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Josh Wright's "Chicago School Papers": An Overview

William H. Page
University of Florida Levin College of Law, page@law.ufl.edu

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By William H. Page

Marshall M. Criser Eminent Scholar, University of Florida Levin College of Law.

In what follows, I consider three of Commissioner Wright's "Chicago School Papers." In these papers, Commissioner Wright considers the past, present, and future role of the Chicago School of antitrust analysis in the shaping of law and policy, offering along the way some interesting insights into what his priorities at the FTC are likely to be. The papers discussed have common themes: the mischaracterization of the "Chicago School," the scientific advantage of dispensing altogether with "School" labels, and a focus on empirical findings in shaping antitrust analysis.

1. Joshua D. Wright, Overshot the Mark? A Simple Explanation of the Chicago School's Influence on Antitrust, 5 Competition Pol'y Int'l, no. 1, Spring 2009, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1370641

The first paper challenges essays collected by a former FTC Chairman, Robert Pitofsky, *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust*. The essays argue, in various contexts, that the Chicago School has won over the courts to a conservative, minimalist antitrust agenda that ignores evidence of consumer harm, and that the Post-Chicago school literature provides a better basis for antitrust policy. Wright argues that the choice between theories should be based on which theory has the best empirical support. On that standard, he argues, the Chicago School wins, because it "provides a more robust theoretical and empirical account of the business practices we observe in the real world along with their competitive effects." The standard also refutes the simple characterization of the Chicago School as conservative in the pejorative sense of skewing inquiry away from demonstrable consumer harm.

Wright begins with a useful history of the Chicago School of industrial organization economics, which refuted the dominant structure-conduct-performance paradigm in the 1970s,[2] and the Chicago School of antitrust analysis, initiated by Aaron Director,[3] developed more fully by Richard Posner,[4] Robert Bork,[5] Frank Easterbrook,[6] and Benjamin Klein (and his many co-authors, including Wright).[7] These analyses have transformed antitrust by eliminating or eroding per se illegality of vertical restraints and placing merger analysis on a sounder economic footing.

He compares this body of work to Post-Chicago antitrust, which has shown that some vertical restraints can reduce efficiency by raising rivals' costs in certain defined circumstances.[8] These

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[2] Yale Brozen et al., Concentration, Mergers, and Public Policy (1982); Harvey J. Goldschmid et al., Industrial Concentration: The New Learning (1974).

[3] Aaron Director & Edward H. Levi, *Law and the Future of Trade Regulation*, 51 Nw. U. L. Rev. 281 (1956).

[4] *See, e.g.*, Richard A. Posner, *The Chicago School of Antitrust*, 127 U. Pa. L. Rev. 925, 928 (1969).

[5] *See, e.g.*, Robert H. Bork, The Antitrust Paradox: A Policy at War with Itself 117 (The Free Press 1993) (1978).

[6] *See, e.g.*, Frank Easterbrook, *The Limits of Antitrust*, 65 Tex. L. Rev. 1 (1984).

[7] *See, e.g.*, Benjamin Klein & Joshua D. Wright, *The Economics of Slotting Contracts*, 50 J.L. & Econ. 473 (2007).

[8] *See, e.g.*, Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 Am. Econ. Rev. 837 (2000); Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 Yale L.J. 209 (1986).

results are the basis for the suggestion that the Chicago School "overshot the mark" in excusing certain practices. Although Post-Chicago analysis has had wide influence in economics departments and in European competitive law, it has relatively little influence on American antitrust, apart from *Image Technical*.[9]

Wright is at pains to refute the characterization of the Chicago School as a branch of conservative ideology. Instead, he insists that it is scientifically based in price theory, empirical verification, and error cost analysis. In the heart of the paper, he offers evidence to support Chicago-inspired reforms of recent years. For example, some Post-Chicagoans have criticized the abandonment of the per se illegality of resale price maintenance, arguing that the need to control free riding by discount retailers does not explain many if not most of the uses of the practice. Wright responds by pointing to studies showing that, even in the absence of free riding, dealers may not provide the optimal level of promotional services, (1) because their profit margin on promotional expenditures is typically less than the manufacturer's margin, and (2) because those expenditures will increase sale of the manufacturer's product at the expense of its rivals' products, even when the expenditures do not increase the retailers' overall sales.[10] In these circumstances, the manufacturer will have a procompetitive reason for using RPM (or some other practice, like slotting fees) to compensate dealers for providing additional (albeit unspecified) promotional services.

Although there are anticompetitive theories of RPM, Wright suggests that the justification for a per se rule depends on the relative frequency of the anticompetitive uses. He points to two surveys of the empirical literature that conclude that RPM usually benefits consumers. In a passage that may shed light on his approach to his new job, Wright concludes:

> A scientific, Bayesian approach to the design of optimal antitrust policy requires that we update our prior beliefs based on the available empirical evidence. In order to select the best performing economic models from those available, antitrust decision-makers must rigorously examine the existing evidence. In the context of RPM and vertical restraints, it is impossible to evaluate the existing empirical literature without reaching the conclusion that these practices are nearly always efficient.

In another section, Wright reviews Post-Chicago theories showing that exclusive dealing arrangements can inefficiently exclude rivals, particularly when it is hard for dealers to coordinate a rejection of the exclusionary proposal or when manufacturers can compensate dealers for their participation in exclusion.[11] He then reviews the literature showing efficiency justifications for exclusive dealing, including by promoting dealer loyalty.[12] Although the empirical literature is thinner, Wright suggests that it favors the efficiency explanations rather than the Post-Chicago "possibility theorems."

In a final section, he rejects the argument that the conservative ideology in Chicago School analysis has misled the Supreme Court in cases like *Brooke Group*,[13] *Leegin*,[14] and *California Dental*,[15] to adopt unduly sweeping rules favoring legality. In response, Wright points to the vot-

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

[10] *See, e.g.*, Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & Econ. 265 (1988).

[11] *See, e.g.*, Eric B. Rasmusen, Mark J. Ramseyer & John Shepard Wiley Jr., *Naked Exclusion*, 81 Am. Econ. Rev. 1137 (1991).

[12] Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 Antitrust L.J. 311 (2002).

[13] Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

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

[15] California Dental Ass'n v. FTC, 526 U.S. 756 (1999).

ing record on the Court, particularly in recent years, when essentially of the Court's decisions other than *Leegin* were decided by supermajorities that included the Court's more liberal justices.

2. Joshua D. Wright, The Chicago School, Transaction Cost Economics and the Roberts Court's Antitrust Jurisprudence, *in* The Elgar Companion to Transaction Cost Economics 230 (Peter G. Klein & Michael E. Sykuta eds., 2009), http://ssrn.com/abstract_ id=1144883

In the second article under consideration here, Wright covers some of the same ground, but focuses on the relationship between the Chicago School and both Transaction Cost Economics (TCE) and New Institutional Economics (NIE), which takes account of transaction costs in comparing institutions. The Chicago School, although based on price theory, has taken account of transaction costs, particularly in Benjamin Klein's many studies of vertical restraints. Non-Chicago scholars in the NIE tradition (e.g., Oliver Williamson) and TCE (Paul Joskow) have also influenced antitrust, but Wright argues that there has been a Chicago School/TCE revolution in antitrust reflected in Roberts Court decisions.

The ensuing discussion of *Leegin*, *Twombly*,[16] and *Weyerhauser*,[17] has surprisingly little to say about the role of transaction costs specifically, apart from highlighting *Twombly*'s reference to the high costs of discovery in antitrust cases as one reason for tightening pleading standards. At the end of the paper, however, Wright indicates that he finds an awareness of the role of transaction costs implicit in the Court's "institutional modesty":

> Each of the three decisions is motivated, at least in part, by the possibility of chilling procompetitive conduct by erroneously assigning liability to efficient conduct. A corollary is that the Court, again in each of the cases but especially *Leegin*, is sensitive to what is known and unknown about the competitive effects of RPM and other contractual arrangements. The combined affinity for price theory and TCE, emphasis on empiricism and knowledge, and institutional modesty in light of the potential for significant error costs follow directly from Chicago School/TCE analytical principles.

3. Joshua D. Wright, Abandoning Antitrust's Chicago Obsession: The Case for Evidence-Based Antitrust, 78 Antitrust L.J. 241 (2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2050531

In the last paper under consideration, Wright continues his support of the substance of Chicago School analysis, but argues for abandoning that label in favor of an approach that bypasses the current multiplication of antitrust schools. He sets three goals for the paper: to describe the increasingly difficult problem of "model selection" for antitrust decision making in a time when scores of models in the economics literature compete to guide our understanding of alleged restraints; to show how the proliferation of schools in antitrust worsens the model-selection problem; and to argue instead for a program of empirical testing to identify the most appropriate model.

Wright begins by defending the Chicago School against oversimplified and misleading characterizations, much as he did in the first two papers. He identifies the essence of the Chicago School in its reliance on price theory with empirical testing (what Stigler called "microeconomics with evidence") and its focus (following Easterbrook) on the costs of judicial error—particularly false positives. He contrasts this approach, once again, with the multiplication of "possibility the-

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[16] Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007).

[17] Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312 (2007).

orems" of anticompetitive effect of vertical restraints. He rejects the recent announcements of a "Neo-Chicago" school[18] as a repackaging of Chicago insights and methodologies with a more accommodating rhetoric, even though the Chicago School (properly understood) has never been doctrinaire or limited in ways that required updating.

He also rejects proposals for a "behavioral" school of antitrust, which claims to offer a more realistic picture of the economic motivations and conduct of producers and consumers than the tradition economic assumption of rationality would admit. Wright suggests that the behavioral approach is unsuited to antitrust both because of its inconsistency with the evidence and its logical failings. First, the evidence does not show that firms are "predictably irrational." Second, if they were, it would seem to follow that everyone is irrational, including regulators, so there would be no reason to think antitrust intervention could improve matters.

Wright then turns to the model selection problem. Among the Chicago School's greatest achievements was the formulation of the consumer welfare standard, which virtually all antitrust scholars have now adopted in one form or another. Discussions of antitrust policy and briefing of antitrust cases are guided on all sides by economics. Moreover, both the Chicago School and its critics endorse empirical testing and updating of theories. Thus, the substance of the Chicago School approach has gained wide acceptance on some of the most important cornerstones of a sensible antitrust policy. The question remains, however, whether the Chicago School name (and the prevalence of a variety of schools) has outlived its usefulness.

The adoption of the consumer welfare standard opened the door for a proliferation of demonstrations, under various assumptions, of the possibility that virtually any restraint could reduce welfare. Generalist judges now must decide which model is most appropriate for decision of the case. This is the model selection problem. Wright argues that the association of models with schools is an impediment to model selection in part because of the tendency of scholars to cast rival schools in pejorative terms. For example, according to Wright, some critics (including Thomas Rosch, the FTC Commissioner Wright has now replaced) portray the Chicago School as resistant to any departure from the standard (and politically conservative) assumptions of price theory. These mischaracterizations "come at the expense of serious scientific analysis of the right question and communicate to courts and agencies abroad that the relationship between economics and domestic antitrust policy is superficial." Thus, he argues, the Chicago School label with a set of policy positions and methodologies carries too much baggage to be useful.

In place of schools, Wright suggests that all should agree on evidence-based antitrust, which would choose theories and models based on their "predictive power" determined by the "best available empirical evidence," and use decision theory to pick rules that minimize social and administrative costs of error. In a key passage, he writes:

> Evidence-based antitrust policies should derive theoretical insights from the Chicago School, the Post-Chicago School, and elsewhere—as long as such insights have empirical support. For example, there would be no principled objection to such a program recommending a Post-Chicago School approach to predatory pricing and a Chicago School approach to exclusive dealing—provided each approach best fit the available evidence. Neither one size nor one school need fit all. The determina-

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[18] *See generally* Su Sun, *Antitrust Law Journal 2012 Symposium: Neo-Chicago, Antitrust Editor's Note: Schools of Antitrust—A Parallelogram of Forces*, 78 Antitrust L.J. 37 (2012); William H. Page, *A Neo-Chicago Approach to Concerted Action*, 78 Antitrust L.J. 173 (2012); Daniel A. Crane, *Chicago, Post-Chicago, and Neo-Chicago*, 76 U. Chi. L. Rev. 1911 (2009); Alan Devlin, *A Neo-Chicago Perspective on the Law of Product Tying*, 44 Am. Bus. L.J. 521 (2007); David S. Evans & A. Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 U. Chi. L. Rev. 72 (2005).

> tive criteria would be to select the theoretical foundation with the greatest predictive power, as determined by credible and reliable empirical evidence. Such a program allows for change over time as new evidence may lead to an updating of prior beliefs concerning either the likelihood that any given business practice is anticompetitive or the net magnitude of social benefits and harms arising out of a practice.

This approach favors a special role for the agencies in conducting research, taking care not to become embroiled in policy disputes that undermine the process. As a cautionary tale, he points the failure of the FTC's Section 2 Hearings. Those hearings resulted in a valuable positive summary of the state of knowledge of the law and economics of monopolization, but disagreements over the normative recommendations led the Commission to abandon the report entirely. The evidence-based approach also argues for greater collaboration by the FTC with antitrust academics, and greater involvement of economists and economically sophisticated managers in the formulation of commission policy.

Evidence-based antitrust also has implications for the courts. Judges should receive more economic training in order to make the right choices among theories. The law more generally should use the best available theory and evidence to establish appropriate filters to improve antitrust outcomes. These include legal standards, like the monopoly power requirement for Section 2 offenses. They also include reliance on procedural settings like *Daubert* hearings[19] and motions to dismiss under *Twombly*[20] for failure to state a plausible claim. Both of these settings provide an opportunity to consider the economic validity of antitrust claims in specific cases.

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[19] Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993).

[20] Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007).