Comment on Crandall and Winston (2003)

By

John M. Connor

Staff Paper #04-01

January 2004

Department of Agricultural Economics

Purdue University

Comment on Crandall and Winston

by
John M. Connor
Professor of Industrial Economics
Dept. of Agricultural Economics, Purdue University
West Lafayette, Indiana 47907-1145
jconnor@purdue.edu

Staff Paper # 04-01
January 2004

Abstract

In a paper published in the *Journal of Economic Perspectives* in the fall of 2003, Robert Crandall and Clifford Winston all but call for the repeal of the Nation's antitrust laws. Their qualifications to make such a radical proposal are in doubt, but more importantly their purported review of empirical studies of overt price-fixing effects is shallow, biased, and naïve. Crandall and Winston's assertion that the direct benefits of convicting price-fixers are slight is central to their paper's thesis. Their review is shallow because the five studies that they examine comprise less than 2% of the economic literature that quantitatively estimates the price effects of explicit price-fixing schemes; it is biased because the chosen studies find no or weak price effects, whereas the vast majority of such studies find significant positive effects on price during the collusive period; it is naïve because the selected studies are either severely flawed or irrelevant.

Comment on Crandall and Winston

by
John M. Connor

This paper is an oddly slap-dash product far below the usual standards of the *Journal of Economic Perspectives.* While the *Journal* encourages articles (generally solicited by the editors) on several underserved topic areas, including "economic analyses of policy issues," those invited in the past usually have been authors with recent and long histories of work in the issue. Indeed, the first purpose of the Journal is "to synthesize and integrate lessons learned from active lines of economic research." A cursory examination of the authors' recent publications fails to find a broad background in research that evaluates the benefits of antitrust enforcement. Rather, both authors have established reputations as specialists in two formerly regulated industries. The *Journal* is more permissive than most economics journals in allowing forcefully argued position papers to appear in its pages, but Crandall and Winston seem to be operating in a zone somewhere beyond provocation.

Crandall's nine most recent publications (all dated 1998 to2002) listed in Econlit deal with regulatory matters in the telecommunications industry, which is hardly typical of the range of industries that occupy antitrust enforcement. In a footnote on page 24 describing his qualifications, Crandall reinforces that characterization by revealing himself to be a consultant for Microsoft and other companies in telecommunications. He chose two of his published articles for the paper's reference list, one written in 1975 and a law review article from 2001.

Winston is an active researcher in transportation economics; all but one of his Econlit-listed publications in the past five or six tears fall in this category. The three articles he chose to cite in the paper's references deal with the airline industry. Again, while Winston is certainly conversant with an industry that may have significant network effects, one is struck with the absence of a concentration of legal-economic research on monopolization, price fixing, or mergers.

The authors either consciously exclude or display a lack of familiarity with much mainstream research on the benefits of antitrust enforcement and ignore most of the optimal deterrence literature. Besides the numerous comments made by Baker (2003) and Kwoka (2003) along these lines, I note the following flaws.

In their shallow, biased, and naive review of studies of overt price-fixing effects, Crandall and Winston cite five works in support of their assertion that the direct benefits of convicting price-fixers are slight. Two articles examine the college-financial-aid case that is, as Kwoka states, hardly typical of the 100 or so cases brought by the DOJ each year. The review is shallow because the remaining three studies comprise less than 2% of the economic literature that quantitatively estimates the price effects of explicit price-fixing schemes[1]; it is biased because the vast majority of such studies find significant positive effects on price during the collusive period; it is naïve because the these studies are either severely flawed or irrelevant.

The article by Newman (1988) is a bloated comment on an analysis of the influential *Bakers of Washington State* case that was published in 1967 about three years after the wholesale bakers were convicted at trial, a conviction upheld on appeal. Newman's analysis takes issue with the estimate that the bakers raised bread prices in the Seattle area an average of more than 10% for several years. Newman's argument that the bakers could not have successfully raised price turns mightily on the entry of a single new firm that imported bread from Vancouver, British Columbia. The original authors of the analysis replied to Newman; among other points Mueller and Parker (1992) cite evidence that the entrant that supposedly broke the bread cartel had two employees and never attained close to 1% of the market. A disinterested reading of these two papers by even minimally trained IO economists would readily conclude that Mueller and Parker get the best of the debate and that Newman's paper is an egregious example of a breakdown in the peer-review process at the *Journal of Law and Economics*.

The second empirical cited by Crandall and Winston is an analysis of airline price wars by Morrison and Winston (1996). This innovative and informative research does not support the view that convictions for explicit price fixing are misdirected. First of all, nowhere in Morrison and Winston (1996) is it claimed that the airlines conspired on price. Equally important is the fact that this research aims at explaining the pattern of price wars on finely defined city-pair routes. Even if the regressions showed that a consent decree had a [presumably negative] effect on the incidence of price wars, such a result does not necessarily imply that prices on the 95%-plus of the routes not involved in price wars did not increase sufficiently to compensate the airlines for the losses on the price-war routes. Finally, the regression results (reported verbally in footnote 48) are of doubtful value in a probit model that contains no less than 56 other independent variables and where the dummy variable for the consent-decree period covers only about six quarters at the end of a 69-quarter data sample.

The third empirical publication cited by Crandall and Winston is Sproul's (1993) analysis of long term price changes in the years following the 1973-1983 indictments of 25 price-fixing conspiracies. This piece of evidence is certainly relevant to the issue at hand, but like Newman (1988) it is deeply flawed in its execution. Werden (2003) has commented on Sproul's paper:

> "Price changes following indictments … are not indicative of the price-elevating effects of most cartels, because many are investigated after they break down and even more break down when they learn that they are the targets of criminal investigations. Moreover, Sproul's data are unsuitable to the task because the price series including the cartelized market typically include so much more that the price effect of the cartel was easily lost; indeed, BLS sampling techniques might have totally missed the cartelized product" (p. 1).

[1] A co-author and I are currently surveying this literature for a paper that ought to be ready in a few months.

Thus, we seem to have another failure in the peer-review process, this time at the *Journal of Political Economy*. The fact that no similar research to Sproul's has appeared since 1993 even though many more indictments are available for testing may be another indicator that researchers have a similar view about its validity. (Also, I am sure that the fact that *JLE* and *JPE* are both University of Chicago journals is just a coincidence.)

I have commented primarily on Crandall and Winston's critique of cartel enforcement, but two other features of their paper deserve comment. First, they claim on page 17 that their regression model assessing merger policy is set up using data calibrated to the two-digit SIC major industry group because of "data availability." As Kwoka (2003: 4-5) says, employing such aggregated data is highly suspect in any sort of industrial-organization analysis. If Crandall and Winston mean that data are not available at industry levels below the two-digit SIC, they are sorely mistaken. Although it takes patience and craftsmanship, enforcement patterns are available at the four-digit SIC level of aggregation (see Preston and Connor 1992).

Second, Crandall and Winston's discussion of antitrust deterrence seems quite muddled and outdated. One international study of antitrust by Stigler (1964) is cited that finds no differences in effects of seller concentration, but their avowed purpose is to comment on deterred *conduct*, not structure. While they seem to grudgingly concede that government antitrust convictions may deter price fixing, they attribute any such deterrence primarily to private suits, citing another *JPE* paper, Block *et al.* (1981). Their final piece of evidence on collusive deterrence violates their stated purpose of searching only for empirical evidence. The article they select is an entirely theoretical unpublished analysis of optimal deterrence (Kobayashi 2002).

References

Block, Michael Kent, *et al.* The Deterrent Effect of Antitrust Enforcement. *Journal of Political Economy* 89 (1981): 429-425.

Baker, Jonathan B. The case for Antitrust Enforcement. *Journal of Economic Perspectives* 17 (Fall 2003): 27-50.

Crandall, Robert W. and Clifford Winston. Does Antitrust Policy Improve Consumer Welfare? Assessing the Evidence. *Journal of Economic Perspectives* 17 (Fall 2003): 3-26.

Kobayashi, Bruce. Antitrust, Agency, and Amnesty, Law and Economics Working Paper 02-04. George Mason University School of Law (2002).

Mueller, Willard F. and Russell C. Parker. Bakers of Washington Cartel: Twenty-Five Years Later. *Review of Industrial Organization* 7 (1992): 75-82.

Preston, Warren P. and John M. Connor. An Economic Evaluation of Federal Antitrust Activity in the Manufacturing Industries: 1980-1985. *Antitrust Bulletin* 37 (1992): 969-996.

Stigler, George. The Economic Effects of the Antitrust Laws. *Journal of Political Economy* 72 (1964): 44-61.

Werden, Gregory J. *The Effect of Antitrust Policy on Consumer Welfare: What Crandall and Winston Overlook, EAG 03-2.* Washington, DC: Economic Analysis Group, Antitrust Division, U.S. Department of Justice (January 2003).