Welcome to the Federal Trade Commission

FTC History: Bureau of Economics Contributions to Law Enforcement, Research, and Economic Knowledge and Policy

Roundtable with Former Directors of the Bureau of Economics

(Sponsored by the Bureau of Economics)

September 4, 2003
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601 New Jersey Avenue Conference Center
Rooms A & B

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Those of us who spent many months working on this project increased our appreciation for the rich legacy of the Bureau of Economics and are proud to present the result to enhance the oral history of BE. We all deeply appreciate the extensive efforts of keynote speaker Jim Miller and the 13 participating former Bureau Directors, several of whom devoted extensive time to preparing detailed presentations of extensive material.

–-Paul A. Pautler
Deputy Director for Consumer Protection

FTC HISTORY: BUREAU OF ECONOMICS CONTRIBUTIONS TO LAW ENFORCEMENT, RESEARCH, AND ECONOMIC KNOWLEDGE AND POLICY

September 4, 2003

P R O C E E D I N G S

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MR. FROEB: Welcome to the celebration of the role of economics at the Federal Trade Commission. My name is Luke Froeb. I'm the current Director of the Bureau of Economics, but I've only been on the job three weeks. I want to thank Dave Scheffman, Chairman Muris, Paul Pautler, and especially Denis Breen for putting on this crash course in management for me. I have hundreds of questions about the role of economics and how to manage the Bureau, and I'm sure I'll get a chance to ask most of them today.

It's self evident to economists that cost benefit analysis should be the foundation of consumer protection and competition policy. The difficulty we've had is convincing others of that fact. No one has been more sympathetic and influential in bringing cost benefit analysis, economic analysis to the Federal Trade Commission over the past three decades than our Chairman, Timothy Muris.

Please see Mr. Muris's written remarks at http://www.ftc.gov/be/workshops/directorsconference/docs/openingremarks.pdf

(Applause.)

MR. MURIS: Thank you very much for that kind but not completely accurate remark. There are a lot of people in this room who are more responsible for getting economics ingrained in the FTC than I've been.

I want to welcome you to this celebration of the 100th anniversary of the FTC's predecessor, the Bureau of Corporations. We're joined today by numerous distinguished guests, including 13 former Directors or Acting Directors of the Bureau of Economics. Given the critical role that the Bureau has played in the FTC's history, including its economic investigation and report writing and its involvement in law enforcement, it's fitting to commemorate this 100th anniversary.

Today's roundtable is one of several celebrations of the rich history of the FTC. Let me just give you a few examples of what we're doing. A few years ago, I created the Miles W. Kirpatrick Award. This award honors the commitment, talent, and contributions of individuals who throughout their public and private careers have made lasting and significant contributions to the FTC.

Basil Mezines received the first award, and we established a tradition by having someone present it to him. Caspar Weinberger actually presented the first award and gave a very interesting talk which we have recorded.

Just to show the persistence of the FTC community, we had to schedule the award ceremony three times. The first date was scheduled for September 12th, 2001, which for obvious reasons didn't work. And right before the second date, Basil's wife unfortunately died. Caspar Weinberger called me and said don't you dare cancel this thing. So he came down, and the third time was the charm.

Last year we gave the award to Bob Pitofsky. Ira Millstein, who is a very prominent antitrust attorney, presented the award. I see some grimaces out there.

(Laughter.)

MR. MURIS: I know why Mike is grimacing, because Ira led the attack on line of business. But Ira is probably best known for his forcing out GM management ten years ago or so. He's a very prominent lawyer. Ira's role was that he was the one who corralled Bob Pitofsky and got Bob to be the executive director of the first Kirpatrick report, which had such an impact.

I also see Marc Winerman here. Marc, Chris White and Jim Hamill from our General Counsel's office are working on oral histories of the FTC. Marc has written an outstanding paper about to be published in the Antitrust Law Journal on the 1914 origins of the FTC.

We're also planning an event to celebrate the FTC's 90th anniversary, which is tentatively scheduled for next fall. The FTC has two ways to determine its anniversary. You can look at when the law passed, which will be next fall, or when the agency opened, which I think would be March of 2005.

Before I tell you about today's events, permit me a few personal remembrances. It's really wonderful to see so many longtime friends. It's especially nice to be with people who remember the doghouse and Barney's sense of humor in his FTC special. If you remember, Barney's was across the street. The FTC special was sliced turkey.

I have memories with so many of you, and I just wanted to share two. One was watching John Peterman's eyes get bigger and bigger until they almost exploded out of his head as the late Mike Glassman explained the cereals case.

(Laughter.)

MR. MURIS: As Mike said, quote, "It's a spatial monopoly, John."

(Laughter.)

MR. MURIS: The other was in Room 432, June 1975. Literally hundreds of people were packed in to see the late Jim Liebler and Mike Scherer do battle. The issue was whether General Foods was predating against Procter & Gamble, and Mike's recommendation that General Foods be forced to license its trademark Maxwell House to new entrants.

As Mike reminded me last night, being the excellent academic that he is, he recovered from the

Commission's rejection of his remedy by publishing an article about predation in the Harvard Law Review, no less.

So I have many fond memories of what we're going to talk about today, and I certainly look forward to this discussion. Unfortunately, the bad news is I won't be able to be here for most of the discussion. The good news is we tape all these things, and it's my entertainment while using my exercise bike. I'm currently watching a memorial service for Phil Elman, and it is quite interesting.

We are also assembling a very large documentary and oral history of the FTC. This program will be an important part of our oral history.

As you all know, the Bureau of Corporations was created as an investigatory, not a law enforcement group. It was created within the Department of Commerce and Labor. The Bureau opened on February 14th, 1903, the same day that the Department opened. In 1915, the FTC opened and replaced the Bureau of Corporations. The Commissioner of Corporations, Joseph E. Davies, became the FTC's first Chairman.

The FTC's first Chief Economist was Francis Walker, the former Deputy Commissioner of Corporations, who remained with the FTC for 26 years. The new Commission inherited both staff and investigations from the old Bureau. The Corporation's investigatory role began a tradition of economic report writing and research that continues to this day. Economic reports by the Commission and its staff have played a crucial role in policymaking by Congress, other federal agencies, and state authorities and legislatures.

Of course, Congress included enforcement and adjudication, as well as investigation, when it created the FTC. The Economic Division, which was the predecessor to the Bureau of Economics, conducted the report writing function through the '20s. The Division's role expanded in 1936 with the passage of the Robinson-Patman Act. The Division, primarily through its accountants, supported RP cases. Sad but true. Data collection became another activity of the Division in the late 1930s.

The Bureau of Economics was created in 1954, and its functions were further enlarged to include merger review, antitrust analysis and case support. Consumer Protection work became a regular BE activity in the mid to late 1970s, and Competition and Consumer Protection Advocacy began in the late 1970s and 1980s.

Today we're going to consider the history of BE and its contributions to research, economic knowledge and policy, and antitrust and consumer protection law enforcement.

To some extent, there are discussions of BE's history in published commentaries and other public documents, including FTC annual reports. There are several older publications on the earlier decades of the Commission and the Bureau of Corporations.

There's also some more recent FTC history covering the Bureau of Economics in various books and articles, including commentaries by our current General Counsel, Bill Kovacic, and in a book that I wrote and edited with Ken Clarkson, which criticized the role of the FTC in the 1970s. BE history also is discussed in the reviews or memoirs of several former BE directors.

Today's discussion will provide a valuable addition to this collection. We will augment what we think we know about the history of BE and the evolving or changing role of the economists at the Commission from the mouths of those who know BE best, its former Directors.

We want to identify from their experiences significant BE contributions to economic research and knowledge and to antitrust and consumer protection policy. Likewise, we want to identify the important but often less visible contributions to FTC law enforcement.

Finally, we hope to learn how internal and external influences affected BE's work. We will consider the FTC's organization, resource levels, relationships with other bureaus, lines of communication within the Commission, and trends and developments in the fields of economics, the economy, the political environment and technology.

Our panel today -- and this is one of the great parts about this day -- consists of former BE Directors and Acting Directors from the past 50 years. They include Jesse Markham, who was Director in the mid 1950s, and Fritz Mueller, Director for eight years in the 1960s. I learned last night that Fritz also had a stint in the White House monitoring prices.

Some of our guests served more than once as Director or Acting Director, like Dave Scheffman and Mack Folsom. Each of our panelists left his or her mark on the Commission, and each has valuable knowledge to share with us today about the Bureau of Economics and the role of economic analysis at the Commission. Moreover, as their biographies clearly indicate, they not only lived for a long time, but each has had a distinguished career beyond the FTC. They are well recognized for their contributions to academia, other public service in government, consulting and corporate America.

We're also pleased to have as our luncheon speaker -- and I'll have a lot more to say about that when I introduce Jim at lunch -- another economist with a distinguished career here and beyond, former FTC Chairman

James C. Miller III.

Dave Scheffman, our most recent former BE Director, will moderate our beginning panels. Dave has served with distinction for a total of 12 years, so far, in the Bureau.

(Laughter.)

MR. MURIS: Luke Froeb, the current BE Director, will moderate the fourth session this morning. Luke comes to us from Vanderbilt University, where he taught managerial economics, regulation, and antitrust for MBAs.

Luke is new to the FTC, but he served as an economist at the DOJ in the late 1980s and early 1990s. We hired him despite that indiscretion.

BE Deputy Director Paul Pautler will moderate the afternoon panels. Paul has made valuable contributions to antitrust, consumer protection, advocacy, and research since his start in BE 25 years ago. He's also a dedicated student of the history of the Commission and of the Bureau.

As most of you know, I consider good economics to be crucial in guiding the FTC's judgments and policies in promoting competition and consumer protection. The Commission's enforcement missions need a sound theoretical framework supported by solid, empirical evidence. Our enforcement programs should be focused on practices that pose the greatest threats to consumers.

In addition, Congress gave us a broader role as a deliberative body and independent expert on issues affecting the market. In this role, we hold public hearings, conduct studies and issue reports to Congress and the public.

BE is an essential part of this policy research and development. I'm proud of the outstanding work of our economists. Indeed, as I have often said, we have one of the world’s great collections of IO economists.

In looking forward, we need to understand the path we have followed. We've reached this point because of the steps taken by our panelists and others with whom they work.

Each panelist can discuss positive acts during his or her tenure. Each no doubt can also remember frustrations and setbacks. Together, they tell a story of evolution, adjustment and progress that provides a valuable lesson for our future.

Finally, I want to thank the Bureau's staff for organizing today's event. I especially thank Denis Breen, Paul Pautler, Luke Froeb, and Dave Scheffman.

Also, I thank again today's participants for sharing your time with us. I now turn the program over to our first moderator, Dave Scheffman.

Thank you.

MR. SCHEFFMAN: Thank you, Tim.

(Applause.)

MR. SCHEFFMAN: We have an extraordinary group of people here in many dimensions in terms of contributions to industrial organization economics, publications, teaching, and textbooks. An extraordinary group of people, and also obviously important to public policy.

One might expect that the main impact of BE arises from actions of the Director, such as whispering into the ear of the Chairman at Commission meetings. Actually, the role of whispering in the ear of the Chairman is an extremely minor part of the Bureau Director's job. I have worked with lots of Chairmen, and they tend not to listen much when we whisper into their ears.

(Laughter.)

MR. SCHEFFMAN: The way the Bureau of Economics affects things is through the work of the staff.

The Directors were effective if they understood that role and harnessed and improved that talent to make economic analysis more relevant to the Commission.

A couple of people not here deserve special mention. One, Mike Mann, a Bureau Director in the 1970s, besides being an outstanding industrial organization economist, was truly one of the nicest people that any of us ever met. We certainly miss Mike.

Another very important person who was not a Bureau Director but undoubtedly would have been here, larger than life, if he were still alive is Mike Glassman, who made some of the biggest contributions to the Bureau.

Two of our panelists, who started in the staff and grew to management positions, were Mack Folsom and John Peterman. These men, and Mike Glassman, were especially effective because they understood BE and the Commission both from the staff and management perspectives, and because they were effective in integrating economic analysis with the needs of Commission attorneys.

With those introductory remarks aside, we're starting with the beginning of the modern Bureau of Economics. That's the panel with Jesse Markham, Fritz Mueller and Mack Folsom. We're going to go in chronological order. Jesse will go first.

MR. MARKHAM: This is the first time that age ever got me anywhere.

(Laughter.)

MR. MARKHAM: I'm reminded that I must start with a caveat. It's exactly 50 years ago that Jack Howrey sent a representative to visit me at Princeton University to see if I would come down and entertain the notion of taking over the Bureau of Economics.

In looking back 50 years ago, to use good computer language, I find that my memory coil works pretty well, but my retrieval system may have some defects.

(Laughter.)

MR. MARKHAM: In fact, I think Denis was somewhat surprised when he found my phone number, called me, and found that a real live person answered the telephone.

(Laughter.)

MR. MARKHAM: Well, anyway, back to the beginning and those two-and-a-half or three years that I was around the Commission.

When Jack Howrey called me into his office, after reviewing the enabling legislation that set up the Federal Trade Commission, he thoroughly convinced me that he was going to take quite seriously injecting a lot more economic analysis into what was going on around the Commission.

He started by reviewing the remand order in the Pillsbury case, where Pillsbury acquired Ballad and Duff. The hearing examiner had simply relied upon the substantiality doctrine, that in some quantitative sense, this had accounted for a substantial amount in a line of commerce.

It was Jack Howrey's illustration of what he wanted the Bureau to do. He said that the hearing examiner did not make the connection between a substantial amount of output in a particular line of commerce and the possibility of substantial injury to competition.

My mentor, Ed Mason, had written two very persuasive articles claiming that economists prefer models, but lawyers like rules. So I pointed this out to Chairman Jack Howrey.

I told him that injecting more economics into the whole system of litigation may be a pretty rough road to travel. How are we going to convince lawyers that economics is in some sense relevant to what they're doing? He said, well, we'll take care of that.

He did hold several staff meetings between the lawyers and the economists after I got there and emphasized the point that he was making.

Well, to jump along, when I got my feet under the desk in that lovely office over on Pennsylvania Avenue, I found that I was not over staffed with economists. John Blair was already busy with a study of mergers and concentration. Frank Kottke was thoroughly committed to a study of the thousand largest corporations. Erston Barnes was head of what we then called the litigation component of the Bureau of

Economics. Betty Bock was busy with the Loria case, and Roy Prewitt, as near as I could understand, was engaged in damage control on a previous study of the petroleum industry.

I learned fairly early in my tenure that we did not have room to hire and beef up the economics department very much. We were going through what was called a RIF, a reduction in force, in Washington at that time. In any case, that's what we had to live with.

Let me describe what the procedures were and how Jack Howrey's mandate became put into practice. In those days before Hart-Scott-Rodino, we spent an awful lot of time scanning the financial press to find and catalogue all the mergers and situations that looked like they might be predatory pricing.

The economists would work on a draft making the economic argument that a situation potentially looked like a case and should be investigated. The draft recommendation would come to my desk. I almost always approved the recommendation and sent it to Harry Babcock, who was then head of the Bureau of Investigation.

From that point on, historically investigations had just been in the lawyers' hands. The change we implemented was to send the economist along with the memo to the Bureau of Investigation, to make it clear that this is my case as well as it is your case. This change had very little opposition from Harry Babcock.

I was reminded when I called on Joe Sheehy, who was the head of the litigation bureau in the Commission, he stated that he could get along with economists. He didn't really hold very much against economists. But on my departing his office, he was the one who reminded me of that old Federal Trade Commission statement, "But you have to remember, Professor, one incriminating letter in the files is worth the testimony of ten economists."

(Laughter.)

MR. MARKHAM: Well, so much then for BE functions, which are all spelled out in the Annual Report. There's no point in my reviewing all of this. The functions really were the screening, developing the initial economic analysis, but going with it to the Bureau of Investigation and having something to do with the content of the letter of inquiry to go to the target of the investigation.

I want to dwell a little bit on the economic study program. We had scarcely gotten started on what I perceived to be something of a new program when we got hit with the coffee study. How could you get a more popular study than this? America woke up every morning to its cup of coffee, and coffee prices were going up. That was the end of the ten-cent cup of coffee in the country.

Again, the role of the economist and Jack Howrey. The Bureau of Investigation literally ran with that. Congress was putting pressure on the Commission to investigate and do something about the price of coffee. You can understand, constituents were very upset about all of this.

So the Bureau of Investigation sent its lawyers to New York, and Howrey called me, and he said "I want you to get to New York, take whatever staff you've got, and I want you to be supervising the investigation."

The lawyers were investigating the New York Coffee and Sugar Exchange activities and looking into the purchasing policies of Maxwell House Division of General Foods, and of all the large coffee producers. John Blair and I then moved from Washington to New York.

In my first conference with members of the New York Coffee and Sugar Exchange, it became clear that we needed an expert on futures trading. And fortunately, we found one in the Department of Agriculture. I'm trying to recall his name. I think it was Robinson. Absolutely a whiz. So we had him added to the staff, and a staff member came over from the Bureau of Commerce who had a degree in economics, but his specialty was marketing.

Well, anyway, that study, produced during my term in that office, was reviewed very favorably. The press I think hailed it as probably the best industry study that had ever come out of a government office. And it was nominated for a prize from the American Marketing Association.

If I have a few minutes left, Denis wanted me to do some reconciliation here between what seemed to be the very prominent role that economists played in 1953 to 1956 or thereabouts, and an article that I wrote, celebrating by the way the 50th Anniversary of the Federal Trade Commission, dating it from 1914 at that time, in which I downplayed the role of economists generally. I think if I had to write that article again, given what's happened since the late 1950s, I would write it a little differently.

The three decisions that the Federal Trade Commission passed down in 1962 seemed to me again to be a triumph of rules over analysis. In one case, the Commission enunciated the slogan of the deep pocket theory. The acquiring company would have more money and therefore would put at a disadvantage the unintegrated smaller firms. In the food case, it opened up the possibility of business reciprocity. In a third, it reverted again to the doctrine of substantiality.

In none of those cases was there any empirical evidence of any anticompetitive effects. Those rules may have been perfectly supportable, but they were not supported in these decisions. The lack of evidence led me to conclude that rules again triumphed over economic analysis in the decisionmaking and in the processes of the Federal Trade Commission.

I end by observing that had I been writing any time after around 1980, I would have given a somewhat different story. The shared monopoly cases that were started were rooted clearly in the theory of oligopoly and in the notion of conjectural interdependence. There was no evidence of an overt conspiracy, but that was I think an excellent example of the application of an economic model to an industrial situation.

Whether the FTC won or lost, it was very appropriate, and in my judgment, it was a signal triumph of analysis over rules.

That about finishes my little presentation.

MR. SCHEFFMAN: Thank you, Jesse. Fritz?

MR. MUELLER: As with Jesse, I appreciate this opportunity to visit with many old friends and to meet others whom I've read about and some I am hearing about for the first time. Jesse was one of my mentors as a young student, young relative to him. (Laughter.)

MR. MUELLER: I have an article elaborating on my presentation forthcoming as “The Revival of Economics at the FTC in the 1960s” in the Review of Industrial Organization, Vol. 24, No. 1 (2004). In many ways, the 1960s were the best of times and the worst of times. A young President had made a call to public service. I was among the many young academicians anxious to answer the President's call. Early in my training, I had learned much about the nature and business of the antitrust agencies. My major Professor, George W. Stocking, often spoke of his experiences as one of the several "chief economists" of Thurman Arnold, and of working with the FTC's long-time chief economist Dr. Francis Walker. Another of my professors, Jesse Markham, was appointed chief economist of the FTC in 1953 while I was in graduate school.

I thought the best Washington job for an IO economist must be that of Chief Economist of the FTC. My colleague, Professor John Stedman of the Wisconsin Law School, provided an introduction to Paul Rand Dixon after President Kennedy announced that Dixon would become the FTC's new Chairman. In February 1961, I visited Dixon while he was still serving as Chief Counsel to Senator Kefauver's Antitrust Subcommittee. Dixon promised to put me on the list of candidates, but he suggested that I also talk to the Subcommittee's Chief Economist, Dr. John Blair, a former Acting Chief Economist of the FTC. Blair, who also was a candidate for the position, discouraged me from going there by saying that the Bureau of Economics was in such bad shape that perhaps even he couldn't fix it. Discouraged by my prospects at the FTC, in 1961 I accepted an offer as Chief Economist to Congressman Wright Patman, the 1961 Chairman of the Joint Economic Committee of the Congress, where I remained until July.

During May and June, I had several interviews with President Kennedy's first two appointees to the FTC, Chairman Paul Rand Dixon, a Democrat, and Commissioner Philip Elman, a political independent. Following an interview in June in which Dixon said that he and Elman had decided that I was one of the two finalists, Elman asked me which position I was applying for, Chief Economist to the Commission or Director of the Bureau of Economics. I was nonplused by the question. This was my first inkling that they were considering creating separate positions. I said that, if forced to choose, I would choose the position of Economic Advisor to the Commission.

At the time I had not known that a 1960 Budget Bureau report had made a devastating criticism of the Commission's treatment of economists. It stated that the BE functioned out of the mainstream of the FTC's mission and played no role in advising Commissioners. Among other things, the Budget Bureau recommended that a special position of Economic Advisor to the Commission be created, apart from the position of Bureau Director, as Chief Economist Corwin Edwards had recommended in 1953 and the Heller Report had recommended in 1955.

The reason various parties had proposed separating the positions of Bureau Director and Economic Advisor to the Commission was their interpretation of the Administrative Procedures Act of 1946, which mandated the separation of functions within administrative agencies. Commissioner Philip Elman, who had served for years in the office of the Solicitor General and was an expert on administrative law, persuaded Chairman Dixon that the same person could hold both positions if the Commission isolated the Bureau Director from the litigating functions within the BE by delegating administrative responsibility of the Division of Economic Evidence to the Deputy Bureau Director.

A few months after I arrived at the FTC in July 1963, the Commission accepted Elman's proposal and permitted the Bureau Director to serve as an economic advisor to the Commission on any matter in which he had not participated at the staff level. A 1962 report of a Committee of the Administrative Conference, which was reviewing the procedures of the FTC and other administrative agencies, endorsed this approach (See Auerbach, "The Federal Trade Commission: Internal Organization and Procedure," *Minnesota Law Review,* 48, 383-522.)

This decision decisively enhanced the role of economists at the Commission in the 1960s. The Chairman always suggested that new Commissioners invite the Commission's Chief Economist to meet with them and have him explain how he might be helpful to them and their staffs. Most Commissioners adopted an "open door" policy to permit me to initiate meetings with them or their staffs on economic matters. I worked most closely with Commissioner Philip Elman, generally conceded to be the most brilliant legal mind to serve on the Commission to that time. He wrote most of the important Commission decisions with economic content. His most brilliant legal assistant was Richard Posner, who had served as legal clerk to Justice William Brennen. In later years, Posner said that I was the first economist he had worked with and that his experience at the Commission began his romance with economics. In those times, Posner, like me, had essentially embraced the industrial organization paradigm of Professor Joe Bain, whose ideas had gained prominence in antitrust enforcement circles in the 1960s. Not surprisingly, Elman's *Consolidated Foods* decision included more than 40 citations to economic authorities, with the largest number citing Professor Bain. Posner successfully articulated his views and played an important role in developing antitrust policy in the 1960s, first at the Commission and later in the Office of the Solicitor General, where he successfully argued the important *Von's Shopping Bag* and *Schwinn* cases before the Supreme Court in 1966 and 1967.

My first priority upon arriving at BE was rebuilding the staff, which had been decimated in 1955 when the FTC asked the Heller consulting group to propose organizational changes at the FTC. The Heller Report recommended moving most BE economists to the staffs of the Bureaus of Investigation and Litigation; moving the BE Division of Accounting to the Bureau of Investigation; and moving the BE Division of Financial Statistics to the Office of the Controller. These changes left BE with only a Bureau Director and a Division of Economic Reports with 12 economists.

I think the reason the economists were moved out of the Bureau of Economics into the legal division was an outgrowth of a controversy between economists and attorneys before Jesse came in. The economists, namely, Blair and the Chief Economist, Corwin Edwards, disagreed vehemently with the economic approach being taken by the legal division, and the lawyers wanted greater control over the economists.

I think it was a terrible idea myself. It's one of those things like your first marriage. It seemed like a good idea at the time.

Prior to my appointment, Chairman Dixon had promised to return all economists to BE. To find a new Bureau Director seriously committed to rebuilding BE, Chairman Dixon insisted on a minimum commitment of four years. This requirement proved fortunate for me, because the other leading finalist for the BE job was unable to obtain a four year leave of absence. I couldn't either, but I was willing to take my chances.

Former BE Director Simon Whitney told me that he had only two personnel recommendations. One was Katherine Abbott, his competent personal secretary; the other was Roy Prewitt, an excellent and loyal economist. I accepted Whitney's recommendations and retained Mrs. Abbott as the BE Secretary and appointed Roy Prewitt Deputy Director of BE.

I quickly discovered that all economists on BE's Economic Reports staff were older than me and that only one had a Ph.D. He was 65 and retired shortly thereafter. The 14 economists returning from the legal bureaus included some very fine economists, especially Roy Prewitt, Dr. Frank Kottke, and Dr. Betty Bock, all of whom had been candidates for the BE Director's job.

We immediately began a serious recruitment effort, which was difficult because universities were hiring economists at record levels in the early 1960s. Among the first I hired was Dr. Irene Till, who had been on Senator Kefauver's staff. She agreed to serve as Chief of the Division of Economic Reports until I could obtain a qualified replacement. In 1962, I hired Dr. Stanley "Gene" Boyle, perhaps the top economist at the Antitrust Division. When Boyle returned to academic life, I appointed Dr. Arthur Anderson of Boston College, one of Carl Kaysen's students at Harvard. As Chief of the Division of Economic Evidence, I appointed Harrison Houghton, who had worked many big cases at the Justice Department in the 1950s and had assisted Senator Kefauver in enacting the Celler-Kefauver Act. Houghton was very knowledgeable in the ways of Washington. Another early recruit was Dr. Russell Parker, a University of Wisconsin Ph.D., who subsequently served as Assistant Director of BE with me and for all successive BE Directors until 1987, when he obtained a leave of absence to come to Wisconsin for several years. He later returned to the FTC until his retirement in the early 1990s. He played a key role in pushing through and implementing the line of business program. Happily, Russ is here today.

During the first few years, BE's publication output was modest. But as the staff grew and the quality improved, the output of economic studies increased from 14 during 1961-1965 to 48 during 1966-1970. To enhance the professional prestige of BE economists, I persuaded the Commission to permit identifying the authors of BE studies. To my knowledge, the Commission had never previously permitted crediting authors of reports. By the end of 1963, BE had 39 economists; thereafter the number increased steadily, if modestly. By 1969, BE achieved recognition as one of the best microeconomics groups in Washington.

My role as Chief Economist to the Commission created many important and unique opportunities. I worked more closely with Commissioner Philip Elman than with other Commissioners. I assisted him in preparing such important FTC decisions as *Consolidated Foods* and *Procter & Gamble,* which the Supreme Court sustained in important decisions. Elman virtually always supported BE initiatives.

I worked closely with Chairman Dixon on many matters, though his legal aids were less inclined to request economic input than were those of other Commissioners. Dixon often asked for my input when he testified before Congressional Committees, and he had me accompany him to Congressional hearings, meetings with officials of executive agencies, and sometimes to meetings with White House staff. He also had me review most of his speeches. Finally, he asked me to hold late Friday afternoons open for frequent meetings to review the past, plan the future, and occasionally to relax with a bourbon and water. Assisting me in advising

Commissioners were my Assistant Director and Chief of the Division of Economic Reports.

My secretary, Mrs. Abbott, handled personal matters involving the typing pool. Shortly after I arrived at the Commission, Mrs. Abbott asked me to select the new supervisor. Three qualified typists had applied for the position of supervisor of the BE typing pool. When I asked why she brought the matter to me, she explained that two of the most qualified typists were white and one was a Negro, as African Americans were labeled in those times. I asked which typist had received the highest Civil Service score. She said the Negro typist had, that no Negro had ever served in a supervisory position at the Commission, and that most of the typists were Negroes. I said fine, it's time to break the racial barrier, and she should appoint the most qualified person. The appointment created quite a stir among typing supervisors of other bureaus, and they brought the appointment to the attention of Chairman Dixon. He called me and congratulated me for being the first Bureau Director to implement President Kennedy's directive to give appropriate recognition to Negroes. I created another stir when I appointed another highly qualified Negro, Mrs. Doris Rocket, as the Assistant to my secretary, Mrs. Catharine Abbot.

An historic racial barrier was broken in 1963 when President Kennedy appointed H. Leon Higginbotham to the Commission, the first African American Commissioner of any Administrative Agency, to become a Commissioner. Higginbotham was about my age, and we became good friends. Higginbotham was subsequently appointed to the Federal bench and later to the Third Circuit Court of Appeals, where he served with great distinction until his death in 1999.

I am proud of the accomplishments of the BE staff of the 1960s. In addition to its many reports, it was responsible for several especially important initiatives. Among the most important were a persistent BE effort from 1962 to 1969 to establish a line of business reporting program; leadership in achieving the Commission’s first premerger notification programs in 1967 and 1969; success in persuading the Commission to require the affirmative disclosure of the octane ratings of gasoline, which some consumer groups view as one of the Commission’s most important consumer protection programs; and contributions to President Johnson’s National Commission on Food Marketing. Time constraints prevent me from elaborating on these initiatives, but perhaps they will come up in other segments of the program.

My greatest disappointment occurred when Ralph Nader unleashed a vitriolic attack on the Commission in 1968 while I was serving on the White House staff. Commissioner Philip Elman, the brilliant and sometimes maverick Commissioner, who had written 121 decisions, dissents and concurring opinions, initially welcomed Nader's investigation, perhaps viewing it as an opportunity to gain publicity for his own proposals to improve the Commission's performance. Nader's staff, or "Nader's Raiders" as the press dubbed them, wrote a devastating report on the Commission. I was personally upset because it omitted any reference to BE, which Nader had previously singled out as the Commission's "crown jewel." Although Elman had encouraged Nader's Raiders to visit me at the White House, they never did. Nader later told me it was a mere oversight and that my reputation would survive the unintended slight.

At the end of his career, Elman became increasingly haunted with what he viewed as the unwarranted legacy of the Nader and ABA reports' characterizations of the FTC's performance in the 1960s. In his memoirs, Elman said, in part:

> The FTC of the 1960s on which I served has gotten a bum rap, and I contributed to it. I was its severest critic, and I fed the material, negative material, to the people on the outside. I was the source of the things that the Nader's Raiders reported, and I worked with the ABA Commission. There were some very

solid accomplishments. We did a lot in the merger field. We did a lot in the deceptive practices area. The cases that were decided by the Supreme Court were all upheld. I think this is a solid record of accomplishment which has been ignored. And in all fairness to history, the accomplishments of that period also ought to be noted. I think now I probably held the Commission to too high a standard.

After leaving the Commission, I had continuing contact with Commissioner Elman when he was of counsel to the Wald firm in Washington, and I consulted with him over about a five-year period. In the last letter I got from Elman a year before he died, he again asked, "Do you think we could have avoided many of those acrimonious situations for which I was responsible? I think I probably held them to too high a standard."

There were many battles, and you'll be hearing about them later.

MR. SCHEFFMAN: Thanks a lot, Fritz for a very interesting history. Mack, you were here in the trenches part of this time, so can you tell us what it was like?

MR. FOLSOM: Okay. I joined the FTC in September 1964 in the Division of Economic Evidence, because George Stocking, my professor, said I should get some experience working on individual cases.

By the time I arrived, all those, quote, "good people" who had been over in the legal bureau and transferred back had been moved out of evidence into other jobs in the Bureau. The group that was left was such that I once said to a person who asked me what I did, "Call me a pseudo-economist, because I'd like to be different from those other people in the Bureau who are classified as economists."

(Laughter.)

MR. FOLSOM: Very quickly, I was visited by a GS-15 who informed me that she had seen a memorandum I had given to my boss, that it was handwritten, and that I had made a recommendation. She bet that I didn't keep a copy of it. I said "You're right." She said "Well, you should never do that, because one of these days, you're going to be wrong and you'll be fired."

I said that if they expected me not to make any mistakes when they hired me, then they were wrong, and if the alternative is to back up to receive my check, I'll continue to do as I'm doing. But it was not a good working environment at the time.

My primary involvement and that of all of the people in evidence was with the attorneys in the Division of Mergers. You didn't have a Bureau of Competition at that time. What they really wanted us to do was to gather data that would help them support the market definitions they had used in the complaint.

Now fairly quickly after I got there and started working with them, they started to say, well, give us a little more input to the market definition question. Subsequently, they'd ask the division to do a survey, to put it into evidence on the market definition they had used.

We had two economists who attempted to put it in. I was called in on a Friday evening and told they had not accomplished their goal. I was directed to go over it to see what I can do and told that I would be testifying on Tuesday.

(Laughter.)

MR. FOLSOM: Well, I went over it. They had them making up two tables that were 180 degrees opposite, so I threw out one of the tables and went home and studied the material. I spent all day Monday making telephone calls to clarify answers. On Tuesday, the Administrative Law Judge accepted the material. However, at the end of my direct and cross, the Administrative Law Judge said that he had some questions for this witness. "Have you analyzed the competitive impact of this acquisition?" I said no. He said, "What is it? What do you think it is?" I said, "I haven't analyzed it." Then he said, "So what would you do?" I started telling him what an economist would study. That I would look at entry barriers, et cetera.

The lawyer quickly settled with the defendant, and Commission lawyers began to consider entry barriers in their merger cases. So in that sense, I think that I did have some input.

(Laughter.)

MR. FOLSOM: Subsequently, the personnel began to be upgraded. Fritz hired Frank Coulton, Arnie Danielson, and Steve Nelson. All were good economists, and Fritz assigned them to the Division of Economic Evidence. They moved me out of the Division to work with Harry Houghton as his assistant while Fritz was over at the White House. That's about the extent of my involvement in the 1960s.

By the end of the decade, the economists were becoming much more involved in making recommendations, and the lawyers were listening to us. The one area in which we were not involved was R-P.

I was asked to work on one R-P case in the whole time of the sixties. The case involved an expert that the respondent was bringing in to testify. I did a search on the man. He was an adviser to the Retail Druggists Association of America.

He was going to be testifying in favor of a manufacturer of drugs who was accused of price discrimination. I said to the FTC lawyer, “He's not going to testify. If he does, he'll lose his job.” We went over to court or the hearing on the day he was to testify. We all sat there. He didn't show up.

(Laughter.)

MR. FOLSOM: Somehow, it got back to Professor Mueller that someone charged me with contacting the man and convincing him not to come. I had not spoken to the man, and I still haven't spoken to him. Fritz called me down to his office to tell me about the charge. I informed him I had never spoken to the man, and that was the end of it.

(Laughter.)

MR. FOLSOM: So thus ends my activity in the sixties.

(Laughter.)

(Applause.)

MR. SCHEFFMAN: Thank all of you for an interesting first panel.

(Applause.)

MR. SCHEFFMAN: What we've heard, very briefly, was that two people were very important in creating the Bureau of Economics as it exists now as an independent entity. It doesn't work directly for the lawyers. And you heard from Mack about how it was to work as an economist during those days.

We now turn to the seventies, the decade when by far, economics was most important in driving the agenda. The various monopolization cases that the FTC and DOJ brought during the seventies really were economic cases. They were founded by what a lot of economists believed that economics showed at that time.

That period was very important for the law and for economics. Both lawyers and economists learned a lot by trying out economic analysis in a forum that could be much more thoroughly vetted even than in the journals, that is, through in depth litigation with serious economists and lawyers on both sides.

Mike Scherer was very important to the Commission's agenda during that time, and he's going to start by reviewing what he and the Commission were doing during that time.

MR. SCHERER: Thank you. One of my economic advisers was John Litner. And Litner used to say to us, "if you want to be a good economist, you've got to have a direct telephone pipeline to God."

(Laughter.)

MR. SCHERER: Last week, we used that pipeline, and Mike Mann gave me permission to speak for him.

(Laughter.)

MR. SCHERER: I'm going to talk about the big cases that we brought during the 1970s. All three originated under Mike Mann's watch, so he's responsible.

The three biggest cases were Xerox, breakfast cereals, and Exxon *et al.* Now I'm going to lateral Exxon *et al.* over to Darius, because I don't have time to talk about all three. Exxon was really a turkey, but it looked like a football.

(Laughter.)

MR. SCHERER: I'm going to talk about Xerox and cereal. Xerox had a commanding position in copying machines. It engaged in a whole bunch of bundling, discriminatory and other practices, and this was a great and important new technology.

When we finally settled the case, Xerox had had an exclusive position in the market for 16 years because of its patent portfolio. According to the patent law, you're supposed to get a monopoly for 17 years, period. We thought it was time to do something about it, so in 1972 we brought a case.

See Mr. Scherer's slides at http://www.ftc.gov/be/workshops/directorsconference/docs/scherer.pdf

Let me turn this projector on to focus things. Xerox dominated the industry in terms of patents. This is something I drew the other day from a database I have. They had 81 percent of all the patents in the industry, and it was really difficult to enter without the leave of Xerox, and they weren't licensing, at least not plain paper patents.

We negotiated this case, and in 1975 reached a consent settlement under which Xerox agreed to end some of its discriminatory practices, and most importantly, to license with minimal royalties. Actually, after the fifth patent, you paid zero royalty, and the maximum royalty you paid was 1.5 percent. Xerox also agreed to license its entire patent portfolio to any comers.

When we reached the decision that this was going to be an efficacious remedy, we had our eye on whom it would affect. And so, of course, did Xerox.

We thought that the principal emerging competitors to Xerox in plain paper copiers would be Eastman Kodak and IBM, both of which had recently entered the plain paper copying industry.

The chief executive officer of Xerox, David Kearns, agreed with our perception. He wrote, among other things, about IBM and Kodak, that with two of the behemoths of industry angling for a piece of its market, "Xerox was plenty worried. The Japanese were also nibbling away, making far more headway, as it turned out, that we realized at the time. But we were totally blinded by IBM and Kodak. In fact, Ray Hay used to say to me over and over again, IBM, IBM, IBM. And that's the way we perceived the situation."

We were wrong. True, Kodak has remained in the industry and done important things. But the Japanese, who had at that time been making coated paper copiers, now moved into the plain paper aspect of the industry and presented a tremendous challenge using the compulsory licensing decree to get access to the necessary technology.

This really had an enormous impact on the industry in the long run. Let me just draw three quotations from David Kearns' book, Prophets in the Dark: How Xerox Reinvented Itself and Beat Back the Japanese:

> "I don't like to dwell too much on the ramifications of the FTC case and the private suits it fomented, because I don't like to make excuses. The real problems that afflicted us, though we were just beginning to realize it, were that we had lost touch with our customers, had the wrong cost base, and had inadequate products. The barrage of suits took something out of us, but the true challenges to the company lay outside the courtroom."

And then skipping a few pages:

> "The new competitive environment after the decree said this meant a new way of viewing the world. The monopoly environment that Xerox thrived in encouraged internal competition, but not external. We would measure the quality of a new Xerox machine according to the specifications of older Xerox copiers. Those specifications didn't mean very much if other companies were producing something altogether better."

And then one more quote:

> "While Xerox products were not bad, and we had some promising new machines in development, our cost structure was not competitive, and we had not figured out how to design for low cost and high reliability. In fact, the initial Japanese products were not more reliable, and generally, their copy quality was worse, but we were charging our customers appreciably more to cover our inefficiencies."

And he goes on in this book to tell how Xerox reinvented itself under this new force of competition, and at least for a long time, until very recently, became a provider of high quality, low cost plain paper copying machines. So I think this was a very, very effective case for the American consumer.

Now let me go on to breakfast cereals, a second of our big cases. The cereal case arose out of several challenges. One was an economic challenge. One was a legal challenge. The economic challenge was Chamberlin's book, which said, hey, forget about this Cournot business. Real oligopolies engage in joint profit maximization. And the evidence that we could assemble suggested that that's what the cereal companies were doing.

See Mr. Scherer's slides at http://www.ftc.gov/be/workshops/directorsconference/docs/scherer.pdf

Let me just put up one more slide. We didn't have these data at the time, but in terms of the 234 to 238 lines of business covered by the Line of Business Report, cereal in every year was right among the top in terms of operating income as a percentage of assets, and it was among the highest industries in terms of its media advertising as a percentage of sales.

We also had census data. Cereal had one of the highest price/cost margins, about 54 percent, of any manufacturing industry on which data were available.

So that was one problem. It looked like we had a Chamberlinian oligopoly here.

The second thing was that antitrust had proven ineffective in dealing with Chamberlinian oligopolies.

Basically, if you didn't have evidence of outright collusion, you couldn't get them on the conscious parallelism doctrine.

I only have five minutes, so I'm going to cut out the legal discussion. Now Mike Mann came in, and this was really Mike Mann's case. Bill Comanor led the way with his article with Tom Wilson showing that advertising and high profitability were correlated.

And then Mike Mann came along and advanced that work further. Mike's definitive statement of the relationships among advertising, concentration and profitability was made in the 1974 book, Industrial Concentration: The New Learning. There's a certain amount of muddle there.

The basic problem we had in this case was, okay, the cereal companies were never cutting prices. They charged very high prices. They made very high margins, and by the Dorfman-Steiner theorem, they were advertising very heavily. But with these continued high profits, why wasn't there entry into the industry?

Well, there was an argument that advertising solidified brand loyalty and constituted a barrier to entry. We didn't believe that. We were at least skeptical about it, and we needed a better theory.

And then lightning struck. Mack, were you with us? Mike Glassman, Dave Malone, Tony Joseph and I went to San Diego, and we met Dick Schmalensee. Dick came up with a new theory of why entry didn't swarm into this high price, high profit industry. His space packing theory of entry barriers was really very satisfying intellectually. I had just written a book on spatial economics. His theory rang the bell, and I said, aha! There's the missing link. There's our barrier to entry, so we made it a significant part of the case.

This was a brilliant move intellectually and an absolute disaster in terms of public relations.

(Laughter.)

MR. SCHERER: The bad press we got was just unbelievable. My home town newspaper, population 16,000, I worked for that paper for four years during high school. Here's the lead in their op ed: "The Federal Trade Commission, which too often of late has seemed to be completely out to lunch, has now apparently decided to be out to breakfast too."

(Laughter.)

MR. SCHERER: "How else can one explain the zany action of the FTC in launching legal battle against the leading U.S. cereal manufacturers on the ground that -- I swear I'm not making this up -- the manufacturer is giving the American housewife too wide a choice."

(Laughter.)

MR. SCHERER: Everybody became obsessed with Schmalensee's entry limitation part and completely forgot about the high prices, the high profits, the high and wasteful advertising and all that.

Then a bunch of other things happened. The case-in-chief was concluded, if my memory is correct, with my testimony in January of 1977, at which point a number of things started happening.

First, Kellogg fired its counsel and brought in a new counsel, Fred Furth, a noted treble damages lawyer, and a very aggressive guy, who sized up the situation and said, in effect, "We're not going to win this battle in the courtroom. We're going to win it in the press and on Capitol Hill."

If you look at all the bad press we got, it started with Fred Furth. He was out there seeding the newspapers with articles critical of the case. The only good press we got were from two media, Consumer Reports and the Los Angeles Times.

Second, Fred Furth commissioned a phony consulting study which said that the remedy we wanted would increase union unemployment. Not true. But we had no opportunity to rebut it. KidVid aggravated our problem. I remember sitting in the conference room with the team after I had left the Commission formally, and Dave Malone announced that Mike Pertschuk was going public next week on KidVid and that it would kill the cereal case.

We talked about it, and we said, God, what'll we do? We went around, and I said, well, I'm the one that knows Mike best. I could go talk to him, but under the rules, it would be wrong. We didn't do it. We grit our teeth and took the consequences.

A whole lot else happened. We had problems with the Administrative Law Judge, who got fired after presiding over nine-tenths of the record, and there was a long break. Furth was very effective on Capitol Hill. The 1978 election eliminated some of our most important supporters.

Both Reagan and Carter announced during their campaign that they would stop the case if they were elected. Indeed, the case ended in a very unhappy way. Subsequently, from 1983 after the case stopped until '91, cereal prices rose by 71 percent. The companies felt themselves free of constraint, and they started raising their prices like mad. Eventually, they went too far, and a price war broke out.

So the best I can say about this case was, it was a nice try. It probably protected the American public for about five years from price increases that cereal makers might otherwise have initiated, but it thereby jeopardized their positions. In the end, it was certainly a loss both in terms of competition law and competition economics.

Thanks very much.

MR. SCHEFFMAN: Thanks a lot, Mike. It's always hard to follow Mike. I'll remind Bill. I think if I know my history right, there was actually another speaker on the day that Lincoln gave the Gettysburg Address, but we don't remember who he was.

(Laughter.)

MR. SCHERER: It was in my home town. No, no. That was the Lincoln-Douglas debate.

See Mr. Comanor's slides at http://www.ftc.gov/be/workshops/directorsconference/docs/comanorslides.pdf

MR. COMANOR: I arrived at the Commission on September 1st, 1978. And it may have been the time when BE peaked in size. When I arrived, there were 225 people in the Bureau, which I gather is much more than it is today. Indeed, there were something on the order of 80 to 90 economists. So it was a big shop, a much bigger shop than had existed before, or I think since.

Let's talk about the small cases of the seventies, the verticals. The decade of 1970s was really a period of change in the realm of vertical restraints, as I'm sure many of you remember, and I think the first two bullet points in this slide really set the high water mark for policies against vertical restraints.

Although resale price maintenance was declared per se illegal back in 1912 or thereabouts, that finding had been essentially overturned by state fair trade laws, which were permitted under the Miller-Tydings-McGuire Act, which authorized state action.

So the federal decision was essentially a dead letter, and the state laws were only repealed in 1975. During that period, both RPM and non-price vertical restraints were per se illegal as long as title had shifted. The Schwinn decision made non-price vertical restraints per se illegal.

That period lasted for all of two years, because within two years, we had Sylvania, which represented the first retreat in the policy against vertical restraints. These two actions, Schwinn and the repeal of the Miller-Tydings and McGuire Acts, set the high water mark, whether for good or for bad, in policies against vertical restraints.

The retreat on vertical restraints enforcement rests on two books by Bork and Posner, which created a whole new view about what policy should be in this realm. Bork and Posner created a new conventional wisdom toward vertical restraints. This view argues that there is a total confluence of interests between manufacturers and consumers, and it questioned whether circumstances could ever exist where vertical restraints had any anticompetitive effects.

The Bork and Posner view suggested a policy contradiction because price restraints were considered per se illegal and non-price restraints were under the rule of reason. That was as untenable a situation then as it is now. Indeed, if you look at Justice White's concurring opinion in Sylvania, he specifically raised that question.

In the Bureau at that time, to the extent that we worried about vertical rather than the big horizontal cases, we worried about this difference. We didn't really know what to do. It was a policy in flux.

There was really considerable uncertainty as to how to proceed, and there was great debate and dispute in the Commission. Some, including some economists, embraced this new conventional wisdom. I wasn’t one of them. But the debate went on. Many said, look, we should get on board with the new conventional wisdom. Of course, the lawyers took an opposite view.

The question was what to do. Chairman Pertschuk was under considerable political pressure regarding KidVid. What he said in this realm was that he didn’t need another fight. Let's punt. So essentially, we punted in the area of vertical restraints in the seventies.

This is not to say that we didn't have any vertical restraints cases. Paul Pautler provided me with some very interesting data. These data summarize the vertical restraint cases for all complaints that were initiated in this period of time. Most dealt with RPM, and almost all were settled by consent. They were relatively small cases. The defendant said, all right. We'll go along. We'll stop doing RPM. And they were over. They didn't make the headlines. There's no press on these cases. But that's essentially what the current data says. That's through '78. And I have some more recent data.

See Mr. Comanor's slides at http://www.ftc.gov/be/workshops/directorsconference/docs/comanorslides.pdf

Well, what do we conclude from this? About 62 percent of the cases brought dealt with RPM allegations, and 96 percent were settled by consent. Almost none of them went to trial. The number of complaints declined almost in half from the first three years of my data set to the second half.

We were really on the edge of a revolution, as almost everybody in this room knows. Antitrust policy standards shifted sharply in the eighties. There were few, if any, vertical restraints cases brought in the 1980s, and with the advantage of hindsight, we can see that the new inhospitality toward these cases really followed the new conventional wisdom of Bork and Posner, which had just taken over.

It culminated, of course, in the Vertical Restraints Guidelines proposed by the Justice Department, which have since been withdrawn.

BE went along with the new conventional wisdom. BE was not the instigator, but the follower here. Two reports that the Commission started in the late seventies were published in the eighties. The two staff reports that I can find that dealt generally with vertical restraints both concluded that we should get out of the business. In fact we did get out of the business.

A conflicting consideration that worried us is reported in Scherer's text on industrial organization: prices typically rose with RPM. He reviewed the literature. I don't have any reason to doubt Scherer's conclusions. The question was, is this a relevant factor?

Of course consumer welfare can possibly be enhanced when prices increase. I don't dispute that. But the question is, is it a likely result? We worried about the higher prices.

The question I would raise for you all is whether the enforcement pendulum has shifted again. Three decisions, all quite recent, have important vertical components. All suggest a much different policy posture than existed in the 1980s, but not one that went all the way back to the way things stood in the sixties and early seventies. I leave you this question: has the post-Chicago economic literature played a role? I think it has done so in setting a tone, but not much more.

I have just a few conclusions. Policies toward vertical restraints since the 1960s have shown considerable fluctuations, perhaps more so than in other areas of antitrust policy.

The extent to which vertical restraints have been accepted or tolerated has varied considerably, as has the tone of the economic literature. Vertical restraints is the only area where Guidelines have been both announced and withdrawn.

While many of the recent studies have been limited in scope, collectively they point in a very different direction than those of the seventies or eighties, and the case law has followed along.

We're all tempted to believe that the policy standard we enforced during our terms in office were the right ones, and that they would persist forever. They would remain in effect even when we left. But for most of us, that was not to be, and it's especially true in the area of vertical restraints. This lesson should teach us all a great deal of humility, if nothing more.

MR. SCHEFFMAN: Thank you, Bill.

(Applause.)

MR. SCHEFFMAN: Darius, Mike handed you the football, and you can of course deal with that or whatever else you'd like to add.

MR. GASKINS: I have two things I want to discuss, and I'll start with the Exxon case. Let me make a comment. I was the Director between Mike Scherer, who was my thesis adviser, and Bill Comanor, and I left to go work for Fred Kahn at the CAB in 1977. So I was there for about a year.

I'm on a little different page. I consider myself the accidental Bureau Director, because I was made the Bureau Director at a time when we had a President who was not elected, Gerald Ford. He was never elected to the position. We had an administration where the normal sorts of political pressures didn't seem to operate, and I got this job.

I thought I was a well trained price theorist. I thought I knew what the problem was. We were there to make sure that we could drive prices down to marginal cost. I found out much to my chagrin that that's not always what the problem is, or the perceived problem. Sometimes you have to keep people from pricing too low.

And if you think that's preposterous, notice the Treasury secretary, who is a friend of mine, John Snow, is in China right now trying to persuade the

Chinese to raise their prices. And he's a well trained economist from the University of Virginia.

So you've got to be careful with what it is you're trying to achieve here. I thought I knew going in that the problem was that prices were too high. That's the General Foods case, and I'll get to it in a minute.

I was quite naive by Washington standards at that point. I assumed that I was there to tell people what I thought, and to manage this bureau of remarkably well trained and hard-working individuals.

I started looking around at what we were doing, and there was this big mound over there called the Exxon case. I started asking some questions about the case, and it occurred to me very quickly that it was a mess. Even though the case may have started out well before OPEC and all the rest, it had been overtaken by events. There had been some major changes in the world, and there might be something wrong with this case.

I didn't know enough about the oil industry myself to persuade the lawyers or the Commission that there was a problem. So I said, I've got an idea. Let's convene a panel. Let's get the best experts in the world on the energy industry. We went out and put together this panel. I think there was about ten of them. Walter Mead, Morrie Adelman, Mike Scherer, a whole bunch of people were on the panel. We said, would you look at this case and give us your advice about where we're going? Do we have a theory? Is it a decent case?

They came back within a remarkably short period of time, about two months, and they gave me a report. I can't remember everything it said, because I had to put it in a safe somewhere. But the report seemed to say this case is not going anywhere. This is ridiculous. You'll never win this case.

There might be a problem having to do with pipelines and access and stuff like that. But this case is not going after that factual situation. So for heaven's sakes, you should dump this case and replace it with a case that might have some merit.

Being a naive person, I dutifully said, well, here's what we do. We'll talk to the lawyers. We went over and talked to the lawyers. The next thing I knew, into the safe goes the report, and that's the end of the story.

(Laughter.)

MR. GASKINS: It bothered me for a long time. I used to worry about what we had done. Was this justice? Here we are part of the so-called prosecution, and we discovered that maybe we don't have such a great case here. Don’t we have an obligation to share this with the other side?

I agonized a little bit. But, you know, eventually, sleep overcame, and I got on with my life. But as I look back on it, with history, the thing that's amazing is that maybe it was the right thing to do, because it was not unlike the coffee problem.

People were very worried about the run up in oil prices. They were angry about it. They were trying to blame somebody. The fact that the FTC had an ongoing case took the pressure off in that particular industry. With the passage of time, the case got dropped.

Now I was naive because I was frustrated that we were using resources, economists in the Bureau, to staff an investigation that wasn't going to go anywhere. Maybe in the bigger picture from 40,000 feet, it was the proper course. But I will go to my grave with some questions about how we handled that particular matter.

Now let me talk about the coffee case. Talk about naive, this is my introduction. We heard Professor Markham talk before about General Foods as potentially gouging people with high coffee prices. Well, they changed. They changed because when Folger tried to come into the Chicago market, predatory pricing was the charge. It was my first week on the job. Two things about the FTC. One is, it's always affected by politics. There are always a lot of politics there, and I learned it only over time. Second, it's driven by external affairs. That is, the changes in the market really affect whether a case is good or bad or whether it makes any sense.

The General Foods case was fairly well along. Folger had attempted to go into this market. Maxwell House dropped its prices aggressively. Prices were lower in Chicago than in the markets where Folger's hadn't tried to enter. And the die was cast.

The Bureau of Economics in the person of Mike Glassman said, this is a great case. Then Cal Collier, who was my boss, came in. He was already getting a little pushback from all the cases that were being brought, and he had a real problem with why we were going after somebody for lowering prices. He'd say it was a visceral kind of a thing.

(Laughter.)

MR. GASKINS: Here I'm in the middle between Mike Glassman on the one hand and the Chairman on the other, and I was getting phone calls at night screaming about what I should do and what I shouldn't do.

I said to Mike, "It does look like it could be predation, but, you know, we've got to worry about a remedy. Also, how do you even decide it's bad for consumers? Some consumers were getting the benefit of low prices today, and some other guys in some other market were paying too much.

Then Collier would say to me "Gaskins, there's no such thing as predation. It can't exist." I said "Wait a minute. It could exist. It's a theoretical possibility." This was well before people had thought about strategic response and stuff like that. But it was bloody awful.

I thought, here I am, trying to figure out what to do. We had a hell of a mess on our hands. I thought at the time I'll be glad when I get out of there because I won't have to grapple with predatory pricing anymore.

Next chapter in my life, I ran into it again about three or four years ago with Jon Baker. I was on a commission studying predatory pricing in the airlines. There it is. You know the story. The little guys enter the market, and American and Northwest drop the prices. Sure looks like predation to me.

But then again, you know, it's also rational behavior. What's the remedy going to be? And again, it's overtaken by events. I don't think predatory pricing is a problem in the airlines anymore. I don't even think it's a problem in the coffee industry, if it ever was. But they're both very intellectually challenging, I'll tell you that. So, those are my two stories about my duration as the Chairman of the Bureau of Economics.

MR. SCHERER: Darius, could I just inject one point on the Exxon report?

MR. GASKINS: Absolutely.

MR. SCHERER: As you say, it was put into a safe. And all of us consultants were told, you shall not show this to anyone. You've signed a confidentiality oath.

I had a friend on the Federal Affairs staff at Exxon, and she told me she had a copy of the report.

(Laughter.)

MR. SCHERER: Not from me. But she had obtained it through such surreptitious methods that there was no way they could use it.

(Laughter.)

MR. SCHEFFMAN: Okay. Thanks, Darius. Mack? It appears that there was a big change from the sixties to the seventies in the role of economists.

MR. FOLSOM: As we moved into the seventies and the shared monopoly type cases began to spring up, I had a real problem as the head of the Evidence Division. How in the devil do I staff these? While I had been working at trying to fire one of the Evidence people a year, and some of the worst ones were retiring, I still did not have the level of economic skills that I felt the Division needed to deal with the more complicated problems. I went over to the Division of Industry

Analysis and approached Jim Dalton, who was a student of Mike Mann, and tried to convince him to come over and head up the cereal investigation. He said, no way.

(Laughter.)

MR. FOLSOM: I went to Detroit to try to recruit some people, and I ran into a young man named Mike Glassman, convinced him to come work for me in Evidence, and turned the cereal matter over to him.

At the same time, there was a young man in Evidence who was working on the matter. He decided that he could not support a complaint. I had told all of my staff members that they could write an objection to any recommendation made by their bosses, what have you, and it would be sent forward to the Commission along with the document.

He came to me three weeks before the thing was to go forward and said, "I want to write a dissent." I said, fine. We'll be going forward three weeks from tomorrow or something, some specific date. You have your memorandum ready, and it will go forward with the package.

He came in the day it was to go forward and said that he had not had time to finish it. He asked me to delay sending forward the recommendation for a week to allow him to finish his memorandum. I said, I'm sorry.

There will be no delay. So there was no dissenting memorandum.

I guess the matter I should feel most guilty about is Exxon. I had serious reservations about Exxon, and in a meeting shortly before the complaint was prepared, I was called some rather unflattering words. Let's say horse's rear end would be the polite way of saying what I was called. After much soul searching, I finally decided to support the complaint. I even helped write the memorandum recommending the complaint.

I said at the time, unless we can prove entry barriers into refining, we should close the investigation. I went into Mike Mann's office, and I said, Mike, don't sign the recommendation memo. Just stay out of it. He decided he would sign it, and, of course, you know the rest of it.

Subsequently, after the report by the experts, Owen Johnson called me up. Darius had left. In fact, I thought Darius was over at CAB when they delivered those reports.

MR. GASKINS: No, no. I was still there.

MR. FOLSOM: Shortly after. Okay. I know they sent you one. I called up Owen and said, Owen, you've announced you're leaving. We're spending money like mad. Let's you and I go tell the Commissioners that this investigation is not going any place and suggest to them that they dismiss the complaint.

Owen, ever the pragmatist, said, "Mack, if we do that, we'll spend the rest of our lives explaining to some congressional committee where we've hidden the money we were paid to make this recommendation." So that was the end of that. I left the Commission not long afterwards.

One other point that I wanted to talk about briefly is the Robinson-Patman Act involvement. BE had not been involved in Robinson-Patman in the sixties. Then a young man named Alan Ward was brought in to head the Bureau of Competition. Alan didn't like the R-P Act, but he felt it was something that he had to do, and he wanted an excuse to get out of it. So he started to send the complaint recommendations through my office for concurrence.

(Laughter.)

MR. FOLSOM: He was picking little bitty companies and recommending complaints because they were charging some customers a lower price than some other customer. I was writing dissents to the recommendations and sending them to the Commission.

The third one involved a manufacturer of men's neckties with a market share of about 4 percent of the neckties made in the United States. I wrote a memorandum explaining that really to be bad as a price discriminator, a firm had to have market power and that there was no way that a firm with a 4 percent market share could have much market power.

The Commission decided not to issue the complaint. We walked out into the hall. Alan looked at me and said, “Mack, I've been giving you fish in a barrel to shoot at. You finally hit one. I'm not going to send any more R-P cases to the Commission.” Well, he didn't.

Then one of the staff attorneys who was very much an advocate of the R-P Act visited a congressional committee. The next thing you know, we were called up to the Hill -- Mike Scherer, myself, and several of the attorneys -- to testify about why we were not enforcing the R-P Act. Mike did a little study where he had someone go through the complaints, look at the size of the companies, and essentially prove to them that the R-P Act was used against small companies, not against large companies where we might have market power problems.

I still remember the congressman when I was talking looking down at me and saying, “If I had anything to do with it, we would impeach you.”

(Laughter.)

MR. FOLSOM: I didn't know how to tell him that they only had to fire me. They didn't have to impeach me.

(Laughter.)

MR. FOLSOM: I kept my mouth shut and kept my job. Then one final thing to show how much politics can get involved in the Commission. We started an investigation of the automobile industry as a shared monopoly. Mike Glassman and I were going around talking to the Commissioners, and the Chairman of the Commission was very much in favor of the investigation.

It turned out, God rest his soul, Engman wanted to run for Senator in Michigan. He thought that this attack on the automobile industry would be his entre into running for Senator.

(Laughter.)

MR. FOLSOM: He forgot that Michigan is the home of the automobile industry. At any rate, the thing never got off the ground, and I'm thankful, because facts such as the Japanese growth in the automobile industry and successful entry of the Koreans have proven that we really did not have a competitive problem with the American manufacturers of automobiles.

One of the alleged monopolies that the Commission investigated while I was the head of Evidence was the hearing aid industry. There was one company that had been very big in the hearing aid industry at the time.

The staff came to me with the data, and I saw that the company's share had dropped from about 90 percent of the industry to about 55 percent of the industry. I asked my staff member, “My God, why do you want to bring a complaint against this company? Look what's happening in the market.” His response was, “Yes, we have to hurry up and sue them before the industry becomes competitive.”

(Laughter.)

MR. FOLSOM: So that's the end of my comments.

MR. SCHEFFMAN: Thanks, Mack. Let me have the moderator's prerogative, a little kibitzing. A lot of us touched Exxon. I see a lot of people in the front row like John Peterman and Mike Scherer.

I was actually the last economics staffer on Exxon. I was assigned to come up with a theory which actually became my part of it, which became my contribution to raising rivals' costs, and it was a great lesson for me. I think it's consistent with what Mack said.

It was a case stupid on its face, because it required some sort of tacit collusion among the eight largest major oil companies, which only had 50 percent of the market at that time.

(Laughter.)

MR. SCHEFFMAN: So there were a lot of heroic things which I didn't deal with in my theory, of course.

But it was a good lesson for me because I said this is how the theory would work. The theory was that they were squeezing the independents. I said, yes, this theory would work. Now bring me the facts. The lawyers, Mark Schildkraut and John Woodstock, came with the facts, and the facts were absolutely the opposite. It was a great lesson for me, because I was more of a theoretical economist at that time, of how important facts were.

And that segues into a semi response to Mike Scherer and a question. Mike and I probably disagree on the cereals case. But I think what you overlooked, and I wonder if you think differently, is that the cases the Commission brought show the strength of the Commission.

The legal opinions coming out at administrative trials in cereals, in titanium dioxide, in coffee, in ethyl and probably others, are really extraordinary documents. They clearly had a profound effect on the law. No one brings a case based on profitability anymore. Hardly anyone now brings a case on being too aggressive a competitor, something that used to be garden variety.

Those cases, along with IBM, killed off a whole line of attack, properly so. But those are extraordinary documents, because, independent of political and the PR stuff, those were seriously litigated cases with very good lawyers and very good economists on both sides, and the decisions are really important documents that have clearly profoundly affected the law.

My concern is, I don't think that economists read administration decisions. Any industrial organization economist should read these opinions. They're so full of facts and the issues you have to deal with actually applying economics, and they certainly had a profound effect on the law.

You were pretty negative about a lot of the circumstances in cereals. But don't you think actually, whether you agree with the opinion or not, documenting the arguments on both sides and what the evidence was is really an extraordinary document in that case and many of the other cases?

MR. SCHERER: I disagree on cereal. The Administrative Law Judge's opinion was in my view mostly non-facts. We had brought forward direct evidence of collusion. He totally ignored that direct evidence. He totally ignored much of the other evidence and having heard only one-tenth of the trial, emphasized that one-tenth that he did hear, and caused a big furor.

Unprecedented things happened. The staff appealed over the heads of their bosses to the Commission, leading Pat Bailey to write the following opinion dismissing the case. She referred first to congressional stormwaters of imposing magnitude, and then said, I quote: “The paradox we are left with is that while there may be a legitimate concern about the anticompetitive effects of the exercise of oligopoly power, it is rarely true that these concerns will mandate an administrative agency to restructure an industry, short of a legislative warrant to that effect” -- Congress was saying don't do it. “Therefore, I will vote that this appeal be terminated, not for the reasons relied upon by the Administrative Law Judge, but because the promulgation of relief by this agency will not in any eventuality -- because of congressional pressures -- conceivably lead to a restructuring of the cereal firms.”

She recognized the claim that the Administrative Law Judge's decision was, quote, "riddled with major procedural errors and does not fairly give weight to certain of the evidence," end quote. She therefore ordered that the case be vacated, quote, "with no precedential or even persuasive authority for any proposition whatsoever."

(Laughter.)

MR. SCHERER: Just a plug. If you want to read the facts in the case, read my write-up in Walter Adams, The Structure of American Industry, 7th Edition.

(Laughter.)

MR. SCHEFFMAN: You have a microphone there for people to ask questions. Go ahead. Question?

MR. BAKER: My question is for you, Mike. To what extent did you feel that you had to engage with the argument that even when there are only a few firms and entry barriers are high, that the firms would not be able to maximize joint profits? Could the firms reach a consensus or deter cheating? Were you grappling with those kinds of questions?

MR. SCHERER: My whole testimony went to that set of questions. I analyzed in great detail the mechanisms by which they set prices and the circumstances under which coordination, tacit and explicit, worked. I thought we had compellingly documented both the tacit agreements and explicit argument that the cereal manufacturers had reached. The ALJ just ignored the whole testimony. He had a good reason for ignoring it. Congress was up there with a 16-inch gun ready to shoot the Commission if it did anything bad.

MR. SCHEFFMAN: Other questions?

QUESTION: On a lighter note, I have a memory of Xeroxing the complaint that was going to the Commission -- and this is for Mack, too, who may remember.

MR. SCHERER: You should have thermo faxed it.

(Laughter.)

QUESTION: Well, the story as I remember is that the machine broke down and we had to call a Xerox repairman.

(Laughter.)

MR. SCHERER: Who asked if he could have a copy.

(Laughter.)

QUESTION: As I remember the story, somebody said, gee, it's been a long time, you know, since the repairman has been there. We've got to get this thing done.

So they go to the Xerox room, and there is the repairman reading the Commission memos.

(Laughter.)

QUESTION: And he says, gee, this is interesting. It's about the company I work for.

(Laughter.)

QUESTION: Can I have a copy?

MR. FOLSOM: I think the answer was no, and it was put in the safe.

(Laughter.)

MR. SCHEFFMAN: Other questions?

MR. MUELLER: My last recommendation to the Commission, in September 1969, requested approval for opening an investigation into a potential monopolization case in the cereal industry.

MR. SCHERER: Didn't know that. Good for you.

MR. MUELLER: Mack, you implied that the Bureau of Economics didn't do much in the R-P area, and that's true.

When I came to the Commission, the Chairman had agreed to return to BE all units that had been taken away in 1955. When the economists came back to the Bureau, without exception, the most competent ones were very pleased to be separate but equal. The one group that was not returned was the accountants. The lawyers objected strenuously, and the accountants stayed in BC.

About that time, my friend Corwin Edwards, the Bureau Director during 1948-1952, visited me. I told him about losing the accountants, and he said to let them go. He said that with a little judicious assistance, I could participate in the demise of the price discrimination cases that those guys were helping the lawyers bring.

Within the first year I had an opportunity to get involved in a Robinson-Patman case. The Commission was meeting, and the General Counsel and I were attending as advisors. The Commissioners were arguing about some 200 cases that the prior Commission had brought against clothing manufacturers for discriminating in their sales to buyers.

There was a heated argument. Commissioner MacIntyre, after all, had been with Patman at the time the

R-P Act was written, and then he wrote a book over Patman's name telling people what Patman had meant. So he thought he was the ultimate authority.

Commissioner Elman had different views on it. The Chairman was ambivalent. New Commissioner Higginbotham was undecided, and they used me as their foil. MacIntyre could not understand my position. Professor Mueller, how can you be such a hawk on Section 7 and so reluctant on the R-P Act? As far as he could see, the language was the same. I tried to explain, and he said, maybe so, maybe so, and got over it.

It boiled down to who was responsible for the discrimination. If there are any culprits, I said, it's the buyers. They're inducing discounts and encouraging competition.

Elman then said, where do we end up? Is the solution here, if there is one, to dismiss all these cases and possibly go after the buyers? I said perhaps that's the logical extension of what's involved. They tentatively voted three to two to get rid of all the cases. I don't know if they dropped the cases against the ones that were involved originally. I also don't recall if they ever did proceed in going after the buyers who were inducing discrimination.

MR. FOLSOM: I thought they later changed their minds and accepted those settlement offers, to the relief of the plaintiffs in the matter, because it gave them an excuse to say to the buyers who approached them about a price discount, no, I'm under order by the federal government not to give you a price discount. That's my recollection of what subsequently happened. Chris White has indicated that's his recollection also.

MR. MUELLER: Mack, you said one thing that reminded me of one of the great moments in FTC oversight. That hearing that you got summoned to, you were getting your hide torn off one side up and the other side down, but you were holding your own. I forget if it was a member of Congress.

But he essentially said, “You're just saying that to keep your job.” You said, “That's not true. I'm actually a quite accomplished shade tree auto mechanic. I could go do that.”

(Laughter.)

MR. FOLSOM: The only problem with that is you remembered the wrong person. That was Mike Wallace of 60 Minutes and not a member of Congress.

(Laughter.)

MR. MUELLER: I stand corrected. But it was a wonderful line.

MR. SCHEFFMAN: Jesse?

MR. MARKHAM: I'd like to comment on a question that was raised by someone whose memorandum I received before I came down. And that was the order to spread the economists out among the lawyers. Was that by way of having greater economic influence over the casework, or was it a way of getting rid of the economists and having them under the aegis more or less of the lawyers?

The report was going to assign the accountants to the Bureau of Investigation and the statistical outfit somewhere else. When I first became aware that that was one of the proposals, I was reminded of Winston Churchill's statement about the British empire, that I must have been brought down to preside over the dissolution of the Bureau of Economics.

But it does make a lot of difference whether you keep economists within the Bureau and acting as equal partners with the law group or have them assigned more or less under the authority of the legal group.

I found it very successful, at least in the three cases that were cited in the Federal Trade Commission Annual Report in 1955, to have the economists take the recommendation from the Bureau directly over to the Bureau of Investigation, just plunk himself down, and say I am here to work on this case.

He was not under the authority of the lawyer, but he was there as an equal partner. And that was one of the reasons I think it was a mistake to break up the Bureau and to assign economists willy-nilly almost anywhere. If they went with the case, the economists always could come back to their Bureau chief and say "You need to go over and talk to those people. I don't think they really understand what I'm supposed to be doing in this case."

But there is a distinction between still being in the Bureau and being assigned out of the Bureau and under the authority of a management somewhere else.

MR. SCHEFFMAN: Thanks, Jesse. All right. Well, we're about on time, so while we don't have a lot of time for a break, but we will be back starting again at 11:15. Thanks.

(A brief recess was taken.)

MR. SCHEFFMAN: Well, we've done the foundations of the modern Bureau, and Jesse's remarks at the end were very important. The Europeans in our view had exactly that problem, that the economists reported to the same people as the lawyers.

And in part perhaps because of our lobbying, they've created an Office of Chief Economist and they have ten Ph.D. economists that report to the Chief Economist. We think that's a good idea. We'll see how it works.

So we had the seventies, in my view, the high point of economic theory in antitrust. But it was the beginning in terms of actually influencing anything. It was also the beginning of economists being able to make lots of money in antitrust, a good thing for those of us who do that.

(Laughter.)

MR. SCHEFFMAN: The influence of economists really took off during the eighties. So we have the eighties Bureau Directors. Unfortunately, we don't have Bob Tollison, but we have Wendy Gramm, John Peterman and Mike Lynch. Wendy?

MS. GRAMM: When I came to the FTC, my first job in government, about six months into the Miller administration, was in the Division of Consumer Protection. I was not paying that much attention to the antitrust side, but I did read what I think Tim had written in the transition report about what the Miller program was, and also later on became Bureau Director.

The Miller Commission’s objective was to promote competition and to have more open and more competitive markets. And that goes across the board domestically, but also with regard to international restraints to trade, and in some of the other policy areas besides strictly what was in the antitrust area.

In antitrust, the emphasis was on the bread and butter horizontal type cases versus the vertical, and away from some of the more innovative theories of antitrust. Of course, someone mentioned earlier that both Reagan and

Carter had campaigned on moving the FTC more toward the mainstream.

I do believe that in that period, even the Washington Post, in criticizing the consumer protection side, probably KidVid, called the Federal Trade Commission the National Nanny. But at any rate, I would say that in the antitrust area, very frankly, the role of economists was pretty much ingrained.

That's not to say that it was ingrained at the Commission per se. That's not to say that the lawyers always liked to get the economists involved in very early stages, and John can tell you about some of those issues. But in terms of the economics, economic analysis was part of antitrust, especially when you compare it to the consumer protection side.

A lot of the academic literature looked at efficiencies and raised questions about the consumer welfare aspects or the efficiency aspects of vertical restraints, for example. So economics was already ingrained in the analysis, and the challenge was to get economists even more involved in the cases both on the consumer protection side and on the antitrust side.

Having a Chairman who was an economist made a real difference, because if there was reluctance on the side of attorneys to listen to economists early on, they not only had Jim Miller to contend with, but they also had

Chief of Staff Carol Crawford. I remember once I had some complaint about some lawyers not being willing to meet with us or listen to the economists, and that they had held some meetings without economists, et cetera. I took the complaint to the head of the Consumer Protection Bureau and to Carol Crawford as the Chief of staff. If the lawyers didn't want to talk to the economists, they had to answer to her, if not to Jim Miller. People didn't want to face her, because she was pretty tough on enforcing the process. I remember Tim Muris saying “I don't care. Do anything. Just don't get Carol Crawford mad at me.”

(Laughter.)

MS. GRAMM: I think that was helpful not only on the consumer protection side, but also on the antitrust side. If you stop and think about what was going on at the time, you had a movement away from the vertical and Robinson-Patman cases, and Jim Miller and others had to testify why they weren't bringing more of these cases.

The economists were examining whether price discrimination had an efficiency rationale and whether there was evidence to demonstrate whether an efficiency motivation actually explained the observed behavior. The Commission had not investigated these questions in previous R-P cases.

Bob Tollison felt that economists were pretty well ingrained into the Hart-Scott-Rodino process. However, it was difficult to refocus efforts to bread-and-butter horizontal cases and away from some of the more innovative theories and some of the vertical theories, because it was a change in focus rather than simply a more careful analysis.

Bringing careful analysis in at earlier stages, which is what Hart-Scott-Rodino was about, got economists in there up to their elbows right from the get-go, even helping draft or modify the questions on the Second Request. At the time, the attorneys tended to request information about everything and the kitchen sink so they could have more time to prepare a case.

If you think about that period, we analyzed some very large mergers in the oil industry. Scott Harvey was involved at the very early stages, and he helped define how to look at mergers of large companies, and in the oil industry in particular. His methodology probably withstands the test of time. I'll let the guys who are practitioners explain more.

Scheffman is raising his eyebrows. I don't know. I don't consult in this area, but there were some major oil mergers, and I think they were good examples of successful collaboration with the lawyers.

You still had the same issues, and it was difficult for lawyers to understand why the economists asked questions that seemed to undermine their cases. It was also difficult for economists to understand that when you're negotiating a case and you're in meetings, sometimes you have to use a little judgment about what you can say and when.

So the tensions that existed back in the early days of economists and lawyers working together also existed during our time there. And it was interesting. When I was back at the FTC during the 2000 transition and talking to folks, a lot of the same issues were still being raised, sometimes by the Commissioners, about the role of economists. Nonetheless, the role of economic analysis was really solidified, but it was a process that was well established in the prior decade. It was just a matter of deepening the analysis and expanding it.

I think the watershed case was the GM-Toyota joint venture. It was a watershed in the sense of the economists being involved from the very earliest stages in that analysis and the economists carrying the day in terms of the decision when it got to the Commission. I think that's about the only antitrust case I remember as Bureau Director. It loomed that large in my mind. I remembered a 1,200 page memo, and I didn't know if I added another zero on it or not.

John Peterman has confirmed with me that in fact it was about a 1,200 page memo that went from the Bureau to the Commission. At any rate, the Commission really did agree with the economists on what was a difficult case for the Commission. It seems to me like it was a no-brainer in retrospect, and even for me at the time. But I was glad that we had the 1,200 pages of support.

I want to mention a couple of things that are, again, a little outside antitrust per se, but that showed what we were doing on the policy front. I know that we're going to talk about intervention later on. But I also want to point out that there was a lot of testimony, and the Commission or Jim Miller were asked for their opinions on things like industrial policy and international trade.

For example, the steel industry was trying to get not only protection, so it wasn't just an ITC kind of issue, but all sorts of other protections. Jim Miller and I believe the rest of the Commission were asked their opinions. The Commission took a very strong stand and a good stand against industrial policies, against picking winners and losers, and in favor of keeping markets open and competitive.

I want to end by mentioning the use of experimental economics in my time at the Federal Trade Commission. It was used not only in the consumer protection area, but also the FTC funded some research in the antitrust area. Indeed, the FTC recently commissioned Vernon Smith and Bart Wilson at George Mason with whom I work to conduct an experimental study on zone pricing in gasoline markets. See Ms. Gramm's documents at http://www.ftc.gov/be/workshops/directorsconference/docs/grammdocs.pdf

So I have included an executive summary of the report that's just been finished that you all probably know about, but also a memo from Charlie Plott to me, and a whole bunch of papers that list the research that they did for the economists using experimental economics. Charlie's perspective is that FTC support fostered a whole bunch of academic research. In Plott's view, this research helped in the antitrust area and in the ethyl case in particular.

MR. SCHEFFMAN: Thanks, Wendy. I screwed up here because obviously I should have begun with Mike Lynch since he was the first of the Bureau Directors of the eighties, so I apologize, Mike.

MR. LYNCH: No problem. I'm going to steal a line from Darius. If he was the accidental Bureau Director, I was the accidental Acting Bureau Director.

(Laughter.)

MR. LYNCH: There were more accidents than I had conceived. This was at the end of Mike Pertschuk's chairmanship. Ronald Reagan had already won the election. Everybody knew that Jim Miller was going to be appointed Chairman of the Commission.

The Bureau Director left, so Mike Pertschuk was looking for a Bureau Director, and I think he went through people wiser than me who said no.

(Laughter.)

MR. LYNCH: Mike and I had gotten to know each other pretty well on the life insurance cost disclosure investigation. I think Mike thought, because of what happened during the committee hearings, that I was politically very astute. This was a sheer accident, never to be repeated. But in any case, when Mike asked me to be the BE Director on an acting basis, I said I don't think I agree with any of your views.

(Laughter.)

MR. LYNCH: And Mike said, what about life insurance? I said, yeah, life insurance is the one thing that we probably agree on. And he said, well, that's one more thing than any other economist.

(Laughter.)

MR. LYNCH: I confess that I had several other motives. Planning is so wonderful. I thought that if I accepted that position, it would be a matter of a few months at most, and Jim Miller would be in place. He would appoint a new Bureau Director, and I would be leaving the Commission.

I thought, well, it's time to do something else, and this would look good on my resume. Instead, there was a hold up in Congress and it dragged on and on and on, so I became a fairly long-term unintended and basically unwilling Bureau Director.

That said, the seventies were certainly tumultuous. We're supposed to be talking about the eighties, but at the beginning of the eighties, we were suffering a bit of a hangover after the tumultuous seventies. And of course we were planning for a new direction.

In any case, one of my tasks was to go to the International Trade Commission to testify against automobile quotas. I was happy to testify because we had a staff report that I thought was good which stated that the competition from the imports was better for the American public than any injury done to the automobile industry. I had no problem whatsoever with our position.

But in the past, I don't know if any Bureau of Economics Director had ever made this presentation to the International Trade Commission. It had typically been the head of the Bureau of Competition. It had been a lawyer who would make these arguments. I was very unused to this sort of argument.

In any case, all of the very bright lawyers declined this honor. So the Chairman and his closest advisors went down the totem pole starting with the BC Director. All asked found reasons why they couldn’t and shouldn’t testify. I was lowest on the pole so the honor fell to me. So I went to the International Trade Commission.

One of my memories sitting there was seeing one of the Commissioners at the International Trade Commission, looking and just glaring at me. He said, I thought I told you never to come back here.

(Laughter.)

MR. LYNCH: I replied, uh, Commissioner, this is the first time I've ever been here, honest.

MS. GRAMM: It was the right thing to do.

(Laughter.)

MR. LYNCH: It was the right thing to do. And actually, the International Trade Commission made the right choice. I don't know how important our report was, but it probably helped. So that was a good thing.

On the other hand, the ITC decision pretty much all but got undone with quota agreements that were independent of the ITC. I'm not sure how beneficial it was, but it probably helped. It probably would have been worse if the ITC had found the other way. That was one memorable experience during my tenure, and it’s pretty much all I have to say. The beginning of the eighties was kind of an unreal period.

MR. SCHEFFMAN: John's next, but Mike's interim tenure was important as were those of Mack, who did it various times, and John.

When you have a change in administration, the Bureau of Economics is a little bit of a white elephant, and you never know how you're going to fit in with the new guys. Interim management is very important in keeping morale up within the Bureau, talking to whoever comes in, and trying to make sure that the Bureau has its rightful place.

John?

MR. PETERMAN: I intend to make a few broad comments, in that context link a few things that I and other economists attempted to do while at the Bureau, and evaluate how successful these efforts might have been.

I came to the Commission in the late seventies, having been an academic involved in antitrust economics. At that time, numerous economists were devoting serious attention to antitrust, to Commission decisions, to court decisions, finding serious weaknesses in many of them, finding approaches wrong, finding weaknesses in case selection, and making strong suggestions that antitrust policy needed a strong base in economic analysis to help direct it.

It was an exciting time for economists who were working in antitrust. When I came to the Commission, that same spirit was evident. It was a very exciting time to be at the Federal Trade Commission.

Courts were demanding economic analysis in arguments before them. The Commission was demanding economic analysis and evidence before making decisions. The Bureau was able to attract very, very capable economists to come and provide an exciting environment to provide the type of analysis that the Commission was demanding.

When I first arrived, there was enthusiasm not only in BE but also in BC. There was a very strong functioning Merger Screening Committee which had become reinvigorated. Both lawyers and economists made decisions jointly on what types of mergers were going to be investigated and which specific ones to investigate.

There was a very serous effort for a jointly run Evaluation Committee where both staff economists and their managers evaluated proposed cases, presented arguments, and discussed the types of evidence that we needed to show possible anticompetitive effects.

One reflection of the importance of developing economic analysis for possible cases involved a very strong effort by BE and BC management to develop what were called investigative protocols, which are largely forgotten now.

But there was an effort to try to take, for example, a horizontal merger, and set out what analytical steps we would take during an investigation, what arguments we would try to advance, and what types of evidence we would seek to support a possible case.

We completed protocols for horizontal mergers, horizontal restraints, vertical mergers and vertical restraints. It was a major effort. I remember working very hard on them. They did not really become policy or really see the light of day, but they did show a willingness and desire to integrate economic analysis into the antitrust mission, and a serous effort by BC at that time to accommodate that goal.

It was also a time when the big monopoly cases were dying out. They either bore no fruit, or from my perspective, they proved too difficult to do. In my view, the Commission didn't have the capability to handle such cases. There was no enthusiasm to continue along that line.

There was some effort by attorneys to continue “industry wide” cases by proposing “no-fault” monopoly investigations where the aim was to challenge brands that had large market shares and to require the licensing of the brand names at essentially zero license fees.

BE was very much opposed to no-fault monopoly cases, and those particular investigations did not go far.

There were also efforts to develop conglomerate merger cases, but none bore fruit (if I remember correctly, because they didn't have a strong economic base to them).

Many of the economists and attorneys at the time de-emphasized vertical cases, largely on the ground that the arguments to support proposed cases were the very ones that academics had strongly criticized, and the proposed cases demonstrated the weaknesses of past arguments. So we tended not to promote vertical cases, or tended to be very, very choosy in what we supported.

One effort to continue support for past vertical policy was an evaluation of about five or six past FTC cases by outside economists, which we published in a book. The volume argued that the past cases bore consumer benefit. That effort, although it was interesting, really didn't carry the day, partly because few of the studies in it were really first rate. Had more of the analysis been superior, I think the retrospective volume would have had more influence.

An example from the retrospective is a study of the FTC challenge of resale price maintenance by Levi Strauss on its Levis jeans. An economist from Yale basically supported the Commission's challenge in that case, largely by concluding that it was a “good” case because Levi’s use of RPM was a mistake, and the Commission helped it overcome its error.

(Laughter.)

MR. PETERMAN: So what did BE focus on? We focused primarily on horizontal restraints. The economists developed great skill and expertise in analyzing horizontal restraints and horizontal mergers, in developing relevant evidence and arguments, and in presenting them to the Commission. Here I think BE was very influential.

The Merger Guidelines were coming into existence in '82, and we began to follow them as investigative guides. The Herfendahl thresholds numbers in the Guidelines are relatively very low. The structure/performance paradigm was coming into disfavor. Weaknesses were being shown. The threshold levels of concentration in the Guidelines seemed very low in relation to new economics research, and also in relation to how competitive firms seemed to be when their Herfendahls in their industries were much higher than those in many cases that we were investigating.

Malcolm Coate has demonstrated that the Commission really has based its decisions on much higher Herfendahls than the thresholds in the Merger Guidelines. I remember one time calling as an experiment maybe 35 eminent industrial organization economists and asking them what post-merger Herfendahl would he or she be concerned about? What should be our cutoff? The average was 2,500 to 3,000, if I remember correctly. Anything lower than that, they (generally) said not to be too concerned about.

The economists who favored the much higher levels, 3,000 or even higher, were those who felt the FTC would too frequently challenge procompetitive mergers. They felt that errors blocking procompetitive mergers would be less likely if the Herfendahl thresholds were very high.

So the Commission gradually did move well above the Guideline thresholds. Efforts were made in the '92 Merger Guidelines to change the levels, but this proposal was not successful.

In management, we always tended to require the economists to analyze the behavior of buyers and sellers and explain how the market actually worked. We expected the staff to develop either a theoretical framework or a compelling story that would allow us to discern how a particular merger would affect competition and why, and to provide any supporting and contrary evidence.

My years covered a great time to be an economist at the Commission, and I hope it still is. I'm sure it is.

MS. GRAMM: I want to mention one thing, Dave, just to follow on to these comments. If you look at the cases that were brought on the antitrust side, you really see the influence of Tim Muris when he moved from BCP

Director to became BC Director, especially with a lot more cases brought where monopolies were basically government-sponsored monopolies.

Some of them weren't successful, but Muris targeted government-imposed restraints and, for example, cases where standard setters tried to raise rivals' costs by excluding others. These kinds of cases from later on in the eighties are worth noting.

MR. SCHEFFMAN: Let me give a little perspective, having been a Bureau Director at that time. I came to the Commission in 1979. You can't overemphasize how much things changed for the economists. It wasn't altogether good, but it was productive.

I remember in the late seventies, most of BE’s resources were in the big monopolization cases. Although there were certainly strong differences of opinion within the Bureau of Economics on the merits of individual cases, the Bureau has always provided total support whenever the Commission has gone to court.

I worked on a number of cases I didn't agree with. That was my job. The Bureau was very important in supporting the litigation in what were all economics cases. So we were actually quite popular with the lawyers.

The situation changed when big monopolization cases went away. The other part of the BC agenda, like the merger program at that time, few economists supported, because of the sort of merger cases that were brought at that time. There was tension because of BE opposition to many merger cases, but there wasn't much of an avenue for the economists to have much role in that.

Overall, however, in the 1970s BE was quite popular within the Commission. During the eighties, the monopolization cases stopped, a merger wave picked up, and the cases and the caseload began to be mergers. At the same time, we had Bill Baxter's brilliant Merger Guidelines in which the methodology laid out was essentially an economic analysis. Prior to Baxter’s reform of the Merger Guidelines, as Mack mentioned, merger cases were generally decided by abstruse arguments about market definition. Prior to Baxter, merger cases had nothing to do with economics.

The brilliance of the Guidelines is that they gave a sound analytical approach that we learned over time was implementable. The new approach also turned mergers into a ball game for economists.

The typical merger we were doing in the early days were 7 to 6 and 6 to 5 mergers. Tim gets blamed for supposedly not enforcing the antitrust laws. By far the most conservative policy, however, with respect to concentration thresholds was under Muris. The Department of Justice and the Commission at the same time were both pretty much holding to the Guidelines' Herfindahl standards.

With the numerical standards, however, a lot of the merger cases weren't ones that economists would get very excited about. Why would you think that this specific 6 to 5 merger would make a lot of difference? We see a lot of industries that are much more highly concentrated than 5 significant firms and look pretty competitive.

With very conservative numerical standards and a new methodology, there was a lot of tension between the economists and the lawyers. We were on a much more equal footing with the lawyers, because the Guidelines used a economic methodology, because Chairman Jim Miller was an economist, and because BC Director Tim Muris was an economist-oriented lawyer.

But we sort of became the lightning rod for the change. It was obviously a tremendous change in policy. The legal bureaus weren't dying for the change in methodology or in policy direction, and these changes were very unpopular at the time. BE was the nay sayers who were saying no, no, this case doesn't make any sense.

So the Bureau of Economics went from being “loved” by the lawyers and supporting litigation to being the unpopular quality control enforcers who would say in a very vigorous way, wait a minute, here are the reasons why this may not make sense. Jim Ferguson is in the background. He was one of the Assistant Directors, and Jim was not a shy guy.

We had some very vocal people, including me, who fought vigorously with the lawyers. It was a very testy time. It was the time in which the Commission and DOJ worked out modern merger analysis. We have a paper on the web site about this period.

But it was a time in which the Bureau of Economics, with so much to say, went from being friends to becoming to some extent the "enemy" from the staff lawyers' perspectives.

What eventually happened was that the lawyers, who are very smart, figured out the Guidelines and learned to play that game, too. They learned to marshal evidence to build cases using the methodology of the Guidelines.

Over time, then, the economists prevailed less frequently when the economists were saying, well, we think there's not enough evidence to support a merger case.

Having just come back to the Bureau, I think that's where we are still today. The economists are very important. The lawyers listen to us. We're not at war with our friends, even though we sometimes disagree with them. The lawyers are very smart, and they figured out the analysis. If it's an argument about evidence, lawyers are going to win against the economists, unless you can come up with some really convincing evidence.

To summarize, the economists' role is important and appreciated. We had that “high point” for a while in the eighties, but it also was a time of great contention and put a lot of pressure on the Bureau. Later Bureau Directors have fortunately defused the contentious nature of the interactions that we had during the late 1980s and early 1990s. We have some time for questions or comments.

MS. GRAMM: Ferguson.

MR. FERGUSON: Let's talk about the surrender by BE management during that period.

(Laughter.)

MR. SCHEFFMAN: Let's do that. Now remember, Jim, general counsel is here, so be careful what you say, but we'll get the gist of it.

MR. FERGUSON: The idea that we had some influence during the early period of the eighties while Jim Miller was Chairman was in part because obviously he supported the program, and Tim Muris supported the program. When you have the Chairman and the BC Director supporting an increased role for BE, that makes it a little easier.

However, the structural change that accompanied more influence for BE was placing emphasis on the Merger Screening and Evaluation Committee meetings at which some evidence had to be presented before cases were allowed to go forward. My impression is that there's been a major retreat from the requirement of evidence before a case could proceed. In fact, in the last ten years, Merger Screening and Evaluation Committee no longer mean anything. They're a rubber stamp. That's where the role of BE declined, because if you can't get in there early and present evidence of the lack of a case, once they get going, they have a momentum of their own, as we've all observed. Therefore, the question is why management didn't do more to maintain the importance of the Merger Screening and Evaluation Committee meetings.

MR. SCHEFFMAN: I don't agree. I don't think it's quite that important. These meetings made a lot of difference in the early eighties, when we were looking at 7 to 6 mergers, when it wasn't obvious that the market definition made any sense, when we didn't really understand the Guidelines, and when we were not using the Guidelines' methodology.

Now in the typical matter, there's normally a solid basis in the case. For example, you usually have a plausible 4 to 3 or 5 to 4. The economists might disagree about the merits at the time of the case. But I think that's much less of a problem. I think that merger screening actually works very well.

What the people did in the nineties during the merger boom, I can't imagine how they were able to do what they did. There was some serious screening that went on, I guarantee, because a lot of stuff was left by the wayside, and we don't see very many complaints about anticompetitive mergers that got through. The merger boom demonstrated that the Merger Guidelines made the enforcement process enormously more efficient.

We used to be really busy when we had two big mergers going on at the same time. Now that's a slow time. That was like a vacation during the nineties. I was amazed when I came back in 2001 when it was still really busy. We had two big oil mergers, two big food mergers, and a number of other mergers going on at the same time. I had never seen anything like that. We would have been under water. It would have been impossible for us to do so many cases simultaneously in the eighties. People got much better at what they did, both the economists and the lawyers.

MS. GRAMM: But then the point that you made, though, is that it's not only that the lawyers figured out our game and can spit out cost benefit analysis as if they are using a template and punching in the numbers. The point is, they also got better in terms of learning not to bring such awful cases to evaluation. They had to.

MR. SCHEFFMAN: I think they're applying the same analysis we do. I think as lawyers, they give more weight to hot documents. Documents are worth a lot more to the typical lawyer than to economists. Economists don't give much weight to opinions in memos.

Lawyers emphasize relatively more statements in documents, and the economists emphasize more of the quantitative part. I believe that the product of the two is, on average, correct decisions. More than on average. Typically they're correct decisions.

Other questions?

MR. SCHERER: Yeah. I think there's something missing from the equation. I'm not sure who originated the idea. It may have been Fritz Mueller. It may have been Don Turner. A quite different approach to mergers begins from the premise established in many empirical studies that the average merger yields zero at best efficiency increase, and therefore, in efficiency terms, mergers are on average a blah. Therefore, if you've got to err in antitrust enforcement, very little is to be lost in the absence of compelling evidence of efficiencies, which can be brought forward in some cases. I've done it myself in merger cases.

But in the absence of such evidence, very little is to be lost if you take too tough a line, by standard Cournot theory, towards the merger. And somehow we have lost sight of that weighing of relative benefits versus relative costs of enforcing a tough merger policy.

I know the people who did these things in the 1990s had a very difficult job. I worked for the Department of Justice on the proposed merger between Lockheed Martin and Northrop Grumman. The team that worked on that concluded that there would be serious losses of competition if this merger took place. But we really let the horse out of the barn with two prior mergers that were not challenged by the antitrust authorities, the merger of McDonnell Douglas with Boeing and the merger of Raytheon with Hughes Electronics.

Those mergers got through and have had a significantly negative impact on our defense posture. Also, I did the efficiencies analysis in the Lockheed Martin Northrop Grumman proposal. They were proposing all sorts of efficiencies. I remember they were going to close down 90 production lines, close 115 laboratories.

I did an item-by-item analysis of what these closures entailed. In something like 85 percent of the cases, the firm in which the laboratory to be closed was located had an exactly parallel laboratory somewhere else within that firm, so that they could have maintained the same R&D work substantively while closing that laboratory without the impetus of merger.

MR. SCHEFFMAN: Thanks, Mike. All right. Well, thank you. Thank you very much, panelists.

(Applause.)

[Break for lunch]

[Resuming]:

MR. FROEB: This is the 1990s. We have Jon Baker and Jeremy Bulow.

MR. BAKER: I'm really delighted to be back and to see all my former colleagues and old friends who have shown up, and to see this lovely new building.

The three challenges I'd like to talk about that were important for the Bureau of Economics during my tenure involved the need to deepen the litigation support capability, the challenge to resources posed by the merger wave, and the challenge of integrating new theories and empirical tools into antitrust practice.

Let me start with litigation support. When Bob Pitofsky, Bill Baer and I arrived in April 1995 and were talking about our management goals, we realized we wanted to expand the Commission's litigation capacity, because we planned to litigate cases and we knew the importance of integrating economic analysis with the legal analysis in doing so.

The lessons that John Peterman had taught the Commission were not lost on us. We saw a need to develop a more cooperative relationship between the Bureau of Competition and Bureau of Economics staffs where both would value the contributions of each other more than we thought might have been going on in the recent past. We recognized this was not just a Bureau of Economics problem, but of course my focus was on the Bureau of Economics aspects of it.

With respect to the Bureau of Economics, there was no issue of undoing what had been going on in the earlier decades. We didn't seek to challenge the Bureau of Economics staff's independent voice to the Commission or its intellectual integrity. The goal instead was to ask the staff to undertake a second, complementary job, helping the attorneys make their case more effectively, sharpen their arguments, improve theories, buttress their evidence, and identify the best answers to the problems with the case that the Bureau of Economics might identify in the event that our training led them to see problems that the lawyers didn't.

We spread this message through joint retreats of the managements of the two bureaus, the Bureau of Competition and Bureau of Economics. We had seminars on litigation support for the Bureau of Economics staff, including one where we brought in senior academics and consultants to talk about their experiences as experts.

In my view, the staffs of both the Bureau of Economics and Bureau of Competition rose to the challenge. One example, and the biggest one from the point of view of the Bureau of Economics, was Staples' proposed acquisition of Office Depot.

Bruce Wasserstein, an investment banker, talked about it as, he said in his book, "a particularly dramatic show stopper" from the point of view of the investment community in understanding the government's merger policy. I believe that case would not have been brought by the Commission or won in court without the extensive contribution that the Bureau of Economics staff made in analyzing the pricing evidence and in analyzing what we concluded were the parties' overstated efficiency claims.

The Bureau of Economics staff played a similar role in litigating the drug wholesaling mergers, another one that went to District Court. This case involved Cardinal, McKesson, AmeriSource and one other. There were four firms. Bergen. Thank you, Harold [Saltzman].

There was theoretical modeling from BE staff that supported the Commission's economic expert, and there was extensive support also for the Commission's efficiencies expert in that case.

When the Pitofsky era at the Commission began, few BE attorneys and BE economists had significant antitrust litigation experience. Both bureaus essentially learned on the job and became more capable and effective in going to court.

In fact, during Jeremy's tenure, the Commission was litigating three cases simultaneously in the District Court. That’s something we could not have done at the beginning of our tenure in 1995.

The effort to develop a more cooperative relationship with the legal staff was made on the consumer protection side as well, where the Bureau of Economics staff played an important role in working on the Joe Camel litigation, particularly in data analysis.

The improved cooperation with the Bureau of Competition gave the Bureau of Economics credibility with the Commissioners and paid off with influence.

Bill Baer and I basically agreed on most cases when we made recommendations to the Commission. But when we disagreed, and when the Bureau of Competition didn't have a signed consent in hand, the views of the Bureau of Economics were highly influential. I think this influence reflected our overall cooperation in serving the aims of the Commission as a whole.

The second challenge that we faced was the merger wave, which strained the resources of the

Commission unbelievably. The resource demands were just overwhelming during my tenure, and I think they got worse for Jeremy.

Antitrust investigations also at the same time became more complex, particularly because we were more often conducting econometric analyses, for example regarding market definition or unilateral competitive effects. Those are probably the most common examples.

On more than one occasion, I remember Bob Brogan coming into my office and telling me that the Bureau of Economics' ability to staff all the antitrust cases was in question. There was an overwhelming demand for economic analysis of the oppressive number of significant mergers that were coming in one after another.

Despite the heavy merger case load, BE supported many other Commission projects. The Commission found time to investigate and challenge nonmerger practices in antitrust. The Toys “R” Us case, Intel, those were big investigations, for example. But the mergers just kept coming, and the Hart-Scott Rodino deadlines meant we couldn't put them on the slow track. We had to address them.

The constant pressure from the merger wave made what we did in the Bureau of Economics in staffing Staples all the more impressive. I don't recall exactly, but Staples involved something like eight economists in a full-time equivalent sense, including staff and managers and a visiting scholar, all working full time or nearly so for several months. A number of others were also involved making significant contributions.

Half of our staff were doing full-time econometrics as were both of our outside experts and their staffs. I believe that no government antitrust case, either Justice or FTC, before or since, has involved as extensive a commitment of resources to econometrics, both in investigation and litigation, as BE made in Staples.

We also put some resources into research and advocacy, but it was basically just enough to keep the functions from disappearing. It was a constant challenge for us even to do that throughout my tenure.

We also found time for an interesting effort to generate antitrust cases that I don't think people outside the agency know about. The idea was to screen the monthly Bureau of Labor Statistics Producer Price Indices in as disaggregated a level as the data permitted. The data go to 7 and even sometime 9-digit SIC industries. We essentially looked at price changes, starting several months before the most recent business cycle trough in the most closely related industrial production index. By linking price and output changes separately for each industry, we timed the trough individually for each industry. We compared prices before and after the trough, once output had returned to its original level in that industry.

The idea was to identify instances when prices rose during a period where output probably wasn't rising, and when most industries were in recession. In such instances, one could probably rule out the hypothesis that the higher prices came from input cost increases or from industries hitting capacity constraints. Industries with price increases during those down times would likely on average reflect the exercise of market power.

This sample gave us a group of industries to study further. One hypothesis was that demand could become less elastic as the economy began to pick up on the way out of the recession, and firms able to exercise market power might take advantage of the opportunity to raise price.

Our screen generated more than 600 industries that were worth looking at. We couldn't possibly touch 600 industries, so Denis Breen, Ron Bond and I picked 25 industries, largely arbitrarily, to look at further, and assigned each one to an economist on the staff to study.

In most of those cases, there was a plausible explanation for the price increase in terms of cost or some other industry-specific factors. Some of our economists talked to the appropriate BLS economist about how they did the survey, and sometimes the data were misleading. For example, the BLS data sometimes didn't fully pick up a quality increase that affected price.

However, in three of the 25 industries, the report came back that there wasn't really any good explanation for the price increase other than market power. In two of those industries, we decided that further investigation wouldn't be appropriate. One of them it turned out was the subject of several Justice Department grand juries at the time, so they were on to this one already.

But for the one that was left, the Bureau of Competition investigated. They asked essentially why did the prices go up and what can we learn from documents associated with that price increase. The investigation confirmed that the price increases probably reflected the exercise of market power, but there wasn't any agreement, and there wasn't any facilitating practice that the Commission could challenge. The Bureau of Competition therefore decided that it couldn't go forward, so it closed the investigation.

Ultimately, we didn't come up with any cases. However, I thought that we had proven the technique. We didn't have the resources to try again on another 25 industries, much less 600 industries.

(Laughter.)

MR. BAKER: But now, Luke, you can make another effort. The merger wave has slacked off and there's a whole new set of industries with unexplained price increases to investigate.

The third area I wanted to mention was integrating new theories and empirical tools in antitrust practice. We recruited new Ph.D.s and visiting scholars with strong backgrounds in theory and econometrics. We also invited some top academics to do continuing education seminars.

We worked on auction theory and unilateral effects in several cases, not just in the drug wholesaling mergers that I mentioned before, but also in Rite-Aid/Revco and Time-Warner/AOL. We had models that we worked out involving all-or-nothing offers and bundling. We also worked on how to implement the minimum viable scale analysis of the Merger Guidelines. We worked on raising rivals' cost cases. We thought about how to utilize Dave and Steve Salop's ideas in actual cases.

We thought hard about efficiencies in conjunction with the 1997 efficiency guideline revisions and in working out ways to estimate pass through rates. In Staples, we worked out how to take advantage of a natural experiment to see how prices varied with market structure. We investigated demand elasticities using econometrics in lots of cases.

One of the most important jobs was to share how we in the Bureau were applying these new econometric techniques and theoretical approaches with the economists and lawyers who advised outside firms. I gave a number of speeches on a wide range of topics trying to explain what we were doing.

I did very little of this work by myself. It really was the staff and the talented economists and managers in the Bureau, and all my Associate Directors and Deputy Directors, who made all this possible. I therefore am not surprised that under my successor, Jeremy, the Bureau remained as highly successful as we were.

Thank you.

MR. FROEB: I'm tempted to call on Jim Ferguson to rebut.

(Laughter.)

MR. FROEB: But we're going to go to Jeremy.

MR. BULOW: Thank you. Of course, at the time I became bureau director, Bob Pitofsky was the chairman. And as you all know, Bob is a real intellectual, and part of what that implied was that he was perfectly happy for me to say what I really thought and entertained debate about any case so long as I didn't persuade Mozelle or Sheila to change their vote.

(Laughter.)

MR. BULOW: So fundamentally, the way we could have influence was either by persuading Bob, which sometimes happened. [Nonpublic material deleted] Or sometimes we could persuade BC. [Nonpublic material deleted].

And the third thing that we do [nonpublic material deleted]. BC's proposal would have more credibility with him if BE was saying that we were going way too far. [Nonpublic material deleted].

MR. FROEB: Well, thank you both. Let's eat.

(Whereupon, at 12:35 p.m., a luncheon recess was taken.)

A F T E R N O O N S E S S I O N

(1:10 p.m.)

MR. MURIS: Let me introduce Jim Miller, but let me also mention that we have several other current and former members of the Federal Trade Commission here besides Jim and me. Tom Leary is here, as is our newest Commissioner, Pamela Jones Harbour. We also have former Commissioners Mary Azcuenaga, Mary Gardiner Jones, and Margot Machol. So we have quite a gallery, and it's been quite a morning.

I have the distinct honor and privilege of introducing Jim Miller. As I mentioned in a memorial service last fall for Jim Liebler, I've been lucky to have had three mentors in my life, each named Jim.

Today I have the honor of introducing the second Jim, Jim Miller. Jim Rill is the third, for those of you who want to know.

I first heard of Jim without meeting him when doing work for Chairman Lew Engman in the fall of 1974. Lew made a major speech attacking transportation regulation. It actually got on the front page of the New York Times, which is a pretty big deal. He relied heavily on Jim Miller and George Douglas's book about the Civil Aeronautics Board, which I read in galleys.

I met Jim, shortly thereafter became friends, and even took a class from him. Within 36 hours of Ronald Reagan's victory in 1980, we had breakfast. Jim stated that he wanted to be Chairman of the FTC. Knowing the mess the place was in, I asked why.

(Laughter.)

MR. MURIS: Jim, who has almost always got the big issues right, was way ahead of me in seeing the FTC's potential. I worked for Jim in the FTC transition, then on the Regulatory Relief Taskforce in the White House, where I worked for Jim and Boyden Gray, and next for four crucial years in the FTC's history, and what years they were!

The FTC abandoned the discredited policies of the 1970s. It went in major new directions, for example, attacking fraud, and becoming competition's advocate before other government agencies. The FTC also strengthened its roles involving health care and the professions. Here Jim's presence was essential. In what was a personal triumph that I believe only Jim could have accomplished, and against odds that even today make me shudder to remember how long they were, Jim preserved the FTC's jurisdiction against the onslaught of the American Medical Association and its allies.

That victory reverberates today. We at the FTC have become the major government institution in the world advocating for competition in health care. Without Jim's triumph, this work would be impossible.

Jim's tenure was analyzed in a major book by two political scientists, who considered themselves neo-liberals, whatever that means. *The Politics of Regulatory Change* is the story of why Jim Miller succeeded at the FTC and Ann Buford failed at the EPA. Let me quote from the book rather extensively:

> Miller ... brought to the FTC a well-considered intellectual framework. On arriving at the FTC, he put together a more concrete deregulatory agenda based on this framework. Buford, on the other hand, came to the EPA with an agenda to get the agency off the back of business. This agenda was grounded in an intellectual commitment rather than an intellectual framework. This difference accounts, in great part, for Buford's problems and Miller's successes. As one former EPA official noted, you can't fight something (environmentalism) with nothing (Buford's strategy of ratcheting down). In this sense, Miller had something and Buford had nothing. His intellectual framework provided a basis for both attacking past FTC policy and defending his administrative and budgetary measures. . . . Miller ... [left his] own distinct stamp on the [agency he] led. When [Janet] Steiger arrived at the agency, she found a legacy on which she could build. Indeed, she defined her mission essentially as consolidating the changes in the legal standards that Miller brought to the agency. As the Associate Director of Advertising Practices under Steiger, Lee Peeler, observed, policy statements formulated during Miler's tenure required "greater attention to economic analysis -- this affects the view the Commission has of advertising: the cases we bring, the way we carry out enforcement, the general orientation of the Commission." . . . Miller's success in modifying the FTC demonstrated dramatically how, with the expansion of executive capacities in American politics, energetic and carefully conceived administrative action, can bring about substantial alterations in regulatory policy.

I give you Chairman Miller.

(Applause.)

Please see the written text of Mr. Miller's speech at http://www.ftc.gov/be/workshops/directorsconference/docs/FTC_Address_Miller.pdf

MR. MILLER: Chairman Muris, Commissioners, Directors, and everyone else: it's a pleasure to be with you today. Please bear with me: I'm just recovering from the awful shock I received at opening up today's *Washington Times* and being confronted with a photograph of Howard Beales. The photo makes him look like some sort of madman!

Chairman Muris was kind to mention that once he was my student. Well, Wendy Gramm, with whom I served on the faculty of Texas A&M, will probably vouch for the fact that I've taught many classes which included students who knew more about the subject than I did. But never did I have such an experience where the student knew as much more about the subject as when Tim Muris was in my class.

I'm honored to be here today -- in part because I'm not officially an alumnus of the Bureau of Economics. I'm reminded that soon after arriving at the Commission I participated in my first Part III matter -- you know, a judicial-type hearing. As I walked out of the hearing room on the fifth floor, someone from the staff came up to me and said, "Mr. Chairman, how long have you been a lawyer?" I responded, "Oh, I'm not a lawyer. I jumped from being an economist directly to being a judge." And so, when I came to the Commission, I jumped directly from being an economist right over BE to become a Commissioner.

I'm glad to see Paul Pautler here -- and glad to see that he's found a comparative advantage. One of his first jobs in Washington was helping me unload a U-Haul truck and trailer containing everything my family brought with us from Texas A&M. Paul surmised that after unloading trucks, working for BE would be just a charm. You know, when I left government and set up office at Citizens for a Sound Economy, I had a series of young women work as my assistant. They'd be with me seven, eight, ten months or a year, and then they’d get married. Then another one would come aboard and work six, eight months or whatever, and she'd get married. People began to comment on the phenomenon. My wife had an easy explanation for it: “After working with Jim Miller for six months, any man looks good!”

I was interested in Paul's rather expansive history of BE. As I began reading it, I was drawn to the fact that for many years Francis Walker was Chief Economist of the Bureau of Corporations and then Chief Economist of the FTC. Here was this Francis Walker: living in a man's world and performing so well. So, rather than finishing the piece, I called Paul, to find out more. Paul told me that Walker was a man, not a woman, and that his father was the first President of the

American Economic Association and prior to that was President of the American Statistical Association. But then I remembered that while Paul and I were at Texas A&M, playing a lot of basketball during the lunch hour, Bob Tollison and I wrote a piece about rates of publication per faculty member. In doing the research, we came across a piece that had been co-authored by Leonard Weiss describing a “Hall of Fame” for women economists, based on the number of publications in major journals. Included in that hall of fame was Sally Herbert Frankel. Writing Weiss a note, I said, “I know Sally Herbert Frankel; he's a man.” Weiss wrote back and said, “Yes; well, that's an easy mistake to make these days; sometimes you can't tell one from the other.”

Mr. Chairman, I notice that the title of the “intervention program” has been changed to “advocacy program.” I really think that's a shame, because the word "intervention" has more pizzazz than "advocacy." You know, you go running into Tim's office and say, "Tim, something's up. Let's go intervene!" That's much catchier than, “Tim, something's up. Let's go advocate!” It reminds me of how that great Georgia Bulldog, Lewis Grizzard, distinguished between the words "naked" and "nekked." According to Grizzard, "naked" is when you don't have any clothes on, and "nekked" is when you don't have any clothes on and you're up to something!

About the intervention program: Tim, do you remember when we sent Bill MacLeod to Minneapolis to deliver papers to the City Council, suing them over monopolizing the taxicab market? Bill held a press conference at which a bunch of taxi drivers showed up. Former Minnesota Vikings, according to Bill. Didn't we send Mack McCarty down to New Orleans to do the same thing? Mack left the Commission soon after that, as I recollect. Those were the days. They were a lot of fun.

In his piece on BE history, Paul addresses what I call the Arthur Burns question. He does so without firm resolution, but at least he tries. Let me explain. When I was at the American Enterprise Institute during the late 1970s, I sponsored a monthly series where we'd invite the head of a regulatory agency to come over and meet with the scholars and then discuss their issues. Mike Pertschuk came one time; we also had the heads of OSHA, FMC -- organizations such as that. I called the program "Meet the Regulators." The guest would talk about what he was doing and then take questions. Arthur Burns, former Chairman of the Federal Reserve Board and then an AEI distinguished scholar, always asked the same question: "Would the world be different if your agency didn't exist?"

I want you to know that I've taken a very careful look at the FTC and have tasked myself to answer the Arthur Burns question. I want to share with you now the results of that inquiry. We can divide the century into decades. Consider the first two decades together; the decade of the thirties; then the forties, the fifties and sixties together; then the seventies; then the eighties; and then the nineties. Now the answers are: probably yes, no, marginally yes, yes, damn right, and yes.

Now in the remainder of this conference, in ruminations about what transpires today, and in your writings, I hope you will keep several things in mind. One is that, as an independent agency, the FTC is very vulnerable, because it has few friends and lots of enemies. Parenthetically, when an organization such as that can keep the allegiance of the public and have a reputation for professionalism and credibility -- such as you have today -- you're accomplishing a lot!

Part of the problem is that you don't have the cover of the Executive. You really don't, because you are "an independent agency." Not everyone would be so bold as Tim, but in 1980, right after the election, as a member of the Reagan-Bush transition team, Tim went up and down the halls at FTC Headquarters saying to no one in particular but to anyone who would listen, "We're going to retry *Humphrey's Executor*." As you will no doubt recall, William E. Humphrey was Chairman of the FTC when President

Franklin Delano Roosevelt took office, and when Roosevelt tried to fire all the FTC commissioners, Humphrey took him to court. After Humphrey's unfortunate passing, his executor won in the U.S. Supreme Court -- a landmark decision that establishes the independence-from-the-Executive of independent agencies. Of course, Tim was just poking fun, though not everybody knew it at the time.

As you will recall, the environment for the FTC was very tense in the early 1980s. The agency had been shut down for a while, and the medical doctors and other professionals were close to obtaining an explicit exemption from FTC authority. I thought, once you open that door, there will be lots of others. So we fought very hard, and ultimately successfully, to prevent that.

Also, in a strategy of trying to consolidate our strength, we peeled off some controversial things. The cigarette lab: we got rid of it; it was just a drag. The cigarette companies hated it because they had no confidence in its results. We spun off the *Quarterly Financial Report* to the Department of Commerce. With the QFR program we were sampling with replacement; sometimes people got hit two times in a row, and they'd go complain to their Congressman or Senator. We closed down the line of business program, another source of controversy and a program that had pretty much run its course. It was a little like being in a sleigh out in the woods on a cold night and being pursued by a pack of wolves. You throw off a few cats and dogs, so the wolves will leave you alone.

A second thing to bear in mind is that the Commission's work has been enhanced by economists in addition to those in BE. Don't forget the contributions of economists George Douglas, Tom Campbell, Tim Muris, Howard Beales, Walter Vandaele, and Bruce Yandle, plus those who think like economists, such as Andy Strenio and Orson Swindle.

A third thing you need to keep in mind is that often economists are easily misunderstood. I'll give you some examples. After Bob Tollison had been Director of BE for about a year, he gave an interview to the Bureau of National Affairs, BNA. The reporter asked him about mergers and how one would analyze their prospective effects. Bob came up with a classic thought experiment. He said,

> You would allow a lot of mergers to go through. would allow a lot of people to put their money on the line and see what happens to prices, profits, sales, R&D. We get a natural experiment in the economy going. Let firms merge and see what happens.

The next day, the BNA story read:

> The chief economist of the Federal Trade Commission would like to conduct, "a natural experiment in the economy. According to Robert D. Tollison, Director of the FTC's Bureau of Economics, the experiment would involve approval of virtually all mergers and acquisitions to the

> point where there are three or four firms per market; then, if there are competitive problems, the enforcement agencies can step in and 'unscramble the eggs.'"

Or take, for example, my first press conference. Soon after I went over to the FTC, and against the advice of Tim, Carol Crawford, and others, I decided to hold a press conference. Carol kept saying, "Why?" "Oh, I want people to know we're here," I said. "Why? Why don't you do something and then hold a press conference?" "I don't know; I just want to hold a press conference," was the best I could come up with.

So I held a press conference and talked about a number of things. I was asked a bunch of questions and thought I was pretty good at responding until somebody asked me about defective products. I offered the example of a hammer: a cheap hammer is okay to pound nails in a wall for hanging pictures, but you wouldn't want to use one to build a house. Following that was a question about ad substantiation. You can catch the drift here -- I recalled something Tim had taught me, but obviously I had not gotten the whole story. In any event, I answered as follows:

> Consumers are not as gullible as many regulators think they are. They make intelligent choices. The thing that concerns me is that if we are so tight with our regulations that only the top-of-the-line kind of products [get produced], then people who would like to purchase a much lower-priced and perhaps not as high quality product

> will be deprived of that opportunity. And I want to make sure that doesn't happen. . . .
>
> On the question of substantiation, yes, I personally have strong reservations about the whole issue.

Now what I was thinking about, of course, is *prior* substantiation, not *ex post*. I went on:

> I want to study this more. I count myself as an academic. I think an academic is a person who wants to know what the evidence is and wants to draw their own conclusions. On some of these issues, I will say I do not know as much about them as I should. I am not going to make a precipitous judgment, but I have substantial problems with the whole idea of substantiation and will be looking at that very critically and may well recommend to my fellow Commissioners that we move away from that standard.

The next day the *New York Times* led off with the following story:

> James C. Miller, 3d, the new Chairman of the Federal Trade Commission, said today the Commission should no longer protect consumers from defective products and unsubstantiated advertising claims.

There was also an Associated Press story:

> Several leading consumer activists said yesterday there would be a flood of false advertising and shoddy products if the Government adopted proposals by the head of the Federal Trade Commission for less regulation of industry.
>
> It's horrifying," said Karen Burstein, Chairman of the New York State Consumer Protection Board. And Rhoda Karpatkin, Executive Director of Consumers Union, the product-testing organization, said, policies advocated by James

C. Miller, the Trade Commission Chairman, would move the country “back to the age of ‘Let buyer beware’ or maybe ‘Let the buyer be milked’."

Obviously, what I had hoped to communicate and what I actually communicated were two different things.

Economists especially have this kind of problem. Lawyers talk about things like this and it sounds esoteric, reporters don't understand what they are saying, and few people respond. When economists talk, reporters think they understand what’s being said. And sometimes they don't get it.

You may remember another case that involved being misunderstood. One of our economists was writing a paper explaining FTC enforcement behavior, and one of the variables in his or her model was the philosophical views of members of relevant congressional committees. In the statistical test, the economist was using the well-known ratings of Americans for Democratic Action and the American Conservative Union. Unfortunately, he or she called up the organizations to get their most current ratings and made the mistake of telling them something -- but apparently not everything -- about the use to which the data would be put. All of a sudden, people went nuts. I got a call from, among others, Congressman John Dingell, Chairman of our authorizing committee in the House. And I told him forthrightly, “As long as I am Chairman of the

Federal Trade Commission, we will never allocate our resources or decide cases based on the philosophy or party affiliation of a member of Congress." Fortunately, I had enough credibility with Chairman Dingell that he accepted my assurances. Of course, that's not what the economist was doing with the data, but it shows how easy it is for an economist to be misunderstood.

And then there was the famous Black Death study that was included in BE's series of working papers. What most people didn't know is that the study was put there because of a commitment by the previous administration -- as an inducement for an especially well-qualified candidate to join BE. Bob Tollison, quite appropriately, believed in keeping commitments.

Well, I couldn't pass up an opportunity such as this without presenting a few recommendations for you -- the Commission as a whole as well as BE.

One! In investigations, I hope that you will maintain transparency as much as you possibly can. Part of my thinking on this goes back to my favorite movie, "My Cousin Vinny." For those of you who have seen it, you'll recall that when the defense attorney, Vinny, played by Joe Pesci, asks the prosecuting attorney, played by Lane Smith, for some information the latter has on his clients, the prosecutor says he would be glad to give it to him, and got on the phone and asked his staff to send over a whole box of stuff. That's transparency. And that's the law in such criminal matters, as I understood it.

On point, yesterday I read in the BNA *Daily Report* that Assistant Attorney General Pate has a coordinated effects manual that the Antitrust Division follows to make determinations of liability. Well, they ought to share that with the public. I realize, of course, it would take Jim Ferguson at least a week to reply to that report! But releasing it would give people on the outside some notion of how the Department of Justice staff goes about its evaluations, and so those in the antitrust bar could better counsel their clients. I'm sure that if Tim had anything like that he'd put it on the FTC website.

Two! Increase the predictability of which -- FTC or DOJ -- gets what, when, and where. Now, I know you tried to do this. Senator Hollings was absolutely wrong, and you guys were absolutely right. I hope that you can overcome that setback and get together with DOJ so there is more predictability about the process of reviewing mergers and acquisitions.

Three! (I learned this one!, two!, three! stuff from Dr. Laura.) This is something hard to do, but to the extent that you can forecast the workload, do it not only for BE and the Commission, but also for lawyers who engage in this kind of practice. When I went over to Howrey, one of the first things people asked me was, “When are mergers going to pick up?” So I started thinking about the question and came up with a little model. Probably two variables would be very important in explaining merger activity -- growth of the economy and cash balances of firms. Then somebody said to me, “This guy over there at the FTC -- Paul Pautler -- he knows all this stuff.” So I called Paul. It turns out that the problem is a lot more complicated and more difficult to model than I thought. Nevertheless, it’s a useful thing to pursue.

Four! Try to measure productivity. I don't know to what extent you do that, but as George Mason University President Alan Merten says, “What gets measured gets better.” But you've got to measure the right things. Once Executive Director Bruce Yandel came to my office and said, “Jim, you will not believe what I just heard.” I said, “What was that?” He said, “I got a call from someone at the Bureau of Labor Statistics requesting our productivity numbers. I said, “I don't know what you're talking about, please tell me.” It turns out the BLS measured the productivity of the FTC as the number of lawsuits per employee! Now if you measure the wrong thing and it gets “better,” you may be getting worse. So be careful.

Five! Find ways to minimize interference with the market for corporate control. This is a dicey thing. If you think about it, the default is, “the market works.” But there are times when the government should say, “Wait a minute, we want to look at this to see if there's a problem.” But since many acquisitions are very complicated, with multiple suitors, you can have an effect on who gets what just by saying, “Wait a minute.” My partner and former FTC official, Mark Schildkraut, reminded me the other day that at one point during my tenure at the FTC, I actually triggered a second request just to hold somebody back until we had concluded the review of a proposed acquisition so that we wouldn't be standing in the way of the market’s making its choice.

Six! Study and help remedy abuses of the legal process for rent seeking purposes. This is something of particular interest to me. And it’s obviously something in which Tim is already interested, because he's got Mr. Delacourt and Mr. Zywicki hard at work on the Commission’s Noerr-Pennington Task Force.

I happen to know from personal observation that there’s a case where a firm is representing that it has a valid patent, and while the claim is baseless, it is going around to customers of its competitors and holding them up for settlement. In another case I know about, a company has gone out and sued a competitor and then has gone on radio and television to tell people about the lawsuit and to claim that as a result of the lawsuit its stock is going up and its competitor’s stock is going down. So, “sell them; buy us.” Both constitute an abuse of the judicial process, and if the business models are allowed to continue, their extent -- and the efficiency costs they impose -- could escalate significantly.

<u>Seven</u>! One of the best things I think the Bureau of Economics can do is to be ready to address controversial issues in a very rational, analytical way. The oil merger report we did in the early eighties is a good example. You remember the petroleum industry was basically frozen in place during the late 1970s. Then, in 1981, the caps were taken off, and there was a lot of reorganization in that industry. As a result, some really spurious proposals were made on Capitol Hill. The Commission was able to work through all the issues and make a substantial contribution to that debate, perhaps heading off some very wrong-headed legislation. A more recent example is SPAM. You've promulgated the Do-Not-Call list, and it appears to make good sense. But as the Commission has noted, SPAM is very different in many ways. Making those kinds of reports is a very useful thing for you to do.

<u>Eight</u>! (I just have twelve!). In your report writing, realize that the major audience is not your

fellow colleagues but others. So, write more briefly. Lawyers are not the only ones who should be writing briefly, and you have even less incentive to be long-winded. As Adam Smith observed, “to increase their payment, the attorneys and clerks have contrived to multiply words beyond all necessity.”

Nine! When recruiting economists, shop at some of the smaller, less well-known schools. If you don't, you're going to miss a Bruce Yandel and some other really good people.

Ten! Be particularly wary of expanding Section 5, unfair methods of competition or unfair or deceptive acts or practices. I know I'm preaching to the choir here. But Section 5 is very open-ended.

Eleven! Stand your ground. Stand your ground. The doctors fight that Chairman Muris mentioned was very important. But there was another case that you may not have heard about -- *Indiana Federation of Dentists*. This was a case where the Commission found liability, and the defendants went to the federal Court of Appeals and got the case overturned. I was mightily troubled about that, partly because we hadn't lost any cases which I had authored or in which I had concurred, and on the merits we thought finding liability was exactly the right thing to do. So I got the Commission together, and the

Commissioners voted to ask the DOJ to represent us and seek *certiorari*. But, DOJ turned us down. And so, now even more troubled, I recommended to my colleagues that we ask DOJ to reconsider. Some of the people at the FTC, especially those in the General Counsel's office, said that was a bad idea. But we did it anyway. I got on the phone to Ed Meese and my current Howrey partner, Brad Reynolds, and others at DOJ, and tried to talk them into it. They told me the probability of the Supreme Court granting *cert.* was remote; and the basis on which we could make an appeal was very narrow and not very substantive. DOJ turned us down again.

I was really distraught at that point. But one day as I headed into my office, one of the staff members -- could be someone sitting in this room -- said, “Mr. Chairman, did you know that the FTC law only gives DOJ the right of first refusal? The Commission can actually appeal a case on its own initiative.” I said, “No, I didn't know that.” So I called another meeting of the Commission, and it was very divisive. The Commissioners voted three-to-two -- against the wishes of our General Counsel, Jack Carley, by the way -- to seek *cert.* on our own. And guess what? The Supreme Court granted *cert.* And guess what? The Supreme Court overturned the lower court. So that's the way we prevailed, just by knowing something was right and standing our ground.

Twelve! (Finally!) Take your work very seriously. I'm talking to the people in BE right now. When I arrived at the Commission, there was a general feeling that the structure-conduct-performance paradigm was sort of old hat. It should make way for the Chicago School approach and so forth. And now, of course, there are criticisms from the Austrians, who say those in the Chicago School are not pure; they've compromised. And the industrial-planner-types who say, well, what we really ought to do is abolish the antitrust laws and let people get together within the context of some sort of industrial planning.

Let me respond to this and close my remarks by reading the last paragraph of my book, The Economist as Reformer:

> How industry is organized and how businesses and consumers are regulated -- whether through cooperative centralized strategies, a free market protected by antitrust, a policy of restrained regulation, or a totally unregulated market -- affects not only our economic well being, but our basic liberties. No orthodoxy prevails forever. We must always be prepared to change our approach when faced with superior reasoning or contrary evidence. But we must also be prepared to oppose unfounded changes that would deprive us of the unsurpassed freedom and prosperity that this country has achieved and that the FTC was established to protect.

Thank you very much!

(Applause.)

(A brief recess was taken.)

MR. PAUTLER: In this session we're going to shift gears from this morning's antitrust matters and take a look at the role of economists and economics on the consumer protection side of the agency.

Economics came to consumer protection at the FTC a lot later than it came to antitrust. In this session, we'll try to describe some of the history of how economics came to be in consumer protection. We'll discuss the work that the economists did on the consumer protection side and indicate the kinds of effects that some of that work has had.

All the Bureau Directors that are here will be able to participate in the session if they'd like to, certainly by grabbing the mike. But we are going to focus on three ex-Bureau Directors.

Ron Bond, who was the Acting Director from '93 to '95 and worked on the consumer protection side, is going to give us a general overview of the work of economists in consumer protection.

Wendy Gramm, who was Director from '83 to '85, is the ex-Director who was most involved in the day-to-day work in consumer protection, because she actually ran the Division for a while.

Mike Lynch, who was the Acting Director in 1980, was very involved in the early work in consumer protection through his position in the Division of Industry Analysis, from which a lot of the staff came when consumer protection began in the Bureau of Economics.

Let’s get going and let Ron Bond give us an overview of economists in consumer protection.

MR. BOND: Thanks, Paul. I came to the Bureau of Economics in 1968. I was a young economist fresh out of graduate school, and I came to the research division, Industry Analysis. For the first five or six years I was here, I don't think I ever heard the term "consumer protection." All of my colleagues had backgrounds in industrial organization, and all of the projects that I remember were industry studies, structure/performance studies, or projects related to antitrust.

Since I was new to the FTC at the time, I certainly wouldn't have known everything that was going on in BE. In preparing for today, I looked back over the list of studies that Denis Breen so very kindly provided us with, and I found several studies from the 1960s that sound as if they're consumer protection related. I'll certainly enjoy hearing from some of the Bureau Directors who were here back then as to what those were.

But what I'd like to do for the next few minutes is to give you my perspective on the evolution of BE's involvement in consumer protection issues beginning in the 1970s.

To put this discussion into perspective, in the 1970s, the FTC was busy trying to reform itself. It had been the subject of critical reviews by both the American Bar Association and Ralph Nader and his Raiders, as we heard this morning. The Bureau Directors and Commissioners were therefore all thinking about ways that they could make the FTC's law enforcement activity both more relevant and more streamlined. What I think that meant on the Consumer Protection side was a newly invigorated enforcement program against deceptive advertising by large national advertisers. It also meant opening a large number of industry wide investigations as a substitute for a case-by-case approach to enforcement.

Given the magnitude and the novelty of the agency's newly invigorated consumer protection enforcement, at least some of the Commissioners and managers in the Bureau of Consumer Protection not surprisingly began to look to the Bureau of Economics for a little assistance. After all, BE had been assisting attorneys for many, many years on the antitrust side.

Thus, during Mike Scherer's tenure, BE became involved for the first time in the day-to-day activities of the Consumer Protection mission. Mike asked his former student, Dennis Murphy, to join him at the Bureau of Economics. Dennis served as Mike's assistant responsible for coordinating BE's Consumer Protection input.

I remember meeting Dennis when he arrived. I didn't think too much about it at the time, but in retrospect, I think that Dennis had to be one very brave young economist. Either that or very foolish. Poor Dennis had only the part-time help of a small handful of economists in the Industry Analysis Division.

He and they, all with backgrounds in industrial organization, no background in consumer protection, and no real prior experience in working with attorneys, had to come to grips with a large number of ongoing investigations that covered such broad and varied subjects as credit practices, funeral industry practices, mobile home warranty performance, over-the-counter drug advertising, vocational school promotion, hearing aid practices, and many more. To give you some idea of how difficult this task must have been, by 1974, very early in the process, the draft staff report for the credit practices investigation was already 650 pages long.

The next year, in 1975, the FTC received new rulemaking powers, and BCP turned many of the industry wide investigations into rulemakings. I recently saw a 1985 speech by Commissioner Azcuenaga which noted that in the three years following receipt of those rulemaking powers, the agency commenced at least 22 major rulemakings. That total represented a substantial commitment of resources.

To enable the Bureau of Economics to keep pace with this substantial growth in consumer protection activities, Dennis moved into the Division of Industry Analysis, and responsibility for consumer protection support moved to that division as a whole. When even that reorganization proved inadequate to keep pace, in 1978, BE created a new Division of Consumer Protection. The first head of the new division was John Prather Brown, a recently hired economics professor from Cornell, who had done post-doctoral work in law and economics at the University of Chicago Law School.

BE's day-to-day involvement in the consumer protection mission therefore evolved over a five-year period during the 1970s. Economists brought new perspectives to the Commission's consumer protection mission. In the 1970s, there was an explosion in the economic literature discussing the role of information in the marketplace. During this period, terms such as search goods, experience goods, credence goods, lemons markets, signaling and bonding were all working their way into the literature. Although some of that literature involved a lot of theory, the core consisted of a couple of simple points: that information is costly, not free, and that advertising can provide useful information. This latter point may not seem very novel now, but through the 1960s, industrial organization economists often looked at advertising simply as a barrier to entry. Considering advertising as a source of useful information therefore was a novel approach in the field.

The second concept that economists brought to the Consumer Protection mission I consider the most important. The idea is that activities generate both costs and benefits, and therefore, to evaluate the merits of activities, one must weigh the costs against the benefits. This idea put the focus of case selection on whether an action would make consumers better off rather than on whether someone might have broken a law.

The third perspective that economists brought to consumer protection from their industrial organization backgrounds was a preference for market solutions over regulatory ones.

I believe it is not possible to isolate BE's contribution over the 25 to 30 years since BE became involved in consumer protection. However, the Consumer Protection mission looks vastly different today than it did back in the mid 1970s. For an economist fighting in the trenches, it may sometimes seem as if BE has made no progress at all. But considering what has happened over the long haul, the differences are very significant.

Economists spent their earliest years in consumer protection focusing on two dozen Magnuson-Moss rulemakings. The economists tried to wrestle with the limited available data to assess the costs and benefits of the proposed rules. Virtually all of the early rulemakings were either terminated or drastically cut back. Subsequent rulemakings have been very infrequent, typically mandated by Congress, and carefully circumscribed.

The switch from rulemaking to cases represents a major change in the agency's emphasis in the Consumer Protection mission. As time passed, economists became more and more involved in the cases, especially in focusing on ad substantiation, unfair practices, and deceptive practices. They brought their economics of information tool kit and their cost benefit analysis tool kit, and they looked for data, often from copy tests, to see how consumers interpreted advertisers’ claims. They also sought to use data to predict the costs and benefits of proposed remedies.

Over all, I believe that the economists’ input has led to more careful case selection. My casual observation is that the agency probably undertakes large national advertising cases less frequently than it once did.

The biggest difference I see, though, is that the Consumer Protection mission today devotes far more resources to policing and attacking blatantly false claims and fraudulent activities. The economists did not necessarily recommend that change in resource allocation, but it is consistent with the way economists analyze cases.

Most of the national advertising cases involved a lot of subtleties. Almost invariably, a careful analysis shows some ways that legal intervention could generate benefits and some ways that legal intervention could generate costs. However, when the claims or activities are blatantly false or fraudulent, the potential cost of intervention disappears. There is no social benefit to falsity or fraud. The only real economic questions are the extent of any consumer injury and whether the enforcement resources could be used to greater effect elsewhere.

So, despite the fact that it may seem when you're in the trenches that progress is not being made, I think in fact that the Commission’s Consumer Protection mission has made substantial progress. I wouldn't say that the progress is strictly due to the economists. I think it is instead due to the economic way of thinking.

Over the years, more and more Chairmen, more and more Commissioners, and more and more managers and attorneys in the Bureau of Consumer Protection have begun to share the approach that economists use. The broad acceptance of the economists' basic framework accounts for the changes over time in the Commission's Consumer Protection case allocation.

MR. PAUTLER: Thank you very much, Ron. I found out from talking to a couple of our ex-directors that there was more activity on the consumer protection front by economists prior to the 1970s than I had previously realized.

Fritz Mueller and Mack Folsom will be able to tell us a little bit about that, and I turn it over to them for a little while.

MR. MUELLER: Given the time constraints, I shall address only what I view as trailblazing actions of the Commission. One area in which I think the Commission does deserve a profile in courage was when it took up the Surgeon General's request that the appropriate government agencies deal with the health hazards of cigarette smoking. At the Commission meeting, and the exact quote is in Commissioner Elman's reminiscences, Rand Dixon said, "You know who the Surgeon General means. He means us." The entire Commission acting unanimously came out with proposed rules after considerable effort, writing what attorneys considered to be the definitive legal basis for the Commission's authority in this area. It was under the direction of Commissioner Phil Elman, and his able assistant, Posner, and with feedback from the entire Commission. But throughout the process, the Commission was unanimous.

Taking on any big industry in this country in the interest of consumers is hazardous, and it was in that case as well. I remember the day I accompanied the Chairman when he testified in defense of the Commission's rules. The opposition from tobacco states especially was critical. The Chairman happened himself to be from Tennessee, which they thought was certainly unforgivable for an enemy of the tobacco industry.

What I remember most is after that hearing, I never felt more proud to be at the Commission. In the audience were the Presidents of the American Lung Society and the AMA. They congratulated Chairman Dixon and said that the Surgeon General identified the problem, but they had feared that no one would do anything. They were sure no agency would act, even though the Chairman had told Congress that the Commission would take action.

The end of the story was that Congress eventually stripped the Commission of its authority over cigarette advertising. But the Commission had laid the legal basis for affirmative disclosure in advertising. In my view and in the view of some of the Commissioners, one of whom is present, the reprimand by Congress caused the Commission to become timid in using its new power to require affirmative disclosure.

When I was the head of the Cabinet Committee on Price Stability for President Johnson, accompanied by Russell Parker and several other great deputies, we wrote a report on micro aspects of improving efficient price decisionmaking. This report, which the New York Times published, criticized the FTC for not using its authority. Well, January 19th I left the Committee and returned to the Commission. February 10th, my first meeting with the Commission after coming back, the full Commission welcomed me.

Commissioner Mary Jones, who is here today, said, Willard, I understand the President's Cabinet Committee criticized the Federal Trade Commission for not using its affirmative disclosure authority. I said, yes, in a staff report. Well, she said, I agree with you. She turned to the other Commissioners and said something to the effect, does anyone disagree? They said no.

Then Commissioner Jones said, do you guys have anything in mind? I said, yes. We suggested requiring octane ratings of gasoline, disclosure of the life expectancy of light bulbs, and labeling the food ingredients of all canned goods.

That day the Commission essentially said, let's go ahead with these recommendations. The Commission directed BE to check with the legal bureau about what could be done. But there was no doubt about wanting to go ahead, whereas before, there had been no movement on that front.

As it turned out, we didn't have any authority in the food labeling area. We did proceed in the other areas.

One reason BE chose the octane rating of gasoline is that we knew that the automobile companies favored the idea of octane rating. They said that if something could be done in that area, they would put it in their manuals.

So we had the auto industry on our side. But the petroleum industry was quite awesome. To make a long story short, the Commission litigated and eventually won the right to require octane ratings, and consumer advocates view octane rating as one of the Commission’s most important consumer protection victories.

Unfortunately, there is no public advertising to help consumers of gasoline believe their automobile manuals when they say that most cars should be using regular rather than high octane.

MR. PAUTLER: Mack, would you like to continue?

MR. FOLSOM: I wrote one of the reports that Ron is probably referring to, the use of games of chance in supermarket retailing. As I was doing that project, I didn't conceive of it as consumer protection. I was concerned that in competition among grocery stores, the winner might be the one who had the most false game, the most attractive game in getting people in.

I got all this literature from the promotion companies, and it stated that the object of the game was not if you will win, but when you will win. If you keep going to the store, you will win the big prize.

Then I discovered how the big prizes were awarded. They decided which store needed a sales boost, and that was the store where they put the big prize piece. Afterwards, you didn't stand a chance of a snowball in the hot place of winning the big prize. But that was the way things operated.

As I said, I was looking at it not so much as consumer protection, but informing consumers and in terms of competition.

Subsequently, I worked on the octane rule, and was a little bit amused, since all the agreements among petroleum companies had been in terms of 90 octane and 100 octane gasoline. As soon as the octane rule was proposed, the well advertised measurement method suddenly was a deceptive way to identify gasoline. You had to have the motor method plus the research method divided by two to give you an average, a number that nobody had ever heard of.

What they didn't count on was the automobile companies starting to designate the type of gasoline each automobile engine required. Each engine now called for 87 octane, which used to be 90 or 94 octane, which used to be the 100 octane that everybody was familiar with. In combination with the new disclosures by the manufacturers, the octane rule may have had a big impact.

My final involvement in consumer protection was being visited by a young attorney from the Bureau of Consumer Protection. I had developed a reputation as someone who testified in a number of cases. In the late sixties, I think economists testified in six matters, and I did something like five of them.

So she came to my office and said, Mack, I want somebody to help me in my analgesic investigation. She said all of the companies advertise that their product is the best for headaches or for relieving minor pains. Now, I want you to testify that they're all lying. I replied that actually, one of them could be right.

(Laughter.)

MR. FOLSOM: Beyond that, for a particular individual, one drug may work better than another, and I can't help you in this regard. This attorney later went on to become Director of the Bureau of Consumer Protection when she came back in a later life.

(Laughter.)

MR. FOLSOM: But that was the end of my involvement in consumer protection until the seventies when we started with Dennis Murphy and John Brown.

MR. MUELLER: Just a footnote to the study about games of chance in supermarkets, which Mack Folsom mentioned. I got a call from Rand Dixon, the Chairman. He said, Willard, what have you guys done to Safeway? I said, I don't know, what do you have in mind? He said that Mr. McGowan, Chairman of Safeway, was coming to see him, and that he wanted to know what my answer was going to be.

I said, one of the things we asked for in connection with that study was the distribution of the winners of their games of chance.

MR. FOLSOM: Yes.

MR. MUELLER: They gave $1,000 awards as part of the games of chance. Safeway has about 40 percent of its business in the District, and 60 percent outside. It gave something like 36 of these awards. Thirty-five of them were in the suburbs, and one was in Northwest Washington near Bethesda. So McGowan was coming to town to see how much trouble Safeway was in.

MR. FOLSOM: You can see why I said I perceived of it as a competitive problem. Within the District of Columbia, Safeway had very little competition. Outside the District of Columbia, it had lots of competition. Safeway gave the big prizes away where it had lots of competition, but it advertised the contest all over the place.

MR. PAUTLER: I'd like to move on from the sixties to let Wendy Gramm tell us what it was like to work in consumer protection while she was running the Division of Consumer Protection.

MS. GRAMM: That was my first job in government. I didn't really want to come to government, except I knew Jim Miller and Bob Tollison and some other folks, and they, along with Carol Crawford, managed to convince me to come, and then put me in the Division of Consumer Protection.

Ron did a great job with his presentation. I don't remember understanding at the time that the Division was brand new. I loved it. It was just fascinating. It was also culture shock for an academic from Texas to come to government. Carol Crawford was Jim Miller's Chief of Staff. Everybody was afraid of Carol, and she made sure the processes went right.

We put in an excellent new evaluation process that helped bring the economists into the analysis of the cases and proposed regulations very early on. Tim Muris was BCP Director, and Howard Beales was a special assistant to him.

Fred McChesney, who was an economist and a lawyer, headed up evaluation, which was the process by which we screened proposed cases at an earlier stage. Attorneys proposing a draft rule or potential case provided recommendations to the Evaluation Committee.

Economists would also have a memo raising the issues that they needed to address if the case were to go forward. The evaluation process was headed by Fred McChesney, and the lawyers who ran it were Janet Grady, Bob Zwirb, and Roy Lavik, people who had a very good background in law and economics.

Tim had a law and economics background as well. Either my staff or I would go to those evaluation meetings, which were very important. At the time I was new to government. I'd take a stack of BCP and BE memos home to read every night. I'd sit there in my rocking chair. Phil would be watching a football game or something, and I would say, "I can't believe what these lawyers are saying. Listen to this." And he'd say, "Don't tell me that. Don't read me that stuff. I get this every day at work. Forget about it."

I didn't have any outlet at home. So I'd walk into people's offices. And I can't remember if it was Pauline's office or Jack Calfee's or Dennis's office. I would say, "Can you believe what these guys are saying?" And of course they'd roll their eyes because they'd been reading this stuff for ages. I was still in the denial phase. They had moved on to acceptance, and I wasn't there yet.

The point is, with Tim and with Jim Miller and the economists, what we were trying to do was to bring economic analysis to the Consumer Protection Bureau. Tim was trying to do that from his side as well, and we were trying to provide support with DCP, the Division of Consumer Protection. And that meant getting involved at very early stages.

Especially after listening this morning to the antitrust side, let me tell you, folks, what you guys were talking about were small battles. I know they were big to you guys, right? They seemed like giant issues. But it ain't nothing compared to what the consumer protection folks were involved with.

Even though Ron said there was a burgeoning literature about the economics of information, it was light years away from what antitrust was about, especially in terms of economic analysis or economists looking at it.

Moreover, the literature was mostly theoretical. Ron talked some about the economics of information from Stigler, Craswell, Salop, and all those folks, and that was theoretical. John Brown did some work on it, and that was theoretical. But that was a heck of a lot more practical than Hurwicz and Arrow and the other folks who were doing stuff on information.

Yet I was familiar with the theory. I remember calling up my friends back in academics saying, listen you guys, Tim Muris is going to bring a case on this in two weeks. I can't wait for two years for you to figure out whether this is a problem.

The academic literature was nowhere near where it was on the competition side. The result of the lack of practical applications was that it was more difficult to convince attorneys to accept economists' views. Luckily, not only was Jim an economist, but Tim also likes to think of himself as an economist.

So the Bureau of Economics would have courses. We set up a course, Economics for Lawyers. Tim would run around screaming, Type I, Type II errors. And lawyers would literally be afraid that he was going to quiz them -- what's the difference between a Type I and Type II error?

(Laughter.)

MS. GRAMM: But the point is that it raised some very important issues. We forced the lawyers to realize that government interference can deter useful business behavior. You can bring a case that will cause businesses to be risk averse and thereby create consumer harm for example by stifling innovation. These basic economic ideas were radical for the time, especially given where the literature was, where the lawyers were, and in terms of what the accepted body of knowledge was in the case law at the time.

Two important things happened during this period. One is that we embedded economic analysis into the daily workings of the Bureau of Consumer Protection, with regard to cases and with regard to rule reviews. The other thing that happened was that new research, often as an outgrowth of the kind of issues we were dealing with, really expanded knowledge in academia. Research Studies that we did within the Federal Trade Commission had and continue to have a long-term impact. When we started, there was a lot of controversy about the National Nanny and overly broad rulemakings that were in the pipeline.

We tried to refocus the agency. We had to deal with the backlog of rulemakings. With Jim Miller, we had to get economists staffing all those cases. To be effective, you really had to be involved throughout, especially at the beginning. You had to read all the cases. You at least had to make some kind of judgment. We spent more time on the most important cases, but we couldn't just blow off a whole bunch of cases.

We were also trying to move from cases where there was not so much consumer harm to fraud. As Ron indicated, this change in focus was not popular.

Howard wrote a memo under Tim's name when we considered one of the first rulemakings that came to the Commission. In that memo, he laid out the protocol that we would use to review all regulations.

We were going to ask whether the problem was widespread and systemic, or whether it could be handled on a case-by-case basis. Issue number one essentially asked whether there was a market failure. Is the problem systemic? Does it cause significant harm? Is the proposed rule effective in dealing with the problem, and do the benefits of the regulation exceed the costs?

This methodology set a template for the lawyers to use to analyze all of their proposed rules, and they changed them, revised them and sometimes closed them based on this protocol.

The economists also tried to help with impact evaluations, and sometimes were successful, sometimes less so. But that was an opportunity to try and get some decent data where we could about rules and their impact.

With regard to cases, as I said before, we were involved at very early stages -- we had advertising, defects, and credit cases. There were millions of credit practices cases. Fair Debt Collection Practices Act, I think, [Robert] Steiner, you were involved in those. Truth in Lending Act. Standard setting.

And again, we asked the simple questions. Instead of just asserting that businesses were out to skin consumers alive, whenever they came into contact with them, we asked whether there was an alternative explanation for their behavior. Is there a harm to consumers? We focused on simple, basic questions. It was a lot of fun and interesting.

Some issues we dealt with in a big way, especially at the very beginning. There was a big debate over penalties. What was the optimal size of the penalties? When the Sentencing Commission came up with its recommendations, we fought it all out. We advocated using injury as a basis for determining an optimal civil penalty.

We concluded that consumer injury was often very difficult to measure, so for a proxy we used amount of illegal gain multiplied by one over the probability of getting caught. Our economists found ourselves, especially in fraud cases, saying, yeah, it looks like a fraud case. Now let's get on to the civil penalty discussion. So we had some input no matter what the case.

I want to make a few final comments. I mentioned earlier that our studies could be important. We had staff at one time saying that no firm should be able to make any kind of health claim about its product unless it could get a consensus of the medical profession to agree. At this time, we had Morton Lite Salt under a consent order, because we had sued the company for advertising a connection from salt to high blood pressure and heart disease. We said you can't do that because the medical profession doesn't agree.

At the same time we had the antacid rulemaking that said antacids were too salty, could cause high blood pressure and heart problems, and therefore, we need a rule. I said there's a little inconsistency here. Furthermore, as an academic, I understood how hard it would be to get the medical profession to agree on anything.

The point is, the food industry can make some truthful health claims. What's wrong with that? Pauline Ippolito and Alan Mathios wrote a series of papers. I remember when Kellogg stated on the box of cereal that higher fiber, or lots of bran, was good for your health. The FDA took out after Kellogg complaining about it. Carol Crawford gave a very important speech saying, hey, this is exactly what you want. You want consumers to get this kind of helpful information.

Kellogg had cooperated with the National Cancer Institute and quoted the NCI study in its ads. Carol Crawford’s speech advocated making positive use of public health research. The study Alan and Pauline did on the impact of advertising of fiber claims on the amount of fiber consumption, and additional research of Pauline, Jan Pappalardo, and Dennis Murphy on the effects of advertising of nutritional claims have helped change the regulatory environment.

We are finally seeing the results of the work that was started decades ago. The new FDA Commissioner has a rulemaking proposal to consider permitting a wider range of truthful health claims on food labels.

The point about FTC research on health claims is that knowledge has been really important and is having an impact today. The FTC studies are still the only research with a solid empirical basis.

MR. PAUTLER: I think we have enough time for a few extra thoughts from Jon Baker about a couple of Consumer Protection issues from the 1990s, and then we'll take a few questions from the audience.

MR. BAKER: Thank you. I wanted to take off from Wendy's mention of the penalties issue, something that I first thought about when I was working for one of the Commissioners. I think it was just after she left as Bureau Director.

When I was Bureau Director, the consumer protection case I remember most strongly involved a dispute between the Bureaus about the right penalty where my concern was that the lawyers were risking underdeterrence. Our internal dispute was about the goal of the penalties. I think it was a business opportunity fraud case, and the victims were defrauded out of tens of millions of dollars. So if you're thinking about deterrence, the important fact was that the case involved fraud. There was no social value to any of the business activity, so the socially optimal penalty should be quite large.

Now almost always when you have these kinds of cases, the defendants don't have any money, so the monetary penalty is academic. Then you're worrying about whether fencing in relief over deters to the extent that it might keep the perpetrators out of legitimate business activities.

But that wasn't the case here. These people had millions of dollars. They didn't have anything like the amount of the fraud, but they had a lot of money. And as I recall, the lawyers had a consent agreement. They settled for something like a million dollars in redress to consumers.

My concern was that while the penalty sounded like a lot, it was really only cents on the dollar for the victims of the fraud. A small percentage penalty would send a message that people who commit fraud could live pretty well, because the proposed settlement left the perpetrators with several million dollars in assets.

The lawyers' response on deterrence was that the Commission could get a lot of valuable advertising by announcing a million dollar penalty. Their main concern was that if we sued and lost, we might not get anything for the victims at all. My view was that if the goal was deterrence, I did not care. We would send a better message by suing than by settling, because the message would be that the Commission would not let anyone commit fraud and get away with illegal profit.

Ultimately we had a dispute over goals between the two perspectives. We economists were concerned about the incentives and deterrence, and the lawyers were more concerned about redress than about deterrence.

Another twist on deterrence and penalties involved whether to challenge agents or principals when both contribute to the consumer protection problem. This issue arose in the context of deceptive advertising. Do you bring the complaint against the ad agency or do you bring it against the advertiser? Our initial economic intuition, following Coase, is that it shouldn't matter. Put the penalty on one party and it will monitor the other one and keep it within the line so the party with the obligation doesn't have to write the check to end up paying the penalty.

We soon realized we could do better if the parties differed in their costs of monitoring each other. If one party in the vertical chain can more cheaply detect and prevent deception than the other one, we can deter deception at the lower social cost by putting liability on the party with the lower cost of monitoring.

To return to deceptive advertising, when do we want to add the advertiser to the complaint? If the advertiser provided the ad agency with unsubstantiated information, this analysis suggests focusing on just the advertiser. But if the ad agency and the advertiser both had correct information but developed deceptive ads together, then it may be appropriate to name both in a complaint and order. This analysis grew out of the same thinking about deterrence and penalties that Wendy started in the 1980s.

MR. PAUTLER: Thank you, Jon. We have a few minutes. If anybody has any questions, or if the economist who runs the Bureau of Consumer Protection has a few words he wanted to say, go ahead.

MR. MUELLER: The Bureau was involved in cost benefit analysis and consumer protection in the 1960s. One of the things that happened in the mid-sixties is that the consumer movement came up, growing at full steam. One of the first things it advocated was licensing everything. You know, shoe repair shops, a whole line of services.

We had taken the position that licensing is a barrier to entry. In fact, some time in that period, we had an economist in San Francisco do a study of one product area, I believe shoe repair. The study showed that in markets where there were licensing requirements, prices were higher than where there was no licensing.

Another example was my first project when I came to the Federal Trade Commission. I was asked to look at the Flammable Fabrics Act enforcement. Someone from the Bureau of the Budget came to the Commission and said that he did not understand how the Commission allocated resources.

I was asked to come up with some sort of rationale, so we did a multiple regression model. We came up with a model that would predict how much bang for the buck we would obtain by putting an additional inspector in one location versus another. And this model seemed to satisfy the Bureau of the Budget.

MS. MARY GARDINER JONES: That reminds me of the Metropolitan fraud program. The Bureau of Economics was saying that you don't get any bang for the buck out of it, because you put a lot of resources in, get a cease and desist order, and the same people will pop up in some other jurisdiction.

My reaction was that the victims were citizens. They pay taxes, and if the poor in those days were about 10 percent of the population, they ought to have 10 percent of our resources. That's just a matter of equity. I didn't give a damn about the bang for the buck. I just thought that was a kind of political issue, and we owed them something.

As a matter of fact, I think we had a lot of cases that have stuck. Whitman was a big fraud case, unconscionable pricing. We got a lot of cases out of that precedent.

I remember very clearly the Bureau of Economics problems with not getting any bang out of the buck. I think there are other ways of looking at this thing. But that's an old classic liberal approach, I understand. I wish it were still there.

MS. GRAMM: We pushed fraud in the Reagan years, too. The economists didn't much like it either, but I think we're seeing the value of it.

MR. FROEB: I'd like to ask all the panel members where they think the current low-hanging policy fruit is.

MS. GRAMM: What do you mean by "low-hanging"?

MR. FROEB: In terms of just cost-benefit analysis, we have such a wide policy discretion over expected gain versus the resource cost, I guess that would be the criterion I'd use.

MR. BOND: In terms of popularity, BCP's Do Not Call list has generated more publicity than anything else I have seen.

You want to know what's next?

(Laughter.)

MR. BOND: Spam.

MS. GRAMM: Spam is a good one. Being rational about privacy issues is good. There's so much weird stuff, and ideas are all over the place on privacy. The FTC has done a good job in that area.

MR. FOLSOM: I'm not certain you'll be able to solve the spam problem before most of us will have purchased the software that cuts off the spam. I just this week went out and bought it for my computer, because it reached the stage where I was getting 10 to 15 of these things a day.

QUESTION: You must have read Tim's speech, right?

MR. FOLSOM: No, I didn't read Tim's speech. But it's out there. Actually, if you buy the McAfee for $29.95, they give you the spam program. So the marginal cost was zero.

ALAN FISHER: Wendy, I'd like to ask you if you could --

MS. GRAMM: I know I shouldn't have done that.

(Laughter.)

MR. FISHER: It's an easy one. I've spent my entire career in antitrust. I have some idea of what BCP is doing now, and I agree with Ron Bond's assessment of the quality. What I'd like is some examples of the kinds of things that you were reading in proposed cases that had you climbing the walls.

MS. GRAMM: I don't know that I'll remember the cases, but basically there was an assumption that whatever the practice was, the businessman was just out to fleece the consumer. The alternative hypothesis of how a practice might be a rational business behavior was never considered.

I'll give you an example. This is not an example from the FTC, but it's an example I used before the SEC not too many years ago. If peas are cheaper at Costco than they are at my 7-11, is that because the guy at the 7-11 is trying to rip me off? You know, that kind of thing. And so, again, that might sound like an anticompetition issue. But it's basically a way of thinking. I have repressed all the examples.

(Laughter.)

MS. GRAMM: We did a sweep looking at APRs concerning the Truth in Lending Act. The lawyers discovered that lenders overstated the APRs as often as they understated them. I mean, it was pretty close. In other words, lenders made mistakes on how they did the APR. We shouldn't bring cases if they're overstating the APR in their ads.

I remember being concerned about instances where firms solicited us to bring actions against their competitors. I remember one instance when a competitor brought a case. Toyota had posters on the walls in their showrooms saying that they had the best repair record.

They were basing this claim on the Rogers report, which was a pretty comprehensive report. The lawyers were saying that the survey did not include every make and model of all the cars, even though the Rogers report showed that these claims were true. We didn't have to argue that case, because the lawyers had already gone in and made Toyota rip down the posters. Dennis is shaking his head. Dennis remembers them all.

There were cases basically like that. It was the assumption and a lack of a view of what alternatives might explain benign behavior, or even consumer-enhancing behavior.

MR. PAUTLER: David?

MR. SCHEFFMAN: One of the most important contributions of DCP is that it actually has some of the best lawyers in the Commission: Keith Anderson, Dennis Murphy, Joe Mulholland, and Lou Silverson.

And the Bureau contributes a lot looking at remedies. In BCP, the remedies are often regulatory because they're conduct oriented. Even the lawyers realize that having someone like Keith or Dennis look over the remedies is really important.

Economists really got involved in the seventies, as I recall when I was there, because of the rulemaking. Some industries clearly had a lot of bad practices, like the funeral industry, and one might be inclined to think that there was something the Commission needed to fix.

When we thought about what the rule was going to be, we had the famous purple casket thing. If the Commission did such and such, what if the low cost casket the funeral home showed was a purple casket? How would we get around that?

From this experience, Dennis and some of the other economists became really excellent regulatory and contract economists. In my experience, the BCP attorneys and management rely on the economists' ability to anticipate unintended consequences.

MS. GRAMM: DCP had a huge impact on another area, defects. If it weren't for the economic analysis and legal thinking in terms of liability, you could have brought any kind of defects case. The lawyers at the time were arguing that a defect was where the product did not meet a purchaser's expectation. If you have a good quality product, then over time, customers' expectations rise. So you would always have a defect at some point in time. Good analysis regarding defects made a huge difference over the long haul.

MR. PAUTLER: Thank you, Wendy. Okay. One more question. Jerry?

MR. BUTTERS: I was interested in the discussion that started on disclosures in tobacco. Today we're in a situation where there's still a lot of information on tobacco that people don't have that would be good for them to have.

I think consumers generally do not know that the tars in tobacco products are what cause cancer, whereas the nicotine is what addicts, and that it would be possible to have nicotine products that give you what you want from that drug but don't kill you.

I wonder if any of you have any ideas about whether the FTC should be doing something about this.

MS. GRAMM: Jerry has always been real smart. One of the reasons the cigarette industry wants FDA regulation is exactly that point. Under FDA regulation, they should be able to advertise products that may be better for consumers than cigarettes.

That’s the kind of information that consumers don't have. I've told industry people that if they want the government to regulate them, they ought to get the FTC to do so, because I figured you guys would do a better job than the FDA. The tar versus nicotine tradeoff is the kind of information that they can't get to consumers now. That's one of the reasons why they want to get regulated -- so they can get some truthful information out there.

MR. LYNCH: Let me ask a follow-up question on a more general point. Is there anything that would prevent the FTC from doing a study of, for example, the effect of additional disclosures like that? You know, just using its expertise to put out a study that then might put pressure on the FDA and so on.

MS. GRAMM: I don't see any reason why you couldn't.

MR. PAUTLER: We'll have to take that under advisement.

(Laughter.)

MR. PAUTLER: I'd like to thank everybody who was on the panel for the session.

(Applause.)

MR. PAUTLER: We'll take a five-minute break.

(A brief recess was taken.)

MR. PAUTLER: Okay. We'd like to get started with our session on BE research. We're going to roll together the two sessions that might be listed on your agenda. I have an old agenda with me, so it may be put together now.

We shall start with Mike Lynch talking a bit about the choice of research topics, and then we'll move on to what someone might call a list of greatest research hits. It's not really greatest hits. It's just things that the various ex-directors thought might be interesting, or different studies that I planted with them at one point or another while I was talking to them on the phone or conversing in e-mails.

So if your particular study isn't listed, don't be too offended. But, of course, any time you do any list at all, you're always going to make more enemies than friends as long as you leave anyone out. So, I apologize in advance.

To start, I want to talk about the research function in BE. One of the earliest functions of the Commission was writing general investigative reports. They aren't reports as a current day Ph.D. economist would think of them. In the early days of the Commission, the

Bureau of Economics, or what then was called the Economic Division, investigated numerous firms or industries and wrote very long, detailed descriptive accounts of how they seemed to operate.

These studies had a very heavy accounting component. Some of them were quite influential in inducing Congress to pass various laws. Over time, the reports of the Commission have evolved and become more analytical, more like what current day economists would think of as research reports.

Now why was BE research done over time? In a lot of cases, BE research supported rulemakings. That would have been true of the optometry study and funeral studies. Other research was done to examine how particular industries operated. And those industry studies would have been a little more like the older Economic Division reports. Those were done in any number of industries, such as food manufacturing, steel, and various drug industries.

Other research was aimed at finding or summarizing the effects of different regulatory regimes or laws. For instance, the Commission’s work on international trade aimed at better understanding the effects of trade restraints. Some of the studies we did on airport slot regulation or on airline regulation would also fall in that category.

In this session, we'd like to discuss the choice of the research topics, the kind of work that economists have done in research. To get started, I'd like to introduce Mike Lynch, who will lead us through the thicket of BE research.

MR. LYNCH: Thank you, Paul. The early history of the Bureau of Corporations of the FTC indicates that by and large, the initiative for economic reports was requests from the President, especially Theodore Roosevelt and Woodrow Wilson, and/or from Congress.

The topics of these investigations and reports reflected the major concerns of the time, the alleged abuse of monopoly power by the beef packers, the Standard Oil “Trust,” major railroads, the tobacco manufacturers, the lumber industry, etc.

In looking through the early reports, the subjects are very familiar. They seem to be with us almost throughout the history of the FTC, particularly oil, transportation, and many food industries, such as meat packing. In any case, a high percentage, and perhaps all of the Bureau of Corporation reports, derived from requests from the President or Congress. As far as I can tell, virtually all of them used compulsory process. The FTC studies used Section 6. The first Bureau of Corporation's report (on the "beef trust") contained very detailed information on prices paid by and to the packers, quantities and profits. In this instance, the beef packers decided voluntarily to open their books and records to the Bureau, after first obtaining assurances that the government would not use the information against them in an antitrust prosecution. The second report, concerning oil transportation and particularly the alleged favorable treatment of Standard Oil, did not use the oil companies' own books and records. Rather, the report's information on "secret rebates" and discriminatory rates granted to Standard Oil came from the railroads' books and records. The New York Central, however, refused to allow access to its records, and apparently the Commission did not challenge the railroad. Both early studies were clearly a part of President Theodore Roosevelt's campaign against "bad trusts," and the Bureau of Corporations produced both reports specifically in response to a request from Congress.

In any case, the Federal Trade Commission, between 1914 and 1939, produced 80 percent of its reports in response to requests from the President or from Congress, and most of them involved the use of Section 6 to gather very detailed and highly confidential information.

The Commission’s reports during the decade of the 1940s focused overwhelmingly on work for the War Board and for the Temporary National Economic Committee (TNEC). There were hearings. Of course, the focus reflects the effects of the Depression. In any case, TNEC produced 43 monographs. At this point, I'm uncertain how many the Federal Trade Commission staff did, but I think it was a reasonable number. Here again, the initiative for most of the reports was a request from Congress or some outside agency.

We've heard earlier about how things changed in the fifties, and really with a few blips, the changes continue to the present time. Since around 1950, the Commission has received fewer requests for reports. In fact, I don't know of any that the President requested. A relatively small number responded to requests from a concurrent resolution of the Congress or a vote of either house of Congress.

There can be all kinds of reasons for the drop off in requested reports. We've heard about some of the backlash from controversial reports at various times. Political ebbs and flows could lead to changes in the demand for FTC investigations. However, I propose a hypothesis for dramatic drop in the FTC's market share of economic investigations in Washington. My hypothesis is that the FTC has faced lots of competition from other groups with economists in the past 50 some years. I was struck going through some of the earlier reports. Many of them arose as a consequence of some big increase in prices. The public became very upset about some price increase and wanted an explanation. I think the 1954 coffee report and some old gasoline reports are clear examples, but there are very many such instances.

We have just seen a very rapid increase in the price of gasoline, something like 12 cents a gallon, just last week. Secretary Abraham announced that the Department of Energy, I believe through the EIA, will study the causes of the recent gasoline price increases and issue a report. I am very familiar with EIA staff and its reports. There are several people there who could probably do such a report in 24 hours, and it would be good. I think one of the reasons for the dramatic decline in requests for reports from Congress and the President is competition. Of course, we all believe that more competition is better. In any case, the FTC clearly faces more competition for microeconomic analysis, and you might want to think about the implications of this competition.

Among the new agencies or organizations, Congress was our main customer for a long time. The Congressional Budget Office now meets part of that demand. CBO has a staff of very able, well trained economists, among other experts.

I've already mentioned EIA. The GAO has a group of economists. The Economic Research Service of the USDA, the FCC, and the Office of Telecommunications at the Department of Defense all have a fair number of economists.

In any case, the FTC, with direct competition from the Department of Justice, is more or less preeminent in studying competition in various industries. There's a lot of competition from a lot of new players, and this competition may account for the falloff in the requests from Congress and the President.

One problem with the decline in requests for studies is a loss of protection from political attacks. For a study that Congress requests, a response to any political attack is to respond that we were only doing what Congress told us to do.

I believe that the reduction in requests from Congress is a disturbing development, because it opens the Commission to more political risk. I'm not sure what to do with it, but the FTC has expertise in advertising. Perhaps we need to do more advertising and marketing of our own reports.

MR. MUELLER: An alternative hypothesis is the rise of the power of business interests that want to gag the Commission. Walker ran into it as soon as he came to the FTC. At the Bureau of Corporations, he reported to President Roosevelt, and he had incredible power.

But the first effort he made when he became Director of the Bureau of Economics was to attempt a survey of something like 100,000 corporations, which didn't get very far before it was pretty well squelched and diminished. Walker had great rapport with Congress.

As anti-FTC sentiment developed in the business community, the first big change, in the 1930s, was to require that both houses of Congress approve a resolution and fund any study before Congress could request one from the FTC. Previously, either house of Congress could call for a study without appropriating any additional appropriations. Because any request for a study now has to go through the appropriations process as well as through both houses of Congress, the process is far more formidable than it had been.

Even with the expanded process, it has been possible to get support from some segments of Congress or from the White House. We had several requests for studies. The merger report was at the request of the Hart Committee, and Mr. Celler joined in it. When the report was sent to the Congress, it was sent to Hart.

During the sixties at one point, there was a concern about a rapid increase in bread prices. The

President’s consumer adviser wanted the Commission to do something. There were exchanges back and forth about getting a request from the White House, but it was considered too sensitive to involve the President. The Sherman Adams case, during the Eisenhower Administration, had demonstrated the political consequences of interfering with the independent agencies. But it was okay for the Secretary of Agriculture to make the request. We had a few other requests that came via that route.

At the President’s request, a National Commission on Food Marketing was created. This Commission, which had investigative authority, consisted of three congressmen, three senators and three public members. The Commission contracted with the Bureau of Economics to do two of its major studies. At the end of its deliberations, the Commission asked for assistance in making its final recommendations, and the Chairman of the Federal Trade Commission authorized me to work with the Commission’s legal aides in preparing the final report. Russell Parker worked closely with us. Not surprisingly, the report reflected the goals of the Commission, as well as the Bureau of Economics, on matters such as line of business reporting, food labeling, and pre-merger notification.

MR. LYNCH: A lot of studies have been put out, despite any business opposition. But they haven't been put out by the FTC. They've been put out by other government agencies. Do you want to move on to the studies, Paul?

MR. PAUTLER: Yes, back to the part that's greatest hits. I've asked a few of the ex-Bureau Directors to talk about some of their favorite reports, and I wanted to go through in approximate chronological order.

First we'll start with an early report on the oil industry that has sort of an interesting history. Mack Folsom knows a little bit about it and will give us a little bit of a description and background.

MR. FOLSOM: When I first came to the Commission, Roy Prewitt, the Deputy Director of the Bureau of Economics, discovered that I had an interest in the oil industry. I had read de Chezeau and Kahn and various and sundry other things.

He began to talk to me about the international oil cartel study, which he indicated he was the author of, and all of the problems that he'd gone through because of it. He was hit by a RIF with a substantial grade reduction.

He also had kept a copy of the original version of the study in his home. After his death, his wife called me and said she was going to donate it to a library, and I suggested that she not do it since there had been a letter from Harry Truman to Chairman Howrey directing them not to publish the report until changes requested by the State Department had been made.

I know about that letter because there was a safe in the library that was marked Top Secret. I was the only employee in the Commission who had a top secret clearance. So they had to call in a safesmith to open the darn thing, and I was there and pulled it out, and there was this now 25-year-old letter. I thought that after 25 years, nothing could be top secret anymore.

I took it to the Secretary's office, where it survived for two days before somebody added it to his private collection. But it was just a very short note from Harry Truman to Chairman Howrey directing him not to publish.

Subsequent to Roy's death, John Blair published a book while he was teaching at the University of South Florida near Tampa. In the book, he claimed that he was the author of the original FTC oil industry report. But as you heard this morning, Roy had a copy of the original. Also, when Jesse arrived at the Commission, Roy was very concerned about trying to put out fires caused by the report, and John Blair was not indicating any concern.

These facts lead me to believe that Roy was the author of the original report.

Fred Kahn, who had been co-author of the de Chezeau and Kahn study, was a frequent visitor to the Commission at that time. Fred considered Roy a real expert in the petroleum industry. That is the report that I was asked to comment on.

MR. FOLSOM: Another report, from my time as the Bureau Director, was interesting to me in two regards. First, it reached the standard conclusion that I would expect economists to reach. It was a study of steel imports.

Economists believe in free trade. The report concluded that the best estimate was that there would be substantial costs to consumers if we restricted steel imports. Congressman Vannit was not happy with the report. He called the Commission and indicated they were to send the people up to his subcommittee for a hearing. Joe Mulholland was very concerned that I would not fairly represent the report. But after I had written a little statement, he decided it was okay.

Well, we went up, and I felt very uncomfortable, because one of the Congressmen on the committee immediately said, “Do you know they're even importing men's suits from Poland today?”

(Laughter.)

MR. FOLSOM: I was sitting there wearing one of the darn things. At any rate, it was an interesting experience to be chastised by the Congressman because we were advocating free trade.

MR. PAUTLER: Friz Mueller wanted to say a few words about a study that was done by the Bureau of Economics in 1958.

MR. MUELLER: During the 1950s, the Bureau of Economics was working on an economic report of the antibiotics industry while the legal bureau was working on a legal case against firms in the industry. Dr. Simon Whitney, who preceded me at the Commission, was Bureau Director during the late 1950s when BE was about to release the Antibiotics Report. Some attorneys pressured Whitney to rewrite the report to make it more helpful to them in their legal case. To his credit, Dr. Whitney would not change the report. However, Dr. Whitney told me that staff economist Roy Prewitt helped him handle the delicate situation by writing a brief conclusion that satisfied the attorneys without changing anything in the body of the report. I suspect that the following quotations from the report shows how Whitney and Prewitt attempted to satisfy the attorneys: "Thus, certain patents have been handled in ways that may represent a conflict with the antitrust laws. Instances of uniformity of prices and some other things, all situations having possible restraint aspects, have been made the subject of a legal investigation by the Commission.”

Three months after the Commission released the Antibiotics Report, the Commission issued a complaint against the manufacturers. I have read the lengthy decision recently to see if there were any references. There is a reference to the report, but only to a few facts such as the number of patents. I often think of Whitney as being in a situation where many Bureau Directors could find themselves. He survived the crisis, and he maintained the integrity of the Bureau of Economics.

MR. LYNCH: One little note of background, on the earlier discussion of the international oil cartel report. The times were tumultuous then as now, and there was a lot going on in the Middle East. Mohammed Mossadeq had taken power and control of the oil in Iran, and in 1953, he was overthrown. The Church Committee (US Congress) published many documents from that period.

A book that's just been published [All the Shah’s Men: an American Coup and the Roots of Middle East Terror - Kinzer] claims that the CIA, actually Kermit Roosevelt in particular, was in charge of the operation to overthrow Mohammed Mossadeq. The original form of the petroleum report would have caused problems at the time had the Commission released it.

MR. PAUTLER: I think the history of the 1952 oil report is that it told a little too much of the truth, things most people didn't know at the time. Right now it's all old news, but in 1952, it was explosive.

MR. LYNCH: Yes. Many of the documents, including the now-famous Achncarry Agreement dividing world markets among the "seven sisters," were made public for the first time in the 1952 FTC report. Information about the Roosevelt/Mossadeq operation was not public until recently.

MR. PAUTLER: Okay. Mike Scherer wanted to mention a report that was actually written by one of the other ex-bureau directors.

MR. SCHERER: I second the nomination of the antibiotics report as one of the great post-war Bureau of Economics reports. Personally, I got my start in the field of industrial organization working on the antitrust case that followed from it.

A report that was in process while I was Bureau Director started before me and came out after me. This report, by Ron Bond, sitting next to me, and David Lean, was on the prices and advertising of two sets of pharmaceuticals.

This was an absolute conceptual breakthrough that really transformed the way we look at product differentiation in all kinds of industries. After the report itself came out, I wrote it up extensively in the 1980 revision of my textbook.

I had shown a copy of the product differentiation chapter to Dick Schmalensee, and it induced Dick Schmalensee to write his famous June 1982 American Economic Review article on the advantages of pioneering brands. This was a very, very important study.

Another one on my hit parade, by Richard Duke, *et al.*, was on the steel industry and international trade. The challenge that led to this study, which we began in 1975 when the steel industry was booming, was, can we do useful industry studies without compulsory process?

We did a lot of them, but the steel effort was by far the most ambitious. It came out. It was a very substantial volume that showed, among other things, that the European producers who were exporting to the United States for the most part received very little subsidy from their governments. The European governments were subsidizing the steel industry heavily, but the subsidies came in countries where very little steel was being exported. This pattern told a completely new story about the allegations of illegal subsidy.

The report came out in November 1977. In a sense, it was too late. On the 20th of September, 1977, in the midst of a crisis in the steel industry, the congressional steel caucus was formed to do something about the dumping of steel in the United States market. This was six weeks before the Duke *et al*. study came out. So in a sense, it was too late. On the 6th of December, 1977, the trigger price system to impede steel imports was implemented.

Again, was it too late? Well, I don't think that was really the problem. I think the real problem is that it's hopeless to muster objective facts and analysis against powerful political forces seeking the protection of their industries.

No matter what the FTC does, I really don't think it can repel those forces. So the failure of that study, which was a very successful study in an academic sense, was really a political failure. Even if it had come six weeks earlier, it probably would not have affected the decisions that ensued.

I've had lots of experiences along this line. Let me just tell you one anecdote. During the 1980s, twice in round one and round two of the dispute of the United States with Canada over the subsidy of soft wood lumber exports, I was an economic expert for the

Canadians. There have been four rounds, the most recent of which was just found wanting by the World Trade Organization.

But anyway, in round two, I found it particularly interesting. They registered me as a foreign agent, and I went and negotiated with the international trade officials of the United States over these allegations of subsidy.

The basic problem was one of spatial rent, Ricardian rent. The British Columbian forests are a hell of a long way away, and they're also difficult to reach. Therefore, they can't command a substantial rent on the timber that is being extracted.

Adam Smith got all of this analysis right in 1776. What I found most astounding was that these international trade officials under the Reagan administration could not understand Adam Smith's basic analysis of spatial rent, even though all of them were wearing Adam Smith ties.

(Laughter.)

MR. SCHERER: So I think there are some areas where it's really hopeless to do first rate analysis.

MR. PAUTLER: Well, on that upbeat note, Bill Comanor is going to tell us a little bit about one of his favorites, which is a conference volume that was put together in 1981. Bill?

MR. COMANOR: My piece of the hit parade is a joint Bureau of Economics/Bureau of Competition report that Steve Salop edited and which appeared in September 1981. It reports on a conference that was held at the Commission in June of 1980, which was still on my watch, so I can still claim a little bit of credit.

I always thought that the Commission, and Bureau of Economics in particular, should do more to organize conferences on issues that they saw as important, to play a role in disseminating new academic findings into the policy arena, and to bring new ideas to the Commission's attention.

That is precisely what this report accomplished. At the end of the 1970s, strategic analysis within industries was a new concept. The debate was between those who emphasized structural factors and those who suggested that efficiencies could completely explain market relationships. It was structural analysis versus efficiencies, and those were the only two alternatives.

Steve Salop came to the Bureau at the time, suggested a new and different set of considerations, arranged this conference, did the political work of getting lawyers involved, and created a first rate conference volume. Even 20 years later, it is still a useful compendium.

Let me quote one sentence from the end of Steve's introduction: "Neither blind structuralism nor tautological efficiencies analysis is sufficient for designing economically rational antitrust policy." He was seeking a middle ground.

My query to you all, and certainly to my colleagues on the panel, is whether Steve's purpose has been achieved in the more than 20 years since that conference took place.

MR. PAUTLER: Okay. I'd like to move on to the next great hit, unless someone actually wants to answer that rhetorical question.

(Laughter.)

MR. BAKER: Yes. Essentially what you're saying is that this was one of the ways in which the mathematical reconstruction of microeconomics around game theory entered industrial organization economics and helped us analyze firm conduct on the antitrust side.

This approach has largely captured the field in academia today and is very influential in how the agency thinks about lots of practices.

MR. COMANOR: It represented a real departure and a way of avoiding the rather sterile debate that we were locked into at that time. That I think was its real claim to fame.

MR. PAUTLER: Now Ron Bond will mention a couple of studies.

MR. BOND: Thank you. I wanted to highlight a couple of studies related to consumer protection.

The first of those studies, a major investigation of the life insurance industry, got BE and the FTC in trouble. Mike Lynch worked on it with Ed Mansfield from BE and with Dave Fix, Peter Pitch and Jack Kahn from BCP. It drew on expertise from industry and state regulators and academia, assembled an incredible array of data, and went through an enormously complex set of calculations.

It showed that ordinary or whole life insurance could be thought of as being comprised of two components: life insurance and savings. It showed in extraordinary detail that for the savings component, the rate of return after subtracting the life insurance component is extraordinarily low compared with market alternatives. It also showed that there was a great deal of variation across policies in the rate of return for the savings component. This variation suggested that consumers had a very difficult time shopping for insurance.

The authors' proposed remedy was a disclosure that the states could then implement. The proposed disclosure was a rate of return table to show prospective customers what the rate of return would be after five years, 10 years, and 20 years. It would be a lot like looking at an annual percentage rate for interest costs.

The proposals made a great deal of sense. This study hit the target, but once again, the target stood up and hit back.

(Laughter.)

MR. BOND: The life insurance agencies and members of Congress apparently didn't like what this report had to say, and within a year or two, Congress told the FTC that it could not study insurance unless Congress specifically asked it to do so.

The second body of research I wanted to highlight, and Wendy has already referred to it, is the work on health claims. Pauline Ippolito and Alan Mathios started by looking at the relationship between fiber consumption and the incidence of cancer.

In the 1970s and early '80s, a great deal of research demonstrated that increased consumption of fiber could lead to a reduction in the incidence of cancer. The press reported that research, and the Surgeon General recommended in a 1979 report that consumers increase their consumption of fiber.

Until 1984, however, none of this information was disclosed in advertising or on food labels. In 1984, the Kellogg Company, in cooperation with the National Cancer Institute, worked out an advertising and labeling campaign to publicize the health benefits of fiber.

Pauline and Alan demonstrated that fiber consumption did not increase during the period prior to 1984, despite all of the press and Surgeon General coverage. However, once Kellogg began its advertising and labeling campaign, there was a 7 percent increase in fiber consumption between 1984 and 1987. These results suggested that advertising was a very effective way of communicating health claims. Ippolito and Mathios followed this report with a study of fat and cholesterol consumption that showed similar results. More recently, Pauline and Jan Pappalardo published a study last year showing in great detail that the amount of advertising devoted to health claims fluctuates quite dramatically as public policy is more and less permissive toward that advertising.

Thanks to this research, we have empirical data to suggest that advertising can provide socially useful information and that public policy can affect the quantity of that advertising.

MR. PAUTLER: That whole line of research is keeping Pauline busy right now as she occasionally talks to people at FDA about these kinds of issues and tries to help their efforts.

MR. LYNCH: But isn’t the FDA a lot more open than it used to be? I remember them. They wouldn't listen.

MR. PAUTLER: Also regarding the insurance study, Mike, even though Congress kicked the FTC out of insurance studies, there's been a pretty big shift since then to term insurance and away from whole life. Your study helped with the educational process that caused the industry to offer different products.

MR. LYNCH: I think that's right. In fact, it was agents selling term insurance, particularly those creating new and more flexible products, that were really effective in getting that message out.

MR. PAUTLER: They advertised.

MR. LYNCH: They advertised. The restriction was that we could not investigate insurance unless either the House or the Senate Commerce Committee requested that we do so. Strangely enough, we did receive three requests, I guess in 1985 or '84.

MR. PAUTLER: Yes. It certainly hasn't been a complete ban. Now we return to Mike Lynch to mention a few of his favorite research projects.

MR. LYNCH: Ron Bond is doing very well in the greatest hits category. One that I wanted to discuss is the staff report on effects of restrictions on advertising and commercial practice in the professions, the case of optometry by Ron Bond, John Kwoka, Jack Phelon and Ira Whitten. The report was significant not only because it led to fewer state and professional association-imposed advertising restrictions in optometry, but also because it provided a model of how to conduct objective research to gather evidence on the important issue of quality.

A lack of quality analysis had been the major stumbling block of almost every previous study of restrictions on advertising. This study, more than any other up to that time, dealt with the quality issue in a convincing way. That was really the foundation for the conclusion that said, and I quote:

> Prescriptions in eyeglasses are no less adequate when purchased from an advertising optometrist or chain firm optometrist, than when purchased from a nonadvertising, noncommercial optometrist in either a restrictive or a nonrestrictive city.
>
> The thoroughness of the examination does vary, but regardless of the thoroughness of the examination, prices tended to be lower in nonrestrictive cities.

The study demonstrated that advertising led to lower prices for eyeglasses but had essentially no effect on the distribution of quality. This study served as a model, and other similar studies followed it. The original purpose of the study was to support the Eyeglasses 2 Rule, but the Commission ultimately did not adopt the proposed rule. Despite the demise of the proposed eyeglass rule, the report and the follow-on reports had major, very positive effects. The discount eyeglass organizations, such as Pearle and For Eyes, that restrictions on advertising had hampered, grew rapidly as states and professional associations eased their restrictions.

The report was also very important, because now anyone arguing before the professional associations or state legislatures has this very impressive report to say that it is in the public interest to ease advertising restrictions.

Ron told me that Lenscrafters is now the number one seller of eyeglasses. Lawyers and dentists now routinely advertise in the yellow pages. Before this study, mainstream optometrists, lawyers, and dentists rarely advertised. The ability of these professional groups to advertise is due in large measure to the pioneering efforts and excellence of this early report.

I want to make some other points, using the optometry study as an illustration. Studies can be very effective and produce a lot of benefit, even if the Commission loses the legal battle. The result does not need to be a rule to affect consumers positively. A good study from the FTC attracts a great deal of attention and helps those opposing a government enforced restriction on competition, even when the Commission cannot compel or use its powers of coercion to make changes. A good study gives advocates a weapon that they wouldn't have otherwise.

I would like to mention one other, much earlier study. On the one hundredth anniversary of the Bureau of Corporations, it is only fitting to remember one of its earliest and most influential reports, *The Report of the Commissioner of Corporations on the Transportation of Petroleum, May 2, 1906.* In 1904, President Theodore Roosevelt had urged Congress to extend the ICC’s power over transportation rates. Specifically, he sought to give the ICC the authority to determine whether a challenged rate was “reasonable,” to decide on a reasonable rate if it found the rate to be unreasonable, and to have that rate go into effect immediately, subject to judicial review. Congressman Hepburn introduced a bill with these provisions in 1904. The bill passed easily in the House, 346 to 7. A year later, Congressman William

Randolph Hearst introduced a bill that declared pipelines to be common carriers subject to ICC jurisdiction.

Although these bills had much support in the House, many Republicans in the Senate opposed the President on this matter. By 1905, Congress had not passed either bill. The Transportation Report proved important in changing this situation. On May 4, 1906, at the height of the Senate debate on the Hepburn bill (amended to include Hearst's provisions declaring pipelines common carriers), President Roosevelt submitted a synopsis of the Report to the Senate. As economic historian Arthur Menzies Johnson wrote,

> The report, summed up in Commissioner James R. Garfield's letter of submittal, proved to be a sensation. Its main theme was that Standard Oil had been profiting by secret rates granted by the railroads, but it also called attention to Standard Oil's pipeline power in this and other connections. Garfield declared that pipelines enabled the oil combination to do its refining in advantageous locations which high road rates and pipeline charges barred to competitors. "The development of the pipeline system by the Standard Oil Company was the result of special agreements with railroad companies," he said. [p.221, footnotes omitted]

The report received a great deal of publicity, most of it favorable. The vote in the Senate now became "perfunctory." The Hepburn Bill passed 75 to 0. Whether for good or ill (and I happen to think that setting rates for railroads was a huge mistake), the Transportation

Report had a major effect on the future of railroads and oil pipelines. It also served as a basis for the government’s antitrust case against Standard Oil. The type of regulation the ICC introduced and evolved heavily influenced later regulatory agencies such as the FPC (later FERC) and the CAB. The Transportation Report has to be one of the most influential, if not beneficial, in BC/FTC history.

MR. PAUTLER: Thanks very much. Jon Baker has a few of his favorite studies to mention.

MR. BAKER: Even though mergers kept us very busy, we still managed to do some studies in the Bureau of Economics when I was here. Several were underway, although some of them might have come out when Jeremy was Director. Some studies involved competition issues in hospitals, which was a litigation problem area for the Commission. A couple involved food advertising, including one in Pauline's research program. Dennis Murphy and some others examined comparative food advertising claims to evaluate whether consumers gain truthful information from those kinds of claims. For me, the most importance lesson was that researchers must use copy testing to determine whether advertising claims are deceptive.

Roy Levy wrote a report on competition in pharmaceuticals. The rent to own industry study probably came out under Jeremy. A lengthy study of the soft drink industry by John Howell, Roy Levy and Harold Saltzman was also released after I left the Commission.

The study that interested me the most, and I think may be the most influential, was a report to Congress on the first proposed tobacco industry settlement. That proposal was the first attempt to settle the litigation between the tobacco companies and the states. The proposed settlement would have required federal legislation to implement it. The idea was to reduce tobacco use and reduce smoking by restricting marketing and advertising, raising the price of cigarettes, and imposing some financial penalties on the industry if youth smoking goals were not met. Price increases would have been realized by requiring the industry to make annual payments, and those payments would have funded federal and state programs to try to reduce tobacco usage.

The firms' desire for a broad antitrust exemption immediately got our attention. But thorough analysis demonstrated that tobacco firms would likely make a big profit on the deal, even without the antitrust exemption. Economic studies had consistently found that tobacco companies and retailers pass through 100 percent of cost increases to smokers. Moreover, under this proposal, the industry would save on marketing expenditures and litigation costs.

The annual industry payments that the proposal envisioned would have been transfers from smokers to the government. The settlement would not have affected shareholders. It was as though the tobacco companies were collecting a tax for the government and for the states. With the addition of an antitrust exemption, the most likely result would have been to make effective coordination more likely. With demand not particularly elastic, prices and profits would probably have increased substantially, even though consumption was falling. The proposed settlement therefore would have been a terrific windfall for the tobacco companies, we said. It might have reduced some youth smoking as well. We pointed out all the different implications. Formally, we were only addressing the need for the antitrust exemption, but as a practical matter, we were raising important questions about the settlement itself.

After we published our report, the tobacco companies came back with a different proposal, the one that has now gone into effect with the states. The new settlement required neither federal legislation nor antitrust exemption, and it only involved the state cases.

Independent of our study, and before he succeeded me as Bureau Director, Jeremy Bulow wrote a Brookings article describing the later settlement in much the same way as I described the original federal settlement, but the Commission did not comment on the state settlement.

MR. PAUTLER: Thank you, Jon. I guess that covers the greatest hits for the moment. I want to switch to a different area of FTC endeavor, the data collection period, which except for a few early collections, covered 1939 to about 1982. I also want to discuss the period of premerger notification between 1969 and 1979, the decade before official HSR filings started.

Few current FTC staff are aware of the premerger notification program of 1969-1979. It would therefore be useful to have some background on the origins of that system. Fortunately, ex-Director Mike Scherer is an expert in the Commission’s data collection.

MR. SCHERER: Okay. Let's throw the cats and dogs to the wolves or whatever [referring to a comment in Mr. Miller’s luncheon speech]. Systematic data collection has a long tradition at the Commission, including accounting work done for the war efforts in both world wars and price and profits studied in various industries over the years.

I'm going to confine my remarks, however, to three particularly controversial programs: QFR, corporate patterns, and that most beloved one, the line of business program.

QFR, which started as a joint program with the SEC before the FTC took it over entirely, provided important inputs into the national income statistics. QFR is the way the Bureau of Economic Analysis at the Department of Commerce estimates quarterly Gross National Product and Gross Domestic Product figures.

Contrary to statements made by Bureau of Economics management on occasion, QFR was the basis for various studies that we have done within the Bureau of Economics. I think Russ Parker did one of them, didn't you, Russ?

MR. PARKER: We used it in several studies.

MR. SCHERER: Yeah, okay. It was used. But you have to want to use it to use it. That's a prerequisite.

It was a pain in the ass, because we had to sample many small businesses. That was part of the point. Small businesses would receive these requests, and they'd call me up as Bureau Director or send me a really nasty letter with a carbon copy to their Congressmen. Soon we'd get a copy from Capitol Hill, and we had to do a lot of negotiating with people to calm them down and get them to comply.

The program went over to Census Bureau since then, and they're doing fine. There's no reason to believe that they're either doing it better or worse than the FTC did. I have one amusing story about one of the complainants. I was having a long conversation with him, and I finally decided to send him a pacifier.

(Laughter.)

MR. SCHERER: I sent him my only President Ford WIN button.

(Laughter.)

MR. SCHERER: And that gesture was a serious mistake, because the button would have been incredibly valuable now. But in any event, that was QFR.

Corporate patterns sought data at the five-digit SIC level for the thousand largest manufacturing firms in the United States. It had two iterations. The first one was in 1950 and was quite uncontroversial. Initial results were published. Not long thereafter I actually wrote an econometrics paper at Harvard using the data, and I later used it in a paper that appeared in the American Economic Review in December '65.

The almost identical survey proposal in 1972 was enormously controversial. There were 300 motions to quash. What happened between 1950 and 1972? What happened is that industry learned that the FTC was no longer a paper tiger; that it was bringing structural cases; that the more it knew about structure, the greater the chance was that the Commission might bring a structural case. The business community therefore wanted to stop the survey. I'm not sure if we ever did publish anything from it. I don't think so.

Let me go on to line of business. Fritz Mueller set the wheels in motion. By the early 1970s, the program was beginning to take definition. As it evolved, it sought from 471 large corporations quite detailed breakdowns of their balance sheets and income statements by individual, narrowly defined line of business. There were approximately 270 categories into which companies were required to break down their operations.

As I recall, the most diversified corporations reported on about 40 lines of business. The average was something on the order of seven or eight manufacturing plus one-and-a-half nonmanufacturing lines of business.

Again, there was absolutely furious resistance. The resistance arose from several different fronts, but if there were a single identifiable leader, it was the

Business Roundtable and its principal attorney, Ira Millstein. When Tim Muris mentioned Ira earlier, Tim saw that I made a sour face. That Millstein, who opposed this program so effectively, represented the Federal Trade Commission in presenting a major award to former Chairman Bob Pitofsky last year. Actually, Ira and I are very good friends. We did a Holmes and Moriarity act for years. He was Moriarity.

I forget how many companies filed motions to quash, 140 or 170 or something like that, claiming various problems. One problem: We don't have the data, or to get the data, we will have to incur prohibitive cost.

Chairman Lew Engman was a genius on this. We got all these motions to quash with very unsubstantiated claims. Lew said, well, let's go back to these guys and invite them to submit supplemental motions detailing and swearing what the problem is for them and what it's going to cost them to solve these problems.

When they had to swear, the cost estimates went down, down, down, number one. But number two, we got a pretty good insight into where we might have to change a few things to reduce the cost of compliance.

Now the uproar was just getting going when I arrived as the Director of the Bureau of Economics. We had just solicited these first motions to quash when one of my best friends and colleagues from Harvard Business School came to Washington and said let's have lunch. And so I went to lunch with him.

This friend was a vice president of the W.R. Grace Company, which was leading one of the groups of opposition to the line of business program, and which had filed a motion to quash telling that it was going to be really expensive for them to comply and they didn't have the data, blah, blah, blah. My friend had come up through the accounting staff of Grace to become vice president in charge of one of its many divisions.

I told him about Grace's motion to quash. He said, hey, it's no problem. We went through the form. We've got all those data readily available on our computers. A couple of items are pretty sensitive, but we've got them. We'll put one MBA on it for a couple of weeks, and the report can easily be compiled.

So, number one, I began to wonder, hey, are these guys really telling the truth in their motions to quash? The second thing my friend said is this. Look, I'm head of a division at Grace, and my division is quite different qualitatively from many of the differentiated product divisions of Grace. I have to go in to Peter Grace once a month, and he chews me out royally for not making profit margins as high as those of leaders of other Grace divisions.

The fact is, I'm in a commodity business and the margins are lower. Dammit, I wish we had a benchmark like this line of business program you're proposing by which I could be evaluated objectively relative to my peers in the same line of business. He thought these data would be very valuable. To quote the Honorable James Miller [the luncheon speech], what gets measured, gets better.

So there were a lot of things that weren't as they seemed in this program. We encountered furious resistance, among other things, from the various public accounting firms located in Washington. We held a hearing at one point, and most of the representatives of the Big Five accounting firms testified and told us what an awful program this was.

Well, what was not known was that one of those witnesses was meeting regularly with me every couple of weeks in secret and telling me, first of all, what problems I could anticipate; second, what genuine problems there were in the proposed line of business forms; third, how to solve them; and fourth, helping me recruit personnel for the program. And he was very much supportive of the program in private, in the secrecy of our meeting room. But in public, my God, this is the prelude to the end.

So again, things were not exactly as they seemed. A second problem alleged was that the data would be useless in any event. My divisional chief friend from W.R. Grace certainly didn't think that was the case. We did get a series of comments trashing the program from consultants hired for a six-digit honorarium by the law firms fighting the line of business program.

I was really miffed that an article critical of the line of business program had appeared in the American Economic Review without disclosing that the author had received a six-figure honorarium for writing the article from the law firms fighting line of business. Indeed, I had refereed the paper for the American Economic Review. And I said, if you want to publish this thing, okay. But you damn well better have the author reveal that he was paid by three different law firms for writing the article.

No such explanation appeared, and I protested to the American Economic Association. I proposed a resolution to be debated on the floor of the annual AEA meeting. The Executive Committee was not terribly happy about that. They said let's settle this out of court. They adopted a rule, a bylaw right on the spot, that any article published in the official publications of the

American Economic Association from henceforth on shall reveal any sources of financial support underlying the article.

I checked the other day in a recent AER and found that it's true. People are doing it. They're following the bylaw that flowed out of this.

We subsequently rebutted the arguments against line of business reporting in an article in the American Economic Review, I believe in March of 1987. The article had the most co-authors of any paper ever printed in the American Economic Review.

There was a serious problem with the line of business program. For the data to be really useful, they had to be timely. We did publish four complete reports, but on average, they were six plus years after the December concluding the average reporting year, and that's simply too late. There were a lot of reasons for the delay. The main reason for the delay was that every time we tried to take a step, we got litigated against. I remember we had a hearing in Judge Weinfeld's courtroom in New York. We had a hearing, and I think there were 170 corporate lawyers on one side of the hearing room and two FTC lawyers on the other side. Every step we took, we were litigated. We did in the end succeed in the litigation. The appellate court said that this program was fine, consistent, and so forth and so on. Opponents appealed to the Supreme Court, which denied *Cert*. So we thought the program could go.

Litigation continued and delays continued. Once we had solved all the litigation problems, we could have issued reports on a timely basis, but then of course we didn't. The program ended with the 1977 report, which was published in May 1982.

Line of business reports could have been a data series of very great value. What gets measured gets better. I still firmly believe that good information on the performance of American industries will provide incentives to improve that performance. But I stand alone. Almost alone.

MR. PAUTLER: Thank you very much, Mike. I also wanted some discussion from you and Fritz Mueller on the 1969 Merger Prenotification Program, how it came to be, and how effective it was. Most FTC staff don't even know that the thing ever existed. Fritz can start because he was earlier.

MR. MUELLER: First, following very briefly on Mike. The greatest tragedy regarding the line of business program was that it covered only 1973-76. These years turned out to be among the worst that one could find to test the concentration-profit relationship.

The first year had a 20 percent inflation rate, and every year thereafter also had exceptionally high inflation rates. I have always relied on two arbiters of the quality of empirical studies in the profession, Mike Scherer and Leonard Weiss. The classic I.O. textbook, Scherer and Ross, has a cautionary footnote on this point explaining that studies based on line of business data may be flawed because of the unique years involved.

My colleague, now deceased, Leonard Weiss, did some of these line of business studies. He was very skeptical from the outset, because a doctoral dissertation of one of his Ph.D. students demonstrated that in years of high inflation, the concentration-profit relation disappeared.

Professor David Ravenscraft took line of business data just for the food industries, which inflation does not affect as much as many other manufacturing industries. He found a statistically significant positive relationship between concentration and firm profits (Review of Economics and Statistics 1983.)

Yet the conventional wisdom has become that studies based on line of business data have proven that there is no significant relationship between market concentration and profit. I think this inference is nonsense. I co-authored an article in the Review of Industrial Organization (1993) futher demonstrating this point.

The Commission-mandated Merger Prenotification Program of 1969 began when the Commission decided to issue merger guidelines in the cement industry and in food retailing. Beginning in 1964, I began urging the Commission to use its power under Section 6 of the FTC Act to require premerger notification, but I could never get more than two votes. Mary Gardiner Jones was one, and Phil Elman was the other. When we prepared the Cement and Food Distribution Guidelines, BE inserted a premerger notification requirement. At that time we got a majority of three, and the Commission's first premerger notification requirement started January 3, 1967.

Then in 1969, I suggested to Richard McClaren, soon to be the new Assistant Attorney General for Antitrust, that we work on a premerger notification program. McClaren feared that we could never get a premerger notification program through Congress. I told him that with his support, I thought that the Commission would go for such a program. He agreed to support my request. Immediately after our discussion, I wrote a memorandum and gave it to Phil Elman. He had it reproduced and circulated for distribution to go to the Commission the next morning, March 20, 1969. The

Commission unanimously accepted all of the recommendations of the Bureau of Economics. All corporations with assets of $250 million making acquisitions of at least $10 million would have to report data prior to completing an acquisition.

Among other data, the Commission required 7-digit product information, and this requirement caused quite a stir. A Business Week story said that the Commission accomplished in three months what Congress had been unable to do for 18 years after passage of the Celler-Kefauver Act.

I happened to be in the right place at the right time. Just before I left the White House staff (January 10, 1969), McClaren had invited me to be on his staff. I declined but said I would work as closely with him as I could. A New York Times journalist has written a book on conglomerates during this period in which he discussed our close working relationship.

MR. SCHERER: Could I just add a very brief anecdotal footnote on premerger notification? It was I think Wednesday, December 24th, 1975. The Bureau of Economics had just had its annual Christmas party. About 2:30 in the afternoon I said to everyone, go home. Have a nice holiday weekend.

I was sitting all alone in the bureau offices and the telephone rang. I picked it up, and it was a lawyer in Boston who had a premerger notification report due the next day, Christmas day.

(Laughter.)

MR. SCHERER: He said “Seven digits. Where the hell do I get that?” I told him where. And I told him how to finish the form. He said, “Okay, I'm going to finish this up and I'm going to get on the plane and I'm going to come to Washington and deliver this report to you. Will someone be there to receive it?”

(Laughter.)

MR. SCHERER: I said, sir, it's Christmas eve. The staff has gone home to their families. I would like to go home to my family. No one will be here this long weekend to use the report. It would be fine if you just put it in Fed Ex and had it arrive on Monday, that'll be just fine with us.

He said, “Okay, I'll do that.” I said, you stay home and have a nice Christmas with your family. Thank you very much. This guy wrote a letter to Peter Rodino saying the FTC didn't give a damn about its premerger notification form.

(Laughter.)

MR. SCHERER: The result was that Rodino scheduled hearings, the end result of which was the Hart-Scott-Rodino Act of 1976.

(Laughter.)

MR. PAUTLER: Thank you very much to everybody on the panel. We have one more session. In the absence of Bob Tollison, who was going to cover the advocacy section or as we sometimes call it, the regulatory intervention program, I'm going to go through it quickly.

MR. LONG: Do you have time for a question or a comment?

MR. PAUTLER: Go ahead, Bill. Ask a question.

MR. LONG: As either the cat or the dog or occasionally, who knows, the wolf, with respect to the line of business program, I thought I would make a couple of observations.

I want to back up to the QFR program. We got rid of it. What we didn't get rid of is the quality of data collection at the Federal Trade Commission. The QFR program has been at the Census Bureau since about 1983, for twenty years.

It's still running strong, and it is one of the best data collection programs at the Census Bureau. I know because I've used data from several of them through the Center for Economic Studies at Census.

It is still one of the best data collection programs, and it was the model that we had in mind for timeliness of collection and publication of line of business data. Census collects the data and reports it before the end of the following quarter. That was our model eventually. We never got to do that.

QUESTION: Why is timeliness so important?

MR. LONG: When doing any kind of benchmarking, for any company or industry trying to make a dollar, timeliness matters. In the commercial sector, it’s not good enough to have data two or three years later.

MR. MUELLER: Having worked at both the QFR program and as a census agent, I have no question that Census is more lax than the FTC in accepting or just not pursuing non-reporting firms.

At one point someone requested how many times Census had brought legal actions against corporations for not reporting etc., and it was just minuscule.

MR. MUELLER: Russ Parker has experience with this.

QUESTION: It's not as important if you're just using the data for research. But if you're using them for benchmarking, it's very important. Everybody in industry says that.

MR. MUELLER: There is a very interesting story about the Commission's reputation in QFR. I was on the Federal Statistics Committee and requested that the SEC segment be transferred to the Federal Trade Commission. When I went to the meeting, the Federal Reserve Board, the Department of Commerce and several other agencies were very much against the transfer.

I said that we have one advantage, and that's Section 6(b). The SEC has no mandatory authority. Reluctantly, they agreed to the transfer. At the time, the Federal Reserve Board was very upset about a big problem with the SEC segment. There was a $7 billion error, and it raised problems with GNP predictions and with regulating financial markets.

Anyway, after the first report under the FTC, I remember going to the committee, and they said, well, just how many of these companies reported to you? I said every one reported. And they said, no, no, no. We want to know how many companies reported to the FTC. I repeated that every one reported. People sat around in silence for two or three minutes and said how did that happen? I said that they're afraid of Section 6(b).

MR. LONG: So QFR was a great success for the Federal Trade Commission, and it still is both intact and successful.

On the line of business program, there is always hope for good work not to be totally discarded. Mike hasn't referred to a paper that he presented last year. It was an alternative approach to an early paper using the line of business data for a technology flows matrix, where you start with R&D effort and find out where it ended up, who were the eventual users. This paper was a path breaking example of data analysis.

He redid the original paper with alternative data and reported the results last year at a conference. To quote Scherer:

> "Basing a technology flow matrix on such contaminated R&D data would impart considerable inaccuracy."

The contaminated R&D data are the data that the Census Bureau collects for the National Science Foundation and that the NSF publishes.

Once again:

> "Basing a technology flows matrix on such contaminated R&D data would impart considerable inaccuracy. The simplest solution to this problem would be to restore line of business reporting in the National Science Foundation Census Bureau surveys, disaggregating the reporting lines more finely than they have been

disaggregated in the past, and exerting strenuous efforts to convince industry participants that the data shed important light on the dynamics of the American economy."

Unquote. In July and August I participated in two workshops at the National Academy of Science, both supported by NSF. The first one was hosted by the Science Technology and Economic Policy Board, and the second one was hosted by the Center for National Statistics. Both conferences focused on line of business reporting for the National Science Foundation Census Bureau data collection effort.

If I were a betting man, I would bet that it's going to happen. So we may be seeing the daughter or son of line of business show up at the Census Bureau with NSF funding probably by the next census year, which is 2007.

To conclude, the detailed data on research and development that were collected by the Federal Trade Commission for those four years, '74 through '77, have been used as the basis for more published economic papers in refereed journals than all of the papers that used data reported at the SEC on R&D or data reported to the Census Bureau in the program that the NSF funds.

MR. PAUTLER: If anybody is interested in seeing a list of many of the papers based on the line of business data, you can see them in our miscellaneous papers lists of BE publications. A lot of them came from research that people did as follow-ons to the line of business.

We've got to move on to the advocacy section if we're going to get any of it in at all.

First, I'd like to acknowledge the work that Denis Breen and our administrative people did in putting this program together. They did an outstanding job.

(Applause.)

MR. PAUTLER: I wouldn't say that trying to get 13 ex-directors together and figure out what they might say is like herding cats, but you're not ever sure what everybody's going to do. That's one reason we're a little behind schedule.

The final area we will cover today is the advocacy program, because BE historically played a significant role in that activity. I'm sorry that Bob Tollison wasn't here to talk about it.

Please see Mr. Pautler's slides at http://www.ftc.gov/be/workshops/directorsconference/docs/pautlerslides.pdf

As slide 2 indicates, one can characterize the advocacy program in a couple of different ways. If you look at the first characterization, it sounds great. Consumers aren't always well represented before regulatory bodies, and an advocacy program that shares our experience and our expertise with other governmental bodies helps them do a better job of incorporating consumer interests.

The bottom portion of slide 2 characterizes our advocacy program another way. We tell other agencies how to do their jobs and insist that they impose some market-based approach.

The reason the characterization of the program is important is that the description carries some judgment. Using the language on the top, everybody thinks what we did was great. Whether you call it advocacy or regulatory intervention, how can anybody say it's bad?

However, if what we're really doing is walking into other people's homes and telling them how they should behave or what they should do, then people can get bent out of joint. In fact, a lot of people got bent out of joint, particularly state regulators who didn't appreciate having the FTC tell them how to do their jobs better, even though in virtually every case, we got a request to come in and give our opinion. Despite the invitations to participate, regulators frequently liked neither our advice nor our market-based approaches.

If Bob Tollison were here to make this presentation today, you would probably soon learn that he is not a real fan of government activity (see slide 3).

(Laughter.)

MR. PAUTLER: Those of you who do know him know that that's an understatement. However, Bob actually said that he thought that allocating resources toward the advocacy program, or what he would have called the “intervention” program, was wise, for at least the attorneys and economists were pointing their guns at real monopoly power. That's the power of the government.

Now, of course, he didn't ever say the attorneys and economists would actually hit their targets, but at least he said we might be pointing in the right direction.

When did the advocacy program start (see slides 4-5)? We heard some discussion earlier. One can claim it started at the beginning of the Commission. One can claim it started in 1974, as Bill Kovacic has stated in writing. One can claim that it started in the 1970s as a result of costs imposed by clumsy government policies, as Mike Scherer wrote in article in 1990. Finally, one can claim that the intervention program was the brainchild of Chairman James C. Miller, as Bob Tollison said. Any of these opinions could be correct. Bob was talking about the more direct, in-your-face anti-regulation approach, which probably was first a leading FTC initiative under the Miller administration. However, during the seventies, the Commission had active advocacy programs in international trade and in the health care area.

Slide 6 is the only graph. It tells the story of the life, near death, and possible return to life of the advocacy program. The graph shows the actual number of FTC filings at various state and federal agencies. Of course, the counts aren't weighted.

The count of filings in 1987 is not representative, because about two dozen of them were virtually identical. There was a proposed Bar Association ethics code that was cranking around all the states, and we filed the same comment in 24 states. So in 1987, one could probably subtract 24 filings to obtain a filing number that is comparable to total filings for other years.

In any event, advocacy peaked in 1987, hit a low point in 1997, and made a little bit of a comeback in 1998. There has been a further revival the past few years. During 1995 to 2000, we focused almost exclusively on energy and electricity. Now the folks in the Office of Policy Planning have expanded the horizons for the program, and we're active in an increasing number of areas beyond electricity.

Over the 20 year period shown in slide 6, we did 714 filings. 102 was the peak; 5 was the low.

How much did the advocacy program cost us? It's always nice to figure out how much you're paying for what you're getting. See slide 7. The FTC never used more than 4 percent of its resources on advocacy. Quite frankly, I'm being conservative there. I bet advocacy was never more than 3 percent of the FTC resources even at its peak.

During the latter part of the eighties, we had pretty intensive scrutiny from various congressmen and senators who were interested in how much we were spending and whether we actually had an invitation to comment on each issue. During these years, we spent a lot of time collecting data on how much we spent on the program, and it was certainly less than 4 percent. Currently, the Commission is spending less than 1 percent of agency resources on advocacy.

Slides 8-10 list numerous topics that have been the subjects of advocacy filings over the years. I am going through them very quickly. We filed numerous comments on international trade, starting in the 1970s. Advocacy concerning horizontal restraints in an incredible number of industries has a long history at the Commission. We filed comments on many regulatory issues in transportation, particularly during the 1980s. One called Love Field, Texas, an airport regulatory issue, is John Peterman's favorite. Other filings involved trucking and rail regulation. Essentially, any regulated transportation industry was fair game for the Commission to file comments reflecting the interests of consumers.

The issue of use-or-lose airport landing slots was one of the most interesting of those issues.

We filed many comments before the Federal Communication Commission. In fact, current FCC Chairman Powell is in trouble for an issue over which we filed many comments during the 1980s -- trying to change the ownership limits on television, radio, and newspaper properties. We filed several advocacy comments and did a couple of studies on that topic. Keith Anderson and John Woodbury were the primary authors of those studies.

We did not participate in the more recent debates on ownership limits at the FTC. Given the acrimony in the debates, perhaps it is fortunate that we were not involved. However, maybe we could have provided some additional support for whatever the right solution is. I have my own prior about the right solution, but we haven't done a study to look at it.

A number of studies involved topic areas that only lasted a few years because the issues went away. See slide 11. State anti-takeover legislation was hot for a while. Car rental legislation was hot when the National Association of Attorneys General was interested in it. Certificate of Need regulation was an important area for a few years, and we did a number of studies that supported our advocacy work in that area.

Did we have any real successes? The next several slides list seven studies that "prove" we actually had a significant effect. Due to the lack of time, I don't think I'll go through all of them. Most were in some of the areas I just mentioned.

The one that I think may have had the biggest effect is number four here (slide 13). Alan Mathios and Bob Rogers did a lot of work on the relative merits of price cap regulation versus the more traditional rate of return regulation. Their study began in 1985 or 1986 and required a couple of years to complete. It provided the only basis the FCC had for its attempt to move toward price cap regulation. The FCC itself has not made public any work that it may have done on the subject. But the Chairman of the FCC cited our research as the only empirical basis for using a less restrictive form of price regulation.

As I said, there were several other provable successes. Slides 17-21 show six of my favorites. Since the time is late, I'm going to skip most of them. Because we did 714 advocacies, the only thing I can do is make the other 708 authors mad at me by listing my six favorites.

(Laughter.)

MR. PAUTLER: I'll slip through these slides quickly. Maybe you can pick them up as they flash past your faces. My last point is that there is a substantial synergy between Bureau of Economics reports and the advocacy program. Slides 22-24 link BE studies to their release dates. All these BE reports were used to support advocacy arguments that we made at various agencies. Without empirical research and solid arguments that have been well thought out, any advocacy filing would only convince those who agreed with your position up front. For this reason, I believe that FTC research in the area of regulation mattered a lot for the advocacy program and allowed us to have the "greatest hits" that I talked about before. Without the research studies, most of our comments would have been a lot less compelling.

We continue to do research in the regulation area, although there's a lot less of it than we did in the 1980s, and much less comes out now as official BE reports. A lot of it now tends to skip the BE release stage and go directly to professional publication. That process actually has benefits for the author. It doesn't have as many direct benefits for the organization, but that's the way it's working out now. I don't know whether that's going to change in the future.

Anyway, that's a quick run through the advocacy program or "regulatory intervention" program. Anyone who has questions may ask anyone in the front row who is still here. Thank you very much.

(Applause.)

MR. PAUTLER: Bill?

MR. LONG: You put up on the screen what you did, either a report or an intervention. Has anybody looked at the results across 700 observations, not just at the winners? We knew you'd talk about the winners.

MR. PAUTLER: Actually, I think you probably saw the word "non-random" up there. That was clearly a non-random selection.

A few non-FTC observers have made general evaluations of the advocacy program. The ABA in 1989 thought that the program was great. Who knows who actually wrote the statement on the slide, but the Kirkpatrick Commission (slides 26-28) said that the program was one of the most important things the Commission was doing.

The closest thing we have to an independent evaluation of the advocacy program was Arnie Celnicker's 1989 study, based on a survey of 1987 recipients of FTC advocacy comments. The FTC staff used this methodology to survey 1989 recipients of FTC advocacy comments. The surveys were a complete sample of advocacy comment recipients during those years.

The recipients responded that the filings and reports were useful. I think 65 percent of them said they'd come back and ask us again for input if the opportunity arose. Arnie published results from the first survey in the St. Louis Law Review in 1989.

That's the closest thing I've got to an evaluation of the advocacy program. It may not be perfect, but this survey is probably more than we do to evaluate most of our programs.

QUESTION: How many industries have we been kicked out of? That's an even better measure of the effectiveness of the program.

MR. PAUTLER: Well, we got some individual responses from people who didn't really like what we said. So we did hit a nerve in a number of instances. One thing you've got to remember about the advocacy program is that there's always somebody on the other side. If we're bothering to comment, somebody invariably has a vested interest on the other side and will be miffed by the FTC showing up to make its argument. I never kept a count of the number of people that told us they were angry about it, but I know there were more than two.

(Laughter.)

MR. PAUTLER: We weren't kicked out of anything, as best I can recall, as a result of an advocacy filing. So we didn't have as much of an effect as, say, Mike Lynch's insurance study.

Any other questions?

MR. HILKE: You mentioned synergies between the reports and the advocacy. There are also some synergies between the advocacy program and the litigation side, because at least in the electricity side, our credibility from competition advocacy has helped in litigation, and vice versa. We could also examine how the effects of doing one activity spill over into the others.

MR. PAUTLER: I'd like to thank everybody for coming today.

(Applause.)

(Whereupon, at 5:15 p.m., the conference concluded.)

Robinson-Patman Act Complaint Respondents: 1961-74
Excluding Section 2(c) Brokerage Complaints

Sales Volume (Millions of $)	Complaints No.	Complaints %		No Contest	Respondent Won Case
More than 100	36	6.5		37%	23%
50 to 100	15	2.7			
25 to 50	23	4.1		72%	
10 to 25	60	10.8			
5 to 10	70	12.6			
1 to 5	163	29.4	76%	84%	0%
Less than 1	32	5.8			
No data	156	28.1		95%	
Total	555	100.0			

Breakfast Cereal Industry Rankings

Out of 234-238 Industry Lines of Business

	1974	1975	1976	1977
Operating Income as Percent of Assets	4	3	3	1
Media Advertising as Percent of Sales*	8	7	7	5

*First-ranked: proprietary drugs; second-ranked, cosmetics or razor blades.

Policies Towards Vertical Restraints in the 1970s

William S. Comanor

University of California
Los Angeles and Santa Barbara

Director, Bureau of Economics, FTC
1978-1980

1970s: A Decade of Change in Policies towards Vertical Restraints (1)

Legal Arena

- 1975, Repeal of Miller-Tydings and McGuire Acts which authorized the state "fair trade" laws.

- 1977, *Sylvania* decision retreats from standard of *per se* illegality towards non-price restraints.

- These two actions set the "high water" mark for a policy against vertical constraints.

1970s: A Decade of Change in Policies towards Vertical Restraints (2)

Economic and Policy Arena

- Publication of books by Richard Posner and Robert Bork that rapidly created a new "conventional wisdom" towards vertical restraints.

  Richard A. Posner, *Antitrust Law: An Economics Perspective*, 1976.

  Robert Bork, *The Antitrust Paradox*, 1978.

- Proposed a total confluence of interests between manufacturers and consumers in regard to vertical relationships.

- Questioned circumstances where vertical restraints can have anti-competitive effects.

- Called into question *per se* illegality standard against vertical price restraints. [Noted by Justice White in his concurring opinion in *Sylvania*.]

A Policy in Flux

- Considerable uncertainty on how to proceed.

  Some embraced the new conventional wisdom and proposed a complete policy shift (led by some B.E. economists).

  Some emphasized that legal standards had not changed, and also questioned the new wisdom (led by B.C. lawyers).

- Chairman Pertschuk, under considerable political pressure for his initiative on Children's Television Programming, took a conservative position.

- Few policy initiatives taken in late 1970s towards vertical economic relationships.

Data on FTC Vertical Restraints Cases Initiated between 1975 and 1981 (1)

<u>1975</u>: 15 cases: all settled by consent
- 7 concerning RPM
- 5 concerning Tying

<u>1976</u>: 11 cases: 10 settled by consent, 1 complaint dismissed
- 6 concerning RPM
- 3 concerning shopping center lease restrictions
- 1 concerning Tying

<u>1977</u>: 6 cases: all settled by consent
- 3 concerning RPM
- 2 concerning Tying
- 1 concerning shopping center lease restrictions

<u>1978</u>: 3 cases: all settled by consent
- 2 concerning RPM

Data on FTC Vertical Restraints Cases Initiated between 1975 and 1981 (2)

1979: 9 cases: all settled by consent
- 7 concerning RPM
- 1 concerning shopping center lease restrictions

1980: 6 cases: 5 settled by consent, 1 case where FTC found liability but 8th Circuit reversed
- 6 concerning RPM
- 5 concerning Tying

1981: 2 cases: all settled by consent
- 1 concerning RPM

Of the 52 Vertical Restraints cases for which Complaints issued:

- 32 (or 62%) concerned RPM
- 50 (or 96%) were settled by consent

32 Complaints issued between 1975 and 1977.

18 Complaints issued between 1978 and 1980.

Number of complaints declined by nearly half.

On the Edge of a Revolution

- Antitrust policy standards shifted sharply in 1981.
- Few vertical restraints cases were brought by the federal enforcement agencies in the 1980s.
- With advantages of hindsight, we can see the precursors of the new standards adopted in the 1980s.
- Economists played a leading role, but not well understood at the time.
- Culminated in Vertical Restraints Guidelines, which have since with withdrawn.

New Standards Supported in FTC BE Staff Reports

FTC Report Overstreet, 1983:

> "The general conclusion drawn here is that the current rigidly applied standard of per se illegality appears to be unnecessarily costly when evaluated in terms of economic efficiency." (p. 1)

FTC Report by Lafferty, Lande and Kirkwood, 1984:

> "Evaluations of RPM cases...[suggest] the following policy conclusions: (1) an approach that allows RPM by a new entrant is very likely to be socially beneficial, and (2) a provision... that allows dealer selection on the basis of quality is also likely to be beneficial." (p. 5)

A Conflicting Standard

Scherer and Ross, 1990: "The weight of the evidence...supports a conclusion that prices are on average elevated [by RPM], perhaps appreciably. ...[Studies] suggest average price differentials of 10 to 23 percent." (pp. 555-6)

- Is this a relevant factor?
- Is consumer welfare likely to be enhanced when final prices are higher?

Has the Enforcement Pendulum Shifted Again?

- *FTC v. Toys "R" Us*
  Opinion by Chairman Pitofsky, 1998
  Affirmed by Court of Appeals (7th Cir.), 2000

- *U.S. v. Microsoft*
  Opinion by Judge Jackson, 2000
  Affirmed liability by Court of Appeals (D.C. Cir.), 2001

- *LePage's, Inc. v. 3M*
  Opinion of Judge Sloviter, Court of Appeals (3rd Cir.), 2003

- These cases have important vertical components.

- Do these cases signal a more active enforcement policy towards vertical restraints?

- Has the post-Chicago economic literature played a role?

TO: Denis Breen
FROM: Wendy Gramm wlg
DATE: Sept. 4, 2003

SUBJECT: Experimental Research Fostered by the FTC

I've attached an executive summary of research funded by the FTC this past year. This study of zone pricing in gasoline markets by Bart Wilson of the Interdisciplinary Center for Economic Science at George Mason University and Cary Deck at the University of Arkansas has just been completed.

I have also attached a memo from Charles Plott to me about the FTC's role in promoting research in experiments, and the impact this has had on academic research over the years. Charlie also sent me copies of papers, which I am giving to you. Many of these papers are NOT in electronic form.

MERCATUS CENTER
GEORGE MASON UNIVERSITY

Wendy Lee Gramm
Distinguished Senior Fellow
Director, Regulatory Studies Program

3301 North Fairfax Drive, Suite 450, Arlington, VA 22201
Phone: (703) 993-4884 ◆ Fax: (703) 993-4935
wgramm@gmu.edu ◆ www.mercatus.org

Experimental Gasoline Markets
Executive Summary

Cary A. Deck
Department of Economics
Walton College of Business
The University of Arkansas
Fayetteville, AR 72701
Phone: (479) 575-6226
Fax: (479) 575-3241
E-mail: *cdeck@walton.uark.edu*

Bart J. Wilson*
Interdisciplinary Center for Economic Science
George Mason University
4400 University Drive, MSN 1B2
Fairfax, VA 22030-4444
Phone: (703) 993-4845
Fax: (703) 993-4851
E-mail: *bwilson3@gmu.edu*

Few industries evoke such strong sentiments by consumers, retailers, wholesalers, and policy makers as gasoline. Zone pricing – the practice of refiners setting different wholesale prices for retail gasoline stations that operate in different geographic areas or zones – has been a particularly contentious topic in the public policy debate for the past several years. Refiners contend, as Chevron does on its website, that they employ zone pricing to "price our wholesale gasoline to our dealers at prices that will allow them to be competitive in relation to their nearby competition."[1] However, state legislators and attorneys general have proposed legislation to ban zone pricing claiming that it "only benefits the oil industry, to the detriment of consumers."[2]

Another controversial issue that is debated in the gasoline industry is divorcement, the legal restriction that refiners and retailers cannot be vertically integrated, i.e., refiners cannot own and operate retail gasoline stations. Maryland was the first state to pass such legislation in 1974, with a handful of other states following suit.

In this study, we test the opposing viewpoints on these issues using the tool of experimental economics. Experimental economics is a research method that permits observation of economic behavior under laboratory conditions. These tests use cash incentives to help understand us how markets perform and why they work the way they do. A laboratory study complements field work by implementing the chief stylized facts of naturally occurring markets and by examining what cannot be measured with field data. For example, in the laboratory we can measure the gains from trade for consumers, retailers, and wholesalers because the experimenter precisely knows consumer preferences and costs of the retailers and suppliers, which are not directly observable in the naturally occurring economy. Holding constant the wide range of potentially confounding effects found in the naturally occurring economy, in this study we compare markets in which zone pricing is permitted to arise endogenously to markets in which uniform wholesale pricing is mandated, i.e., zone pricing is prohibited. Such a comparison affords a direct examination of the welfare effects of the proposed legislation on consumers, station owners, and refiners before executing it in the field. Similarly, we vary the degree of vertical integration to assess the impact of divorcement. We also explore the "rockets

* Corresponding author.
[1] http://www.chevron.com/about/currentissues/gasoline/pricing_qanda/gasoline_pricing_qa.shtm#7.
[2] See "Testimony of Connecticut Attorney General Richard Blumenthal Before the House Judiciary Committee," http://www.house.gov/judiciary/blum0407.htm, April 7, 2000.

and feathers" phenomenon, the perception that retail gasoline prices rise faster than they fall in response to cost shocks, another topic that has led to much public debate.[3]

Our laboratory environment contains two types of geographic retail areas, isolated and clustered. The geographically clustered area is at the center of a grid and served by four retail stations, whereas there is one station in each of the four geographically isolated areas in the corners of the grid.

Most broadly, we conclude that uniform wholesale pricing and divorcement each harm consumers.

Our specific findings on zone pricing are summarized as follows:

- When zone pricing is banned, consumers in the clustered area pay 10.9% higher prices than when zone pricing is permitted. As a percentage of the total value from consuming gasoline, these higher prices represent a reduction in total consumer welfare of 17-18%.

- Consumers in isolated areas pay the same prices with zone pricing as they do when it is prohibited.

Why does uniform wholesale pricing not help the consumers in isolated areas and harm those in the clustered area? The answer is two-fold. First, high station prices in the isolated areas are not the *result* of high refiner prices with zone pricing, but rather the *cause*. Station prices in the isolated areas are higher because (a) consumers in those areas prefer not to travel long distances to purchase lower-priced gasoline in a more competitive area and (b) there is only one local station. The refiners then use zone pricing to capture the station profits at these isolated and hence more profitable stations. This is consistent with the naturally occurring contexts in which refiners capture the profits of lessee dealer stations because the refiners own the land on which the station operates. (In addition, lessee dealers are unable to change their suppliers, as is the case in this experiment.) In the clustered area with strong station competition, the refiners price very competitively, and as a result, consumers pay lower prices. The upshot is that refiners capture more profits from the stations with zone pricing, but not to the detriment of consumers.

The second part of the answer stems from the unintended consequences of uniform wholesale pricing, namely that it ties refiner pricing decisions in isolated areas to those in the competitive, clustered area. When refiners are forced to sell at a uniform price, they would rather set a single price that is higher than the comparable zone price in the clustered area to capture some of the profits of the stations in the isolated areas. Hence, consumers in the clustered area pay higher pump prices. Consumers in the isolated areas do not see lower prices because nothing has fundamentally changed at the retail level. In fact, consumers have even less of an incentive to travel further to the clustered area because those prices are now higher with uniform pricing. The end result is that uniform pricing stymies competition in the clustered area and yields no benefit to consumers in isolated areas.

[3] Palmeri, C. "Is Big Oil Pumping Gas Prices?" *Business Week Online*, May 22, 2003.

Our major finding on vertical integration (company-owned stations) versus divorcement (lessee dealer stations) is:

- Consumers in the clustered area and isolated areas respectively pay 13.2% and 16.5% lower prices with company-owned stations than with divorcement. As a percentage of the total value from consuming gasoline, these lower prices represent an increase in total consumer welfare of 20.1% to 50.6%, depending upon whether consumers are closer to the clustered area or the isolated area.

Consumers pay higher prices with lessee dealer stations because the refiners first mark up price to the stations, which in turn place an additional markup on the price to the consumers. This finding affirms the results of previous field studies,[4] lending credence to our other findings.

Our other major findings are that:

- Banning zone pricing nearly triples average station owner profits, but has no effect on refiner profits.

- Station prices in the clustered area adjust quickly with zone pricing, but still rise faster than they fall (a "rockets and feathers" finding). It takes one quarter of the time for 90% of cost increase to be passed-through to consumers as it does for a comparable reduction in costs to be reflected in prices. Station prices in the isolated areas adjust more slowly than in the clustered area, but rise as fast as they fall.

- With company-owned stations, prices rise as fast as they fall in response to changes in station costs, but this response is much slower than with vertical separation.

- Banning zone pricing breaks down the long run relationship that captures how station prices adjust to changes in costs. The negative implication is that when refiner costs fall, station prices do not follow. This also means that station prices are insulated from increases in wholesale costs, but we also observe that mandating uniform wholesale prices generates high station prices in the clustered area.

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[4] See Barron, John M. and Umbeck, John R., "The Effects of Different Contractual Arrangements: The Case of Retail Gasoline Markets." *Journal of Law and Economics* v27, 1984, pp. 313-28; and Vita, Michael G., "Regulatory Restrictions on Vertical Integration and Control: The Competitive Impact of Gasoline Divorcement Policies." *Journal of Regulatory Economics* v18, 2000, pp. 217-33.

To: Dr. Wendy Gramm
265 E. 66th, Apt. 31C
New York, NY 10021
From: Charles R. Plott
Subject: FTC sponsored economic research

The four papers listed below are projects that were funded (in part) by the FTC. The research efforts in these projects, supported by the FTC, have evolved into a substantial impact on experimental economics and on the profession in general. Several seminal papers were based on the research. All of the major issues introduced by the research are still actively studied in the profession and while the papers themselves are seldom referenced today, the literatures that rest on the papers are voluminous. The papers are listed with a brief comment about contents and an example or two of major papers that followed.

1. C. Plott and L. Wilde, "Professional Diagnosis vs Self-Diagnosis: An Experimental Examination of Some Special Features of Markets with Uncertainty", *Research in Experimental Economics*, Vol.2, Vernon L. Smith (ed), JAI PRess, 1982, 63-112.

A. Contents

This was the first paper to explore asymmetric information in experiments. The problem was to study the efficiency of markets in which the quality of the item delivered was never known to the buyer. Examples were the asymmetric information characteristic of professionals ranging from physicians to auto mechanics. What is the role of competition in such markets?

B. Impact

The Plott and Wilde paper methodology was applied to finance, industrial organization and then to the general creation and testing of "information aggregation mechanisms". The two Plott and Sunder papers were developed directly through the Plott and Wilde methodology. The papers became the foundation for modern experimental finance in which specialized instruments (options and futures) and in which the role and importance of insiders are studied from an efficiency perspective. The path leads directoy to the research that recently got DARPA intro trouble - see the SEJ paper for the connections. Hundreds of papers followed these initial papers, which serve as our fundamental understanding of asymmetric information in market environments and in some cases political science as well. The papers that first opened the special areas are listed below.

(i)C. Plott and S. Sunder, "Efficiency of Experimental Security Markets with Insider Information: An Application of Rational-Expectations Models," *Journal of Political Economy*, 90 (4), August 1982, 663-98.
(ii) C. Plott and S. Sunder, "Rational Expectations and the Aggregation of Diverse Information in Laboratory Security Markets", *Econometrica*, 56 (5) September 1988,1085-118.
(iii) C. Plott and Ross Miller, "Product Quality Signaling in Experimental Markets", *Econometrica*, 53(4), July 1985, 837-72.
(iv) C. Plott, "Markets as Information Gathering Tools", *Southern Economic Journal*, 67 (1),2000,2-5.

2. M. Lynch, R. Miller, C. Plott and R. Porter, "Product Quality, Informational Efficiency and Regulations in Experimental Markets", *Research in Experimental Economics*,4, JAI Press, 1991, 269-318.

A. Contents

How does the right to advertise influence markets in which the quality of the purchase is know to the buyer only after the purchase? Do "lemons" emerge and are the poor quality goods avoided through reputation development?

B. Impact

This is the first evidence of the existence of lemons and the methodology is used as the control for cases in which lemon's corrections are to be studied.

More recently the "behavioral economics" crowd has been suggesting that trust (independent of any reputation phenomenon) is a sufficiently reliable human trait that industrial organization and policy can rely on it. The research on trust was developed without a clear realization that the experiments were similar to those used to study markets for lemons but the results seemed much different. Additional study of the issue using the results and techniques of Lynch, Miller, Plott and Porter paper have ~~caste~~ doubt on the robustness of the trust phenomenon to slight changes in the experimental design. The manuscript by Paul J. Healy can give you references and a flavor of the issues and suggests that classical principles are more reliable than those based on "other regarding" preferences.

(i) Paul J. Healy, " Fair Wages or Markets for Lemons? Reconciling the Results of Conflicting Experiments", California Institute of Technology, August, 2003.

3. Grether and C.R. Plott, "The Effects of Market Practices in Oligopolistic Markets: An Experimental Examination of the Ethyl Case", *Economic Inquiry*, XXII, October 1984,479-507

A. Content

This is the first attempt to use laboratory experimental methods in an anti trust case. It was also the first experiment to use the concept of "facilitating practices" as part of the treatment variables. The practices themselves were (and are) of general interest because of their subtle power to helping solve the underlying "public goods" or "prisoner's dilemma" problem.

B. Impact

The following two papers are examples of how the Grether and Plott paper influenced the literature. The first is an example of how conspiracy and conspiracy deterring institutions are explored. The second is an example of how the same issue finds its way into a much broader discussion of public goods provision.

(i) L. Clauser and Charles Plott, "On the Anatomy of the 'Nonfacilitating' Features of the Double Auction Insitution in Conspiratorial Markets", *The Double Auction market: Institutions, Theories and Laboratory Evidence*, D. Friedman and J. Rust (Eds.), Addison-Wesley, 1993, pp.333-53.
(ii) C.R. Plott, "Laboratory Experiments in Economics: The Implications of Posted Price Institutions", *Science*, 232, 9 May 1986, 732-8.

4. C.R. Plott, "Theories of Industrual Organization as Explanations of Experimental Market Behavior" *Strategy, Predation, and Antitrust Analysis*, Steven Salop (ed.), Federal Trade Commission, September 1981.

A. Content

This a review paper done for the FTC and presented at an FTC conference. Basically, it summarized the experiments of the day as related to industrial organization theory and the possible interests of the FTC.

B Impact

The impact of the paper does not come from the paper itself but from the fact that the paper was expanded into a review paper that has had a major impact on economics. At one time it was among the most referenced papers that used experimental methods and served to introduce the economics profession to what might be learned through the application of the methods.

(i) C.R. Plott," Industrial Organization Theory and Experimental Economics", *Journal of Economic Literature*, XX, December 1982, 1485-527.

FTC Sponsored Economic Research

Supplement to Memorandum from Charles R. Plott to Dr. Wendy Gramm

Additional Study not discussed in the memorandum:

1. M. Lynch, R. Miller, C. Plott, and R. Porter, "Product Quality, Consumer Information and 'Lemons' in Experimental Markets, *Empirical Approaches to Consumer Protection Economics,* Pauline M. Ippolito & David T. Scheffman (eds), Federal Trade Commission (1984), 251-305.

The Role of Economists in Competition and Consumer Advocacy

September 4, 2003

What is the Advocacy Program?

The interests of consumers are not always well represented in some legislative and regulatory forums. The goal of the Commission's advocacy program is to share our experience and expertise with governmental and self-regulatory bodies about the potential effects on consumers of proposed legislation, rules, industry codes, etc.

VERSUS

We tell other people how to do their job through market-based approaches to regulation and public policy.

What is the Advocacy Program? (Continue)

Tollison (1983, p. 217) says the purpose of the early 1980s intervention program was to attack government-maintained monopolies through comments to other regulatory agencies.

I think that such a resource allocation [toward advocacy] by the agency is wise,
for at least its attorneys and economists are pointing their guns at real monopoly power.

When Did the Advocacy Program Start?

1. In the earliest days of the Commission, when the FTC submitted comments to the Fuel Administration (on coal pricing) and the War Industries Board (on steel).

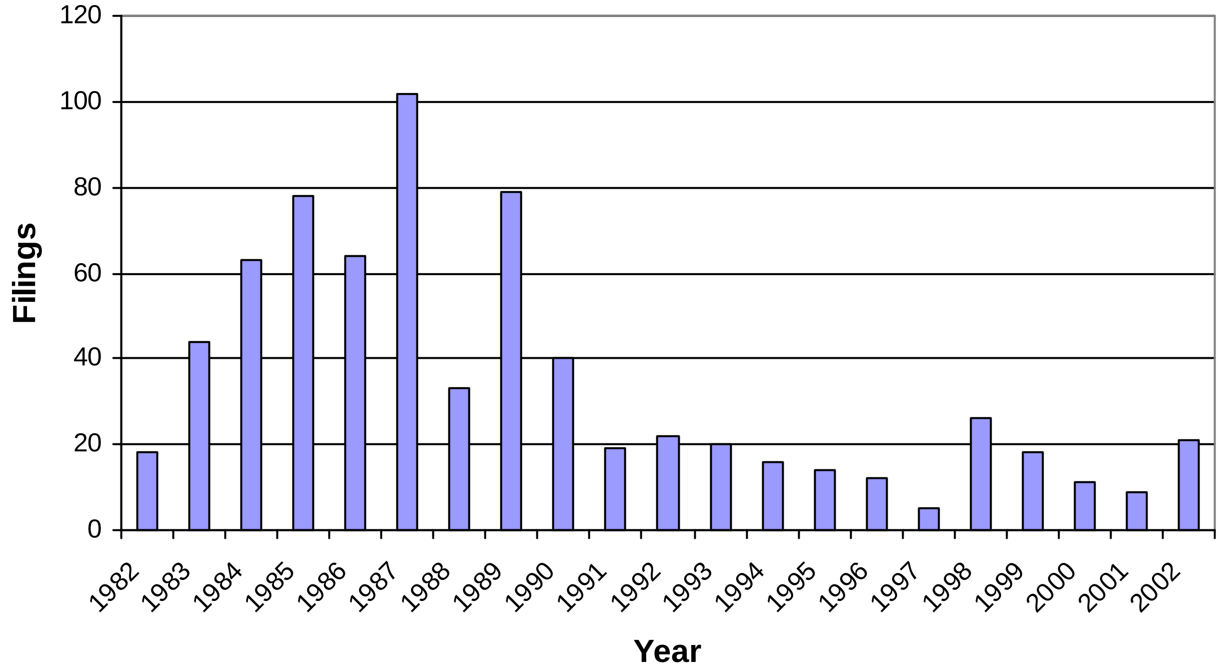
2. Competition advocacy was made part of the competition mission in 1974, under Chairman Louis Engman. (Kovacic 1982, p. 649).

When Did the Advocacy Program Start? (Continue)

3. As a result of several 1970s BE economic reports documenting the costs imposed by clumsy government policies (e.g., petroleum pricing, optician regulation, occupational licensing). (Scherer 1990, p. 471).

4. Brainchild of Chairman James C. Miller III (Tollison 1983, p. 217).

Advocacy Filings 1982-2002



How Active Has the Advocacy Program Been and What Has It Cost?

Number of filings = 714 from 1982-2002
Peak 1987 = 102
Through 1997 = 5
Current 2002 = 21

Resource use at peak 1987: <4% FTC (<35 workyears); 6-8% BE (7-10 workyears).
Current <1% FTC (5 workyears); 2% BE (1-2 workyears).

Advocacy Topics: Hardy Perennials

Restraints on international trade (1975-1990) in steel, Canadian softwood lumber, DRAMS computer chips, tuna non-rubber footwear, etc. Fifty-three filings between 1982-1989.

Restraints on health care advertising and commercial practices and contracting (1978-1994).

Horizontal restraints and entry barrier legislation (e.g., occupational regulation) lobbied for by various professions and business groups, including attorney ethics codes (1980-2000).

Advocacy Topics: Hardy Perennials (Continue)

Regulation issues in airlines (Love field, Logan airport, “use or lose” landing slot, etc.), rail, and truck transportation (1980-1993).

Postal regulation issues (a dozen filings from 1981 to 1989).

Regulatory reform in telecommunications: broadcasting, and cable TV regulation, must carry, fin-syn, PTAR, electromagnetic spectrum allocation, telephony (1983-1995), (3 dozen FCC filings over the years).

Advocacy Topics: Hardy Perennials (Continue)

Auto dealer entry restrictions and off-site auto sales (1982-1995).

Taxicab regulations (Twenty filings from 1983-1989).

State regulation of gasoline sales and marketing (dozens from 1984 to 1992, 2002 - 2003).

Regulation of health and nutrition claims for foods in advertising and labeling (1987-1993, 2000, 2002).

Restructuring of the electricity generation, transmission, and distribution industry (1995-2002) FTC advocates competitive structure rather than using behavioral rules

Topics Lasting a Few Years

State Anti-takeover legislation 1984-1990

Health Care Certificate of Need laws 1983-1989

Rental Car legislation 1988-1990

Selective contracting and "any willing provider" laws 1993. Pharmacy groups and others lobby state legislatures for protection against the anticipated effects of HMOs and health care reforms

Effects of the Comments - Some Nonrandom Examples

(1) Corporate Average Fuel Economy Standards 1986, 1988. Decisions not to raise the automobile fuel efficiency standards were based on an empirical analyses provided by BE staff.

(2) Certificate of Need regulation in North Carolina in 1989. BE comment played a key role in the Policy Board recommendation against continuing the entry restraints. Last in a series.

Effects of the Comments - Some Nonrandom Examples (Continue)

(3) Use or Lose rules for landing slots at four major U.S. airports. In August 1992, the FAA increased the "use-or-lose" usage rate from 65% to 80% on a weekly basis citing prominently to the FTC comment, which reported that slot usage by the major slot-holders already approaches or exceeds 90%, and that larger firms used their slots more intensively than did smaller owners.

(4) Comments to the FCC regarding the relative merits of price cap regulation versus rate of return regulation in 1987 provided the factual basis for the FCC action. Chairman of the FCC, cited FTC empirical results as the basis of the FCC policy choice in a letter to Congressman

Effects of the Comments - Some Nonrandom Examples (Continue)

Dingell in1988. The research suggests that interstate long-distance prices could fall by 7 percent if AT&T could price its service more flexibly. In addition, entry restrictions tend to raise rates by 10 percent.

(5) BE's empirical work showed that rules proposed by FDA in 1992 would disallow health claims for large classes of healthy food, such as fish and lean meats. FDA altered the rules so that better versions of bad foods would be able to tout their superior characteristics.

Effects of the Comments - Some Nonrandom Examples (Continue)

(6) FTC staff filing to FDA on direct-to-consumer prescription drug advertising in early 1996 “turned the tide” toward allowing information to flow to consumers regarding drug therapy options according to unsolicited comments by an attorney for an advertisers trade association.

Effects of the Comments - Some Nonrandom Examples (Continue)

(7) FTC efforts to highlight the competition issues in electricity industry restructuring had an impact as one leading researcher in the area (Bill Hogan) used BE's arguments to make the point that open access to transmission grids would only work if sellers truly trusted the independence of the grid operator. In addition, one FERC Commissioner used FTC staff advocacy comments as a principal basis for his speech material. (Massey on ISOs).

Advocacy Favorites: Pick Six

(1) Massport's (Boston's airport authority) Program for Airport Capacity Efficiency, February 29, 1988.

The staff of the FTC commented on Massport's proposal to change its landing slot prices to reflect costs, including congestion costs. These comments were the focus of much media attention, and the Executive Director of Massport in a March 1988 letter thanked the FTC staff for helping shape Massport's policy. BE did additional work on possible follow-up briefs after DOT tried to kill the Massport proposal.

Advocacy Favorites: Pick Six (Continue)

(2) The Federal Communications Commission's AM/FM Radio and Television Ownership Rules, July 15, 1987.

In July 1987 the BE staff commented on the FCC proposals for alterations in the form of regulation of radio ownership. FCC rules restricted the extent of ownership of radio and TV stations in the same market. BE staff presented theory and empirical evidence to support the idea that such cross-ownership could be efficient and lower production costs without leading to adverse competitive consequences due to increased concentration. In December 1988 the FCC liberalized their rules regarding cross-ownership and cited to the FTC staff comments on efficiency aspects of cross-ownership generally.

Advocacy Favorites: Pick Six (Continue)

(3) The FCC's Financial Interest and Syndication Rule which restricted ownership of the rights to re-run TV shows, 3 filings in 1990-1991.

The FTC staff argued for repeal of these outdated rules. New empirical analysis relating to the proper market definition was provided in an appendix and the FTC staff comment was the only unbiased comment to directly address the issues raised by the economic analysis of the movie coalition's experts. DOJ Assistant Attorney General Rill found the economic analysis "superb".

Advocacy Favorites: Pick Six (Continue)

(4) The FCC's Must-Carry Rule for Cable TV, November 26, 1991.

The "must-carry" rules, compelled local cable systems to retransmit on its basic service tier all of the locally broadcast stations. This comment contained a careful empirical analysis of the effects of must-carry requirements showing that the must carry rules did not solve a significant problem, since almost all cable stations carried all the local stations whether they were required to or not. The cable systems apparently wanted to carry stations people wanted to watch. There was also no evidence that the cable companies were trying to monopolize any advertising market as the must-carry proponents alleged.

Advocacy Favorites: Pick Six (Continue)

(5) Housing and Urban Development proposals to ban referral fees paid by home mortgage lenders, July 15, 1988; Follow-on RESPA Reform, 2002.

Made the point that regulating one small component of the price of a bundle of services was likely to mislead mortgage shoppers and lead to higher, not lower, mortgage rates for borrowers.

(6) Federal Energy Regulatory Commission's open access rules for electricity distribution, August 7, 1995. BE's opening salvo in 8 years of comments on various aspects of electricity system regulatory reform.

Selected BE Reports Used in the Advocacy Program

International trade restraints 1977, 1980, 1984, 1987, 1989, 1994
State board optometry rules 1980
Airport landing slot allocation 1983, 1988
Taxi entry and price regulation 1984
Dental hygienists 1986
Retail market area laws for auto dealers 1986
Certificate of need and health care services 1986, 1987, 1988

Selected BE Reports Used in the Advocacy Program
(Continue)

State anti-takeover laws 1987
Regulation of long distance telephony 1988
Ocean Shipping 1989, 1996
Trucking deregulation 1988, 1995
Health claims for foods before and after the NLEA 1989, 1996, 2002
Occupational regulation 1990

Selected BE Reports Used in the Advocacy Program
(Continue)

Other BE-funded studies:
Hospital Merger Report 1991-1994 (various journals)
Natural Gas Pipelines 1993
Regional Effects of Import Restraints 1996
Cable TV Must Carry 1997
Fats and Oils Advertising before the NLEA 2000
Gasoline Divorcement 2000
Selective Contracting and Any Willing Provider Laws 2001

Advocacy Program Evaluations

Some effort was made to assess the Advocacy Program's impact.

> Celnicker, 1989 Law Review article reviewing 1985 - 1987 comments concluded that

the FTC provided input that decisionmakers found useful.... Sixty-five percent of the survey recipients indicated that they either had requested, or plan to request, FTC input on other issues.

A follow-up survey done internally over the next 2 years produced the same conclusion.

Advocacy Program Evaluations (Continue)

The 1989 ABA Antitrust section's "Kirkpatrick Report" stated:

> The FTC's Competition and Consumer Advocacy Program is one of the most important of the FTC's various projects.... It has generally provided quality advice about issues of consequence.

Advocacy Program Evaluations (Continue)

The FTC's competition advocacy program permits it to accomplish for consumers what prohibitive costs prevent them from tackling individually. It is the potential for the FTC to undo governmentally imposed restraints that lessen consumer welfare, and to prevent their

Advocacy Program Evaluations (Continue)

> imposition, that warrants the program's continuance and expansion. ...potential benefits from an advocacy program exceed the Commission’s entire budget.

These positive evaluations, however, were followed by the decline and then near-death of the program over the 1990 to 1997 period.

Advocacy Program as a Bureaucratic Vagabond

Since 1980 each Bureau played a role in Advocacy, with BE being the key substantive player. The process required a lot of coordination (not to mention patience).

1980-1982 The Bureau of Competition (BC) provided most of the coordination. (Healthcare competition and international trade restraints focus).

1983-1984 The program is formalized and centered in the Bureau of Consumer Protection's Evaluation division. The intervention effort was lead by Andrew Strenio.

Advocacy Program as a Bureaucratic Vagabond
(Continue)

1985-1986 New head of the program, Walter Vandaele. BC's policy group under Sid Moore also played a substantial role as did Keith Anderson, head of Regulatory Analysis in BE.

1986-1988 Executive Director's Office. The coordination function was handled by Jim Giffin.

1988-1994 Office of Competition and Consumer Advocacy (OCCA) was formed and Richard Fielding and Bruce Levine took over control, replaced by Michael Wise in 1992?

Advocacy Program as a Bureaucratic Vagabond (Continue)

1994-1997 BE becomes home of the program. Mike Wise remained with the Program, becoming Associate Director for Advocacy and Legal Counsel in the Bureau of Economics.

1998-2001 Advocacy moves to Policy Planning. Bill Cohen handled the coordination tasks for four months and Michael Wroblewski took over in April 1998.

Advocacy Program as a Bureaucratic Vagabond
(Continue)

2001-2003 GC/Policy Planning split the function. The management of the advocacy function moved briefly to GC with Mike Wroblewski in June 2001, then it moved to OPP in 2001/2002 with Jerry Ellig, except for electricity and pharmaceutical patent matters which Wroblewski retained.