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How Conservative Economics Has Influenced Antitrust

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Abstract

This paper, written for a Georgetown University Law School conference in April 2007, addresses the allegation that "conservative" economic analyses have had a disproportionate influence on the substance and vigor of U.S. antitrust enforcement and adjudication. It acknowledges the significant impact of research associated with the University of Chicago and its satellites, much of it inspired by the critical suggestions of Aaron Director. It argues that the "Chicago" efforts have for the most part been beneficial, helping to illuminate weaknesses in accepted antitrust doctrines. Thus, a vigorous academic debate has been stimulated. To the extent that biases have resulted, they stem more from one-sided judicial interpretations of the extent theories and evidence and from the appointment of antitrust enforcement officials who take a one-sided view of the academic debate and/or who believe that "government is the problem, not the solution."

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1. Introduction

The conference task, as I interpret it, is to evaluate the influence conservative economics has had on the enforcement and adjudication of antitrust in the United States. I assume it to be proven, without undertaking the arduous task of providing support, that the economic doctrines underlying the corpus of judicially accepted antitrust law have gravitated during the past half century in a more conservative direction.

This statement of the problem immediately demands a deeper level of analysis. Antitrust is accomplished through enforcement, and what gets done depends in significant measure on the laws Congress passes and how the courts, especially the higher courts, interpret statutes whose implications and intent are often not precisely stated. What gets written into the statutes and how they are interpreted by the courts depend in part upon economic analysis, although to be sure, much else is thrown into the stew. If there has been a change in emphasis over time, the cause may lie in the underlying economics. But it is much more probable in my opinion that changes are attributable to how antitrust enforcers and the courts read what economics has to say, that is, on which among conflicting propositions they have placed emphasis and which ones they have downplayed. And those choices depend importantly upon the values the decision-makers -- typically, lawyers rather than economists -- bring to the table. As Paul Samuelson wisely quipped, "Economists should be on tap, not on top."

No one can deny that there are conflicting economic analyses. That, in my opinion, is an unmitigated blessing. Knowledge advances through the juxtaposition of alternative theories and testing against evidence to determine which ones are more nearly correct. "More nearly correct" is as close as I dare come in characterizing what economics can add to the debate, because economic propositions are among the least provable of those addressed in the various sciences. Economists' subject matter is intrinsically complex,

characterized by uncertainty, reciprocal expectations puzzles (the analogue of physicists' three-body conumdrum), and incommensurable values. Our data are often deficient and our empirical methodologies less than satisfactory (but improving). Accepting that we cannot conclusively separate what is true from what is untrue, the best one can hope for from economics in informing antitrust enforcement and adjudication is that differences in the findings from economic analyses will be made clear, as will the probable reasons why those differences cannot readily be resolved.

If the above premises are anywhere near correct, we should be thankful for the existence of a so-called "Chicago School" of economics, which is often (incorrectly, I shall argue) associated with conservative economics. One clear characteristic of the Chicago School -- not the only one, to be sure -- is what I, as a person born and raised in what Chicago Tribune publisher Robert R. McCormick called "Chicagoland," identify as the great Chicago "a'giner" tradition. If the conventional wisdom says X is true, one redoubles one's efforts to find the flaws supporting that inference and perhaps also to show that instead, Y is true. Epitomizing this attitude was the role of Aaron Director at the University of Chicago.[1] Director encouraged legal and economic scholars at Chicago to investigate critically the facts, assumptions, and theories underlying important antitrust doctrines. Those investigations often identified weaknesses in the foundations and sometimes showed that the emperor had no clothes. That train of scholarly work has been of enormous benefit to all of us.

It should be recognized too that virtually all professional economists plying their trade in the United States are conservatives, in the sense that we believe in free markets and capitalism as instruments of discovery and engines of progress -

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1 . On Director's influence, see Stephen Stigler, "Aaron Director Remembered," and Sam Peltzman, "Aaron Director's Influence on Antitrust Policy," Journal of Law & Economics, vol. 48 (October 2005), pp. 307-330. In the Preface to his book, The Antitrust Paradox ((Basic Books: 1978), p. ix, Robert Bork acknowledges the decisive role Director played in Bork's education and says that Director "has long seemed to me, as he has to many others, the seminal thinker in antitrust economics and industrial organization." Director was in residence at the University of Chicago from 1947 to 1965.

- views we adopt inter alia from Friedrich Hayek[2] -- and in markets as relatively efficient allocators of resources. If some of us (not I) once believed in central planning as a superior alternative, we were disabused of that notion by the failure of socialism in the Soviet Union and China and the rather more equivocal triumph of capitalism. I believe it was Chicago's George Stigler who once observed that "The study of economics makes a person conservative."

That said, it must be recognized that there are widely varying degrees of conservatism in the economics practiced within the United States (as elsewhere). The differences stem more from fundamental values and assumptions about human behavior and about the desirability of such phenomena as unequal income distribution than from the choice of one analytic or empirical technique over another. It would certainly be a mistake to view Chicago as the citadel of all conservative economics. One could with equal accuracy point to conservative schools with roots at Auburn University (uniquely attached to the pronouncements of Ludwig von Mises), the University of Virginia, George Mason University, the University of Rochester, and Washington University, not to mention minority groups at a host of institutions including my alma mater and employer, Harvard University. And for dogmatic differentiation, one would be hard-placed to match the range of extremes represented by economic think tanks.

2. The Influence of "Chicago" Economics

As I have indicated, the University of Chicago is often singled out as the leading bastion of conservative economics. This, I believe, is wrong for at least two reasons. First, by digging into and exposing flaws in accepted antitrust doctrines, Chicago has focused and sharpened the debate -- a virtue that I identify with enlightened liberal scholarship. But second and more tellingly, Chicago economists and antitrust scholars have been far from monolithic in advocating a retrenchment of antitrust enforcement programs. I mention briefly four of the most prominent counter-examples.

(1) While New Deal politicians were backing off from their

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2 . See Friedrich A. Hayek, The Road to Serfdom (University of Chicago Press: 1944).

ill-fated experience with cartelization under the National Recovery Administration, "conservative" Chicago economist Henry Simons proposed in 1936, among various policy redirections:[3]

> ... Operating companies must be limited in size, under special limitations prescribed for particular industries by the Federal Trade Commission ... There would be a breaking down of enormous integrations into more specialized firms, with ownership separation among phases of production which are now largely separate in place and management. For horizontal combinations, the policy would require ownership separation among operating units which are now connected by little more than common advertising and selling organizations.

(2) The most sweeping proposals for deconcentration of concentrated industries made by an official governmental commission came in 1968 from the so-called Neal Report, chaired by University of Chicago Law School dean Phil Caldwell Neal, who had co-taught the School's antitrust law course with Aaron Director.[4]

(3) Richard Posner's 1976 book and related articles recommended much more stringent enforcement of the Sherman Act toward jointly-acting oligopolies even in the absence of classical conspiracy evidence.[5]

(4) A powerful demonstration of the welfare distortions that can result from tying arrangements in other than fixed-proportions cases was published by John McGee, who was an associate professor of economics at Chicago between 1957 and

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3 . Henry C. Simons, "The Requisites of Free Competition," American Economic Review, vol. 26 (supplement), March 1936, pp. 103-104. See also his Economic Policy for a Free Society (University of Chicago Press: 1948), pp. 52-59.

4 . Report of the White House Task Force on Antitrust Policy, July 5, 1968. The text of the task force's proposed legislation is reproduced in Harvey J. Goldschmid, H. Michael Mann, and J. Fred Weston, eds., Industrial Concentration: The New Learning (Little Brown: 1974), pp. 449-456. A commentary by Dean Neal appears in the same volume at pp. 377-383.

5 . Richard A. Posner, Antitrust Policy (University of Chicago Press: 1976), Chapter 4. See also Posner, "Oligopoly and the Antitrust Laws: A Suggested Approach," Stanford Law Review, vol. 21 (June 1969), pp. 1562-1606.

1962.[6]

Other better-known work by Professor McGee worked in the opposite direction, diluting the presumptions of antitrust violation through predatory pricing. In his appreciation of Aaron Director's influence, Sam Peltzman asserts that the largest antitrust change attributable to Director was on the question of predatory pricing.[7] Up to the time of McGee's seminal article,[8] the research for which was suggested by Aaron Director, it was generally assumed that the Supreme Court acted correctly in 1911 when it condemned Standard Oil and, in a parallel case, American Tobacco, for achieving and retaining their near-monopoly positions, among other things through predatory pricing. Through his analysis of the Standard Oil case facts, McGee challenged this supposition. His work was cited by the Supreme Court in its 1986 dictum that "there is a consensus among commentators that predatory pricing schemes are rarely tried and even more rarely successful."[9] However, McGee was by no means the only economist writing on predation. Already by the time of the Matsushita decision, there was a substantial scholarly literature documenting what should have passed for predation by any reasonable definition and showing the rationality of sharp-price cutting by a dominant firm to discourage new entrants.[10] Since there was a diversity of

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6 . John S. McGee, "Compound Pricing," Economic Inquiry, vol. 25 (April 1987), pp. 315-339.

7 . Supra note 1 at 325.

8 . John McGee, "Predatory Price Cutting: The Standard Oil (N.J.) Case," Journal of Law & Economics, vol. 1 (October 1958), pp. 137-169. See also McGee, "Predatory Pricing Revisited," Journal of Law & Economics, vol. 23 (October 1980), pp. 289-330; and Lester G. Telser (another Chicagoan), "Cutthroat Competition and the Long Purse," Journal of Law and Economics, vol. 9 (October 1966), pp. 259-277.

9 . Matsushita Electric Industrial Corp. Ltd. et al. v. Zenith Radio Corp. et al., 475 U.S. 574, 589 (1986). The Court cites McGee and also Robert Bork, supra note 1. Bork in turn at the page of his book cited by the Court gives pride of place to McGee.

10 . See the literature review in my text, Industrial Market Structure and Economic Performance, 2nd ed. (Chicago: Rand McNally, 1980), pp. 336-340; David Kreps and Robert Wilson, "Reputation and Imperfect Information," Journal of Economic Theory, vol. 27 (August 1982), pp. 253-279; and Paul Milgrom and John Roberts (not the Supreme Court chief justice),

scholarly views at the time key Supreme Court pronouncements were rendered on predation, the fault for ignoring one side of the scholarship must be attributed to the Court's myopia, not to economists' contributions. More recently, a careful analysis has cast doubt on whether McGee's reading of the Standard Oil case facts was accurate and brings forward considerable evidence supporting an inference of predation.[11] In a world governed by the canons of scholarship rather than stare decisis, one might in some future case expect a renunciation by the Supreme Court of its previous misconceptions.

Reversion from the tough predatory pricing precedents of Standard Oil, 1911, also was influenced by Phillip Areeda and Donald Turner through a journal article they almost certainly intended to influence ongoing cases against IBM alleging predation against plug-compatible computer equipment makers.[12] Areeda and Turner, professors at Harvard Law School, can hardly be characterized as Chicagoans. Yet their article has been cited favorably in subsequent predation cases, including Matsushita and the Supreme Court decision dismissal of Brooke Group.[13] In my research for this paper I read Brooke Group, probably for the first time, anticipating biased coverage of the burgeoning economic literature on predation. To my great surprise, I found seven citations to my own textbook. Disarmed, I abandon the attack.

The domain of judicial interpretation most closely associated with the University of Chicago involves vertical restraints such as exclusive franchises, exclusive territorial arrangements, and resale price maintenance. In it, Sam Peltzman records "a partial victory for the analysis inspired by [Aaron]

"Predation, Reputation, and Entry Deterrence," Journal of Economic Theory, vol. 27 (August 1982), pp. 280-312.

11 . James A. Dalton and Louis Esposito, "Predatory Price Cutting and Standard Oil: A Re-Examination of the Trial Record," Research in Law and Economics, vol. 22 (2007), pp. 155-205.

12 . Areeda and Turner, "Predatory Pricing and Related Practices under Section 2 of the Sherman Act," Harvard Law Review, vol. 88 (February 1975), pp. 697-733. The article was cited in a subsequent IBM appeal, California Computer Products Inc. v. International Business Machines, 613 F. 2d 727, 743 (1979). But in the same section, the appellate court cited numerous other articles disputing the Areeda-Turner theses.

13 . Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993).

Director."[14] Two key contributions were Lester Telser's 1960 article on free-rider problems and Robert Bork's argument that, by providing the wherewithal for demand-expanding merchandising efforts, minimum-price restrictions imposed by manufacturers upon their retailers can be welfare-enhancing.[15] There are three problems with this attribution. First, the sharpest swerve in Supreme Court interpretations concerning the desirability of vertical restraints came in a decision that considered a wide spectrum of scholarly views.[16] Telser's contribution went unmentioned, although the free-rider concept entered indirectly through Justice White's concurring opinion, citing an article by Richard Posner, other facets of which were relied upon heavily by the majority.[17] Second, recognition that vertical pricing relationships could cause welfare losses that might be solved by vertical integration had a much longer history, dating back at least to the 1830s.[18] And third, the Bork proof has been shown

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14 . Supra note 1 at 325.

15 . Lester G. Telser, "Why Should Manufacturers Want Fair Trade?" Journal of Law & Economics, vol. 3 (October 1960), pp. 86-105; and Robert H. Bork, "A Reply to Professors Gould and Yamey," Yale Law Journal, vol. 76 (March 1967), p. 731; "Resale Price Maintenance and Consumer Welfare," Yale Law Journal, vol. 77 (April 1968), pp. 950-960; and The Antitrust Paradox, supra note 1 at 295-296.

16 . Continental T.V., Inc., et al. v. GTE Sylvania, Inc., 433 U.S. 36, 48, 53, 54 (1977). Justice Rhenquist, who added weight to a new conservative majority on the court, abstained. Citing "a leading critic of vertical restraints" at p. 56, the Court disagreed with William S. Comanor's argument that product differentiation efforts reduce interbrand competition more than they convey socially valuable information. "Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath," Harvard Law Review, vol. 81 (May 1968), pp. 1419-1438. This is an issue that engaged (and continues to engage) scholars over a much wider ideological spectrum.

17 . Richard Posner, "Antitrust Policy and the Supreme Court: An Analysis of Restricted Distribution, Horizontal Merger and Potential Competition Decisions," Columbia Law Review, vol. 75 (1975), pp. 282-293. Following the decision, Posner applauded it in "The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision," University of Chicago Law Review, vol. 45 (Autumn 1977), pp. 1-20.

18 . See e.g. Charles Ellet Jr., An Essay on the Laws of Trade in Reference to the Works of Internal Improvement in the United States (Richmond, VA: Bernard: 1839; Reprinted by Augustus Kelley, 1966). Ellet's insight can also be found in Alexander Hamilton's Federalist Paper No. 22. See also Joseph Spengler (not a Chicagoan), "Vertical Integration and Antitrust

to be a special case, by no means applicable in all vertical pricing or resale price maintenance situations.[19]

Perhaps the most dramatic pro-conservative swing has been in the enforcement and adjudication of mergers. How dramatic it has been is suggested by Figure 1, from various tabulations of the average annual rate of exit through merger from Fortune magazine's annual lists of the top 100 U.S. industrial corporations.[20] From the mid-1930s into the late 1970s, exit rates were quite low, but they then soared after 1982. Through the Celler-Kefauver Act of 1950, Congress eliminated previous loopholes in Clayton Act Section 7 with respect to mergers and made clear its intent that the law be enforced vigorously. A series of tough precedents followed, leading Justice Stewart to exclaim in a dissent, "The sole consistency that I can find is that in litigation under Section 7, the Government always wins."[21] A decisive turn toward greater lenience was the 1974 decision in the General Dynamics - United Electric Coal case, which is attributable more to a change in the ideological composition of the Supreme Court than to identifiable intellectual influences. But enforcers' zeal has undoubtedly been damped to some extent through articles inter alia by Henry Manne[22] and Michael Jensen[23], leader of what might be called a Chicago - Rochester axis, stressing the benefits of mergers. On

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Policy," Journal of Political Economy, vol. 58 (August 1950), pp. 347-352.

19 . See F. M. Scherer and David Ross, Industrial Market Structure and Economic Performance, 3rd ed. (Houghton-Mifflin: 1990), pp. 542-548. For a parallel proof, see William S. Comanor, "Vertical Price Fixing and Market Restrictions and the New Antitrust Policy," Harvard Law Review, vol. 98 (March 1985), pp. 990-998.

20 . The sources are described in F. M. Scherer, "A New Retrospective on Mergers," Review of Industrial Organization, vol. 28 (June 2006), pp. 328-329.

21 . U.S. v. Von's Grocery Co. et al., 384 U.S. 270, 301 (1966).

22 . Henry G. Manne, "Mergers and the Market for Corporate Control," Journal of Political Economy, vol. 73 (April 1965), pp. 110-120. Manne's J.D. decree was from the University of Chicago in 1952.

23 . See e.g. Michael Jensen, "Takeovers: Their Causes and Consequences," Journal of Economic Perspectives, vol. 2 (Winter 1988), pp. 21-48. Jensen's Ph.D. was from the University of Chicago.

their contributions too a substantial dissenting literature exists. At the enforcement level, the Merger Guidelines of 1982 were shepherded through the antitrust agencies by a Harvard-trained economist, Lawrence J. White, and drew upon Chicago (George Stigler[24]) mainly in choosing the Herfindahl-Hirschman index rather than previously emphasized concentration ratios to measure merger consequences. A significant modification occurred in 1984, when the Merger Guidelines incorporated an efficiency defense whose intellectual basis was a classic 1968 article by Oliver Williamson[25] -- not a Chicagoan.

Also noteworthy is the absence of enforcement against jointly-acting oligopolies since the Kellogg case of the late 1970s and the tetraethyl lead case of 1983.[26] Diverse economic analyses led to government defeats in both of those cases. Kellogg's principal economist was Harvard-trained and chaired. Game-theoretic considerations not associated with Chicago (and anticipated in my 1980 textbook edition[27]) were influential in the tetraethyl lead case. But the composition of the Federal Trade Commission had become more conservative under the Reagan Administration. And there may have been some backlash from challenges to accepted oligopoly structure - performance doctrine by Chicagoans Yale Brozen[28] and Harold Demsetz.[29] The intellectual dispute was crystallized at the Columbia Law School New Learning conference, whose proceedings were published in

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24 . "A Theory of Oligopoly," Journal of Political Economy, vol. 72 (February 1964), pp. 55-59.

25 . "Economies as an Antitrust Defense: The Welfare Tradeoffs," American Economic Review, vol. 58 (March 1968), pp. 18-36.

26 . In the matter of Kellogg et al., 99 F.T.C. 8, 16, 289 (1982); and In the matter of Ethyl Corp. et al., 101 F.T.C. 425 (1983).

27 . Supra note 10, pp. 163-164.

28 . "Concentration and Structural and Market Disequilibria," Antitrust Bulletin, vol. 16 (Summer 1971), pp. 244-248.

29 . "Industry Structure, Market Rivalry, and Public Policy," Journal of Law & Economics, vol. 16 (April 1973); and "Two Systems of Belief About Monopoly," in Goldschmid, ed., supra note 4, at pp. 175-181.

1974,[30] which threw the economics profession into a state of doctrinal disarray. That matters were more complex than a simple flow of causation from concentration to high profits was shown through articles resulting from the Federal Trade Commission's Line of Business program, most notably, by David Ravenscraft.[31] Clearly, as a result of such work, what economics taught about oligopoly was perceived by antitrust enforcers as more mixed, and enforcement became less vigorous. But again, the influences here are complex and point to many locales other than the University of Chicago.

3. Other Influences

To the extent that there has been significant back-tracking in antitrust precedents and enforcement, I suspect that there are two more important root causes, each of which can be identified with conservatism per se, even if not with conservative scholarship and especially economic scholarship.

For one, a foundational belief among many conservatives -- not all, to be sure -- is that "government is the problem." This was a belief embodied in Henry Simons' approach to monopolies. He recognized that monopolies existed and that they harmful effects, but he was reluctant to let government agencies regulate them. Instead, he proposed that they be broken up structurally so that they would act competitively without sustained government intervention. Similarly, in what for at least a while was the greatest monopolization case of the second half of the 20th Century, that belief probably underlay assistant attorney general William Baxter's readiness to break AT&T into eight fragments. If I interpret his position correctly, Baxter saw as AT&T's greatest sin the abuse regulatory processes in order to suppress entry and preserve its monopoly. Judge Greene agreed in his interim decision, suggesting that the Federal Communications Commission "may realistically be incapable of efficiently regulating a company

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30 . Goldschmid ed., supra note 4.

31 . "Structure-Profit Relationships at the Line of Business and Industry Level," Review of Economics and Statistics, vol. 65 (February 1983), pp. 22-31. Ravenscraft might be called a Chicagoan; he grew up in Peoria and received his Ph.D. from Northwestern University.

of AT&T's size, complexity, and power."[32] Where this belief goes too far is when it leads to the appointment to key positions in the Federal antitrust enforcement and adjudication hierarchy persons who believe it so passionately that they adopt a "do nothing" approach to their jobs. I believe it went too far during the Reagan Administration, and it has clearly gone too far, not only in antitrust but many other Federal agencies, under the Bush II Administration.

An argument rooted more deeply in conservative perspectives on economics is the assertion by John McGee, whom I have singled out previously as a believer in vertical market failure. At least with respect to merger and monopolization policy, McGee has argued that:[33]

> Unless we are dealing with industries into which the State blocks entry, industrial reorganization schemes have very much the same results as simply dictating to consumers what and from whom they can buy. In my view, this is both antieconomic and, to use an old-fashioned word, tyrannical. In sum, I conclude that apart from those industries dominated by State controls, there is the strongest presumption that the existing structure is the efficient structure.

Professor McGee may be extreme in this Panglossian diagnosis, but such views in attenuated form have been held by many of the individuals who have led the antitrust agencies under recent Republican administrations and the jurists appointed by those administrations to the higher courts. Antitrust policy has almost surely been affected.

Let me add one point in the same general vein. Those who from firmly-held conservative or libertarian principles believe that government is the problem, and/or that free markets are unlikely to go astray for more than brief anomalous periods, tend to be fervent in their beliefs. Those like myself who

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32 . U.S. v. American Telephone and Telegraph Co. et al., 524 F. Supp. 1336, 1359. Judge Greene quoted at p. 1362 Robert Bork's suggestion that "Predation by abuse of governmental procedures ... presents an increasingly dangerous threat to competition ... [with] almost limitless possibilities." Bork, supra note 1, at p. 347.

33 . "Commentary," in Goldschmid et al., eds., supra note 1, at p. 104.

believe that markets do a pretty good job, but on occasion need a corrective nudge, are inclined to be the kinds of economists President Harry Truman deplored -- those who equivocate with, "On the one hand, but on the other hand..." When one has such a complex perception of economic reality, one is unlikely to be fervent. And when there is a clash of views, at least in the currently polarized and showmanship-infatuated United States, fervor tends to trump ambivalence.[34] And that, I believe, more than anything else, explains the ascendance of conservative thinking in antitrust law and economics.

4. Technological Innovation and Patent Antitrust

I turn finally to a matter I have neglected, but that cannot be ignored, because it is far more important than the efficacy of markets in allocating resources and distributing income at any moment in time: the impact of market structure and related institutions on the vigor and pace of technological innovation. A more rapid rate of technological progress can in a relatively short period overwhelm any resource allocation inefficiencies attributable to monopoly, which tend in any event, as shown by Chicagoan Arnold Harberger,[35] to be modest in relation to gross domestic product.[36] The subject is a huge one, but here I must be highly selective.

Joseph A. Schumpeter, a conservative economist teaching at Harvard during the 1930s and 1940s, argued in 1942 that even when markets were monopolized, "creative destruction" would ensure a rapid pace of technological innovation and progress in an advanced capitalistic economy. As I show in a paper written for an American Bar Association compendium, he was partly right.[37] Competition through creative destruction does work, but

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34 . Or the ambivalent are cited only for inferences consistent with conservative values and ignored on other points.

35 . Arnold C. Harberger, "Monopoly and Resource Allocation," American Economic Review, vol. 44 (May 1954), pp. 77-87.

36 . For a quantitative illustration, see Scherer and Ross, supra note 19, at p. 31.

37 . F. M. Scherer, "Technological Innovation and Monopolization," forthcoming in W. D. Collins, ed., Issues in Competition Law and Policy. The article analyzes "great" monopolization cases in seven major industries.

sometimes it needs a helping hand, among other things, from antitrusters limiting barriers to competitive entry by firms with superior new ideas.

Here I address a narrower but important point. Half a century ago, antitrust enforcement took a generally skeptical view of restrictive patent agreements. Reviewing the findings of the Temporary National Economic Committee, George Stigler (then at the University of Minnesota, not Chicago) found the patent policies of the Hartford-Empire Company to be "an eloquent example of an evil demanding correction" and concluded that "The case for limitation of restrictive [patent] licensing is surely irrefutable."[38] The antitrust case waged against Hartford-Empire provided an important precedent for tough-minded compulsory licensing of patents used to monopolize industries and sustain their monopolization.[39] In the ensuing decade and a half, more than 100 compulsory licensing orders were issued under antitrust proceedings.[40]

Attempting to ascertain how such governmental intervention, and in particular the 1956 decrees that ordered compulsory licensing of all patents held by innovative giants AT&T and IBM, affected investment in research and development, eight colleagues and I at the Harvard Business School interviewed and administered mail questionnaires to 91 companies. We found to our surprise that the decrees had little adverse impact on R&D investment, and more generally, that for established corporations, the expectation of patent protection was in most cases unimportant to R&D commitments.[41] This finding has been validated by several more ambitious studies, among others, by

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38 . George J. Stigler, "The Extent and Bases of Monopoly," American Economic Review, vol. 32 supplement (June 1942), p. 14.

39 . U.S. v. Hartford-Empire Co. et al., 46 F. Supp. 541 (1942), 323 U.S. 386 (1944), 324 U.S. 570 (1944).

40 . Marcus A. Hollabaugh and Robert Wright, Compulsory Licensing Under Antitrust Judgments, staff report, Subcommittee on Patents, Trademarks, and Copyrights, Senate Committee on the Judiciary (1960), pp. 2-5.

41 . F. M. Scherer et al., Patents and the Corporation, 2nd edition, privately published (Boston: 1959).

Edwin Mansfield[42] and by the current president of Yale University, Richard Levin.[43]

Ignoring this literature but echoing the empirically unsupported arguments in a book by a Chicago-affiliated lawyer,[44] Reagan Administration appointees to the Antitrust Division back-pedalled significantly, staking out a broad area in which restrictive patent licensing agreements would not be challenged. Underlying the policy reversal was an assumption that:[45]

> Efforts to appropriate as much as possible of the surplus -- the social value in excess of marginal cost -- lying under the demand curve for patented technology do not harm competition. Indeed, the potential for appropriating those rents is the engine [emphasis added] that drives the technology market.

The increased rent appropriation, I hardly need to add, was to be accomplished through a variety of practices extending the duration and (e.g., through tying practices) the scope of patent grants. This premise is quite inconsistent with the large body of empirical evidence on the conditions under which well-established corporations are willing to invest in innovation. And yet it was used, despite the great Chicago tradition of supporting one's findings with empirical evidence, to justify a substantial policy change. And since that time, there have been very few antitrust cases in which compulsory licensing of patents has been ordered. A correction in the intellectual foundations of U.S. policy toward intellectual property is needed.

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42 . "Patents and Innovation: An Empirical Study," Management Science, vol. 173 (1986), pp. 173-181.

43 . R. C. Levin, Alvin Klevorick, Richard R. Nelson, and Sidney Winter, "Appropriating the Returns from Industrial Research and Development," Brookings Papers on Economic Activity (1987: Microeconomics), pp. 783-820.

44 . Ward Bowman, Patent and Antitrust Law: A Legal and Economic Appraisal (University of Chicago Press: 1973), especially pp. 64 and 254-255.

45 . Remarks by Abbott P. Lipsky Jr. before the American Bar Association November 5, 1981, reproduced in CCH Trade Regulation Reporter para. 13,129.