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The Federal Trade Commission and the Defense of Free Markets

by

Thomas B. Leary, Commissioner*
Federal Trade Commission

David T. Chase Free Enterprise Institute
Eastern Connecticut State University

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It is a great pleasure to be here. I am always pleased to speak anywhere at an institution that has “free enterprise” in its title, and I am also particularly honored to speak here because my very close colleague Orson Swindle spoke here two years ago. I know those of you that heard him will never forget him; he is one of the most remarkable human beings that I have ever had the privilege to know and work with closely.

I am going to give you a lot of subjective views here today. I am talking about things that I feel very deeply - - and I suspect that some of my colleagues agree with me - - but I am not giving you government policy. I have some individual views on aspects of our work that I am sure are of concern to you.

The Core Value of Freedom

When we talk about the importance of free enterprise, a lot of people may think that we are primarily concerned with economic efficiency. I think, however, that the freedom part is the core value in its own right - - not only in the United States but also throughout the Western world. Freedom has many aspects but the one that is important here is an idea, which evolved very slowly over about a thousand years, that people should be free to engage in whatever occupation they choose. They are not bound to follow the particular occupation of the family they were born into. That is a fundamental and glorious idea. It has taken a long time for Western society to apply the concept universally but, nevertheless, we moved steadily in that direction. If you can engage in any occupation, it means that you are free to sell not only your labor, but also your goods and your ideas.

The corollary of this seller freedom, and the thing that makes it fully effective, is the notion that buyers have the corresponding freedom to buy whatever they want. With rare exceptions, individual buyers can exercise this freedom, even if they choose things that are very bad for them. This is what we call consumer sovereignty, and it is also a precious legacy.

I think economic efficiency is not a core value in itself but rather a way to mediate between conflicting freedoms. Obviously, my unfettered freedom can impinge upon some one else’s unfettered freedom, either as a buyer or a seller. The goal of economic efficiency helps us to resolve competing freedom claims.¹

The Basic Structure and Role of the Federal Trade Commission

Let me illustrate how some of these ideas play out in the work of the Federal Trade Commission, the agency I work for. I will start with some history. I apologize to those of you who are familiar with this history, but those of you who are not may find it interesting. In 1911, the Supreme Court decided the famous Standard Oil case,² which is well known to students of business and economics as a decision that broke up John D. Rockefeller’s Standard Oil Company. For antitrust lawyers, however, there is something even more significant that came out of the

Standard Oil case - - the beginning of what we call the “rule of reason.” Remember that Section 1 of the Sherman Act,³ the basic antitrust statute, prohibits contracts in “restraint of trade,” without qualification, but the problem is that all contracts restrain trade to some extent. That is what contracts are for. To avoid a ludicrous result, the Supreme Court said in Standard Oil that only “unreasonable” restraints violate the antitrust laws.

This eminently sensible result caused a great deal of concern and confusion at the time. How do you distinguish between conduct that is reasonable and conduct that is not? How are people going to know when they have violated the law? In response, Congress did two things. First, it passed the Clayton Act in 1914,⁴ which gave more specificity to antitrust by addressing things like mergers, director interlocks, and exclusive dealing. Second, Congress created an independent agency to provide expert guidance. This was the genesis of the Federal Trade Commission,⁵ now the senior independent agency in the United States Government.

Before discussing what the Commission does, let me digress briefly and describe what it means to have an independent agency. I am sure you grew up with the notion that we have three branches of government: a legislature, an executive branch and a judiciary. An independent agency is outside these three traditional areas of government. I am appointed by the President of the United States but the President of the United States cannot remove me from office. The Senate confirmed me, but nobody in Congress can tell me what to do about a particular matter. The Judiciary ultimately reviews our work, but they do so under a standard which gives deference to administrative discretion.

We are also bipartisan. Of five commissioners, no more than three can be members of the same political party. The terms are staggered, so no more than one term expires every year. The objective is to make sure that a change of administration will not cause an abrupt change in policies.

What do we do with our independence? We have three major functions. One is to deal with antitrust law matters, such as anticompetitive mergers or exclusionary agreements. Another major activity is consumer protection, which addresses false and deceptive advertising practices. There is a close nexus between our competition and our consumer protection missions. Remember the supply curves and demand curves, which you studied in Economics 101. Competitive restraints (the antitrust violations), tend to raise the supply curve because they increase offering prices or restrain sellers in the market. False advertising tends to raise the demand curve because it creates the impression that products are worth more than they otherwise would be if they were advertised honestly. So supply and demand will intersect at a higher price, to the detriment of consumers, and society’s resources will be misallocated. That is the nexus between our two missions and that is the fundamental justification for having both of these responsibilities in the same agency, although I cannot tell you that Congress in 1914 was thinking of it in this way.

The third thing that we do - - which I think is equally important and will therefore stress today - - is conduct a great deal of research to find out more about particular problems in various sectors of the economy. We have a lot of what we call workshops or hearings, to which we invite experts with widely diverse points of view on particular subjects. We try to study problems on the frontiers, if you will, and then we may also use our “bully pulpit” to advocate free-market solutions to other decision makers like states, other agencies of the federal government and, occasionally, even foreign governments. All of these activities are summed up by the basic title of the talk: The Federal Trade Commission and the Defense of Free Markets.

With this background on who we are and what we do, I would like to provide some specific examples of the problems we address. I am going to talk about four areas. Each is complex enough to justify a talk in its own right, but I am just going to give you a quick introduction to some current issues. The first two areas involve issues in the competition and consumer protection arenas that I just mentioned. The third one is the distortion caused by government regulation. The last deals with impediments to free trade and international commerce. I originally wanted to say something about privacy, but I recently learned that this was the issue that Orson Swindle talked to you about two years ago, so I will take a pass on it other than to say that we fundamentally see eye-to-eye on these things.

As we consider these separate areas, there will be certain recurring themes. People may agree on ultimate objectives but they do not necessarily agree on immediate answers. The world is a complex and untidy place and the Federal Trade Commission is just one player among many. We can count on incremental improvements but perfection - - or even a clear understanding of what perfection might be - - will always elude us.

I. Understanding the Competitive Process

There has been an immense change in the way the United States antitrust agencies have looked at competition matters in the past 25 years.⁶ When I first started to deal with antitrust matters after I got out of law school in 1958, the perceived wisdom and the jurisprudence in the United States essentially was that big is bad. Worse, efficiency was bad. If two parties merge and became more efficient through merger, for example, it would give them a “competitive advantage” that would make it harder for smaller companies to compete. This result was contrary to the Jeffersonian vision of diffused small enterprises, which was a very powerful vision and a lingering one well into the latter part of the last century.

That bias against efficiency changed dramatically after the late 1970s, and the change began with scholarship. A large group of people rightly share credit as pioneers of the free enterprise, efficiency orientated approach to the antitrust laws. The most familiar name, of course, is Bob Bork.⁷ Unlike most of the group, he is a lawyer, not an economist, but a lawyer very conversant in economics and way ahead of his time. The influential economists included names like Yale Brozen, Harold Demsetz, John McGee and Fred Weston. I had the personal

satisfaction of meeting and learning from each one of those pioneers in 1970s, when I was working for General Motors, a company that then had an obvious interest in their research.

There were other factors that contributed to the acceptance of this new view. One of them was the very sick economy that we had in the 1970's, with high inflation and unemployment, and a perception that our businesses were being clobbered by overseas competitors. Nothing seemed to be working and the notion that we could dispense with efficiency suddenly was not all that popular anymore. The people who had been in favor of no-growth and smelling the roses just a few years before discovered that no-growth was no fun. So, all of these factors converged and there was a tremendous revolution in antitrust.

A lot of people mark the turning point as the 1977 decision of the Supreme Court in the Sylvania case,⁸ which overtly recognized what was then called the “New Learning” - - an efficiency-orientated view of antitrust. It is an interesting fact that the economic learning which the Sylvania Court endorsed did not come from the briefs of the parties, but rather from an amicus brief submitted by the trade association of the automobile industry. We lawyers who worked on that brief did not dream up the learning on our own. We had been educated in these ideas by those particular pioneers I mentioned.

Today, this new learning is mainstream competition law. Although we may differ on the facts of individual cases, all of my colleagues agree that the objective is to maximize efficient outcomes. We all start in the same place and we are all trying to do the same thing. This broad consensus is a great demonstration of the power of ideas and, in my view, has made an immense contribution to consumer welfare. Conflicting freedoms of sellers and buyers are mediated in a more sensible way.

This does not mean all problems are solved, however. A major cause of continuing disagreement is the fact that much of antitrust involves what we call issues of “incipiency.” Incipiency issues require an attempt to predict what is going to happen in the future - - both in the short term and the long term. The need for this is obvious when you are looking at a proposed merger; you are trying to imagine a world that has never been. The same thing is also true when you are trying to decide the competitive effects of aggressive conduct by powerful companies. Will it ultimately be pro consumer or anti consumer?

Different people will inevitably predict the future differently. When speaking to an audience of business people, I will frequently ask them to imagine the role of a CEO. Notwithstanding immense improvements in the ability to measure and model, I do not think many CEOs would accept the notion that a computer could do their job. There is still room for individual perception and there is no way we can model the universe. At least, not yet. The same thing is true when those of us in law enforcement try to apply the antitrust laws. In complex fact situations, there is always going to be room for slightly different views of what the future may be. On those very rare occasions when we have split votes, I do not have a sense that I am right and others are wrong. We just see the future differently.

Are there some systematic differences depending on political ideology? Perhaps, to a slight degree. Differences in basic political orientation may lead to a slightly different assessment of the risks of over-enforcement or under-enforcement. Assessment of the collateral harm that comes from errors in either direction is a subjective judgement. The way we view risks in this world, in my opinion, depends upon a large number of factors that lie at the core of our being, and there is no point in arguing about it. You cannot argue profitably about fundamental value judgements, any more than you can argue sensibly about religion. These things do not lend themselves to proof or disproof, and that is part of the untidiness we have to live with.

2. The Costs of Deception

The second major area I want to discuss is deceptive advertising. Some of the offenses involve outright fraud and theft, and the issues do not require a great deal of economic analysis. But, some of the economic harms caused by deceptive activity are a little more subtle.

It is important for a business audience to understand that the harm done by fraud and deception goes well beyond the harm caused to an individual consumer who has been deceived or an individual business that has been disadvantaged by the dishonest advertising of a competitor. We need to think about the associated “externalities.” (My understanding is that an economic externality arises when a particular transaction has an impact on people who are outside the transaction, but that impact is not necessarily recognized in the transaction price.) Businesses in this country suffer from fraud and deceptive advertising, even if it involves products that are not remotely connected to the products that they sell. The reason is that false advertising of some products makes people skeptical about advertising of all products. The most honest advertiser in the world has to spend a lot more than would otherwise be needed, in order to overcome that mental block. That is why we so often exhort the business community at large to regulate itself, in its own interest - - even if the pockets of fraud are perceived as remote. But, it is hard to get people to do that.

Consider one example. There seems to be a symbiotic relationship between the defrauders and the defrauded. If you were to sort through our cases, you would be struck by the incredible persistence of naive ideas, like the notion that you can get rich or thin without doing any work. We are trying to persuade the media that it is in their long term interest to screen out the most obviously fraudulent advertising, just as they screen out advertising that is offensive for other reasons. If they were more selective, it should ultimately increase the value of the advertising that passes through the screen. I do not believe, however, that progress will be easy.

In my experience, one of the biggest obstacles to the expansion of freedom and consumer welfare is that even the most honest business people tend to be parochial. Maybe they have to be because time and resources are scarce and, for all of us, the more remote projects tend to stay at the bottom of the pile. But, in the long run business pays a price and consumers pay a price. The Commission cannot do more in this area than engage in what I call exemplary justice, so that

people on the business side will clearly understand what is wrong and people on the consumer side will know about some particular scams that they need to look out for. There is no way in the world that an agency with 1000 employees can cover the entire United States economy. We bring some exemplary cases, we publicize them actively, and we talk a lot - - hoping that somehow or other we will reduce the harm, but recognizing that our efforts can never eliminate it. We could use more help.

3. The Unintended Consequence of Government Regulation

A third area of tension that we have to deal involves the actions of government at both the state and federal level. This is where our advocacy role becomes most important. We do not have the prime responsibility for dealing with matters like the environment or health and safety; there are other agencies that have Congressional mandates of their own. We do not make the ultimate decisions, but we can perform a service if we provide information on the consequences of various decisions.

A lot of the regulation undertaken by other government agencies is based on concerns over negative externalities, which I have already cited as a legitimate one. But, it is also necessary to take account of positive externalities or the negative externalities of the regulation itself. Consider a commonly cited example from the auto industry, where I once worked. There are environmental and safety consequences resulting from the production and sale of automobiles that are not captured in the purchase price. The manufacturer does not want to take account of them and consumers do not either. However, the social costs are not as high as people think because there are offsetting positive externalities no one thinks about.

I do not for a moment underestimate the social costs of auto deaths and injuries, but has anyone ever stopped to consider what the harm would be if there were no automobiles and people had to be rushed to hospitals in ox carts? Or if firemen and policemen had no vehicles? Think of it the next time you hear the sirens. Environmental pollution is also a serious problem, but think about what the pollution problems would be if you still had horses fouling the city streets. Think of how expensive goods would be if they had to be distributed the way they were 100 years ago, or if there were no supermarkets or warehouse stores that really depend on an automobile culture.

I could - - and, at one time, would - - continue this digression at much greater length, but the general point is that we need to think very hard about all the spillover effects when we cite the existence of externalities to justify even more intrusive regulation. While we recognize that externalities give rise to government regulation by entities with the sovereign responsibility to weigh them, the Commission can lend its expertise in the operation of markets to assist this balancing process. Those people who have the decision-making power will at least be aware that regulation can come at a price.

Let me cite a recent specific example where the Commission has provided useful information. We have done a number of studies, at the request of Congress, on the causes of the intermittent spikes in gasoline prices during the last few years. I do not know whether you have had this problem in Connecticut, but you have undoubtedly heard about problems in the Mid-west and West Coast. We have done a great deal of research, studies, and reports on these matters. One of the principal causes seems to be the proliferation of what are called “boutique” fuels, specially formulated for environmental conditions in a specific area. The people responsible for air quality believe that is important to have boutique fuels and that is not our decision to make. It is inevitable, however, that if they are mandated and there is a local disruption of supply for some reason - - like an accident in a refinery or pipeline, or a strike - - the effects will be tremendously magnified because the market can not correct as quickly as it otherwise might. You cannot readily transship from another area because the allowable fuels are specific to particular areas. Since the demand for gasoline is extraordinarily inelastic in the a short term, there will be an immediate price spike when there are local shortages. This causes highly publicized distress and political uproar.

When we study the matter and report to Congress, our bottom-line message is likely to be: “It is not up to us to decide whether this proliferation of boutique fuels is justified; that is your business, and the business of local authorities, not ours. But, as long as those rules exist, there is a high risk of these short-term aberrations and the competition laws that we enforce cannot alleviate the problem.” Needless to say, this advice is not always greeted with enthusiasm.

4. The “Globalization” Debate

The last subject I want to mention is the tension over world trade issues. The “globalization” debate has, of course, been the subject of extensive press coverage - - not to mention riots in the streets. We survived the meeting of the World Bank in Washington a couple of weeks ago with virtually no disruptions but, if we ever let our guard down, you are likely to see something like what happened in Seattle a few years ago. This is a big issue and one of the things that concerns me is the fact that our own government sometimes appears to be inconsistent. We preach the virtues of free trade to the world but we have our own tariffs and subsidies of various kinds.

These are not matters for which the Federal Trade Commission has any direct responsibility, but I am frequently asked to comment on them - - particularly abroad - - because of our role as competition advocates. Our institutional bias is always in the direction of free trade, whether it is intrastate, interstate, or international. This is not a partisan issue in the Federal Trade Commission and I think we have a consensus that in the long run the human condition is improved by lowering trade barriers around the world.

If you look at what has happened in the past forty years in the worldwide economy, there has been improvement in every fundamental measure of human welfare you can think of - - like longevity, per-capita food supply, or reduction of child labor. The rapid expansion of world trade

has conferred benefits on the entire world. With the exception of some pockets caused by identifiable anomalies, world trade has helped the underdeveloped world as well as the developed world. Some people have the idea that the undeveloped world has not benefitted from free trade because the developed world may, in some ways, have benefitted more. This does not make any sense because trade is not a zero sum game. One person's benefit does not disappear because someone else benefits even more.

The decision makers in the U.S. government do not suffer from this illusion, so why is our government sometimes inconsistent? I can offer some purely subjective opinions.

In the first place, a representative government - - which all of us will agree is superior to the alternatives - - also has associated costs. One of the costs is the need to compromise with important constituencies, and some important constituencies do not understand the realities of what I will call the "but for" world. We in the Commission are used to this concept because when we look at the impact of a particular competitive practice, we have to try to figure out what the real world would look like if parties behaved differently. This is not a comparison with some ideal world that could be imagined. If you ignore reality, you might argue that the export of low wage jobs to an underdeveloped country hurts the underdeveloped country because the people there are working under conditions that we would consider brutal. Working conditions may well be deplorable by our standards but the conditions are better and the jobs are better than what would be available if the U.S. slams the gates. I cannot imagine that it will benefit an undeveloped country if we refuse to buy its goods, but that hard fact is not widely understood.

People in the United States have always had a strong missionary impulse, and this impulse has honorable antecedents. Our new republic was the hope of the world, the first truly representative government in history. We emerged from that experience with a feeling that we had something special to offer. There are a lot of perfectly well meaning people today who think we can export to the world our enlightened views on environmental matters, labor standards, energy conservation or other worthwhile objectives that we can comfortably contemplate in prosperity. The trouble is that insistence on some of those things may make conditions in an underdeveloped country much, much worse.

The perceived infirmities of globalization are also subtly exaggerated by the imperatives of the news media. The dislocations caused by free trade are immediately targeted and highly visible, while the benefits tend to be long term and more defused. The distress of steel workers who have lost their jobs, and the distress of their families, makes the evening news. If you put a tariff on steel to protect those jobs, the increased costs of products that use steel, or the loss of jobs that would otherwise be created in some import-dependent sectors, are hard to capture on television shows. Elected officials will respond to what is on television news and to the things their constituents are concerned about. That is another real-world fact that we have to recognize.

Finally, one of the major problems is that the benefits of a free market are predicated on a stable world order. The free flow of goods internationally has not been a normal state of affairs in human history.⁹ I happen to think there is a symbiotic relationship. The benefits of globalization increase the costs associated with trade disruptions and consequently may reduce their incidence, which in turn further enhances the benefits. But, people in charge of governments are unlikely to risk a nation's basic security on the assumption that further disruptions are impossible. Whatever the relative inefficiency of our domestic steel industry, the United States is not likely to put itself in a position of total dependence on imports, anytime soon. It is just not going to happen. The same thing would be true of automobiles or any other basic industry we consider essential. Other countries feel the same way about their own basic industries. This is yet another reason why the world is untidy.

When I am abroad, people sometimes ask: "How can people in the United States be such hypocrites? You preach free trade but do not practice it." Well, the fact is we do practice it. A lot of our industries have been destroyed because of worldwide competition and, in the long run, it is a good thing to concentrate on the areas where we have a comparative advantage. But, we are not entirely consistent and no one is entirely consistent.

When people accuse the United States of hypocrisy in these matters, I am also tempted to respond with the observation that "Hypocrisy is the homage that vice pays to virtue."¹⁰ When you are hypocritical, you at least implicitly acknowledge your imperfections. Perhaps an even better response would be the one attributed to the official mistress of a French king, who was apparently also noted for her many charitable works and conspicuous piety. When she was upbraided for hypocrisy by one of the court ladies, she is supposed to have replied: "My dear, just because I commit one sin, it does not mean I have to commit them all." So it is with the untidy compromises that we have to make in this great, free country as we lurch our way - - with two steps back for every three steps forward - - toward ever greater freedom and prosperity for all of our citizens.

Conclusion

The cause of freedom progresses by fits and starts, but progress it does. I firmly believe, on the basis of abundant evidence, that freedom is essential not only for efficiency in the short term but also for innovation and fundamental improvements in human welfare over the long term. Think about whether any of you would like to have lived a hundred years ago. Or a thousand years ago. Or four thousand years ago. The pharaohs who lived four thousand years ago were thought to be gods and treated like gods on earth. And now, with modern medical science, we can examine their mummies and realize that their teeth were rotting in their heads and they lived with constant pain. I suspect that every one of us here today has a better quality of life than those gods on earth who lived four thousand years ago.

We can thank freedom for this. I am proud to be part of an agency that is devoted to the advancement of freedom and honored by the opportunity to speak of freedom at an institution dedicated to its cause.

* This lecture is the edited transcript of informal remarks, delivered at the David T. Chase Free Enterprise Institute on October 7, 2002 at Eastern Connecticut State University. The opinions expressed are those of the author alone, and not necessarily shared by any other Commissioner.

1. For an expanded discussion of this idea, see Thomas Leary, Freedom as the Core Value of Antitrust in the New Millennium, 68 Antitrust L. J. 545 (2000).
2. Standard Oil Co. v. United States, 221 U.S. 1 (1911).
3. 15 U.S.C.51.
4. 15 U.S.C. 312.
5. 15 U.S.C. 541.
6. The Commission has concurrent jurisdiction with the Department of Justice on many antitrust matters.
7. Robert Bork's book, The Antitrust Paradox, A Policy At War With Itself (1978), was immensely influential.
8. Continental T.V. Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).
9. See, e.g., Douglas H. Ginsburg, International Antitrust: 2000 and Beyond, 68 Antitrust L. J. at 571 (2000).
10. The quote comes from the Reflections of the 17th Century French philosopher, La Rochefoucauld.