrust geographic markets and political jurisdictions: trans-national integration of competition policy at a regional or even global scale. Even if local antitrust analysts recognize the problem they face when markets (or more generally, the loci of persons who receive benefits or bear costs as a result of antitrust policy actions) do not coincide with borders, \textit{there is nothing they can do about it}, beyond seeking what may be a very obscure second-best solution. Local laws focus on local effects in order to

\(^{22}\) According to the hypothetical monopolist paradigm in the Merger Guidelines, a relevant market is "a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products . . . likely would impose at least a 'small but significant and non-transitory' increase in price." \textit{Id.} § 1.11.

\(^{23}\) \textit{GAL, supra} note 4, at 6.
constrain law enforcement and respect national sovereignty. Inter-jurisdictional cooperation will not work when costs and benefits are distributed asymmetrically across jurisdictions. Professor Gal, taking a pragmatic view of all this, focuses simply on domestic welfare effects.

Professor Gal’s focus on domestic welfare effects conforms to trends in modern antitrust scholarship. Modern antitrust enforcement policy was revolutionized in the last generation by its adoption of a welfare-economics approach. It is this modern, welfare-oriented policy that has been swept up and internalized by the newly-established competition agencies around the world. This technology transfer was successful because the economic principles are universal, as are some of the investigative and screening techniques employed by U.S. and E.U. law enforcers in the price fixing and merger analysis areas. In contrast, the case law is not readily transferable. As U.S. case law is burdened not merely by the unique economic context of U.S. markets but also by various substantive flaws, it is probably a good thing that it is not transferable. Even so, as Professor Gal points out, one cannot import U.S. antitrust policies (and especially enforcement standards) as if the economic context in every country were the same as in the United States.

There is a deeper problem with the global adoption of competition policy modeled on U.S. antitrust technology. While U.S. federal antitrust enforcement policy is now largely welfare-oriented, it is oriented toward the welfare of domestic consumers. It is ambivalent at best toward domestic producer welfare, and it is largely antagonistic to the economic welfare of foreign consumers. For example, export cartels are exempted from U.S. antitrust liability, and the evaluation of proposed mergers of U.S. companies does not take into account either costs or benefits to non-U.S. consumers. For this and other reasons, the adoption of domestic

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24 The antitrust law of the Ninth Circuit is often mentioned in this respect. See, e.g., Herbert Hovenkamp & Avarelle Silver-Westrick, Predatory Pricing and the Ninth Circuit, 1983 ARIZ. ST. L.J. 443 (1983). For other examples, see ROBERT BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF (1978). While many of Bork’s examples are dated, the relatively recent Supreme Court decision in Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451 (1992), arguably fits this mold as well. In Kodak, because of a lack of supporting evidence, the Court rejected the standard economic argument that sophisticated buyers would consider both original equipment costs and future repair costs in purchasing a copier, therefore enabling Kodak to “monopolize” the “market” for its own spare parts, despite the intense competition in the copier market. Id. at 465-78.

25 This is an important issue in Schumpeterian competition, where firms compete through innovation for the whole market.


27 See Brief for the United States as Amicus Curiae Supporting Petitioners, F. Hoffmann-La Roche Ltd. v. Empagran S.A., No. 03-724, 2004 WL 234125, at *28 (filed Feb. 3, 2004) (“[T]he central purpose of the antitrust laws is to protect consumers, competition, and commerce in the United States.” (emphasis in original)) (citing Pfizer Inc. v. Gov’t of India, 434 U.S. 308, 314 (1978) (“Congress’ foremost concern in passing the antitrust laws was the protection of Americans...”)); see also 1A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW § 272h (rev. ed. 1995) (“The
consumer welfare as the sole objective of competition policy in every
country around the globe is incompatible with global welfare optimization
because such policies fail to internalize economic effects that spill over
national borders.

With increased international trade and deepening economic
interdependence has come pressure for harmonization and coordination of
competition policy. This pressure arises largely from the private sector,
which fears expensive and slow parallel reviews of proposed transactions
and possible inconsistent standards and policies in other matters. As
antitrust regimes and merger notification provisions have proliferated,
there has been a growing chorus of complaints from lawyers and
executives of multinational firms about the cost and delay involved in
undertaking merger transactions.28 Both transactions costs and delays
burden trade by increasing the costs and risks of firms participating in
international markets. In addition, domestic producers and sympathetic
officials often erect entry barriers impeding foreign producers. For this
reason, negotiations on customs unions almost always include provisions
calling for harmonization of competition policies. Analogous problems
complicate investigation and deterrence of international cartels.

One remedy for these problems lies in a supra-national coordination
mechanism or an international competition authority. The former would
reduce delays and procedural burdens, while the latter would, as in the
European Union, impinge on sovereignty. Professor Scherer urged this a
decade ago, and he was not the first.29 The World Trade Organization, for
example, has procedures responsive to the concern that local exclusionary
practices might tend to substitute for formal trade barriers in limiting entry
of competitive foreign suppliers and that such practices should be
discouraged by competition policy agencies.30 Subsequently, there has
been great debate about international antitrust policy, especially in the
context of the successive rounds of trade talks.31 Singh provides a recent,
well-argued case for international antitrust enforcement.\textsuperscript{32} Others are skeptical.\textsuperscript{33} The Doha round of talks, in spite of all this concern, has made no serious progress on a trans-national system of antitrust enforcement, and apparently there is little prospect for any in the future.\textsuperscript{34}

What would a trans-national competition policy regime look like? There are two operational models for trans-national antitrust policy: the United States and the European Union.\textsuperscript{35} These two systems strike different balances between state and federal interests. On the issue of geographic jurisdiction, the U.S. system gives the attorneys general of the fifty states the same authority to investigate and take action under federal law against any national merger, for example, as it gives the two federal agencies.\textsuperscript{36} Not only do individual state attorneys general have the power to enforce \textit{federal} law, and not merely in their own states, but they also usually have \textit{state} antitrust laws that may differ in some respects from federal law. This duplicative jurisdiction can produce mischief. The state attorneys general can and do hold up merger transactions, for example, in order to obtain parochial concessions unrelated to competition policy.\textsuperscript{37} They also sometimes bring antitrust actions under economic theories and legal interpretations that are in disfavor at the national level or within academia. In the European Union, by contrast, Brussels can preempt the member states.\textsuperscript{38} However, some member states—notably Germany and Great Britain—take local enforcement very seriously.\textsuperscript{39} In general, U.S. states are less restrained than federal prosecutors by fear of setting adverse precedents or offending proponents of economic efficiency.

The lessons from the U.S. and E.U. experience, however, is that member states do not easily give up antitrust jurisdiction and that, where

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\textsuperscript{34} Edward Swaine, \textit{Against Principled Antitrust} 2-3 (Univ. of Pa. Law Sch., Inst. for Law and Econ., Research Paper No. 03-06, 2003). \\
\textsuperscript{35} On the European system, see David J. Gerber, \textit{Law and Competition in Twentieth Century Europe: Protecting Prometheus} (1998). \\
\textsuperscript{37} It is difficult to document these cases because they usually involve private or even tacit threats and settlements. The author witnessed one such event, in which a state official withdrew a threat seeking an antitrust injunction against a proposed merger in return for a promise to keep open a local manufacturing facility making products unrelated to those involved in the merger. \\
\textsuperscript{38} See Gerber, \textit{supra} note 35, at 394. \\
\textsuperscript{39} See \textit{id.} at 413.
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jurisdiction is concurrent or "coordinated," federal and state authorities may pursue quite different, even contradictory, goals. Most polities see antitrust policy as too important to be left solely to international or federal agencies. Highly visible transactions, unpopular marketing methods, and alleged monopolists with poor public relations skills (such as Microsoft) make attractive targets for politically ambitious local prosecutors. Neither in the United States nor in the European Union are member states' jurisdictions limited to markets wholly within their borders. This is not a satisfactory model for an international approach to competition policies affecting producers or consumers in multiple countries. 40

An interesting question for future research is whether the infeasibility of an appropriate trans-national forum in competition matters affecting multiple jurisdictions justifies, as a second-best policy, multiple local jurisdictions each ignoring the external effects of its policies. Of course, just as in the United States and the European Union, a preference for federalism is likely to lead to some degree of dual jurisdiction between any international agency and national or local authorities. But such an outcome is unlikely to lead to worse effects than having national authorities put effectively negative weight on the welfare of foreign consumers.

Problem L: The Law

The foregoing suggests that antitrust policy in a jurisdiction of any size should be tested against a somewhat more general standard than the normal but modest one tacitly accepted by Professor Gal—essentially, whether it makes sense in the market in question. More importantly, antitrust is but one of a range of policy instruments, including virtually all of what we call civil and criminal law, that can be used to mitigate market failures. In this Section I will leave Professor Gal's book temporarily to one side because it does not address developing economies, even though

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40 While considerations of political sovereignty are likely to remain an insurmountable barrier to true integration of competition policy, nevertheless there exist efforts to exchange non-sensitive information and experience. For example, the International Competition Network describes its functions, on its website, as follows:

The International Competition Network (ICN) provides antitrust agencies from developed and developing countries with a focused network for addressing practical antitrust enforcement and policy issues of common concern. It facilitates procedural and substantive convergence in antitrust enforcement through a results-oriented agenda and informal, project-driven organization.

The ICN brings international antitrust enforcement into the 21st century. By enhancing convergence and cooperation, the ICN promotes more efficient, effective antitrust enforcement worldwide. Consistency in enforcement policy and elimination of unnecessary or duplicative procedural burdens stands [sic] to benefit consumers and businesses around the globe.

they are, of course, "small." Neglecting to understand and account for the effects of law on economic incentives is far more tragic in developing economies than in countries that have grown rich on fortunate but unintended compatibilities between law and economic growth, where the neglect is merely academic.

In the developing world, the failure of the economic system to deliver a decent standard of living to most of the humans on the planet appears to be traceable in significant part to the absence of decentralized, unregulated markets, and especially competitive markets. These economic failures probably show us what any economy, including that of a developed nation, would look like absent effective legal institutions that reduce risk and uncertainty, internalize externalities, and align individual incentives with the conditions for efficiency and growth.

The revolutionary global market reforms of the 1990s, made possible by the collapse of the only rival economic model, have begun slowly to change this situation. But markets do not operate perfectly. The improvements brought by competitive markets also bring costly dislocations, and people understandably use political tools at their disposal to resist being subjected to competitive pressures and costly adjustments. Economic policy interventions in markets become not just useful but inevitable.

The economic learning that underpins modern antitrust policy has broad relevance that extends beyond cartels and monopolists. It is equally useful in managing externalities through the operation of environmental and land use law, in deciding how to enforce contractual arrangements, in mitigating the consequences of asymmetric information and opportunism, in creating or enhancing investment incentives, in designing incentive-compatible regulatory regimes, and in implementing a range of other patches and inoculations of markets riddled with real world imperfections. Understanding how and when to apply these patches requires the same skills as modern antitrust analysis, largely because an understanding of and faith in competitive markets are key ingredients of successful policies and laws compatible with efficient incentives.41

41 Because of this, antitrust professionals may do far more good advocating competitive market solutions to economic problems throughout the government than if they limit themselves to antitrust enforcement. The experience of the United States in this respect is quite instructive. There have been startling improvements in the competitive performance of those regulated industries, such as securities exchanges, transportation, and telecommunications, where the Antitrust Division advocated competitive market solutions early and often, starting around 1970. In contrast, regulated industries where the Antitrust Division advocated competitive solutions later or on a more limited scale, such as electricity generation and transmission, have improved their performance much more slowly. Competition advocacy has been a key, perhaps a necessary, ingredient in the successful deregulation of large sectors of the U.S. economy. For a recent discussion of the competition advocacy programs of the Antitrust Division and the Federal Trade Commission, see ANTITRUST DIVISION, U.S. DEP'T OF JUSTICE, ANTITRUST DIVISION MANUAL ch.5 (3d ed. 1998), available at
Whatever else it may be about, law is about economic incentives. It is widely believed that Western legal systems have promoted economic growth;\textsuperscript{42} certainly they have not prevented growth. There are some clear examples of how this works. We know that where well-defined and readily transferable private property rights exist, markets work more effectively. We have as supporting evidence the collapse of the socialist economies of the former Soviet Bloc as well as the failures of many utopian experiments elsewhere. Similarly, the invention of the limited liability company, which required grudging changes in legal institutions, promoted greater efficiencies of scale in manufacturing and commerce.\textsuperscript{43}

The general mechanism by which these legal structures affect economic activity is no mystery. A person who expects the state to protect his right to retain the rewards of his efforts or investment works harder or invests more than one who does not have such expectations. The same is true if a person expects the state to protect her human rights, such as freedom from racial discrimination or arbitrary confinement, because that increases the returns to her investments in human capital. A person is less likely to invest in an enterprise over which she has little managerial control if all her personal assets are at risk than if only her investment is at risk.

A society that uses law to remedy market imperfections must recognize that law enforcement has its own costs, and these costs dictate that most of the welfare-enhancing effects of law be felt as incentives rather than controls. Controls are generally too expensive and require too much information. In the criminal law, incentive effects underlie the well-known concept of optimal deterrence. In civil law, using law as a remedy for market failure in torts, contracts, and property requires close attention to the Coase theorem, so that rights, created to internalize all external economic effects, are assigned initially to efficient holders, in the likely event that transactions costs are significant. Efficient laws create incentives compatible with efficient decisions by economic agents that are based on agents' expectations regarding the future behavior of courts and other law enforcement institutions.\textsuperscript{44}


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necessary ingredient in economic growth. All economic decisions are based on expectations, because most of the consequences of decisions lie in the future and nothing can be certain in the future. The economic role of the law is, in many cases, to facilitate prediction by reducing uncertainty. If a promisor breaches in circumstances for which the contract is silent, the promisee will have remedies that are more clearly defined and thus more certain under contract law than in its absence. In other cases, the law perfects economic interests in the results of economic activity. Time and money invested in education or training cannot be destroyed by discriminatory employment practices or unjust imprisonment. There are many other examples. What they have in common are substantive legal rules compatible with economically efficient incentives and a corresponding understanding, based on belief and experience, of the likelihood that the law will be applied and enforced. It does not matter what the substance of the law is if no one expects it to be enforced or if it is subject to easy and frequent change. Economically efficient law thus requires not merely substantive soundness but also the effective management of expectations, which are often achieved through procedural norms.

Antitrust is an easy case for the application of these principles. Antitrust law deals chiefly with price fixing, monopoly, and increased concentration through merger, in essence behavior that drives inefficient wedges between prices and marginal costs. If we ignore its populist and redistributive motivations, as it is today fashionable to do, antitrust law is the paradigm of a legal approach to correcting or at least mitigating a particular species of market failure.

Even if antitrust has the same competition-promoting and efficiency objectives from one country or “economy” to another, both the substantive laws and the enforcement standards must differ in order to conform to the differing factors affecting local agent incentives and, no less important, to reflect the differences in the legal systems. In the United States a federal prosecutor considering whether to bring a particular antitrust case before a court will consider the merits of the case: whether the necessary facts can be proved, whether there is an appropriate remedy, whether the case is the most effective use of scarce budget dollars, and so forth. But in addition, the prosecutor will consider the effects of bringing or not bringing the case

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45 This requirement is discussed from a number of angles in WILLIAM EASTERLY, THE ELUSIVE QUEST FOR GROWTH: ECONOMISTS' ADVENTURES AND MISADVENTURES IN THE TROPICS (2002).

46 Gal argues, as noted above, that small economies are less able than large ones to afford non-efficiency objectives in antitrust. This is correct but understates the point. It is very difficult to find philosophical justifications for the sacrifice of efficiency (and therefore consumer welfare) in pursuit of other goals, no matter what the size of the economy. See generally LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE (2002).
on two other very important matters. These matters are, first, how the case will affect the expectations of non-party economic agents with respect to future enforcement actions and the resulting change in agent incentives; and second, how the case will affect the law itself if the case is won or lost. Such considerations are often dispositive, and rightly so. Indeed, if there is a choice between the "correct" outcome of a proceeding, viewed narrowly in terms of the welfare of the parties, and the establishment of "correct" incentives for non-parties based on the outcome of the matter, economic analysis strongly favors the latter "correctness" over the former.

If we assume for the sake of argument that U.S. antitrust laws and enforcement standards are economically optimal for the U.S. economy and the U.S. legal system, it follows that U.S. antitrust laws and standards almost certainly are not optimal for every other country. Even if the business environment and other relevant circumstances were the same in other countries as in the United States, legal systems are sui generis. For example, if we assume the treble damage remedy in U.S. antitrust law for price fixing victims yields exactly the correct level of deterrence for U.S. price fixers, it is quite likely to be entirely inappropriate in Gondwanaland, where all judges are understood to be corrupt, as well as in other countries for other reasons.\(^47\) Similarly, antitrust doctrines based on assumptions about the computational limitations of U.S. civil courts, such as *Illinois Brick v. Illinois*,\(^48\) may be inappropriate in a country that relies instead on antitrust enforcement by an expert agency utilizing administrative law.

What is also remarkable about discussions of antitrust policy in any jurisdiction is that they are often conducted as if all economic actors will adhere to the law, such that the sole requirement for successful antitrust policy is a sensible set of statutes and enforcement standards. But a law to which everyone adheres, like a law to which no one adheres, is almost certainly either a bad law or a good law badly enforced. Enforcement has costs, and enforcement decisions are made on imperfect information. The


\(^{48}\) 431 U.S. 720, 736-48 (1977) (barring downstream customers’ recovery of treble damages for price fixing markups felt initially by resellers).
same is true of decisions to adhere to a law. It follows that there will, with respect to any law, be an optimal degree of unlawful agent behavior. The management of this tradeoff between enforcement decisions (including enforcement expenditures) and the resulting costs of unlawful behavior is complex and necessarily feeds back on the choice of substantive law, because some kinds of laws can be enforced with greater clarity, creating better-defined and more certain agent expectations, than others. An obvious example is the comparison of a law that gives judges no discretion in criminal sentencing with one that gives judges broad discretion. In antitrust law, a good example is the FTC/DOJ Merger Guidelines, which increase the precision with which private parties can predict how the government will exercise its prosecutorial discretion.

Professor Gal addresses these problems in the sense that she emphasizes the importance of taking into account the extent of the market relative to efficient scale and other such economic matters that vary by country. She does not, however, consider the differences among jurisdictions in the relationship between courts or administrative agencies and the formation of expectations among economic agents. This is a significant omission.

Professor Gal is hardly alone in neglecting the microeconomic process by which law influences behavior. A great effort has been under way for the past decade to export not only U.S. antitrust law but whole sectors of U.S. and European commercial and civil law to the so-called transition economies of Eastern Europe and the poor nations of the developing world, as noted above. Many leading academics, lawyers, and economists have worked hard on these efforts, and substantial support has come from international development agencies and unilateral donors. This effort is based in large part on the statistical correlation that appears to exist between "good institutions"—in other words, the rule of law—and successful development. The effort is not based, generally speaking, on a close examination of the ways in which it would be useful for economic agents to behave and on how laws and law enforcement might influence agents’ incentives to those ends. Of course, it is far easier to export Western law than to design new laws more sensitive to local conditions or to consider more effective ways of implementing indigenous laws.

Antitrust is but one example of a persistent blindness of legal scholars


and economic development specialists alike to the central role of law in channeling the behavior of all those who are never touched directly by it. Basic human rights have strong deontological justifications, for example, but their chief welfare effect may depend on the link between increased personal security and stronger savings and investment incentives, especially in human capital formation. High-level principles will do little or no economic good—that is, they will not reduce poverty or other miseries—if they do not work their way down to a change in the expectations and therefore the incentives of agents. A statute may be enacted or a constitution amended with no effect whatever on the economic well-being of the people.

Much of the recent transfer of law from developed nations to developing and transitional nations has been the mere adoption of poorly understood and almost certainly inappropriate statutes (and constitutions). Little or no attention has been paid to the likely effects, if any, they have on the expectations, and therefore the incentives, of people. This is sloppy work because the problems are tractable. Expectations themselves can, albeit with difficulty, be measured. For example, survey techniques can determine whether men and women expect a new statute protecting women’s rights to be enforced by local courts. It is these expectations, not the substance of the law, that determine the law’s effects, if any, on domestic violence or sex discrimination in employment. Incentives, while not directly observable, lead to changes in economic behavior, which also can be measured on a micro level. It is not difficult to imagine ways in which the analytical and empirical tools of social science could assess in a particular context the effectiveness of different substantive laws and different combinations of enforcement and publicity aimed at achieving specified goals, such as a shift from child labor to increased school attendance.

Thus, it may be more cost-effective to provide for the predictable enforcement of existing imperfect indigenous laws than to introduce new ones. The effect of introducing a new law, abstracting from substance, tends merely to reinforce the jaded view that formal laws have little relationship to reality and are thus easily changed to suit the current fashion in donor preferences or elite interests. No one rationally changes expectations on the basis of laws so easily and frequently changed. Similarly, mere statutes do not protect rights in the face of jury or judicial lawlessness, which undermines efficient incentives to develop rights in the first place.

For an example of such a study, based on an examination of legal aid clinics for poor women in Ecuador, see Bruce M. Owen & Pablo Portillo, Legal Reform, Externalities and Economic Development: Measuring the Impact of Legal Aid on Poor Women in Ecuador (Stanford Law Sch., John M. Olin Program in Law & Econ., Working Paper No. 255, 2003).
Further, even a well-designed law that is enforced predictably can have little effect on general expectations and incentives if credible information about it is not readily available to the public, either directly or through opinion leaders and professional intermediaries. Thus, again, it may turn out to be more cost-effective to design and implement credible means of disseminating accurate information about existing law and law enforcement than to reform the laws themselves. In short, there are economic tradeoffs among these inputs into the process of creating incentives more compatible with economic efficiency and growth. It is surely wrong and even irresponsible to put all the emphasis on the intellectual substance of the law, while neglecting its effects on the majority of people whose chief purpose it is to affect—all those who never meet a prosecutor or see the inside of a civil courtroom.

The problems of Tailoring, Geography, and Law stand between all the world's people and those improvements in their welfare that can be achieved through competitive global markets. While problems G and L are not at all unique to competition policy, and Professor Gal is in good company in ignoring them, the future success of both competition policy and other legal reforms intended to support competitive markets and development depends critically on greater attention to the details of jurisdiction and of influencing economic behavior by changing expectations. The latter is far from being a revolutionary idea. As Oliver Wendell Holmes, Jr. put it more than a century ago, "The prophecies of what the courts will do in fact, and nothing more pretentious, are what I mean by the law."52 These prophecies are the levers by which law influences economic behavior, for good or ill.

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52 Oliver Wendell Holmes, Jr., The Path of the Law, 10 HARV. L. REV. 457, 461 (1897).