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1 Introduction

After almost two decades in which antitrust policy veered sharply toward the philosophy that less is more, the policy changed in the late 1990s when the U.S. Department of Justice mounted challenges to the practices of successful service enterprises dealing in software (Microsoft), consumer payment cards (Visa and MasterCard), and air travel (American Airlines).

All three antitrust suits involved industries in which networks were crucial. Microsoft supports a network of hardware manufacturers, personal computer vendors, computer users, and software developers that depend on the company's Windows operating system. Visa and MasterCard have created vast networks of merchants who accept credit, charge, and debit cards that are issued to consumers by thousands of financial institutions. American Airlines operates an air carrier network connecting hundreds of cities worldwide.

Do challenges to the practices of these network industries signal a return to an era in which Washington second-guessed market outcomes instead of simply setting ground rules for competition and allowing markets to respond on their own? Or were antitrust activities of the later Clinton years an aberration—a last hurrah for hard-line trustbusting? In October 2002 the AEI-Brookings Joint Center for Regulatory Studies invited experts with a variety of perspectives on those questions to discuss them

and to assess the future of antitrust policy. This book presents a compendium of their thinking.

The panelists agreed on two basic facts: that the approach of the Department of Justice to enforcement of antitrust legislation in the late 1990s was aggressive and that the impact of the cases filed then will be felt for many years to come. Agreement, for the most part, ended there. Two of the panelists argued, albeit for different reasons, that the Justice Department had lost its way. The other two argued that while the department missed some opportunities and made some missteps, its aggressive stance was largely justified by changing technology and market conditions.

This introduction offers a summary of the four viewpoints, noting both differences and common themes. Lawrence J. White, of the Stern School of Business at New York University, presents the most comprehensive discussion of Clinton-era antitrust policy, so I begin with his chapter. Robert Bork, with the American Enterprise Institute, is narrower in focus, but he agrees with White that the Clinton administration's antitrust policy was based on sound law and economic theory. The final two chapters take a very different stance, arguing that the antitrust policy of the Clinton administration was ill conceived. Howard H. Chang, David S. Evans (both with NERA Economic Consulting), and Richard Schmalensee (at the Massachusetts Institute of Technology) argue that the Justice Department ignored consumer harm as a criterion for pursuing two of the three high-stakes suits of the 1990s. George L. Priest, at the Yale Law School, agrees, but he contends that the lack of focus on consumers stemmed from a fundamental misunderstanding of network industries.

In "Antitrust Activities during the Clinton Administration: An Assessment," Lawrence White offers a relatively sanguine assessment of antitrust actions during the 1990s. In his review, covering far more than just the *Microsoft, Visa/MasterCard*, and *American Airlines* cases, he concedes that the decade did bring a "new activism" to antitrust enforcement efforts. But White maintains that continuity remained strong, that the basic approach of earlier regimes was not changed. For example, the Justice Department stood by the *Horizontal Merger Guidelines* promulgated in the 1980s.[1] And despite the wave of mergers in the late 1990s, neither the Justice Department nor the Federal Trade Commission succumbed to what he labels "populist temptations" to block conglomerate mergers.

1. U.S. Department of Justice and Federal Trade Commission (1992).

To put antitrust enforcement during the decade into perspective, White refers to a variety of cases. With regard to *Microsoft*, he describes the software maker as a dominant firm operating in a market in which entry is difficult and contends that the company went out of its way to raise its rivals' costs and to increase its market power.[2] White argues that while the Justice Department's challenge of Microsoft was not entirely coherent, it was justified. Similarly, the debates about overlapping governance of the payment card system and of card issuance in *Visa/MasterCard* were worth raising and the case itself worth pursuing.

White argues that the case against American Airlines was not as clear cut as either *Microsoft* or *Visa/MasterCard* but the situation still justified the intervention. In the more than two decades following airline deregulation, he observes, few new carriers have been able to survive competition from the large incumbent airlines. Certainly, the hub-and-spoke design of the incumbents is an effective means for taking advantage of network economies. But White argues that the incumbents abused their market position by expanding the frequency of flights in response to their rivals' entry, even as they matched their fares.

White acknowledges that it is difficult to differentiate aggressive competition from predatory behavior, especially when nonprice predation, such as an increase in passenger capacity, is at issue. Nonetheless, it is important to try to make the distinction in situations that include a dominant firm, strong market concentration, and difficult market entry—and where it is realistic to expect that losses from predatory behavior can be recouped. American Airlines fit those criteria, White says; therefore, despite the fact that the government lost, the suit was justified and pushed predation theory forward.

After discussing these three, White touches on other cases brought during the latter half of the 1990s. *Intel* and *Dentsply* focused on the problems of raising rivals' costs; *Toys "R" Us* came to grips with important issues of vertical restraints on trade; *Staples*, *MCI WorldCom–Sprint*, and *Heinz–Beech-Nut* raised significant merger issues, including the question of when company promises of postmerger efficiencies should outweigh concerns over postmerger industry concentration. Whether the government won or lost, he argues, the pursuit of those cases advanced antitrust jurisprudence.

2. Full citations to the cases mentioned here appear in the various chapters.

White does contend, however, that the antitrust agencies made some missteps and missed some opportunities altogether during the 1990s. For example, he argues that the Federal Trade Commission miscalculated when it chose not to present empirical evidence in *California Dental*, which led the court of appeals to recommend that the case be dropped. Regarding missed opportunities, he would have liked either the FTC or the Justice Department to challenge the Bell Atlantic–NYNEX merger on grounds that the match would eliminate potential competition. Moreover, he argues that the failure to develop vertical-restraint guidelines left a significant hole in antitrust policy.

Taken as whole, White concludes, the antitrust enforcers of the late 1990s followed in the footsteps of their predecessors. Several cases filed during that time were controversial, but they had a "solid analytical foundation." In the end, he says, the Clinton antitrust legacy is a mix of important initiatives leavened with some missed opportunities.

Robert Bork, whose chapter, "High-Stakes Antitrust: The Last Hurrah?," focuses on the three high-profile cases, agrees with White concerning the overall direction of Clinton antitrust policy. Bork comments that although the current Bush administration has "less appetite" for pathbreaking antitrust suits than its predecessor, enthusiasm for enforcement of antitrust law has always tended to cycle. High-stakes antitrust actions are sure to return. Bork also agrees that of the prominent cases of the 1990s, *Microsoft* and *Visa/MasterCard* were clearly justified, pointing out that both involved organizations with market power whose executives viewed network effects as insufficient protection for their monopoly status.

Microsoft, Bork argues, was one of the few cases in which a court of appeals sitting en banc unanimously upheld a finding of predation by a monopolist. He presents several examples of Microsoft's predatory behavior, defining predation as employing tactics other than efficiency to eliminate competitors. Although he acknowledges that internal company communications can be very misleading, couched as they often are in the language of war, he nonetheless argues that Microsoft's e-mails exposed its predatory intent. When it became apparent to the company that network effects and the "applications barrier to entry" were insufficient to protect its monopoly profits, it turned to a predatory campaign. The e-mails laid out the means by which it would attack its rivals, and the company's actions matched those plans.[3]

3. For two other views on this case see Evans and others (2000).

In Bork's view it is unfortunate that the negotiated *Microsoft* settlement did not capitalize on the government's resounding victory in the courts. The consent decree, he observes, did not even prohibit the behavior the district court and the en banc court of appeals held illegal. Of most concern is the lack of a prohibition on "commingling" the software code for the Windows operating system with other software codes, such as that for Microsoft's Internet Explorer browser.

Visa/MasterCard, Bork contends, was similar to *Microsoft* in that it involved the abuse of monopoly power. He argues, moreover, that the government's case was "if not quite a slam dunk, close to it." The two cooperatives had a selective view of competition. They deemed American Express and Discover to be direct competitors that had to be excluded from Visa and MasterCard's systems but allowed member banks to issue one another's cards—and allowed one member, Citibank, to issue Diners Club cards as well. The result of Visa and MasterCard's card issuance rules was thus to narrow consumers' choice in credit and charge cards and to limit new offerings in debit and multifunction, chip-enabled "smart" cards.

As for the two cooperatives' counterargument that opening the system to American Express would give that company the opportunity to skim off the best banks, Bork asserts that both Visa and MasterCard already do that themselves, that indeed such "cherry-picking" is what competition is about. Thus he agrees with the district court decision that the bank associations' card-issuing rules were in violation of section 1 of the Sherman Anti-Trust Act.

In contrast, Bork contends that the government's case against American Airlines was off target. Here, he distances himself from White, arguing that the Justice Department's lack of a clear remedy emphasizes the faulty logic behind the case. Although this action, like *Microsoft* and *Visa/MasterCard,* involved network industries, unlike computer operating systems and payment cards, networks in the airline industry facilitate competition. Multiple networks currently exist and compete against each other, Bork contends, and competition is strong among hubs and among airlines. He points out that American never priced below the low-cost carrier entrants; indeed, at the low prices met by American, demand was sure to be greater. Thus the airline's fares and flight expansions on the contested routes fall under the defense of "meeting competition," which should apply to the Sherman Act as well as to the Robinson-Patman Act.

If lowering prices to competitors' levels and increasing output were anticompetitive, what remedy could the courts reasonably impose? Should

American have to maintain its relatively high prices and relatively less frequent flights in the face of competition? If not, should the courts put themselves in the position of dictating American's legal minimum fares, which would be somewhere between the old American price and the low-cost carriers' price? Bork argues that because none of these options makes economic or legal sense, they expose the shaky foundation of the government's case against the airline.

In "Has the Consumer Harm Standard Lost Its Teeth?" Howard Chang, David Evans, and Richard Schmalensee argue that the foundations for the government's cases against both Microsoft and Visa/MasterCard were shaky as well. They point to a lack of focus on consumers in the Justice Department's antitrust efforts during the 1990s. In particular, they contend that the Clinton Justice Department relied on the assumption that harm to competitors automatically led to harm to consumers. In both *Microsoft* and *Visa/MasterCard*, as well as in *Intel*, a contemporary case that was settled before going to trial, the government confounded two distinct concepts. Harm to a competitor does not inevitably imply harm to the competitive process and thus harm to consumers, the prevention of which is the ultimate goal of antitrust laws. To link the two concepts, the Department of Justice should have presented direct evidence that the challenged practices had raised prices, lowered output, reduced quality, or otherwise harmed consumers.

At the heart of any standard of consumer harm adopted by the courts is the tension between the risk of being too lenient and the risk of being too strict. If a standard is too lenient, companies come to believe that they can behave anticompetitively without risk of government intervention. If a standard is too strict, courts will condemn practices that help consumers, undermining competition instead of spurring it. Because the courts cannot eliminate both risks at once, the goal is to set the standard to minimize the expected costs of the inevitable errors. The authors contend that the consumer harm standard espoused by the Clinton Justice Department risked discouraging procompetitive practices. Rather than demonstrating actual or likely consumer harm, the government presented evidence that competitors were harmed and that those competitors were important to the industry. The department, they point out, did not show that harm to those important competitors actually harmed the competitive process and thereby harmed consumers.[4]

4. Bork challenges the contention that the government must provide proof of harm to consumers. He argues instead that consumer harm can be inferred from "certain forms of exclusionary market

In *Microsoft* the Justice Department claimed that Netscape had the potential to create competition for Microsoft's Windows platform and that Microsoft's actions undermined Netscape's potential to challenge Windows. Determining whether Netscape was in fact a nascent threat is not easy, but the authors argue that the government could have attempted to buttress its case with empirical analysis. For example, did the actions Microsoft took that were deemed illegal by the appeals court in fact reduce Netscape's share of the market for Internet browsers below the threshold necessary to form an alternative platform to Windows?

Chang, Evans, and Schmalensee go on to say that one of Microsoft's economic experts did compare Netscape browser use among a control group of Internet users whose choice of browsers was not likely to be affected by the anticompetitive acts and a group of users whose browser choice could have been affected by those acts. Microsoft's expert found an insignificant difference between the two groups, implying that the company's actions did not play an important part in reducing Netscape's browser share. Certainly experts can disagree on the proper way of measuring harm, and the authors do not advocate one particular set of tests. Rather, they argue that the Justice Department never engaged in that debate; it simply did not present evidence that Microsoft undermined competition or harmed consumers.

In *Visa/MasterCard*, the authors observe, the government never attempted to determine the extent to which competitors—American Express and Discover—were harmed by Visa's and MasterCard's refusal to let their network members join competing systems. Nor did the government try to measure the extent to which the alleged harm to American Express and Discover generally affected competition in payment cards. As with *Microsoft*, the authors contend that those issues could have been addressed empirically. For example, the government could have used quantitative analysis to back its claim that additional issuers lead to increased card issuance. It also could have assessed whether additional issuance had benefited consumers in the past through lower prices or higher quality.

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behavior." Once the government raised the possibility of consumer harm through inference, defendants had the burden of proof to show that their actions resulted in efficiencies. Chang, Evans, and Schmalensee counter these comments by arguing that, while direct proof is not always possible, the "quick look" standard Bork advocates is inadequate. At a minimum, the inference of consumer harm through harm to a competitor should be backed by evidence that the competitor suffered injury significant enough to limit its effectiveness. Only after consumer harm has been established should the court turn to the impact on economic efficiency.

In the opinion of Chang, Evans, and Schmalensee, an error-cost analysis suggests that a strong standard for consumer harm would reduce the cost of a false conviction while keeping the cost of a false acquittal relatively low. They argue that the Department of Justice should have been more rigorous in presenting proof of consumer harm. It remains to be seen whether other circuit courts and eventually the Supreme Court will reject the Clinton Justice Department's lax approach.

Also seizing on the extent of consumer harm, George Priest argues in "The Government's Flawed Efforts to Apply Modern Antitrust Law to Network Industries" that the central problem in the Clinton Justice Department's approach to enforcement of antitrust law was its failure to explain how competition between networks would benefit consumers. Priest posits that the department failed in this effort because it did not possess a coherent theory of how networks should best be organized. It never showed that introducing additional competition at the network level would benefit consumers. Moreover, the department's arguments in the three prominent cases were inconsistent, and no attempt was made to synthesize an overarching argument for how antitrust laws should apply to networks.

Priest contends that in *Microsoft*, the government did not develop a theory of how a market with multiple competing operating systems would function to the benefit of consumers or even be able to sustain itself. Nor did the government explain why, if substantial benefits could have been realized from multiple systems, such competition had not developed through market forces. Priest points out that the Justice Department acknowledged that Microsoft had earned its operating system dominance on the merits of the system—that is, the department never claimed that Microsoft had broken the law in establishing its monopoly.

Bear in mind, Priest comments, that markets for operating systems, like those for other network products, are winner-take-most markets. Typically, competition is *for* the market, not *within* the market. Thus, if no illegal acts were committed in gaining the operating system monopoly, the dominance reflects the work of market forces—the network benefits arising from standardizing operating systems and from developing scores of applications compatible with that system. Therefore, the government's case was predicated on a contradiction.

Priest contends that the Justice Department made similar mistakes in its suit against Visa and MasterCard. On one hand it argued that a bank sitting on the board of one of the cooperatives should be precluded from

sitting on the board of the other, that the governance structures of the two associations should be completely separate so as to foster competition. On the other hand it argued that it was anticompetitive for Visa and MasterCard to prevent their members from issuing American Express and Discover cards. That is, at the level of the individual member the systems should not be separate—indeed, that members should merge the card issuance networks by offering as many brands as possible. These two ambitions are internally inconsistent, Priest observes, and moreover the claim that member exclusion rules are anticompetitive is inconsistent with the department's arguments in *Microsoft*. The department attempted to create new, separate networks in *Microsoft* but asked the court to force the merger of existing competing networks in *Visa/MasterCard*.

In *American Airlines* Priest maintains that the government's case was lacking for a different reason. There the Justice Department chose to ignore the network character of the airline industry. Rather than acknowledge that American's passenger service operated in a network of routes, it limited its focus to routes between selected cities also served by low-cost carriers. It claimed that American set predatory prices and unfairly increased capacity on these routes in response to competition. But Priest notes that the allegedly predatory prices were identical to fares charged by the low-cost carriers, and it is difficult to see how improving service is anticompetitive. When American's costs are calculated in a way that accounts for running a network, as opposed to operating a handful of disjointed routes, the case for predatory pricing collapses.

According to Priest, the government's arguments in these three cases did not advance the application of antitrust laws in an evolving economy. At best the Justice Department ignored the implications of network industries; at worst its arguments were inconsistent and contradictory, lacking a coherent theory of how competition among networks benefits consumers.

The four viewpoints represented in this book can be reduced to two basic positions. White and Bork largely support the government's antitrust efforts in the late 1990s. Although they recognize some mistakes on the part of the Justice Department and Federal Trade Commission, they nonetheless believe that the antitrust arguments the government put forth were well grounded in legal and economic theory. Chang and his colleagues and Priest, however, contend that the antitrust enforcement was based on faulty economic logic and did little to advance antitrust jurisprudence. In particular, the government lost sight of the driving force behind antitrust enforcement: harm to consumers.

The two-viewpoint description, though, glosses over some important differences: White and Bork disagree about *American Airlines* and Chang and colleagues and Priest disagree about the primary cause of the Justice Department's missteps. Indeed, each chapter makes different arguments stemming from different vantage points. White holds that despite the government's loss, *American Airlines* was important because it advanced the thinking on what constitutes predation. Bork disagrees, stating that vague worries about competition with low-cost carriers are no substitute for well-thought-out economic theory. On this point, at least, Priest agrees with Bork. Priest argues that the government's lack of understanding about network industries in general led to a confused attack on several companies operating in those industries. Chang, Evans, and Schmalensee do not even discuss *American Airlines*; they argue instead that the government's failures in antitrust enforcement during the 1990s stem not from a poor understanding of networks, but from a poor evidentiary standard for proving consumer harm.

Had AEI and Brookings invited additional observers to contribute to the debate, it is likely there would have been still more viewpoints. But regardless of the variety, one thing is clear: given the far-reaching nature of the major antitrust cases brought under the Clinton administration, its antitrust legacy is likely to be felt for quite some time.

References

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