

# GLOBAL GOVERNANCE, ANTITRUST, AND THE LIMITS OF INTERNATIONAL COOPERATION

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How can regulation keep up with transactions? The contemporary world economy make it easier to produce and sell across national borders. The partition of transactions into separate geographical components in turn makes it easier to pick and choose regulatory regimes. Antitrust law has dealt with this problem for nearly a century. At one time it regarded the assignment of a transaction to a particular territory as a prerequisite for the application of its rules; lately it has required much less. As a result, overlapping national regulation has become the dominant structure.

Overlapping regulation has its own problems. National regimes may impose inconsistent rules and pursue conflicting ends. In response, regulators and scholars have begun to explore the possibility of international governance. The proposals vary, but at their heart lies a conviction that the inadequacies of national regulation justify the creation of international institutions to promote coordination of national regulatory programs.<sup>1</sup>

I argue, in opposition to most commentators, that dispensing with international institutions seems the most promising approach to the problem. Creation of new international institutions to

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<sup>2</sup> Concrete steps by regulators include the formation of the International Competition Network, an initiative of the U.S. Department of Justice, and the decision to include antitrust policy as a topic for the Doha Round of trade negotiation held under World Trade Organization auspices. The ICN website is <http://www.internationalcompetitionnetwork.org/index.html> (last visited Feb. 26, 2004). For the competition policy program of the Doha Round, see World Trade Organization, Ministerial Conference – Fourth Session – Doha, 9-14 November 2001 – Ministerial Declaration – Adopted on 14 November 2001, ¶ 25, WTO Doc. No. WT/MIN(01)/DEC/1 (Nov. 20, 2001). For scholarly proposals to go further down this path, see Eleanor M. Fox, *International Antitrust and the Doha Dome*, 43 *Va. J. Int'l L.* 911 (2003); Andrew T. Guzman, *International Antitrust and the WTO: The Lesson from Intellectual Property*, 43 *Va. J. Int'l L.* 933 (2003). Other recent scholarship attests to renewed interest in the issue of international cooperation and antitrust. For a representative sample, see Eleanor M. Fox, *Antitrust and Regulatory Federalism: Races Up, Down, and Sideways*, 75 *N.Y.U. L. Rev.* 1781 (2000); Ignacio Garcia Bercero & Stefan D. Amarasinha, *Moving the Trade and Competition Debate Forward*, 4 *J. Int'l Econ. L.* 481 (2001); Andrew T. Guzman, *Is International Antitrust Possible?* 73 *N.Y.U. L. Rev.* 1501 (1998); Antonio F. Perez, *International Antitrust at the Crossroads: The End of Antitrust History or the Clash of Competition Policy Civilizations?* 33 *Law & Pol'y Int'l Bus.* 527 (2002); Ed Swaine, *Against Principles Antitrust*, 43 *Va. J. Int'l L.* 959 (2003); Alan O. Sykes, *Externalities in Open Economy Antitrust and Their Implications for International Competition Policy*, 23 *Harv. J.L. & Pub. Pol'y* 89 (1999); Daniel K. Tarullo, *Norms and Institutions in Global Competition Policy*, 94 *Am. J. Int'l L.* 478 (2000); Michael J. Trebilcock, *Competition Policy and Trade Policy*, 31 *J. World Trade* 71 (1997); Spencer Webber Waller, *An International Common Law of Antitrust*, 34 *New England L. Rev.* 163 (1999); Russell J. Weintraub, *Competing Competition Laws: Do We Need a Global Standard?* 34 *New Eng. L. Rev.* 27 (1999); Diane P. Wood, *International Harmonization of Antitrust: The Tortoise or the Hare?* 3 *Chi. J. Int'l L.* 391 (2002); Symposium: *Can We Regulate Competition Internationally? A Case Study of the Attempted GE/Honeywell Merger*. 23 *U. Pa. J. Int'l Econ. L.* 457 (2002); Symposium, *International Coordination of Competition Policy: Does Global Antitrust Law Have a Future?* 43 *Va. J. Int'l L.* 911 (2003).

grapple with antitrust or assigning this task to existing organizations presents underappreciated risks, and the status quo of near international anarchy has underappreciated benefits. The growing call by regulators and scholars to widen and deepen international cooperation regarding competition policy needs to be resisted. Judge Wood, a leading authority on international antitrust, recently wrote that “Harmonization is something to which only a curmudgeon would take exception.”<sup>3</sup> I rise to that challenge.<sup>4</sup>

My argument against international cooperation has both negative and affirmative elements. On the negative side, the claims for international imposition of either substantive rules of antitrust law or assignments of regulatory jurisdiction rest more on hope than evidence. There are good reasons to believe that either form of cooperation will produce undesirable outcomes. In particular, government failure at the national level may replicate itself at the international level, yet international regimes are more difficult to unwind than is domestic regulation.

On the affirmative side, I identify forces underlying international economic relations among the world’s most prosperous and powerful states that can punish those nations whose antitrust produce substantial losses in global welfare, and reward those that employ policies that enhance global welfare. In an information-based economy with substantial international mobility of financial and human capital and significant international trade, states that impose an antitrust law that protects domestic producers from welfare-enhancing competition should experience lower levels of investment and innovation. Countries that use competition law to punish more efficient foreign producers will suffer losses in consumer welfare without obtaining any offsetting competitive gains, once innovation losses are taken into account. Countries that use competition law to punish foreign producers that engage in inefficient forms of industrial organization, on the other hand, should experience some economic benefits.

My argument fits into a larger project.<sup>5</sup> Since the end of the Cold War, the pull towards greater international cooperation in economic regulation has seemed irresistible. The growing prominence of existing institutions, especially the World Trade Organization, the International Monetary Fund, the World Bank, the Organization for Economic Cooperation and Development, and the organs of the European Union and the North American Free Trade Agreement, is matched by calls for the creation of new regimes with additional regulatory powers. Much of the

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<sup>3</sup> Diane P. Wood, note *supra*, at 391.

<sup>4</sup> Cf. Paul B. Stephan, *The Skeptic Speaks: I am Not a Blind, Pig-Stupid Opponent of Unification*, Proceedings of the 96<sup>th</sup> ASIL Annual Meeting 336 (2002); Paul B. Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 Va. J. Int’l L. 743 (1999).

<sup>5</sup> See Paul B. Stephan, *Accountability and International Lawmaking: Rules, Rents and Legitimacy*, 17 Nw. J. Int’l L. & Bus. 681 (1996-97); Paul B. Stephan, *The New International Law – Legitimacy, Accountability, Authority, and Freedom in the New Global Order*, 70 U. Colo. L. Rev. 1555 (1999); Paul B. Stephan, *Sheriff or Prisoner? The United States and the World Trade Organization*, 1 Chi. J. Int’l L. 49 (2000); Paul B. Stephan, *International Governance and American Democracy*, 1 Chi. J. Int’l L. 237 (2000); Paul B. Stephan, *Regulatory Cooperation and Competition – The Search for Virtue in Transatlantic Regulatory Cooperation—Legal Problems and Political Prospects* 167 (George A. Bermann, Matthias Herdegen & Peter L. Lindseth eds. 2000); Paul B. Stephan, *Courts, Tribunals, and Legal Unification – The Agency Problem*, 3 Chi. J. Int’l L. 333 (2002); Paul B. Stephan, *The Political Economy of Conflicts of Laws*, 90 Georgetown L.J. 957 (2002); Paul B. Stephan, *Institutions and Elites: Property, Contract, the State, and Rights in Information in the Global Economy*, 10 Cardozo J. Int’l & Comp. L. 801 (2002).

criticism of these developments reflects either a deep suspicion of the culture and values of late-stage capitalism and global markets or an atavistic celebration of national sovereignty. My critique is different. One does not have to reject markets and competition as virtuous means to advance human liberty and dignity, nor privilege the nation state as a paragon of democratic governance, to resist the kinds of international cooperation that seem to loom in the world economy's future. I argue that one can accept the inevitability of the complex of phenomena too easily lumped together under the facile rubric of "globalization," worry about its consequences for people around the world, understand the limitations of nation states in the face of these challenges, and still express skepticism about the burgeoning growth of an international technocracy. International antitrust simply presents an opportunity to test this general argument.

This paper proceeds in three parts. First, I provide a positive account of the incentives countries face under conditions of international trade to choose competition policies that do not maximize global welfare. This account rests on a demonstration of the inseparability of competition policy from trade policy, and on a comparison of the potential welfare losses resulting from protection-motivated competition law and conventional tariff-based protection. I argue that the less transparent nature of competition law makes its trade effects especially troubling. Second, I review proposals to develop international regimes either to harmonize substantive competition law or to allocate regulatory jurisdiction. I identify reasons why such regimes are likely to be unsatisfactory. The same considerations that lead countries to use competition law as a form of protection remain relevant in the context of international relations. Moreover, an international regime will present additional problems of administration, application, and adaptation. Third, I discuss the long-term incentives to avoid protection that nations face under conditions of capital mobility. I review the empirical literature on trade and development and argue that a similar positive correlation should exist between optimal choices of competition policy and economic growth. In the conclusion I explore the limits of my argument and suggest areas for future inquiry.

## I. THE PROTEAN NATURE OF COMPETITION POLICY AND ITS POTENTIAL FOR ABUSE

Part of the problem of international antitrust is understanding the relationship between competition policy and antitrust law. Most U.S. regulators and some scholars seem to take for granted that the two subjects are congruent. A consensus among them exists about the goals of competition policy – principally the maximization of consumer welfare – and the general soundness of the means the United States uses to pursue that end. It seems easy enough to assume that the rest of the world understands what we mean when we talk about competition and consumer welfare, and not too hard to believe that any disagreements about optimal competition policy stems from an incomplete understanding of the state of the debate in the United States.

A moment's reflection, however, will suggest the difficulty of the problem of creating international competition law. From an international perspective, we do not have a common vocabulary or sense of subject, much less a common commitment to substantive ends.<sup>6</sup> Once one

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<sup>6</sup> See Wolfgang Pape, *Socio-Cultural Differences and International Competition Law*, 5 *Eur. L.J.* 438 (1999).

appreciates how undefined the concept of competition policy is, the difficulties of coordinating national regulatory regimes becomes clearer.

First, I explain why competition policy has no logical boundaries, and instead bleeds into industrial policy and, more importantly, trade policy. Second, I provide a theoretical argument supporting the prediction that variance among nations will lead to significant differences in national competition policies. In particular, I explain how conventional competition policy techniques – merger regulation and attacks on producer collusion – can function as a trade barrier. Third, I provide evidence that important states on occasion do use competition policy for protectionist ends. This undermines the often unstated assumption that only insignificant barriers stand in the way of a coordinated and institutionalized global antitrust regime.

### *A. What Is Competition Policy?*

Competition policy means many different things to its various practitioners and students. At a formal level, its boundaries may seem clear. A government invokes competition policy to regulate private actors who coordinate their economic choices.<sup>7</sup> U.S. antitrust law seems the principal and best example. But what of government decisions not to regulate economic coordination? Is this weak competition policy or, behind a facade of regulatory indifference, governmental direction of economic cooperation? Once one recognizes the difficulty of distinguishing indifference from direction, it becomes impossible to cabin competition policy so nicely.

The fundamental indeterminacy of the concept becomes even clearer when one looks at its implementation in practice. Under the aegis of competition policy, governments regulate producer choices, including decisions to cooperate with other producers. Regulation of prices, of marketing practices and of the array of products offered all come within its scope. Competition regulation involves decisions about competition, but does not necessarily imply a preference for the consumer welfare criterion as the benchmark of competitive markets. Support for a national champion, suppression of large-scale efficient producers that threaten politically influential small producers, and setting quotas on output all can constitute competition policies, even though most economists would regard these strategies as presumptively inimical to consumer welfare.<sup>8</sup>

This seemingly obvious point is critical. Most regulators, practitioners, and scholars in the United States believe that competition policy involves government intervention against

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<sup>7</sup> See Eleanor M. Fox, *International Antitrust and the Doha Dome*, note *supra*, at 915: “It is often said that antitrust is about private restraints of trade, and trade law is about public restraints.”

<sup>8</sup> See Daniel J. Gifford & Robert T. Kudrle, *Alternative National Merger Standards and the Prospects for International Cooperation*, in *The Political Economy of International Trade Law – Essays in Honor of Robert E. Hudec* 208 (Daniel L.M. Kennedy & James D. Southwick eds. 2002); Michael Trebilcock & Robert Howse, *Trade Liberalization and Regulatory Diversity: Reconciling Competitive Markets with Competition Politics*, 6 *Eur. J.L. & Econ.* 5 (1998). National champions proliferate, among others, in the airlines and telecommunications industries. The protection of German and Japanese shopkeepers from supermarket competition has been explained as part of a political bargain. “Rationalization” of product markets through government-enforced production quotas is characteristic of agriculture in Europe and the United States, the diamond industry, OPEC, and the ill-fated “New International Economic Order” of the 1970s.

anticompetitive behavior by private actors. But competition cannot be an end to itself. Some kinds of collusion can be unambiguously desirable, such as (some) provision of standardized goods or long-term supply contracts. As Oliver Williamson famously observed decades ago, markets and organizational hierarchies typically exist as alternatives, and there are no *a priori* reasons always to prefer one over the other.<sup>9</sup>

One cannot have a competition policy, then, without some concept of desirable cooperation. It follows that a state concerned about the level of competition in a given market might either forbid or mandate particular forms of cooperation. Competition policy thus fades into industrial policy. They are conceptually the same, even if the two terms suggest different regulatory methodologies, attitudes, and specialists.

Except in closed economies, competition and trade policy also overlap. Trade policy at its heart involves choices over the level of competition between domestic and foreign producers a state will permit or encourage. This point seems obvious as a matter of logic, but, for reasons I explore below, it becomes paramount with respect to industries that have increasing returns to scale, which is to say the most important sectors of the richest national economies. In many instances, competition and trade policies thus become two sides of the same coin.

Why does a conviction persist that competition policy constitutes an autonomous discipline with its own technical expertise? Competition law appeared in the United States in response to private decisions to consolidate production. Its principal manifestation was the Sherman Act, which attacked cooperative actions “in restraint of trade” and abuses of monopoly power.<sup>10</sup> We should see this congruence between competition law and public regulation of private cooperation and consolidation as a historical accident, however, and not as the core of what constitutes competition policy.

Even with its historical background, U.S. competition law never has manifested an implacable hostility to all forms of industrial consolidation. It accepts, for example, cooperation among producers organized or mandated by the several U.S. states,<sup>11</sup> as well as collusive political action to bring about such state mandates.<sup>12</sup> The United States for almost a century has promoted collusion among exporters,<sup>13</sup> and more recently has supported similar cooperation among producers in supposedly strategic economic sectors such as semiconductor design and

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<sup>9</sup> See Oliver E. Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications: A Study in the Economics of Internal Organization* (1975).

<sup>10</sup> Act of July 2, 1890, c. 647, § 1, 26 Stat. 209, codified as amended at 15 U.S.C. §§ 1-4 (1994). For a challenge to conventional accounts of U.S. competition policy as driven by the pursuit of efficiency and consumer welfare, see *The Causes and Consequences of Antitrust: The Public Choice Perspective* (Fred S. McChesney & William F. Shugart II eds. 1995).

<sup>11</sup> *Parker v. Brown*, 317 U.S. 341 (1942); *California v. ARC America Corp.*, 490 U.S. 93 (1989); *City of Columbia v. Omni Outdoor Advertising*, 499 U.S. 365 (1991).

<sup>12</sup> *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); *Mine Workers v. Pennington*, 381 U.S. 657 (1965); *Professional Real Estate Investors v. Columbia Pictures Indus.*, 508 U.S. 49 (1993).

<sup>13</sup> *Webb-Pomerene Act of 1918*, 15 U.S.C. §§ 61-65 (1994); *Export Trading Company Act of 1982*, 15 U.S.C. §§ 4001-21(1994); *Foreign Trade Antitrust Improvements Act of 1982*, 15 U.S.C. § 6a (1994).

production.<sup>14</sup> When one turns to Europe or Japan, examples of competition policy coexisting with and even reinforcing coordinated producer behavior become abundant.

The overlap between competition and trade policy leads to two important complications. First, as I discuss below, a state may tailor its regulatory choices to its position in the world economy, favoring producers or consumers depending on which actors predominate locally. Second, a state may purport to pursue a uniform competition policy but in practice apply different rules to foreign and domestic actors. In theory, trade law forbids this: All developed countries have accepted an obligation of “national treatment” or nondiscrimination between its own subjects and others.<sup>15</sup> But the protean nature of competition policy promotes administrative discretion and facilitates discrimination disguised by a veil of fact-specific, balancing-of-the-totality-of-circumstances analyses.

An obvious and pervasive example of discriminatory competition law is the antidumping regime that most developed countries employ.<sup>16</sup> Formally, antidumping is part of trade law, while predatory pricing is the subject of antitrust. But functionally, these rules target the same behavior – successful price competition that crowds out competitors. In most countries, however, foreign producers face more onerous restrictions. Under U.S. antitrust law (which applies to domestic and foreign producers alike), prohibited predation requires proof of below cost sales in circumstances where new entrants are unlikely to enter the market once the predator raises prices.<sup>17</sup> Dumping, which applies only to imports, penalizes any sale at a price below that used in the producer’s home market, even if the import price comprises a profit margin.<sup>18</sup>

Antidumping regimes present a specific instance of a more general problem. Imagine Good A, the production of which has substantial economies of scale. Further imagine that Good B is a substitute for Good A. Suppose that the producers of Good B can influence decisions by the authority that regulates the market where Goods A and B compete. If this regulatory authority has the discretion to forbid levels of consolidation that preclude the achievement of economies of scale, an enforcement action brought against the producers of Good A will protect the Good B producers from salutary competition. Moreover, if the competition authorities operate under a sufficiently discretionary mandate, they can take this action without compromising their ability to tolerate comparable collusion by producers of Good B. Again, my claim is that nothing in the concept of “competition policy” precludes regulatory choices that decrease the overall level of competition in a market, much less requiring the level of competition that maximizes welfare.

The broad definition of competition policy not only makes sense logically, but underscores the difficulties of achieving an international consensus about its content. Even if states could agree that efficiency – optimization of the sum of consumer and producer welfare – is the only

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<sup>14</sup> National Cooperative Research Act of 1984, Pub. L. No. 98-462, 98 Stat. 1815 (1984), 15 U.S.C. §§ 4301-06.

<sup>15</sup> General Agreement on Tariffs and Trade, art. III, T.I.A.S. No. 1700.

<sup>16</sup> *See id.*, art. VI (authorizing antidumping regimes); Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, T.I.A.S. No. 9650 (restricting antidumping regimes).

<sup>17</sup> For the rules governing predatory pricing, see *Matsushita Electrical Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

<sup>18</sup> See 19 U.S.C. §§ 1673-73i (1994); Council Regulation (EC) No. 384/96, O.J. L 56/1 (1996).

legitimate objective of competition policy, agreement as to whether a particular regime advances or detracts from efficiency would remain elusive. Specifying the optimal mix of competition and cooperation in a particular economic sector is inevitably controversial.<sup>19</sup> Technological innovation and other kinds of change, as well as shifting consumer preferences, limit the lessons one can learn from a sector's history. Once legitimate differences over the optimal level of competition arise, it becomes difficult, if not impossible, to determine whether a regulator is pursuing efficiency-driven competition policy.

The proliferation of alternative objectives for competition policy multiplies the difficulty of finding common ground. Given the difficulty of fixing optimal levels of competition, we should expect much competition law to take the form of elastic standards rather than of precise and constraining rules. With increased discretion comes inconsistency: One cannot insist on maximizing consumer welfare, for example, and still promote national champions or protect inefficient small producers. Tolerance of inconsistency in turn opens the door to discrimination. Regulatory choices driven by animus towards foreign producers can be reconciled with other, permissible rationales. The more open-ended and multi-factored the policy, and the greater the discretion of regulators to decide where and how to apply competition policy, the easier it becomes to disguise trade protection as competition policy.<sup>20</sup> The possibility of strategic deployment of competition law would be greatest where governments have exclusive enforcement authority, the situation that exists almost everywhere except in the United States.<sup>21</sup>

## *B. Competition Policy and Local Interests*

Once one accepts that competition policy embraces great, and potentially pernicious, flexibility, it becomes possible to speculate about what ends a given state might choose to pursue. Modern trade theory offers strong support for specific uses of competition rules to protect domestic producers. Public choice theory provides a more general explanation for why individual states would invoke competition policy for illiberal ends. Both analyses predict that, absent an effective international regime to constrain their choices, national regulation of competition will generate global welfare losses.

### *1. International Trade Theory*

As a conceptual matter, three considerations can influence a state's incentives to externalize the effects of its competition regulation. First, producers in the sector in question may be over- or under-represented in that state as compared to the global distribution of that sector's producers. For example, oil and natural gas production dominates a few national economies, while many

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<sup>19</sup> See Frank H. Easterbrook, *Does Antitrust Have a Comparative Advantage?* 23 Harv. J. L. & Pub. Pol'y 5, 7 (1999) ("And here's the big point: *by and large, we can't know when competition has 'failed.'*")

<sup>20</sup> Andrew T. Guzman, note *supra*, at 939. See also Ed Swaine, note *supra*, at 966-74.

<sup>21</sup> Even in the United States, governmental enforcement decisions have a powerful effect on private suits, as evidenced by the preference of private plaintiffs to follow in the wake of Justice Department litigation. See also Mark R. Joelson, *An International Antitrust Primer: A Guide to the Operation of United States, European Union and Other Key Competition Laws in the Global Economy* 168-76 (2d ed. 2001) (arguing that administrative control over the content of U.S. antitrust control has grown significantly in the last quarter century).

important economies produce virtually none of that good (the European Union and Japan). Second, consumers of the good in question similarly may be over- or under-represented in the state. Third, the global market for the good may be more or less competitive. This last factor will affect the distribution between producers and consumers of potential gains from industrial consolidation.

Consider first a good, the production of which has increasing returns to scale up to the market clearing price. “Natural monopolies” and “network goods” are general instances of this phenomenon. The good may have declining marginal costs due to economies of scale, or the value created by the good may increase with its consumption. In either case, the most efficient producer is a monopolist.<sup>22</sup>

Further assume that consumption of this good is more or less evenly distributed globally, if not per capita then per GDP. Ignoring strategic issues and the possibility of coordination, a state should prefer to function as the home of this industry. The state can capture some portion of the producer’s monopoly rents, while its consumers will suffer no more than if any other state hosted the monopolist.

Under these conditions (increasing returns to scale and international trade), a rational competition policy would have the state protect the local producer and inflict costs on the producers of all other states. Monopoly does not produce a global welfare losses (although some local consumers and producers will be worse off than they would be if the state forbade the monopoly) and benefits the host state to the extent of producer surplus. While some consumers in the host state might suffer, most of the lost consumer surplus will be externalized to outsiders.

Strategic trade theory, as developed by Krugman and others in the late 1970s, addresses exactly these economic features.<sup>23</sup> It maintains that increasing returns to scale characterize production in many sectors and that monopoly industrial organization thus constitutes a norm rather than a deviation for large portions of the most developed economies. The premises of liberal trade theory – that international trade proceeds in competitive markets and that comparative advantages in production capacities determines the efficient distribution of production – thus do not hold. Strategic trade theory argues that the distribution of monopolist producers, rather than the distribution of producer endowments, explains more about trade patterns. As a positive matter, it predicts that the higher levels of international trade that result from lowered costs of transportation and communication as well as reduced legal barriers will bring about greater levels of industrial concentration. As a normative matter, strategic trade theory specifies the circumstances where states should prefer protection (broadly conceived to include subsidies to the local producers as well as import barriers) to free trade. This

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<sup>22</sup> See generally William J. Baumol & David F. Bradford, Optimal Departures from Marginal Cost Pricing, 60 *Am. Econ. Rev.* 265 (1970).

<sup>23</sup> See Strategic Trade Policy and the New International Economics (Paul R. Krugman ed. 1986); Elhanan Helpman & Paul R. Krugman, Market Structure and Foreign Trade – Increasing Returns, Imperfect Competition, and the International Economy (1985); Avinash K. Dixit & Victor Norman, Theory of International Trade (1980); Kelvin Lancaster, Intra-industry Trade Under Perfect Monopolistic Competition, 10 *J. Int’l Econ.* 151 (1980); Paul R. Krugman, Increasing Returns, Monopolistic Competition, and International Trade, 9 *J. Int’l Econ.* 469 (1979).

justification for protection goes strongly against the grain of liberal trade theory, which denies the value of protection.<sup>24</sup>

What does strategic trade theory suggest for countries that have no hope of hosting an industry with increasing returns to scale? A country's choices depend on its share of the global market for the good in question. Those with small shares usually would not be able to prevent the foreign producer from moving toward monopoly. If such a country tried to regulate the producer, it could either raise prices in the local market or refuse to import. Both outcomes would hurt consumers in the regulating country with no offsetting benefits.<sup>25</sup>

A country with a large share would have another option. Assuming a sufficiently large market share, such a country would have the capability to force the producer to internalize the costs of its regulation. It rationally would block efficient growth by the producer in instances where the benefits from consolidation, no matter how large, would accrue to the producer and the increase in competition would generate some benefits for local consumers, no matter how small. Put simply, under specified conditions that seem realistic if not abundant, some countries will have both an incentive to restrict producers from undertaking welfare-enhancing consolidation and cooperation, and the capacity to implement its policy. These states will choose a competition policy that, in terms of global efficiency, requires too much competition and not enough hierarchy.<sup>26</sup>

The mirror argument also applies. Some states may host producers that have diminishing returns to scale and export most of their production. Examples would include industries that depend disproportionately on factor endowments, such as extraction or farming. These states might benefit if their producers participated in a successful cartel. Monopoly rents would stay at home and the lion's share of the lost consumer surplus would fall on consumers in the export markets. Under these conditions, states would embrace a competition policy that not only tolerates, but mandates cartelization. In other words, these states would seek to effect a competition policy that, in terms of global efficiency, requires too much hierarchy and not enough competition.<sup>27</sup>

These incentives become even more salient to the extent that states can evade the national treatment obligation and discriminate against foreign producers. Where this condition holds, regulators can apply one standard of acceptable collusion to foreign producers, and another to its own residents. In the case of increasing-returns-to-scale industries, a rational regulator would block collusion by foreign producers while encouraging local producers to consolidate and grow. With respect to decreasing-returns-to-scale industries, the same regulator usually would promote

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<sup>24</sup> For discussion of the tensions between strategic trade theory and liberal theory and a reconciliation based on political economy arguments, see Paul R. Krugman, *Is Free Trade Passé?* 1 *J. Econ. Persp.* 131, 143 (1987) ("It is possible, then, both to believe that comparative advantage is an incomplete model of trade and to believe that free trade is nevertheless the right policy.")

<sup>25</sup> Cf. Alan O. Sykes, *Countervailing Duty Law: An Economic Perspective*, 89 *Colum. L. Rev.* 199, \_\_\_\_ (1989).

<sup>26</sup> See Andrew T. Guzman, note *supra*, at 942; Andrew T. Guzman, *Choice of Law: New Foundations*, 90 *Geo. L.J.* 883, 906-09 (2002); Andrew T. Guzman, note *supra*, at 1512-15.

<sup>27</sup> See Andrew T. Guzman, note *supra*, at 943; Andrew T. Guzman, note *supra*, at 1512-18.

competition among foreign producers. If little domestic consumption and large levels of domestic production of the good occurred in its country, however, the regulator would tolerate or even promote cartelization of the industry.

In sum, both uniform and selectively enforced competition law can function as a form of trade protection. Because selective enforcement is harder to detect and monitor than a direct trade barrier, however, it may pose a greater problem than conventional forms of protection. Uncertainty about when competition law will apply may deter risk-averse transactors and require wasteful investments in precautions (such as legal services and lobbying). The ambiguous and elusive nature of this kind of protection also may make it more difficult to mobilize coalitions to oppose it. By contrast, conventional trade barriers, in the form of high tariffs or quotas, are quantitatively precise, easier to detect and to oppose, and generally entail lower costs of organizing opposition.<sup>28</sup>

## *2. Political Economy*

The previous subsection premised its arguments on an unrealistic assumption, namely that political decisionmakers seek to optimize the welfare of the polity that they represent and govern. Positive theory predicts, and plenty of evidence confirms, that in many situations government will pursue outcomes that reflect the preferences of homogenous and compact interest groups at the expense of the general welfare.<sup>29</sup> Lower organizational costs enable some groups to elicit rents from government. And one of the best studied and documented examples of successful rent-seeking is that of domestic producers seeking protection against foreign competition to the detriment of domestic consumers.<sup>30</sup> Producers have focused identities and technological expertise; consumers suffer from an array of identities (worker, family member, sports fan) and lack specialized knowledge. It is rational for producers to invest more than consumers do in obtaining desired outcomes from government, and rational for politicians to provide a return to this investment.

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<sup>28</sup> See Alan O. Sykes, *Regulatory Protectionism and the Law of International Trade*, 66 *U. Chi. L. Rev.* 1 (1999) (explaining inefficiency of regulatory protection relative to tariff barriers to trade). See generally John L. McGinnis & Mark L. Movsesian, *The World Trade Constitution*, 114 *Harv. L. Rev.* 511, 572-80 (2000) (discussing costs of covert protection and its connection to nontransparent regulatory standards).

<sup>29</sup> The canonical texts include James M. Buchanan & Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (1962); Dennis C. Mueller, *Public Choice II* (1989); Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Rev. ed. 1971); Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 *Q.J. Econ.* 371 (1983); Richard A. Posner, *Theories of economic regulation*, 5 *Bell. J. Econ. & Mgmt. Sci.* 335 (1974); George J. Stigler, *The theory of economic regulation*, 2 *Bell J. Econ. & Mgmt. Sci.* 3 (1971).

<sup>30</sup> The original insight is credited to Pareto. Vilfredo Pareto, *Manual of Political Economy* 379 (Ann S. Schwier & Alfred N. Page eds. & Ann S. Schwier trans. 1971) (1927). For later work developing the same point, see Dennis C. Mueller, *Public Choice II* 238-42 (1989); Mancur Olson, note *supra*, at 143; Anne O. Krueger, *Political Economy, International Trade, and Economic Integration*, 82 *Amer. Econ. Rev.* 109 (1992); Wendy Tacaks, *Pressures for Protectionism: An Empirical Analysis*, 19 *Econ. Inquiry* 687 (1981). See also Douglas A. Irwin & Randall S. Kroszner, *Interests, Institutions, and Ideology in Securing Policy Change: The Republican Conversion to Trade Liberalization after Smoot-Hawley*, 42 *J.L. & Econ.* 643 (1999) (tracing shift away from protection to an increase in influence of exporters, not of consumers).

The political economy story provides another set of explanations for variance among national competition policies. The ability of particular groups to minimize the costs of organization and political action must vary across countries, due to differences in the way politics is carried out and financed as much as because of differences in group characteristics. We should not expect similar groups to come out winners in different countries, much less win to the same extent.

To summarize, no conceptual reason exists for competition policy not to serve the ends of trade protection, and both modern trade theory and public choice theory identify incentives leading states to pursue policies that lower global welfare. What still must be established is that states actually vary in the regulatory choices they make in name of competition policy, and that this variation is inefficient from a global perspective. A secondary issue is whether states exploit the flexibility that competition policy gives them to impose different regulatory choices on foreign producers in violation of the national treatment obligation. I consider evidence of these practices in the next section.

### *C. The Evidence*

By hypothesis, in a world where international trade occurs, one and only one competition policy can maximize global welfare. Any deviation from that policy among states must reflect one of four considerations:

- (1) The nonconforming law applies to an economic sector not subject to international trade.
- (2) The nonconforming law reflects a decision by the regulating state to reduce the welfare of its subjects in pursuit of a policy goal that is not amenable to welfare calculus. (A variation on this consideration is that people in different states may differ in their consumer preferences, and thus the consumer welfare criterion may vary among states.)
- (3) Variations in laws reflect genuine empirical disagreements among regulators as to the consequences of particular regulatory choices.
- (4) Variations in laws reflect efforts by a local population to externalize the costs of regulatory choices while capturing their benefits.

Consideration (1) is unlikely to explain differences between the major developed countries, all of which have significant levels of international trade. Consideration (2) seems implausible with respect to these states, given the abundance of standardized consumer goods (global brands) that trade in these economies. Significant differences among states in the content of their competition law – horizontal variation – could reflect either consideration (3) or (4), and is not proof of welfare-reducing deviations from an ideal global policy. Significant differences within states as to the content law applicable to domestic and foreign persons – vertical variation – is consistent only with consideration (4). Moreover, the presence of substantial vertical variation within a country at least hints that its contribution to horizontal variation also reflects consideration (4).

Surveying the competition law and enforcement practices of the major economic powers – the United States, the European Union and Japan – we find overwhelming evidence of horizontal variation and significant circumstantial evidence of vertical variation. This is enough at least to

shift the burden of proof to those who would deny that the competition laws of these countries that contribute to deadweight losses in the world economy. A prima facie case thus can be made that the status quo of international antitrust is suboptimal.

### *1. Horizontal Variation – Institutional Features.*

Differences in institutional structure among the three principal economic powers is evident. The United States disperses enforcement power among two federal agencies (the Antitrust Division of the Justice Department and the Federal Trade Commission) and private attorneys general, who benefit from various financial incentives (treble damages) and procedural advantages (class actions, broad pretrial discovery, jury trials). A residual and not well defined power of States to apply their own regulatory regimes further complicates the picture.<sup>31</sup> In the European Union, by contrast, the Competition Directorate of the European Commission has broad and preemptive power over enforcement powers. The fifteen Member States have some residual power to regulate competition, but all rely on a single national authority with virtually no private enforcement.<sup>32</sup> Japan has a unified regulatory authority (the Fair Trade Commission), no subnational entities with regulatory powers, and high barriers to private litigation.<sup>33</sup> Some degree of collaboration between the government and industry cartels exists, although scholars debate the extent and scale of the government's contribution to these cartels.<sup>34</sup>

### *2. Horizontal Variation – Substantive Aspects.*

The substantive goals of U.S. antitrust law reflect the shifting preferences of administrations as well as changes in the courts' understanding of competition regulation. Over the last thirty years U.S. regulators have taken a more relaxed attitude toward forms of collusion and industrial concentration that seem driven by efficiency considerations. Consumer welfare has become the touchstone of competition policy, as opposed to opposition to the accumulation of power and influence in the hands of private firms. The courts also have moved in this direction, embracing efficiency as the principal criterion and embracing anticompetitive practices that plausibly may increase consumer welfare.<sup>35</sup> Finally, for sixty years the courts have permitted state-level

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<sup>31</sup> See authorities cited in note supra.

<sup>32</sup> See Notice on Cooperation between national Courts and the Commission in applying Articles 85 and 86 of the EC Treaty, 1993 OJ (C39) 6.

<sup>33</sup> See John O. Haley, *Antitrust in Germany and Japan – The First Fifty Years, 1947-1998*, at 71-90 (2001); J. Mark Ramseyer & Minoru Nakazato, *Japanese Law – An Economic Approach* 6-9 (1999); J. Mark Ramseyer, *Lawyers, Foreign Lawyers, and Lawyer-Substitutes: The Market for Regulation in Japan*, 27 *Harv. J. Int'l L.* 499 (1986).

<sup>34</sup> The traditional story of Japanese economic success between 1945 and 1990 stressed the role of the Ministry of International Trade and Industry in directing and even compelling cooperation among producers. Ronald Dore, *Flexible Rigidities: Industrial Policy and Structural Adjustment in the Japanese Economy, 1970-1980* (1986); Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975* (1982); Ezra Vogel, *Japan as Number One: Lessons for America* (1979). Recent work argues convincingly that this story fails to fit the evidence, and instead reflects excessive reliance by foreign scholars on the accounts of Japanese social scientists, whose accounts in turn were shaped by their Marxist or socialist ideologies. MITI failed to establish cartels that Japanese industry did not want, and could not immunize cooperative firms from prosecution by the Fair Trade Commission. Yoshiro Miwa & J. Mark Ramseyer, *Capitalist Politicians, Socialist Bureaucrats? Legends of Government Planning from Japan*, 38 *Antitrust Bulletin* \_\_\_\_ (2003).

<sup>35</sup> Daniel J. Gifford & Robert T. Kudrle, note supra, at 220-23.

experimentation with alternative approaches to the competition/collusion tradeoff. In a reversal of the normal preemption rule that underlies U.S. federalism, state-administered collusion displaces federal regulation.<sup>36</sup>

In form, the substantive goals of EC competition law seems virtually identical to that of the United States.<sup>37</sup> Articles 81 and 82 of the current revision of the Treaty of Rome closely track Sections One and Two of the Sherman Act: Article 81 prohibits “concerted practices” that “may affect trade between Member States” and “have as their object or effect the prevention, restriction or distortion of competition,” while Article 82 outlaws “any abuse” of “a dominant position.” Given the cultural, economic, political and sociological differences between the two entities, however, it should surprise no one that these capacious words have achieved a significantly different meaning in the EC. At the risk of oversimplification, EC competition law evinces greater skepticism, relative to recent U.S. practice, about the benefits of producer consolidation and cooperation. One aspect of this skepticism, not so much articulated as displayed, is concern about private concentrations of power threatening governmental authority.<sup>38</sup> In addition, EC competition law clearly opposes the substitution of lower-level (that is, national) supervision for Community-administered competition policy. Unlike the United States, the lower-level entities cannot authorize anticompetitive practices.<sup>39</sup>

An examination of specific policy issues further illuminates the differences between U.S. and EC law. No consensus exists on the distinction between successful consolidation and abuse of monopoly power,<sup>40</sup> on when vertical supply and purchase commitments encourage productive firm-specific investments and when they unnecessarily restrict consumer choice,<sup>41</sup> or when predatory pricing constitutes a genuine threat to consumer welfare and when the strategy contains the seeds of its own frustration, thus making regulatory intervention unnecessary.<sup>42</sup> Some of these differences undoubtedly reflect empirical uncertainty, but others suggest disagreements over policy that cannot reflect a commitment to maximizing global welfare.

Japan has the Antimonopoly Law, a substantive competition law that in form follows closely that of the United States. But its Fair Trade Commission, although perhaps not quite the lapdog that some commentators portray, has not had the opportunity to develop as rich and informative a practice as has its U.S. and EU counterparts. It has brought criminal prosecutions against core

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<sup>36</sup> See note *supra* and accompanying text.

<sup>37</sup> At the risk of unnecessarily complicating things, I wish to preserve the distinction between the European Union, based on the Maastricht Treaty as amended, which provides a framework for economic, foreign affairs, and police cooperation among the fifteen (soon to be twenty-five) members, and the European Community, a legal structure created by the Treaty of Rome as amended, which provides the legal basis for economic regulation and in particular competition law. Thus one can say that EC competition law applies in the European Union. In other words, the European Union is a place, the European Community is a source of law.

<sup>38</sup> Eleanor M. Fox, *Antitrust and Regulatory Federalism*, note *supra*, at 1791-93.

<sup>39</sup> Treaty of Rome arts. 83(2)(e), 86(1), 87(1); *Costa v. ENEL*, [1964] E.C.R. 1141.

<sup>40</sup> Daniel J. Gifford & Robert T. Kudrle, note *supra*, at 230-34.

<sup>41</sup> Compare *Continental TV, Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), with *Centrafarm v. Sterling Drug, Inc.* (Case 15/74), [1974] E.C.R. 1147.

<sup>42</sup> Compare John R. Lott, Jr., *Are Predatory Commitments Credible? Who Should the Courts Believe?* (1999), with Peter H. Huang, *Still Preying on Strategic Reputation Models of Predation*, 3 *Green Bag* 2<sup>nd</sup> 437 (2000).

anticompetitive behaviors, that is price fixing and output restrictions undertaken by groups of producers. It has not attacked other practices that result in significant costs to Japanese consumers, and it has no influence on government policies in some industries that protect numerous small producers from efficient competition by consolidated firms.<sup>43</sup>

### *3. Vertical Variation*

Turning to evidence of vertical variation, one can describe incidents where protection supplies the most plausible explanation for what happened. My examples are representative, and by no means exhaustive. They seem sufficient to at least create a presumption that such protection through selective competition rules does occur.

At the outset, one should note that in all the major jurisdictions, the institutional structure of competition law discussed above facilitates vertical variation. The use of broad, nonspecific standards maximizes enforcement discretion, as opposed to precise rules that tie the enforcer's hands. Of course, there exist other plausible explanations for the choice of form. The enforcement bureaucracy may seek to maximize its discretion for reasons unrelated to protection, and even a welfare-maximizing lawmaker might regard bonding costs as unacceptably high relative to other means of supervising the enforcement process. Nonetheless, it is relevant, although by no means decisive, that the substantive competition law of the United States, the EU and Japan all give regulators the kind of discretion that impedes monitoring to detect discrimination. The presence of motive and opportunity to discriminate against foreigners strengthens, although it does not prove, the case.

Examples from all three jurisdictions indicate that the discretion enforcers enjoy has allowed actions that seem inexplicable except as a way of advancing the interests of local producers. I begin with the United States. Several recent suits brought by both the government and private litigants reek of protectionism. During the run up to the 1992 presidential election, the Bush Administration, pressed by candidate Clinton's charges that it did not adequately protect U.S. producers from foreign competitors, announced that it would abandon the Reagan Justice Department's position that, except in limited instances, U.S. antitrust law would not address foreign anticompetitive practices that had no significant impact on U.S. consumer welfare.<sup>44</sup> The Clinton Administration carried through on its campaign posture, bringing and settling a suit against a British firm that allegedly imposed licensing restrictions on the use of its patented technologies to restrict the production of flat glass manufacturing outside the United States.<sup>45</sup> The following year it obtained an indictment against a Japanese paper company for participating in a conspiracy to fix the price of thermal fax paper.<sup>46</sup> Both actions rested on dubious economic

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<sup>43</sup> See John O. Haley, note *supra*, at 154-57, 162-68 (2001).

<sup>44</sup> U.S. Dep't of Justice, Antitrust Enforcement Policy (1992), reprinted in 62 Antitrust & Trade Reg. Rep. (BNA) No. 1560, at 483-84.

<sup>45</sup> *United States v. Pilkington plc*, 1994-2 Trade Cas. (CCH) ¶ 70,841 (D. Ariz. 1994); *United States v. Pilkington plc and Pilkington Holdings, Inc.* Civil No. CIV 94-345 TUC WDB (D. Ariz.) – Response of the United States to Public Comments Concerning Proposed Final Judgment, 59 Fed. Reg. 52,823 (1994).

<sup>46</sup> *United States v. Nippon Paper Industries Co.*, 109 F.3<sup>rd</sup> 1 (1997), cert. denied, 522 U.S. 1044 (1998).

theories but succeeded in signaling a willingness to punish foreign producers to the advantage of their U.S. competitors.<sup>47</sup>

The private suit that most clearly reflects conventional trade protection is the epic battle between U.S. television set manufacturers and the Japanese consumer electronic industry. The trial court, the Third Circuit, and four Justices of the Supreme Court embraced a theory that producer collusion in the home market of the Japanese producers, coupled with successful price competition in the U.S. market, sufficed to make out a violation of the Sherman Act.<sup>48</sup> This theory merges antitrust law with antidumping law, inasmuch as the latter gives relief to U.S. producers seeking protection from foreign competitors without requiring any proof of predation or other harm to U.S. consumers. In effect the U.S. industry sought compensation for its failure to compete with the Japanese producers. A few years after a narrow majority of the Supreme Court rejected the suit, the parallel with trade law was made explicit. The U.S. government successfully collected antidumping duties based on the same evidence that the U.S. industry has assembled in its antitrust claim.<sup>49</sup>

Turning to the EU, one notes first the Commission's notorious refusals to approve mergers of U.S. firms that compete with important European producers, first among them the Boeing-McDonnell Douglas transaction.<sup>50</sup> The suspicion that the Commission sought to give a leg up to Airbus, Boeing's great rival, has been impossible to suppress. But merger regulation hardly represents the only Commission activity that smacks of protectionism. Other examples involve prosecutions for abuse of dominant position. This concept, although superficially similar to Section Two of the Sherman Act's prohibition of abuse of monopoly power, in practice has a broader reach that seems disproportionately to take in successful competition by non-EC firms. A classic case is its prosecution of United Brands, the American banana producer.<sup>51</sup> Not only did the Commission embrace an improbable theory of abuse, but it acted against a background of Community trade regulation that systematically protected bananas produced in former European colonies from competition by United Brands.<sup>52</sup> Consumer welfare, in particular that of banana-loving Germans, mattered not at all here.

In the case of Japan, one does not find prosecutions of foreign firms so much as tolerance of private collusion to keep out foreign competition. In this respect Japanese competition policy represents the stance of much of world outside of North American and Europe. Weak or

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<sup>47</sup> By contrast, the courts have shown no willingness to punish domestic producers that collaborate with the U.S. government in inducing foreign producers to join in a cartel. See *Consumers Union of United States, Inc. v. Kissinger*, 506 F.2<sup>nd</sup> 136 (D.C. Cir. 1974) (treating dispute as moot), cert. denied, 421 U.S. 1004 (1975).

<sup>48</sup> *Matsushita Electrical Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

<sup>49</sup> *Zenith Electronics Corp. v. United States*, 755 F. Supp. 397 (C.I.T. 1990). Later U.S. legislation closed the gap even further by requiring distribution of antidumping (as well as countervailing) duties to protected domestic producers. Continued Dumping and Subsidy Offset Act of 2000, P.L. 106-387, § 1(a), 114 Stat. 1549, codified at 19 U.S.C. § 1675c. The permissibility of this law under the Uruguay Round Agreements is currently the subject of a WTO dispute proceeding.

<sup>50</sup> See Eleanor M. Fox, *Mergers in Global Markets: GE/Honeywell and the Future of Merger Control*, 23 U. PA. J. INT'L ECON. L. 457 (2002); Daniel J. Gifford & E. Thomas Sullivan, *Can International Antitrust Be Saved for the Post-Boeing Merger World? A Proposal to Minimize International Conflict and to Rescue Antitrust from Misuse*, 45 *Antitrust Bull.* 55 (2000).

<sup>51</sup> *United Brands Co. v. Commission* (Case 27/76), [1978] E.C.R. 207.

<sup>52</sup> World Trade Organization, *Report of the Appellate Body, European Communities – Regime for the Importation, Sale, and Distribution of Bananas*, WTO Docs. No. WT/DS27/R/USA (May 22, 1997), WT/DS27/AB/R (Sep. 9, 1997).

nonexistent regulation of anticompetitive practices reflects the preferences of local producers, who seek monopoly rents both through domestic collusion and obstruction of import competition. Some proponents of strategic trade theory saw Japan's competition law as one element of a comprehensive trade and development program. More recent scholarship suggests that the government simply accepts, and does not manage, industry-led cartelization.<sup>53</sup> In a complaint brought to the World Trade Organization, the United States argued that Japan's tolerance of inefficient retail distribution systems constituted a trade barrier in violation of the General Agreement on Tariffs and Trade, but the WTO rejected the claim.<sup>54</sup>

Finally, one should note a particular instance of substantive convergence among all major industrial economies. Virtually every country expressly exempts export cartels from its competition law. This practice manifests a welfare calculation that gives no weight to foreign consumers, and suggests some indifference to local consumers that probably bear some costs from foreign export cartels. Regarding the exemption of export cartels as a global norm, rather than as local aberrations from good competition policy, reinforces the impression that competition law, among its many functions, serves as a source of trade protection.

At the risk of repeating myself, I do not maintain that these examples prove that competition law inherently or primarily operates as a tool for protection. I argue only that it is susceptible to such pressures, and that one can document instances where the susceptibility has manifested itself. The evidence undermines the conception of competition policy as something separate from, and motivated by different values than, trade policy. Our understanding of why states restrict international trade, it suggests, also may illuminate our expectations about why and when governments, and to a lesser degree private litigants, invoke competition law. And this insight leads to an obvious conclusion: If international cooperation is an effective means of advancing trade liberalization to the benefit of general welfare, then it will lead us to a better international antitrust regime as well.

#### *D. Summary*

Competition policy embodies imprecise normative judgments that invite controversy and defection rather than consensus and commitment. Because its scope extends to such a wide range of economic activity, it has the potential to inflict significant costs on many transactors. In particular, it tempts states both to impose nominally neutral policies that favor local producers and consumers at the expense of global welfare, and to administer their policies in a discriminatory fashion to similar ends. Uncertainty about the willingness of states to pursue this strategy further burdens international transactions.

If we cannot expect states to develop a coherent competition policy for international transactions in the absence of coordination, should we seek create some mechanism that will

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<sup>53</sup> See Yoshiro Miwa & J. Mark Ramseyer, note *supra*.

<sup>54</sup> World Trade Organization, Report of the Panel, Japan – Measures Affecting Consumer Photographic Film and Paper, WTO Doc. No. WT/DS44/R (Mar. 31, 1998).

coordinate national competition policies? What would such coordination look like, and what problems might it engender? I now turn to these questions.

## II. VISIONS OF INTERNATIONAL ANTITRUST

The previous section establishes that states engaged in significant international trade face strong incentives to adopt competition laws that do not maximize global welfare. States whose producers mostly export, or whose consumers do not have significant market power with respect to foreign producers, have little reason to have any competition laws at all, other than as cosmetic gestures to appease foreign critics. Japan may be a case in point. States that have significant market power but do not provide a home to producers may insist on levels of competition that may benefit their consumers but lower efficiency. States in a race to host increasing-returns-to-scale industries may block consolidation by rival firms while protecting the national champion. All states may avoid bright-line competition rules in favor of nonspecific standards that permit selective prosecution of foreign producers to advance protectionist ends.

Each of these outcomes maximizes local welfare to the cost of global efficiency. Multiple application of these laws – superimposing the laws of multiple jurisdictions with different standards on a single firm – would function simply as a tax on firms operating internationally. And a tax on globalization seems perverse and harmful.

What is to be done? Experts have suggested various strategies for harmonizing and unifying global competition law. One would locate negotiations over the content of an international agreement to harmonize competition law in the WTO and give that organization the authority to enforce such an agreement. The current WTO negotiations (the Doha Round) have embraced competition law as a topic, although no concrete proposal yet has emerged. Alternatively, the major economic powers might agree to allocate regulatory jurisdiction in a way that minimizes conflicts among regulators. A series of bilateral agreements to which the United States is a party represent modest steps in this direction, and scholars have suggested other architectures for jurisdictional allocation. I first describe what these proposals might look like and then discuss their drawbacks.

### *A. International Coordination of the Substance of Competition Law*

In both the United States and Europe, the history of competition regulation has been one of gradual ascension of the state hierarchy, from the states to the federal government in the United States and from nations to the EC in Europe. Should this progression continue, so that an international body would take on the responsibility of regulating the competitive practices of international businesses? Proposals to do so exist in both soft and hard versions.

#### *1. Proposals for International Administration of Competition Law*

Many, perhaps the majority of specialists writing on international antitrust have supported at a minimum soft harmonization of competition laws among states. For example, the Organization for Economic Cooperation and Development (OECD), a group that comprises the world's richer

nations, has promulgated guidelines for competition policy to which its members should adhere.<sup>55</sup> These establish a minimum level of regulation that each state should impose and also suggest a baseline to which they should gravitate. In 2000 the U.S. Justice Department's International Antitrust Advisory Committee called for greater standardization of merger review, technical assistance to encourage the creation of competition policy and enforcement agencies in countries that have none, and gradual assimilation of international practice leading toward standardization of competition policy rules.<sup>56</sup> This report led to the creation of the International Competition Network (ICN), an international organization of government regulators that sponsors conferences to promote harmonization.<sup>57</sup>

Others would go further. Both Eleanor Fox and Andrew Guzman have called for the forging of an agreement on competition policy modeled on the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).<sup>58</sup> They would have the WTO serve both as the forum for negotiating the substance of such an agreement and the agency that resolves disputes over its meanings and enforces its obligations. Guzman argues that because harmonization would require some states to forego regulatory choices that, at least in the short run, would advantage their national interest, negotiations must take place in a structure that maximizes the opportunity for winners to compensate losers with concessions in unrelated areas.<sup>59</sup> The WTO seems ideal for this purpose both because of its scale (146 countries) and scope (its regulatory subjects include trade in goods and services, intellectual property, agricultural health and safety, and certain forms of investment regulation, among others).

Guzman also has argued for changes in the organizational structure of the WTO to accommodate its expanded jurisdiction. He calls for the division of the organization into departments, each with responsibility for substantive areas such as trade, competition, environment, labor, and intellectual property. Depicting these policy areas as rivalrous, he would have each department act as an advocate for its particular subject and rely on WTO internal dispute resolution processes to reach compromises.<sup>60</sup>

The bold new world that Guzman hopes to usher in would entail a single body of competition law applicable to firms operating internationally. States would enforce this law, but a department of the WTO would supervise their actions to ensure that they neither neglected their obligations nor exceeded the international regulatory limits. To the extent conceptions of optimal competition law conflicted with those of, say, intellectual property, labor standards, or food safety, the WTO would make tradeoffs and then require WTO members to honor them.<sup>61</sup>

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<sup>55</sup> The documents take the form of Council Recommendations, which the OECD publishes, along with documents on related issues, at [http://www.oecd.org/document/59/0,2340,en\\_2649\\_37463\\_4599739\\_1\\_1\\_1\\_37463,00.html](http://www.oecd.org/document/59/0,2340,en_2649_37463_4599739_1_1_1_37463,00.html) (last visited Feb. 26, 2004).

<sup>56</sup> International Competition Policy Advisory Commission, U.S. Department of Justice Final Report (2000), <http://www.usdoj.gov/atr/icpac/finalreport.htm> (last visited Feb. 26, 2004).

<sup>57</sup> See note *supra*. See also Eleanor M. Fox, International Antitrust and the Doha Dome, note *supra*, at 917, 929.

<sup>58</sup> Eleanor Fox, International Antitrust and the Doha Dome, note *supra*, at 929-30; Andrew T. Guzman, note *supra*, at 951-56.

<sup>59</sup> Andrew T. Guzman, note *supra*, at 950-51.

<sup>60</sup> Andrew T. Guzman, Global Governance and the WTO (working paper, Aug. 15, 2002).

<sup>61</sup> *Id.*

Fox has a less ambitious (or perhaps more idealistic) vision, although hers shares essential elements with Guzman's. She would give the ICN a greater role in formulating an international consensus on antitrust policy, although she would rely on the WTO for administration and enforcement of that consensus. She believes that states ultimately will develop a unified sense of what constitutes an "antitrust harm" and will recognize a universal right to address such harms.<sup>62</sup> She does not invoke, but her argument suggests, the rhetoric of international human rights law, which presupposes a cosmopolitan international commitment to the eradication of certain universally condemned practices.

## 2. Critique

In previous work I have questioned the value of proposals such as Guzman' and Fox's.<sup>63</sup> Summarizing my objections here, I note weaknesses in the concept of international cosmopolitanism, agency problems associated with international administration of nontransparent regulatory programs generally and particularly regarding international dispute resolution, the potential drawbacks of executive branch representation of national interests in international negotiations, and the difficulty of unwinding international regulatory structures. Taken together, these arguments lead one to search for alternatives to globalization of competition policy.

*a. Cosmopolitanism.* Fox invokes the spirit of cosmopolitanism to undergird an optimistic account of why many states ultimately may reach a consensus on the content of competition policy.<sup>64</sup> This concept has become fashionable lately in certain academic circles, although I do not know if Fox intends to invoke all that its advocates assert.<sup>65</sup> International cosmopolitanism takes Rawlsian arguments for justice to the international level, asserting that thoughtful people would commit to a level of equality for all humans and therefore would embrace massive transnational wealth transfers. In particular, because transnational wealth redistribution achieved by individual actions seems overambitious and morally heroic, this body of thought justifies strong redistributive programs by states.<sup>66</sup>

As Fox suggests, the broad claims of cosmopolitanism apply specifically to international antitrust. If one accepts the premise that variations among national competition policies reflect differences in local welfare, then any convergence toward a global standard would entail making some groups in some countries better off, others worse off, and probably would diminish the welfare of at least some countries overall (say, OPEC members). Recognition of a universal right

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<sup>62</sup> Eleanor Fox, *The End of Antitrust Isolationism – The Vision of One World*, 1992 U. Chi. L. Forum 221, \_\_\_\_.

<sup>63</sup> See sources cited in note *supra*.

<sup>64</sup> Eleanor M. Fox, *International Antitrust and the Doha Dome*, note *supra*, at 914 (referring to "cosmopolitan understanding" of antitrust); *Globalization and Human Rights: Looking Out for the Welfare of the Worst Off*, 35 N.Y.U. J. Int'l L. & Pol. 201 (2002).

<sup>65</sup> For a discussion and critique, see Jack L. Goldsmith, *Liberal Democracy and Cosmopolitan Duty*, 55 Stan. L. Rev. 1667 (2003).

<sup>66</sup> See Iris Marion Young, *Inclusion and Democracy* (2000); Martha C. Nussbaum, *Patriotism and Cosmopolitanism*, in *For Love of Country* (Joshua Cohen ed. 1996); Martha C. Nussbaum, *Toward a Viable Cosmopolitanism* (Mar. 1, 2000 draft); Tomas W. Pogge, *An Egalitarian Law of Peoples*, 23 Phil. & Pub. Affairs 195 (1994).

of freedom from competitive injury thus implies a commitment by states to international wealth redistribution.

While arguments for equality and the redistribution needed to attain it have a certain appeal, the ambitious claim of international cosmopolitanism has serious difficulties. First, the idea that solidarity transcends distance – that people can identify with and care equally about persons at a great cultural as well as physical remove – seems fanciful as a positive matter and problematic as a normative one. One does not have to surrender any part of a core commitment to respect and care for all humans to recognize both that people flourish among their familiars, and that a great variation in culture and environment reflects the natural and desirable variety of humans and their corresponding social needs. Rawls recognized this problem when he limited his call for international justice to nations sharing similar values and political systems.<sup>67</sup> Jack Goldsmith has observed that, to the extent state policies reflect the preferences of subjects expressed through the processes of liberal democracy, they should take these affinities into account.<sup>68</sup>

Second, implicit in the cosmopolitan argument is an equation of a financial resources with freedom from physical brutality. It is easy to derive from Rawlsian principles a commitment to protect all people from murder, torture and other forms of state cruelty, and the cosmopolitan position simply extends the point to material well being. But this equation of physical integrity and economic status is more slippery than the cosmopolitan argument acknowledges. Communities vary wildly in how they express and value economic status. Wealth is a social, and therefore local, artifact to a far greater extent than is physical inviolability.<sup>69</sup>

Third, wealth transfers require exactions from the source of wealth, as a voluntary surrender of resources never seems to suffice. Thus, the threat of force (if only in the form of economic sanctions) is a necessarily complement to a redistributive project. This in turn means that the risk of international conflict is deeply embedded in international redistribution. In the case of competition policy, enforcement of a common norm would entail some entity authorized to impose sanctions on shirkers and malfeasors. But one cannot contemplate the use of force without conceding the possibility of its abuse. At its heart, then, the cosmopolitan position, both in general and with respect to international antitrust, contains a commitment to international coercion that needs critical examination.

*b. Agency costs of international entities.* Designing an international body to administer and enforce an agreement on substantive competition policy presents serious issues of instrumentality design and incentives. It is useful to conceptualize such a body as the agent of the various states that collectively wish to implement an agreement on competition policy, much as the managers of a business serve as the agent of the firm's investors. In both cases, the fundamental problem involves aligning the agent's interests with its principal to maximize the value of the agency relationship. The principal – here the states seeking to implement a collective

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<sup>67</sup> John Rawls, *The Law of Peoples* (1999).

<sup>68</sup> Jack L. Goldsmith, note *supra*.

<sup>69</sup> I do not mean to deny the Foucauldian point that physical invasion has aspects of social construction. My point is a relative one, that perceptions of wealth depend more on social structure than do perceptions of pain.

competition policy – cannot fully anticipate how it wants the agent – here the WTO or some comparable body – to respond to future problems. The principal understands that the agent might want to maximize some good – its budget, power, glory, leisure, or compensation – that it would not want maximized. It must respond to this challenge by structuring the agency relationship so as to limit *ex ante* the agent’s discretion (what the literature calls bonding), supervising what the agent does *ex post* (what the literature calls monitoring), or otherwise tolerating outcomes that do not reflect its preferences.<sup>70</sup>

Just as an investor cannot just hand over their money to managers and ask only that the managers maximize their return, states cannot ask an international organ simply to choose a competition policy that maximizes global welfare. The states either must accept the risk that the organ will make suboptimal choices – perhaps embracing a harebrained economic theory or using competition law as a guise to advance some redistributive project – or rein in its discretion through some mix of bonding and monitoring. But bonding forecloses some policy responses that, in hindsight, would turn out to be optimal. Monitoring consumes resources, and if coupled with a right of retaliation, also may induce unwarranted conservatism on the part of the organ’s officials.

These are general problems, and have turned out not to be insurmountable in many instances. But in the case of international antitrust, they loom especially large. Two features of competition policy exacerbate the agency problems accompanying a delegation to an international organization. First, the absence of any clear understanding and definition of good competition policy makes bonding more problematic. The architects of an international regime either must find the few areas where clarity and consensus exists and settle for a seriously incomplete regime, or they must trust the international organ with broad discretion. Second, because it is likely that any universal competition regime that increases global welfare will make some countries worse off, effective monitoring of the organ’s performance will only clarify the scope of the injury particular states will experience.<sup>71</sup>

The history of the GATT and its successor, the WTO, illustrates why adding competition policy to the WTO’s already significant responsibilities may not work. The GATT’s great achievement was postwar liberalization of the international economy through tariff reduction. High tariffs, however, are an ideal subject for international cooperation. This form of protection neither disguises itself nor hides its effects. Tariffs single out goods traded internationally for special excises stated in precise quantitative terms, and quantification of their effects presents no great challenge. Reciprocal tariff reduction agreements thus are easy to negotiate, easy to monitor for compliance, and generally do not produce sore losers.

Conversely, when regulation takes the form of case-by case application of general standards shaped by complex policy goals with significant potential for international wealth redistribution, those affected by the regulation and those who impose it cannot easily commit to a mutually

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<sup>70</sup> See generally Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305 (1976).

<sup>71</sup> See Paul B. Stephan, Courts, Tribunals, and Legal Unification, note *supra*, at 347.

beneficial agreement.<sup>72</sup> The experience of the last two decades illustrates the point. The shift in the international trade regime's focus to nontariff trade barriers, including health and safety rules and environmental regulation, has embroiled the WTO in great controversy. The agreements giving the WTO this authority largely involve ambiguous commitments that raise profound interpretative problems. The efforts of the WTO organs to apply this standards to concrete cases has triggered intransigence on the part of the states accused of violation, sharp criticism of the dispute resolution process within the community of trade experts, and passionate attacks from populist forces.<sup>73</sup>

The WTO has had little direct involvement with competition policy, but the few times it has engaged with these problems illustrate the shortcoming of international supervision of national competition law. In the Kodak-Fujitsu dispute, the WTO dispute settlement process rejected the claim that Japan's tolerance of inefficient retail distribution networks, which impeded the entry of foreign products, constituted an impermissible trade barrier.<sup>74</sup> The case had murky facts and suffered from less than deft advocacy by the United States, but it still suggests the difficulty of detecting disguised protection. Arguably Japan tolerates the gross inefficiencies of small scale retail outlets in part because they protect domestic producers from foreign competition, but the inference necessary to reach this conclusion was beyond the grasp of the WTO.

A symmetrical dispute involving U.S. antitrust law reinforces the point. The case involved a European attack on the Antidumping Act of 1916. This statute, as interpreted by the U.S. courts, simply recapitulates the substantive requirements of a predatory pricing violation under the Sherman Act.<sup>75</sup> No criminal or civil suit under the 1916 Act has ever succeeded. But, because in form the 1916 Act regulates dumping in a matter not authorized by the WTO agreements, the WTO condemned it as violating U.S. obligations under the 1994 Agreement on Antidumping Duties.

Formalism provides the key to understanding both decisions. The WTO has not found it possible to deal with costly but hard-to-prove *de facto* discrimination, but had no difficulty with a purely hypothetical case of *de jure* discrimination.<sup>76</sup> Transparent but innocuous conduct brought about WTO condemnation, while nontransparent but potentially harmful conduct generated no response. Both decisions reflect a reluctance to stray from the uncontroversial

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<sup>72</sup> John L. McGinnis & Mark L. Movsesian, note *supra*, at 566-72.

<sup>73</sup> Robert L. Howse & Elisabeth Tuerk, The WTO Impact on Internal Regulations – A Case Study of the Canada-EC Asbestos Dispute, in *The EU and the WTO: Legal and Constitutional Issues* 283 (Gráinne de Búrca & Joanne Scott eds. 2001); Alan O. Sykes, Domestic Regulation, Sovereignty, and Scientific Evidence Requirements: A Pessimistic View, 3 *Chi. J. Int'l L.* 353 (2002) (technical barriers to trade and WTO dispute resolution process); Daniel K. Tarullo, note *supra*, at 494 & n.57 (citing disputes over Cuba sanctions, meat hormones, preferences for former colonies, and dolphin protection).

<sup>74</sup> World Trade Organization, Report of the Panel, Japan – Measures Affecting Consumer Photographic Film and Paper, WTO Doc. No. WT/DS44/R (Mar. 31, 1998). For discussion, see Paul B. Stephan, Courts, Tribunals, and Legal Unification, note *supra*, at 348-49; Paul B. Stephan, Sheriff or Prisoner? note *supra*, at 56-61 (2000); Daniel K. Tarullo, note *supra*, at 484.

<sup>75</sup> See *In re Japanese Elec. Prods. Antitrust Litig.*, 807 F. 2<sup>nd</sup> 44 (3<sup>rd</sup> Cir. 1986); note *supra* and accompanying text.

<sup>76</sup> World Trade Organization, Report of the Appellate Body, United States – Antidumping Act of 1916, Report of the Appellate Body, WTO Doc. Nos. WT/DS316/AB/R, WT/DS162/AB/R (Aug. 28, 2000). For discussion, see Paul B. Stephan, Courts, Tribunals, and Legal Unification – The Agency Problem, note *supra*, at 349.

meaning of the agreements that form the organization's charter, even at the cost of the substantive ends that these agreements purportedly pursue. One cannot expect much more from any future agreement on competition policy.

As noted above, Guzman appreciates the present deficiencies of the WTO. His response to this challenge is Weberian. He would rely on bureaucratic rationality embodied in distinct, policy-defined departments to formulate good policy and negotiate the competing interests.<sup>77</sup> In effect, he would replace national governments representing the material interests of their producers and consumers with technocratic élites guided by substantive expertise.

The ambition of this proposal is so remarkable that one wonders where to begin a critique.<sup>78</sup> The classic concern about bureaucratic rationality is that it masks a powerful urge for aggrandizement. In the international arena, we have few if any examples of agencies that have avoided the temptation. Budgets grow, capacities for effective intervention decline, and faith in international policymaking falters, only to rise up again in new areas. Geneva seems a graveyard for past idealism, not a hotbed of innovative solutions to the world's problems.

*c. Dispute resolution.* Limiting an international agency to the task of settling disputes over the meaning and application of an international agreement does not avoid the agency problems discussed in the prior section.<sup>79</sup> U.S. practice illustrates how the application of indeterminate standards shifts discretionary authority and the capacity to shape policy to the dispute resolution body. In the United States, antitrust law is what the courts say it is, largely without congressional input into the policy's content.<sup>80</sup> In theory, an international tribunal might follow in the footsteps of the U.S. judiciary and become the principal source of international competition law. In reality, this hope is implausible.

U.S. federal judges have life tenure and a great fund of social capital. They come to the bench after achieving distinction in any of a number of legal fields, and they wind up on the Supreme Court after facing intense public scrutiny and surviving a daunting political gauntlet. They benefit from a tradition of judicial lawmaking that for the most part has gained acceptance and even admiration from the general public.

None of these statements can be made about the members of the WTO dispute settlement bodies or, for that matter, any adjudicator in the international system. The members of the WTO appellate body, the closest analog to a common law appellate court, serve for six years, with nomination and replacement at the pleasure of specific countries or blocs, rather than of the WTO membership as a whole. Given this short leash, the possibility for articulating and

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<sup>77</sup> See note *supra* and accompanying text.

<sup>78</sup> For a discussion that anticipates Guzman's proposal and, to my view, advances devastating objections, see John O. McGinnis & Mark L. Movsesian, note *supra*, at 552-66.

<sup>79</sup> But see *id.* at 572-89 (arguing for welfare benefits of WTO dispute resolution). I consider the McGinnis-Movsesian argument strongest where the WTO addresses disputes over clear and therefore transparent principles. As the clarity of the principle dissipates, so does the likelihood of efficacious dispute resolution.

<sup>80</sup> *Standard Oil Co. v. United States*, 221 U.S. 1, 59-60 (1911).

imposing a competition policy that any significant state finds undesirable seems unlikely except over the very short run.<sup>81</sup>

*d. Executive branches as national agents.* In both international bargaining and monitoring of international agencies, states act through their executives, not their parliaments. For states operating under some version of the Westminster system where the leading parliamentary party forms the executive, this point may not have much significance. But even in these countries, actors within the executive may have interests that diverge from that of the legislature, including possibly a preference for larger budgets, projects that show off the executive to good effect, and work that increases the actors' future returns from their post-political careers. And in many states, the executive operates under the influence of a different political party from that enjoying dominance in the legislature. This separation may exist even if the executive answers directly to parliament, as in a Westminster system, where no single party controls the legislature.

I previously have argued that these factors may express themselves as a tendency of governments to commit to harmonization and unification projects that produce little hard law but provide officials with high-profile venues to display themselves.<sup>82</sup> One might even suggest that the ICN constitutes a case in point. These efforts may seem harmless enough, but they have the potential to destabilize the legal environment in which firms operate. They may distract individual states from desirable changes in their competition laws, induce cosmetic changes to appeal to the international audience, and send confusing signals to bureaucrats and judges responsible for interpreting and applying national law.

*e. Inflexibility in the face of changed circumstances.* Law-based international institutions are hard to create and even harder to reform. The principle of unanimity that applies to treaty systems means that amendments, like the initial institution, require unanimous consent. As circumstances change, it often becomes desirable to alter the mandate and tools of the regime, but holdouts are likely. For this reason, international regimes tend to administer broad standards and norms rather than precise rules, and they tend to collapse or become irrelevant rather than reform themselves. Important counterexamples exist, but compared to both private firms and states, international organizations manifest inferior adaptive capability.<sup>83</sup>

## *B. International Coordination of Regulatory Jurisdiction*

Recognizing the many obstacles to substantive harmonization of competition law, some governments and commentators have considered coordination of jurisdiction as an alternative way of addressing the overlapping jurisdiction problem.<sup>84</sup> The ideal is universal acceptance of jurisdictional criteria that would submit transactions to one, and only one, regulatory authority. The search for jurisdictional stability underlay the forty-year struggle between the United States

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<sup>81</sup> Paul B. Stephan, Courts, Tribunals, and Legal Unification – The Agency Problem, note *supra*, at 336-38.

<sup>82</sup> Paul B. Stephan, Accountability and International Lawmaking, note *supra*, at 695-97.

<sup>83</sup> Cf. Albert O. Hirschman, *Exit, Voice and Loyalty* (1970).

<sup>84</sup> For a thorough review of the literature, see Joel P. Trachtman, *Economic Analysis of Prescriptive Jurisdiction*, 42 Va. J. Int'l L. 1 (2001);

and its trading partners over the “effects” test for antitrust jurisdiction as well as justifying the various agreements between the Justice Department and other states on antitrust enforcement.

### *1. Allocations of Regulatory Jurisdiction*

In a simpler world of mechanical and formalistic jurisdictional tests, overlapping regulatory authority did not pose a problem. Only the sovereign on whose territory a transaction occurred would impose its rules.<sup>85</sup> But with the rise of multijurisdictional transactions, territoriality came under pressure. U.S. courts first relaxed the territorial test by requiring that only some part of the transaction in question occur in U.S. territory.<sup>86</sup> By the end of World War II, the lower courts cast aside even that constraint, instead applying U.S. antitrust law to any action that had direct and intended effects in the United States.<sup>87</sup> Europe and the Commonwealth countries resisted this approach, but by the end of the 1980s the EC had incorporated the effects test into its own competition law.<sup>88</sup>

Almost as soon as the effects test emerged as the U.S. standard for international antitrust, some courts and commentators proposed to limit it. It is unclear whether the critics foresaw the potential costs of multiple regulation or simply disliked the foreign criticism that the test generated. For whatever reason, their efforts dominated most discussion of international antitrust during the 1970s and 1980s. The leading treatise on international antitrust proposed that courts use a “rule of reason,” base on multiple criteria, to limit U.S. jurisdiction in cases that otherwise satisfied the effects test.<sup>89</sup> The object of the test was to restrict the exercise of jurisdiction in some instances where the effects test would permit regulation. It did not purport to create a world where every transaction would have one and only one regulator, but it did aspire to reduce the instances of multijurisdictional conflicts.

The Ninth Circuit embraced the rule-of-reason standard, and the Third Restatement of the Foreign Relations Law of the United States proclaimed it the general norm.<sup>90</sup> The campaign to limit antitrust jurisdiction suffered a setback in 1993, when, in *Hartford Fire Insurance Co. v. California*,<sup>91</sup> a narrow majority of the Supreme Court both endorsed the effects test and rejected the rule-of-reason limitation. But poor argumentation in the majority’s opinion has enabled litigants to keep alive the prospect of the rule of reason’s reemergence.<sup>92</sup>

As this account illustrates, disputes over jurisdictional scope typically take place in the judicial arena. Legislators typically fail to address the issue of extraterritorial regulation, and courts usually craft choice-of-law rules to fill in statutory lacunae. In the case of antitrust,

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<sup>85</sup> *American Banana Co. v. United Fruit Co.*, 213 U.S. 347 (1909) (dictum).

<sup>86</sup> *United States v. Sisal Sales Corp.*, 274 U.S. 268 (1927).

<sup>87</sup> *United States v. Aluminum Co. of America*, 148 F.2<sup>nd</sup> 416 (2<sup>nd</sup> Cir. 1945).

<sup>88</sup> *In re Wood Pulp Cartel* (Case 89/85), [1988] E.C.R. 5193.

<sup>89</sup> I James R. Atwood & Kingman Brewster, *Antitrust and American Business Abroad* 166 (1981).

<sup>90</sup> *Timberlane Lumber Co. v. Bank of America*, 549 F.2<sup>nd</sup> 597 (9<sup>th</sup> Cir. 1976); Restatement (Third) of the Foreign Relations Law of the United States § 403 (1987).

<sup>91</sup> 509 U.S. 764 (1993).

<sup>92</sup> See *United States v. Nippon Paper Industries Co.*, 109 F.3<sup>rd</sup> 1, 26-27 (1997), cert. denied, 522 U.S. 1044 (1998).

however, some intergovernmental agreements also seek to distribute regulatory jurisdiction. The U.S. Justice Department has negotiated compacts with Australia, Canada, the EU, Japan and Mexico, among others.<sup>93</sup>

Superficially, these agreements appear to address the problems of overlapping regulation. A review of their terms, however, reveals that they do not even create soft law. Rather, the bilateral agreements express only a desire to consult and cooperate, and do not limit the discretion of any regulatory authorities. None of these instruments has terms that a U.S. court could enforce, and the US-EC agreement entails judicial enforcement only in the sense that it provides the EC Commission with an additional grounds for making demands of national regulators.<sup>94</sup> Each purports to embrace the rule of reason as the basic concept for allocating regulatory jurisdiction, but all use a long list of unweighted criteria that have the effect of insulating almost all exercises of regulator review from attack. Moreover, the agreements do not seek to coordinate merger approval, the area that has caused the greatest recent tension. If anything, the bilateral agreements illustrate the conflicting interests that jurisdictions have in imposing their competition law on international transactions, and the difficulties of surrendering regulatory discretion in spite of the potential benefits obtained by a reduction of overlapping constraints on private transactors.

Finally, one should note the ongoing negotiations regarding a Hague Convention on International Jurisdiction and Foreign Judgments in Civil and Commercial Matters.<sup>95</sup> This multilateral instrument, if adopted, might limit the power of a signatory state to exercise some regulatory jurisdiction over extraterritorial transactions, and would make civil judgments produced by proceedings that conform to the convention subject to execution by all parties to the Convention. But no one who follows these negotiations seriously believes that the United States will sign the Convention or that Congress would accede to it. Rather, even this modest attempt to reach an international consensus on the allocation of regulatory jurisdiction seems an entirely academic exercise.

To summarize, the courts have supplied three different strategies for allocating regulatory jurisdiction. The territorial approach would severely limit the scope of competition law in cases where production took place offshore. The effects test maximizes a state's regulatory power. The rule of reason muddles these two approaches. In theory states might agree to concrete and specific allocations of authority, but nothing achieved to date meets this description. To the contrary, the agreements we have suggest the difficulty of imposing significant constraints on national regulatory power.

## 2. Critique

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<sup>93</sup> For texts of the agreements, see [http://www.usdoj.gov/atr/public/international/int\\_arrangements.htm](http://www.usdoj.gov/atr/public/international/int_arrangements.htm) (last visited Feb. 26, 2004).

<sup>94</sup> See *France v. Commission* (Case C-327/91), [1994] E.C.R. I-3641 (discussing enforceability of agreement as Community law).

<sup>95</sup> Preliminary Draft Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters (Oct. 1999), at <http://www.hcch.net/e/conventions/draft36e.html> last visit Feb. 26, 2004).

The use of rules that allocate regulatory jurisdiction as a substitute for unification of substantive law is most closely associated with U.S. corporate law. During the last decade Roberta Romano has produced an influential reappraisal of this subject.<sup>96</sup> Her work has developed a conceptual apparatus that translates into other substantive areas and, in due course, has led to a rich and lively scholarly debate about regulatory competition generally.<sup>97</sup>

As Romano observed, the challenge is choosing jurisdictional criteria that will not promote a flight of transactions to a jurisdiction that permits significant externalization of the transactions' costs. Her work is a response to the traditional critique of the formalistic U.S. choice-of-law rule for corporate law (place of incorporation), which asserts that managers incorporate in jurisdictions that maximize their opportunities to enrich themselves at the expense of investors. The "race to the bottom" metaphor arose in this context.<sup>98</sup>

Romano demonstrated that managers often will have to internalize the costs associated with rules that enabled them to exploit investors, and thus should have a preference for rules that maximize firm value. She found in corporate law a virtuous race to the top, where her predecessors had seen only a regrettable regulatory collapse. Stephen Choi and Andrew Guzman extended her argument to the international arena, advocating a regime that would allow the issuers of securities to choose which jurisdiction would regulate their transactions.<sup>99</sup>

A consensus does not exist regarding the validity of Romano's empirical claims about U.S. corporate law, much less Choi and Guzman's extension. The debate focuses mostly on the supply rather than the demand side, involving arguments over the willingness of states to compete for corporate charters.<sup>100</sup> Most scholars, however, agree with the analytics underlying

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<sup>96</sup> Roberta Romano, *The Genius of American Corporate Law* (1993); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 *Yale L.J.* 2359 (1998); Roberta Romano, *The Advantages of Competitive Federalism for Securities Regulation* (2002).

<sup>97</sup> See also *Regulatory Competition and Economic Integration – Comparative Perspectives* (Daniel C. Esty and Damien Geradin eds 2001); *International Regulatory Competition and Coordination: Perspectives on Economic Regulation in Europe and the United States* (William W. Bratton, Joseph A. McCahery, Sol Picciotto & Colin Scott eds. 1996); William W. Bratton & Joseph A. McCahery, *The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World*, 86 *Geo. L.J.* 201 (1997); Joel P. Trachtman, *International Regulatory Competition, Externalization, and Jurisdiction*, 34 *Harv. Int'l L.J.* 47 (1993). Earlier influential work includes Warren E. Oates & Wallace M. Schwab, *Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing*, 35 *J. Pub. Econ.* 333 (1988); Frank H. Easterbrook, *Antitrust and the Economics of Federalism*, 26 *J. L. & Econ.* 23 (1983); Saul Levmore, *Interstate Exploitation and Judicial Intervention*, 69 *Va. L. Rev.* 563 (1983); Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 *J. Pol. Econ.* 416 (1956).

<sup>98</sup> Adolph A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property* (1932).

<sup>99</sup> Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 *S. Cal. L. Rev.* 903 (1998); Andrew T. Guzman, *Capital Market Regulation in Developing Countries: A Proposal*, 39 *Va. J. Int'l L.* 607 (1999). See also John C. Coffee, Jr., *Racing Toward the Top? The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 *Colum. L. Rev.* 1757 (2002); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 *Theoretical Inquiries L.* 387 (2001); Paul B. Stephan, *Regulatory Cooperation and Competition – The Search for Virtue*, note *supra*, at 193-96; Frederick Tung, *Passports, Private Choice, and Private Interests: Regulatory Competition and Cooperation in Corporate, Securities and Bankruptcy Law*, 3 *Chi. J. Int'l L.* 369 (2002).

<sup>100</sup> See Lucien Bebchuck & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 *Yale L.J.* 553 (2002); Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 *Va. L. Rev.* 1335, 1338-41 (1999); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 *Stan. L. Rev.* 679 (2002).

Romano's claim: The degree to which formal and transactionally determinable choice-of-law rules should apply depends primarily on externalities. To the extent that the ratio of externalized costs to benefits matches that of those internalized, the transactors, at least if they meet minimum standards of competence, should have the freedom to choose their regulatory environment. Under these conditions, a race to the top can occur.

Using Romano's framework, the argument that competition regulation is susceptible to a race to the bottom, and therefore should not be subject to transactor choice, is straightforward. At its heart competition law involves producer conduct, either unilateral or in concert, that may have harmful effects on consumers. Allowing producers to choose which regime will regulate the harm they impose on consumers would make sense only if consumers could boycott producers that choose consumer-unfriendly regimes. But competition law, at least in theory, focuses on exactly the kinds of producer actions that reduce consumer choice. If the touchstone is the likelihood of externalities, producer choices about competition law generally should have no significance.<sup>101</sup>

Straightforward analysis also demonstrates that none of the three rules used by the courts for allocating state regulatory jurisdiction will produce optimal outcomes.<sup>102</sup> First, a universal commitment to territoriality would prevent a state from regulating offshore producers intending inefficiently to limit competition in the state's market. Barring all such desirable regulation can be justified only if one can demonstrate that on balance extraterritorial regulation would decrease welfare. But some states might limit competition rules to cases that both maximize efficiency and increase consumer welfare. Moreover, in industries where production is moveable, and firms thus can induce states to compete for their activities, producers would exploit a territoriality regime to move to states with producer-friendly regimes.

Symmetrical arguments expose the flaws in the effects test. That approach multiplies the number of states with jurisdiction over transactions and thus increases the likelihood that private organizational decisions will confront governmental resistance. As with the territorial rule, whether governmental intervention will increase welfare constitutes an empirical consideration. There is no categorical reason to believe that the benefits from desirable competition rules permitted by the effects test necessarily will be greater than the costs generated by inefficient regulation.<sup>103</sup> The most one can claim for the effects test is that it maximizes sovereignty by

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<sup>101</sup> Some subjects, such as contracts implementing vertical cooperation, may present sufficiently debatable competition issues to justify deference to the transactors. See *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985). These contracts typically involve merchants who have some competitive choices prior to their entry into the agreement and involve project-specific investments that on balance may increase welfare. See generally Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 Va. L. Rev. 1089 (1981). Under these circumstances, the parties are more likely to internalize the costs of whatever competition regime they choose, and without the freedom to choose they may pass up valuable transactions.

<sup>102</sup> See Andrew T. Guzman, *Choice of Law: New Foundations*, note *supra*, at 904-13.

<sup>103</sup> William Dodge argues that courts should express a bias in favor of over-regulation on the ground that special interests find it easier to block regulation they disfavor than to have enacted legislation that they favor. William S. Dodge, *An Economic Defense of Concurrent Antitrust Jurisdiction*, 38 Tex. Int'l L.J. 27, 33-36 (2003). The argument confuses prudential concerns with welfare claims. Courts might defer to legislative choices about jurisdiction on the ground that they do not have the capacity to second-guess legislative choices. But it does not follow that because special interests have

allowing states to choose the scope of their regulation free of international constraints. But maximization of sovereign choice is not necessarily a good thing. Arguments for expanding individual choice do not translate to the level of the state.<sup>104</sup>

The one approach that seems unambiguously flawed is the rule of reason. William Dodge misstates the case when he characterizes this approach as producing the same outcome as the territorial method.<sup>105</sup> Rather, the rule of reason only increases the likelihood that one state, presumably the place of production, will impose its competition rules. But unlike either the territoriality rule or the effects test, the rule of reason contains a high degree of instability and unpredictability. It allows courts to balance unweighted factors on an ex post basis, making reliable guesses about regulatory jurisdiction difficult if not impossible. It creates legal risk without eliminating the costs of either under-regulation or over-regulation.

If the judicially crafted formulas for allocating jurisdiction produce suboptimal outcomes, should governments enter into agreements to allocate regulatory jurisdiction? The extant agreements suggest that we already have reached the limits of state-to-state bargains. No state seems willing to submit to serious and enforceable constraints on its regulatory jurisdiction. Two reasons for this reluctance suggest themselves. First, states will not surrender jurisdiction to regulate without some clear and reliable expectation of what substantive rules other states will apply. Second, and following from the first, states recognize that the jurisdiction issue simply recasts the question of preferences for substantive competition rules.

This last point also suggests why a global bargain to allocate competition policy jurisdiction may be undesirable as well as unattainable. On reflection, the jurisdictional question presents exactly the same issues and problems as does substantive harmonization. There is no neutral template for allocation that transcends the interests engaged by competition law, and no reason to believe that those interests would not affect the structure of any international bargain. In particular, giving an international agency responsibility for supervising how states exercise their jurisdiction would lead to exactly the same agency problems discussed in the previous section.

### *C. The Future of International Supervision of Antitrust*

The EU, the United States, and most scholars have treated international antitrust as a problem that international institutions can solve. The details of the solutions differ, but they have in common a conviction that an international forum will serve as a means for transcending local interests of states in favor of global welfare. This faith in international cooperation is misplaced.

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a comparative advantage in blocking adverse legislation, that only public-regarding regulation will pass through this filter. It is just as plausible that we see less legislation than we might because of the comparative advantage of compact groups, but that the legislation we do see still reflects private rather than public interests.

<sup>104</sup> I previously have criticized commentators that invoke the concept of sovereignty as justification for particular positions on regulatory jurisdiction. On close analysis, these invocations invariably turn out to be stalking horses for other substantive claims that require distinct argumentation. Paul B. Stephan, *The Political Economy of Choice of Law*, note *supra*, at 957-59.

<sup>105</sup> William S. Dodge, note *supra*, at 28: “The territorial and balancing approaches belong in the exclusive-jurisdiction category.”

Analogies to trade agreements do not work, because the interests at stake in competition policy are far less transparent and far more likely to involve international wealth redistribution than those triggered by direct trade barriers, making competition law far less susceptible to oversight and satisfactory dispute settlement. We have every reason to believe that international supervision either will be inconsequential, along the lines of existing agreements on international antitrust, or pernicious.

My critique opens the way to reconsidering what may happen if states do not face international constraints on how they conduct their competition policy. Given certain plausible assumptions about the world economy, in particular those sectors that draw significantly on skill and innovation, an anarchic international environment may contain substantial impediments to a global race to the bottom in competition law. I explore this possibility in the next section.

### III. ANARCHY, INTERNATIONAL ANTITRUST, INNOVATION AND INVESTMENT

In the first part of this paper, I described a static model that predicts what competition law a state will enact and enforce. This model rests on two assumptions, that states seek to maximize a weighted sum of local consumer and producer interests, and that the choice of competition policy has no secondary effects on consumer or producer welfare. The model regards states as choosing among a fixed set of outcomes that proceed directly from particular competition policies. Choices in one time period do not affect the set of choices available in the next.

A dynamic model, by contrast, assumes that choices made in the first time period alter the possibilities available in the next. I focus on a model of innovation that emphasizes increasing marginal returns and explore the relationship of this model to competition. One inference drawn from this model is that inefficient competition policy can lead to long-term losses in a globally competitive economy.

The question remains whether the static or the dynamic model offers a better fit for particular sectors of the world economy. In industries such as agriculture and natural resource extraction, the distribution of location-specific natural endowments may dominate welfare calculations and innovation may play a less important role. In these sectors, we would expect to find inefficient industrial structures that generate, or at least seek, monopoly rents, along with significant levels of trade protection. But in other, knowledge-based sectors, mobile factors of production, namely human and financial capital, play a greater role. In these industries, a dynamic model provides a better fit, because protection, either through government regulation or private collusion, may affect access to human and financial capital.

Where the dynamic model applies, international intervention to regulate competition policy may be unnecessary. States that embrace inefficient competition policies to protect local producers or to benefit local consumers should experience lower rates of innovation and eventually lose the ability to compete internationally. Even though not all economic sectors or states will experience this effect, enough will to call into question the need to institutionalize international competition policy.

## A. *Knowledge and Industrial Structure*

A dynamic model of international competition policy depends critically on the propositions that innovative pressures in some important economic sectors force producers to innovate or exit, that protection from competitive pressure undermines the ability of producers to innovate, and that producers in economic decline will eventually lose political influence as well. I explore each of these propositions in turn.

First, consider the relationship between innovation and market success. A substantial theoretical literature explores the impact of knowledge-based investments on economic growth. In the standard model, knowledge has low reproduction costs. Returns on knowledge thus depend critically on the size of the market in which goods embodying knowledge can be sold.<sup>106</sup> Increases in the scope of the market, such as the creation of the U.S. common market in the nineteenth century and of Europe's in the second half of the twentieth, expand the opportunities for exploiting knowledge and thus rewards investments in knowledge more greatly. Trade liberalization and other strategies for broadening market size thus raise incentives to invest in knowledge.<sup>107</sup>

Recent research tends to support this hypothesis. Studies by Jeffrey Frankel and coauthors have demonstrated a strong positive correlation between trade openness and labor productivity, a good proxy for innovation.<sup>108</sup> A more recent paper by Francisco Alcalá and Antonio Ciccone refines these results by looking at the relationship between productivity and openness in tradable goods, as opposed to gross measurements of an economy's openness to trade.<sup>109</sup> Their analysis shows an even stronger link between innovation and an economy's exposure to international competition.

It is important to clarify what this work does and does not indicate. Under conventional models of development, a country's economic growth depends both on its physical and human capital and on its efficiency in using these assets. Other considerations, in particular institutional quality, has a strong relationship with levels of capital stocks, and the link between economic openness and institutional quality is not well understood. What the empirical work indicates, then, is not that openness is the most influential factor in economic growth, but that it is an important factor in explaining how effectively an economy exploits the stock of physical and human capital it has.

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<sup>106</sup> See Paul M. Romer, *Endogenous Technological Change*, 98 *J. Pol. Econ.* S71, 72 (1990):

Once the cost of creating a new set of instructions has been incurred, the instructions can be used over and over again at no additional cost. Developing new and better instructions is equivalent to incurring a fixed cost. This property is taken to be the defining characteristic of technology.

<sup>107</sup> For empirical evidence, see Richard R. Nelson & Gavin Wright, *The Rise and Fall of American Technological Leadership: The Postwar Era in Historical Perspective*, 30 *J. Econ. Lit.* 1931 (1992).

<sup>108</sup> Jeffrey A. Frankel & David Romer, *Does Trade Cause Growth?* 89 *Amer. Econ. Rev.* 379 (1999); Jeffrey Frankel & Andrew Rose, *An Estimate of the Effect of Common Currencies on Trade and Income*, 117 *Q. J. Econ.* 437 (2002).

<sup>109</sup> Francisco Alcalá & Antonio Ciccone, *Trade and Productivity*, Draft June 2002.

Other arguments support the proposition that barriers to competition will impede investment as well as innovation. Monopoly rents derive from restricting production below a level that efficient competition would dictate. Lowering production implies, although it does not require, reducing the level of investment in the industry. Barriers to entry, whether imposed by private agreement or the state, implies fewer opportunities for the deployment of capital.<sup>110</sup>

To be sure, the link between investment and barriers to competition is not as well documented as that between innovation and market size. But the hypothesis that inefficient limits on competition serve as a barrier to investment is plausible. Some data support an indirect inference. The strong finding in the trade literature that declining industries, rather than infant ones, have the greatest demand for protection is suggestive.<sup>111</sup> It implies that industries that have lost their capacity to attract new investment tend to seek less competitive market structures.

These claims explain why competition policy that does not pursue efficiency will prove costly to states. First, states that permit local producers to construct inefficient constraints on competition are functionally equivalent to states that undertake such protection directly. Tolerance of inefficient collusion in an industry is likely to lead to lower rates of investment and innovation than otherwise would obtain. For industries that depend significantly on human and financial capital, these losses should lead to low growth or shrinkage in the affected sector. Gradual immiserization eventually should either impair an industry's ability to resist regulation or lead to its economic irrelevance.

Second, states that use their competition law to impose inefficient organizational structures on foreign producers, with the object of protecting local producers, encourage lower rates of investment and innovation in the protected sector. If bad competition law is the functional equivalent of trade protectionism, then equivalent consequences should follow. The sector should become increasingly uncompetitive internationally and eventually wither.

One can immediately anticipate a counter argument drawn from one strand of strategic trade theory. Where oligopolists contend for an industry characterized by positive returns to scale, state intervention may tip the balance. This intervention might include punishing foreign producers with competition law to facilitate the local producer's ascendancy as the efficient global monopolist.<sup>112</sup> If states generally can choose when to invest in industries that will become globally dominant, then they should include competition law among the tools that they can use to implement such decisions.

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<sup>110</sup> Early statement of the connection between monopolization and reduced opportunities for investment can be found in John A. Hobson, *Imperialism – A Study* 74-78 (3<sup>rd</sup> ed. 1948).

<sup>111</sup> For a review of the evidence and a theoretical justification, see Oona A. Hathaway, *Positive Feedback: The Impact of Trade Liberalization on Industry Demands for Protection*, 52 *Int'l Org.* 575 (1998).

<sup>112</sup> U.S. Competitiveness in the World Economy (Bruce Scott & George C. Lodge eds. 1987); James A. Brander & Barbara J. Spencer, *Export Subsidies and International Market Share Rivalry*, 16 *J. Int'l Econ.* 83 (1985). For claims about the feasibility of government selection of winning technologies by persons whose later record in governments to some extent undermines their thesis, see Ira Magaziner & Robert Reich, *Minding America's Business* (1982).

Considerable evidence suggests, however, that states rarely do a good job of picking winners. A decade ago many U.S. scholars saw Japan as a model of successful strategic trade policy. Invoking this model, they purported to identify U.S. industries where government-led success would generate great local benefits at no significant global cost. Revisionist studies of Japanese policy reveal that the government generally supported industries that did not have much success in international competition and did little for those sectors – automobiles and consumer electronics – where Japanese producers did enjoy some success.<sup>113</sup> More generally, as noted above, governments tend to weigh in on behalf of declining industries more often than they bestow favors on rising sectors.<sup>114</sup>

This argument for virtuous pressures to produce efficient competition law is subject to two important qualifications. First, states that serve as a base of operations for firms that largely export their products may seek to free ride on the regulatory efforts of importing states. If no single importing state were to consume a substantial share of the global output of such producers, those states might not invest sufficient resources in imposing competition rules. Under these circumstances, consumers over the short run would suffer losses due to excess prices and low supply, while the producing country might witness the eventual decline of the industry it hosts. Here collective action by the affected states to impose an appropriate competition policy might produce a better outcome.

Second, the argument assumes that states eventually will respond to the decline of local producers by withdrawing the protection that contributes to their decline. There is some point at which this assumption must be correct: An industry that collapses completely must not have any ability to procure desired outcomes from government. But it does not follow that economic and political decline must be symmetrical. A sense of beleaguerment might lead an industry to overcome internal divisions and concentrate more directly on influencing governmental outcomes. The U.S. steel industry provides a case in point: Although some firms have increased their international competitiveness through increased investment and higher labor productivity, others have used adversity as a ground for procuring repeated episodes of protection from import competition and have made no significant improvements in their production methods. There is plenty of evidence that failing industries can obtain costly protection until collapse becomes imminent.

These qualifications are important, but do not seriously undermine the claim that virtuous forces make international cooperation less imperative. First, the free-riding scenario seems somewhat hypothetical. States generally have some incentive to protect their consumers from anticompetitive practices, whether or not the local injury is a large portion of the global injury. Most importantly, they do not have to limit their remedies to recovery of the cost of local injury. Criminal sanctions, punitive damages and injunctions give local authorities the capacity to address a local harm proportionately to its global ramifications.

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<sup>113</sup> See sources cited in note *supra*.

<sup>114</sup> Hathaway proposes a theory that ties the withering away of protection to the decline of protected industries. Oona A. Hathaway, note *supra*.

Second, the disconnect between economic and political power is a general problem and not limited to local law production and enforcement. Any state that will protect a failing industry by prosecuting its foreign rivals will use its international relations to pursue similar goals. In particular, such a state will block any international accord that takes away its discretion to impose such protection.

I do not mean to suggest that the appeal of a competition law that both frustrates inefficient collusion and does not impede beneficial industrial cooperation is always manifest, or that the consequences of bad competition law is immediately painful. Rather, I make two claims. First, in industries that compete for capital internationally and that can realize significant returns from increases in labor productivity, good competition law matters. Second, the political mechanism that mediates between an industry's economic status and a state's policy preferences should not change when the state pursues those preferences through international cooperation rather than by domestic lawmaking and enforcement. These claims in turn suggest that, with respect to economic sectors dependent on human and financial capital, states have some incentive to eschew competition policies that otherwise might generate short-term gains at the expense of global welfare.

### *B. Regulatory Competition and International Antitrust Revisited*

Models of regulatory competition, such as those developed in Romano's work, invoke a stylized market in which states (putative sellers) offer packages of law to firms (putative buyers) under conditions of consumer choice. In these models, states gain some benefit by having firms choose their law and thus wish to attract these buyers; firms choose laws that maximize benefits to the firms' decisionmakers. As I argued above, setting up such a market for competition law seems undesirable. We would expect firms not to choose laws that maximize general welfare, but rather to seek opportunities for monopoly rents. For this reason, we do not find it disturbing that, in the contemporary world, firms have little influence over the choice of competition regulation that will apply to their activities. For the most part firms can avoid a state's competition law only by abandoning that jurisdiction entirely, neither producing, selling, basing personnel, or holding attachable assets in the territory of that state.

The dynamic model of competition law's effects on innovation and investment, however, introduces an indirect form of regulatory competition. If states compete for capital and opportunities to generate returns from knowledge, they should have some incentive to choose competition law that increases its opportunities for both. Under this model, states would not compete for producers as such, but rather for capital and innovation. To the extent good competition law increases a state's attraction for either, a virtuous cycle may proceed. Such a cycle would substitute for international coordination of state choices.

This vision of virtuous competition for innovation and investment is not as far fetched as one might think. A conventional story about the rise of Europe, endorsed by a Nobel prize winner and supported by a recent review of the historical evidence, stresses the pressure placed on

nearby states by innovation in their neighbors.<sup>115</sup> The evidence suggests that rent-seeking becomes more expensive in the face of a neighbor's technological progress, and that competition among neighbors offers a powerful explanation for a state's willingness to sacrifice vested interests in the service of adaptation. Europe, a geographically fragmented entity, experienced more of this competition; the geographically vast and hermetic empires of China and Russia did not. And in today's world, with lower costs in transportation and communication, geographical contiguity places less of a role in economic competition among states than in the past.<sup>116</sup>

This hypothesis requires important qualifications. First, it applies largely to high value-added goods, including services, and not to industries that depend mostly on factor endowments. Second, the mechanism driving the virtuous cycle is considerably less transparent than the seemingly straightforward competition for corporate charters, a contest the existence of which still remains subject to debate.<sup>117</sup> The incentive for virtuous policy involves a long-term effect rather than short-term payoffs. One might plausibly respond that political cycles do not run this long, and that no one can realistically expect political actors to respond reliably to such forces.

These objections have great force. Their rebuttal depends largely on guess about the future rather than on evidence from the past. The fundamental issue is the nature and extent of the much hyped "new economy" at the international level. For virtuous competition in competition policy to have much purchase, two discernible trends in international economic relations will have to become more pronounced. First, the portion of international transfers involving high value-added goods will have grow even more. Second, the pace of technological innovation, and the response of mobile capital to this pace, also will have to quicken. These developments would increase the importance of competition policy and shorten the time between policy choice and economic consequences.

Looking only at the last three years, one might argue that the new economy never was much more than a pipe dream, and that any expectation of its near term recovery rests on irrational hope more than evidence. If one were to expand the horizon to the past decade, however, the story becomes more complicated and less fanciful. Japan, a country that exports capital rather than investing it at home and that displays considerable structural rigidity and resistance to domestic competition, has experienced zero or negative growth during the period. The EU, with a competition policy that has more bite than Japan's but still seems to protect local producers more than does U.S. policy, has not enjoyed nearly the same growth in labor productivity or inflows of capital that the United States has seen. Push back fifty years and the picture becomes

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<sup>115</sup> Douglass C. North, *Structure and Change in Economic History* 29 (1981); E.I. Jones, *The European Miracle: Environments, Economies, and Geopolitics in the History of Europe and Asia* (1987); Azam Chaudhry & Phillip Garner, *Political Competition Between Countries and Economic Growth* (Draft Aug. 29, 2002).

<sup>116</sup> Less, of course, does not mean no role. The United States' largest trading partner remains Canada, not Japan or any European country, and cross-border trade among EU nations exceeds flows between those members and the rest of the world. See U.S. Department of Commerce, *Current Trade Statistics*, <http://www.ita.doc.gov/td/industry/otea/> (last visited Feb. 26, 2004); World Trade Organization, *International Trade Statistics 2002*, chart III.35, III.36, III.38, [http://www.wto.org/english/res\\_e/statis\\_e/its2002\\_e/chp\\_3\\_e.pdf](http://www.wto.org/english/res_e/statis_e/its2002_e/chp_3_e.pdf) (last visited Feb. 26, 2004).

<sup>117</sup> See authorities cited in note supra.

even muddier, with postwar recovery driving great early growth in Japan and Europe. One simply cannot make any strong claim, positive or negative.

Still, the possibility that competition law can become the subject of a race to the top remains intriguing. If one takes seriously my criticism of international cooperation, international anarchy can start to look good. The chance that trends now at work in the world economy may reduce the need for hard law at the international level should temper our enthusiasm for lawmaking projects that a minimum divert resources, and possible may make the problems of international antitrust worse.

#### IV. CONCLUSION

In the last decade or so economists have developed the concept of “government failure” to complement the traditional notion of “market failure.”<sup>118</sup> The idea, roughly put, is that the structure of government can cause suboptimal outcomes and avoidable deadweight losses. The broader implication of the concept is that an analyst cannot make the case for government action simply by identifying a market failure. Always there remains the question of whether a governmental response will make the problem better or worse. The economist’s cliché, “Compared to what?” applies here too.

This paper argues that the problem of government failure exists at the international level. To make the point, I have focused on a classic market failure problem, namely private actions that frustrate competition. A conventional analysis argues that, in a world of international transactions, states will fail to pursue competition policy that maximizes global efficiency. Most analysts have taken this argument to dispose of the question of whether some kind of international governance is necessary to respond to the problem, with disagreement limited to the best design of the institutional response. I, in contrast, argue that a serious risk of government failure attends any proposal for serious international governance in this area, and that under certain assumptions the market failure may not be as great as first believed.

Why has the policy consensus so largely settled on a different approach? Perhaps I am simply a contrarian, and the case for some kind of international governance is stronger than I acknowledge. One should consider, however, reasons why policy debate might skew in favor of governance even in the absence of a strong affirmative case.

A sociological observation might provide one answer. Legal élites benefit from governmental action. They design the structure, staff it, and criticize it. This general point takes on particular salience in the international arena, where messy encumbrances on élite policy formation – elections, competitors, and the like – do not exist. For someone committed to the proposition that ideas and articulateness have a privileged role in policy formation, international governance is an inviting playground.

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<sup>118</sup> See Anne O. Krueger, *Government Failures in Development*, 4 *J. Econ. Persp.* 9 (1990).

The possibility that technological innovation and capital might provide a better check on anticompetitive behavior than do government agents is especially disconcerting for members of this class. The people who make these economic forces possible – compulsive tinkerers, lunatic risk-takers – often have little affinity with the bright, well spoken and presentable folks who make legal institutions work.<sup>119</sup> Ceding power to people who often cannot explain what they do is sufficiently unwelcome that fair minded lawyers will struggle with evidence suggesting that they should.

I do not claim that this sociological explanation suffices as a ground for governmental inaction across the board. Rather, it suggests that the proponents of new governmental structures, free of the constraints that bind national states, bear a special burden of justification and need to draw on extra reserves of skepticism. The current debate on international antitrust wants these qualities.

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<sup>119</sup> See also Robert Nozick, *Why Do Intellectuals Oppose Capitalism?* 20 Cato Online Policy Report (Jan.-Feb. 1998), published at [http://www.cato.org/pubs/policy\\_report/cpr-20n1-1.html](http://www.cato.org/pubs/policy_report/cpr-20n1-1.html) (last visited Feb. 26, 2004).