THE UNITED STATES DEPARTMENT OF JUSTICE, ANTITRUST DIVISION PUBLIC ROUNDTABLE SERIES ON COMPETITION AND Deregulation,
THIRD ROUNDTABLE ON ANTICOMPETITIVE REGULATIONS,
COMMENT OF THE GLOBAL ANTITRUST INSTITUTE,
ANTONIN SCALIA LAW SCHOOL, GEORGE MASON UNIVERSITY

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This comment is submitted in response to the United States Department of Justice (“DOJ”) Antitrust Division’s Public Roundtable on Anticompetitive Regulations as a part of its Discussion Series on Competition and Deregulation. We submit this comment based upon our extensive experience and expertise in antitrust law and economics.¹

As an organization committed to promoting sound economic analysis as the foundation of antitrust enforcement and competition policy around the world, the Global Antitrust Institute commends the Division for inviting discussion concerning an important

¹ The Global Antitrust Institute (GAI), a division of the Antonin Scalia Law School at George Mason University (Scalia Law), is a leading international platform for economic education and research that focuses upon the legal and economic analysis of key antitrust issues confronting competition agencies and courts around the world. University Professor Joshua D. Wright, Ph.D. (economics), is the Executive Director of the GAI and a former U.S. Federal Trade Commissioner. John M. Yun, Ph.D. (economics), is the Director of Economic Education, Associate Professor of Law at Scalia Law, and former Acting Deputy Assistant Director in the Bureau of Economics, Antitrust Division, at the U.S. Federal Trade Commission. Professor of Law Douglas H. Ginsburg is a Senior Judge, United States Court of Appeals for the District of Columbia Circuit, Chairman of the GAI’s International Board of Advisors, and a former Assistant Attorney General in charge of the Antitrust Division of the U.S. Department of Justice. Tad Lipsky is the Director of GAI’s Competition Advocacy Program, Adjunct Professor at Scalia Law, a former Deputy Assistant Attorney General for Antitrust and a former Acting Director, Bureau of Competition, U.S. Federal Trade Commission. The GAI gratefully acknowledges substantial assistance in the preparation of this Comment provided by Scalia Law student Travis Royer.
topic. Expert competition agencies such as the DOJ’s Antitrust Division and the Federal Trade Commission (“FTC”) play an important role in ensuring that competition and consumer welfare are taken into account when regulation is contemplated. This comment highlights the costs of regulation and the harm to consumers that can result from impairment of the competitive process. Specifically, this comment addresses the use of government price controls to regulate competition. We illustrate the consequences of price controls with historical examples and identify modern markets subject to price regulations that will likely result in similar anticompetitive consequences and harm to consumers.

Price regulation and antitrust are alternative mechanisms to control market forces in the presence of market failure. As the Division accurately points out in its description of this Roundtable, regulation accompanied by centralized decision making supplants competitive market processes and threatens to harm competition. Or, as Judge Frank H. Easterbrook succinctly states it: “Regulation displaces competition.” The determination of prices through the dynamic interaction of supply and demand is a fundamental characteristic of well-functioning markets. Prices serve a critical signaling function in market economies, allowing market participants to adjust their behavior in response to the

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relative values of goods being bought or sold.\(^5\) Government control over prices is inherently less efficient in responding to ever-changing conditions compared to the ordinary market forces that exist in competitive markets. Regulatory schemes “require centralized decisions instead of a free market process” and “set static rules devoid of the dynamic realities of the market.”\(^6\)

Economic learning and history counsel that, absent strict “natural monopoly” supply conditions or other sources of market failure, competitive forces among buyers and sellers, unconstrained by price regulation or other distortions, generate efficient pricing and investment decisions.\(^7\) The antitrust laws are not designed to promote particular market outcomes, but rather to curtail anticompetitive practices that interfere with the competitive market processes that determine prices.\(^8\)

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\(^6\) Makan Delrahim, Assistant Att’y Gen., Dep’t of Justice, Keynote Address at the ABA Antitrust Fall Forum, Antitrust and Deregulation (Nov. 16, 2017), https://www.justice.gov/opa/speech/file/1012086/download.

\(^7\) Kenneth J. Arrow & Gerard Debreu, *Existence of an Equilibrium for a Competitive Economy*, 22 ECONOMETRICA 265, 265 (1954) (“It is well known that, under suitable assumptions on the preferences of consumers and the production possibilities of producers, the allocation of resources in a competitive equilibrium is optimal in the sense of Pareto…, and conversely every Pareto-optimal allocation of resources can be realized by a competitive equilibrium.”).

\(^8\) See Michael D. Whinston, *Lectures on Antitrust Economics* 1 (2006) (“Regulation tends to be industry-specific and to involve the direct setting of prices, product characteristics, and entry, usually after regular and elaborate hearings. By contrast, antitrust law tends to apply quite broadly, and focuses on maintaining certain basic rules of competition that enable the competitive interaction among firms in the marketplace to produce ‘good’ outcomes.”); Easterbrook, *supra* note 4, at 24 (“The antitrust laws, in contrast, are designed to preserve the functioning of competitive markets that, at least presumptively, produce allocative efficiency.”).
The Inefficiency of Price Regulation in a Market Economy

Reliance upon centralized price regulation – a term we use to refer to government imposed rate setting or the imposition of maximum or minimum prices – perhaps is the appropriate policy decision in the rare instance of a durable “natural monopoly,” where (1) substantial scale economies relative to consumer demand exist, making it more efficient for a single firm, rather than multiple firms, to produce a product, and (2) the existence of substantial fixed costs or other entry barriers prevent other firms from regulating prices by competing to displace the incumbent supplier in the long run.9

Firms compete in market economies to earn economic rents by supplying consumers with desirable products on the basis of price and quality. This competitive process sometimes results in a firm earning monopoly power through its superior efficiency, higher quality, or innovation. But monopoly power can also be gained through anticompetitive behavior. Examples of efficient and productive acquisition of monopoly power are common, ranging from Schumpeterian innovation, such as the introduction of the automobile, telephone, or transistor, to the introduction of innovative services such as mail-order sales.

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9 Of course, the presence of natural monopoly conditions is a necessary but not sufficient condition for price regulation. Competition for “the market,” may generate competitive outcomes under these conditions and the net benefits of that competition may exceed those of price regulation. See Harold Demsetz, Why Regulate Utilities, 11 J. L. & ECON 55 (1968).
Monopoly power is often short-lived as it begins to erode upon the entry, imitation, or innovation of competing products and services. This competition to earn monopoly rents through innovation and quality improvements – often called dynamic competition – is highly procompetitive and is recognized by economists as the primary source of economic growth. For example, economists estimate that at least half of all long-run gains in economic well-being are attributable to improvements in technology.\[10\]

It is generally recognized that attempts to increase short-term static welfare by regulating the monopoly price come at the cost of dampening incentives for dynamic competition. United States antitrust law has recognized how price regulation in the name of preventing the exercise of temporary monopoly power can result in the chilling of incentives to introduce new products, innovate, and take on risk.\[11\] In *Trinko*, the Supreme Court explained:

The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices—at least for a short period—is what attracts ‘business acumen’ in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct.\[12\]

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\[12\] *Id.*
To maintain incentives for dynamic competition, an agency must distinguish between transitory monopoly power earned through the competitive process, monopoly power that is the result of anticompetitive behavior, and monopoly power that results from identifiable market characteristics (like declining average costs over an entire demand curve).

Many industries are characterized by few players and high entry barriers but are not subject to price regulation. As an OECD study on price caps in the telecommunications industries recognized, “[p]rice control schemes can cause significant distortions particularly if applied for a long period” and “distract from the need to think strategically beyond a preoccupation with prices in order to focus on the interfaces of effective competition and less about the regulated firm itself.”¹³ In the United States, price regulation is almost exclusively reserved for public utilities, (so called “natural monopolies”) such as the local distributors of electricity and natural gas. It can be tempting for regulators to increase static welfare in the short run by regulating price and distributing the benefits from successful inventions to consumers, but doing so can disrupt dynamic competition and innovation—ultimately harming competition and consumers in the long run and slowing economic growth.¹⁴

¹⁴ See R.R. Braeutigam, The Effect of Uncertainty in Regulatory Delay on the Rate of Innovation, 43 L. & CONTEMP. PROBS. 98 (1979); Carmelo Giaccotto, Rexford E. Santerre & John A. Vernon, Pharmaceutical Pricing
The Problematic History of Price Regulation

When the government sets the market price for a given product, the only transactions that take place are those that are profitable at the government-mandated price rather than at the equilibrium price set by the dynamic interaction of supply and demand. Whereas supply and demand are constantly shifting in response to changing costs and preferences, a centralized price can be changed only after deliberation; practically speaking, the government price will always be higher or lower than the equilibrium. Economic theory and empirical evidence make clear that price regulation harms consumers and competition.

Gas and Oil Price Controls

When the price of crude oil spiked on the world market in the 1970s, the United States responded by imposing a price ceiling on crude oil and gasoline, purportedly in the interest of consumers. Decades later, there is ample evidence that the controls had significant negative effects not only on oil producers, but on consumers as well;

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unintended negative consequences were rampant and were compounded each time more regulation was introduced to address them.

For consumers, centrally-planned lower prices were accompanied by supply shortages, long lines at gas stations, and efforts by gas stations to make up for lost revenue by charging more for other services (e.g., oil changes or carwashes). Any benefit realized by those that were able to get cheaper gas were more than offset by attendant costs; one study demonstrates empirically that simply the time spent in gas lines, taken alone, created costs higher than what consumers saved from lower prices.\textsuperscript{16}

Upstream, domestic oil producers suffered as well.\textsuperscript{17} Faced with a price cap, domestic oil companies could not recoup their costs and stopped importing and refining crude oil. Economist Joseph Kalt found that while federal price controls from 1974-1980 saved consumers (monetarily) between $5 and $12 billion in annual gas costs, the diminished incentives of domestic producers caused an artificial shortage of 0.3-1.4 million barrels of oil per day. The net effect of the price regulation was up to $6 billion in deadweight loss.\textsuperscript{18} G. Jackson Grayson Jr., Chairman of the United States Price
Commission from 1971 to 1973, remarked after leaving his post “as a result of my sixteen


\textsuperscript{18}Id.
months as a price controller, I can list seven ways that controls interfere (negatively) with the market system and hasten its metamorphosis into a centralized economy.”

More recently, the FTC expressly recognized the importance of price signaling and the anticompetitive effects of centralized price regulation in its report concerning rising gas prices after Hurricane Katrina. Evaluating the effect of anti-price gouging statutes, the FTC explained that absent higher prices at the pump, consumers would have no incentive to curb their demand, ultimately leaving the gasoline producers with “no incentive to send new supplies to [an] affected area, as they would if the price increased,” resulting in long gasoline lines and shortages.

The FTC’s critique of price regulation was not specific to the petroleum industry. The FTC went on to conclude that “[c]onsumers might be better off in the short run if they did not have to pay higher prices for the same quantity of goods; in the long run, however, distortions caused by controls on prices would be harmful to consumers’ economic well-being” and that “[if price] signals are distorted by price controls, consumers ultimately might be worse off because producers may manufacture and distribute an inefficient

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19 C. Jackson Grayson, Jr., Controls are Not the Answer, 17 CHALLENGE 9, 10 (1974).
21 Id. at 203.
amount of goods and services, and consumers may lack the information necessary to properly value one product against another.”

Price Caps in the California Electricity Crisis

In 1996, California passed a law aimed at deregulating the electricity industry. The state’s electricity market faced consensus criticism in the early 1990s: California’s regulated markets delivered electricity at too high a price and the outlook for future business investment in the state suffered as a result. The goal of deregulation was to increase competition among privately owned power generators in order to lower prices for consumers. To accomplish this, the new system was designed to have many independent producers interacting directly with consumers in a market system.

The restructuring plan was not well designed. The plan called for a restructured wholesale market in which the incumbent and new entrant utilities would compete. All retail electricity prices were frozen until 2002. The intended purpose of the retail price

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freeze was to assure consumers that deregulation would not result in higher prices and to assure utilities that retail prices would not drop relative to wholesale prices. Thus, the utilities would purchase electricity in a competitive wholesale market, but were forced to sell at a fixed price at the retail level. On the supply side, this meant that the utility companies suffered financially when spot prices at the wholesale level went above rates at the retail level. On the demand side, when prices were artificially low (i.e., the wholesale price was above the retail price ceiling), consumers had no incentive to restrict consumption.\textsuperscript{25}

Through a combination of intense weather conditions and resident income growth, demand for electricity increased and what had been excess capacity was used up. Ultimately, the combination of decreased generating capacity for each of the three utilities and the price freeze that held retail prices artificially below wholesale levels became unsustainable by early 2001. As the Congressional Budget Office reported:

Not allowing retail prices to change with conditions in the wholesale market had three important effects. First, and critically, when wholesale prices rose, net cash flows for the investor-owned utilities fell, which made it impossible

\textsuperscript{25} See Tim Brennan, \textit{Questioning the Conventional “Wisdom”}, REG., Fall 2001, at 63-69; Paul L. Joskow, \textit{California’s Electricity Crisis} 43 (Nat’l Bureau of Econ. Research, Working Paper No. 8442, Aug. 2001) (“Competitive electricity markets will not work well if consumers are completely insulated by regulation from wholesale market prices. California deregulated wholesale prices, but failed to deregulate retail prices or to allow the utilities to use forward contracts to hedge their default service supply and pricing obligations. The terms and conditions of default service made it necessary for utilities to buy at an unregulated hourly wholesale spot market price and to sell at a fixed regulated retail price for up to four years. Not only did this drive the utilities to the point of insolvency after wholesale prices rose above the fixed retail price in June 2000, but it has also made it very difficult for competing retail suppliers to attract customers or for consumers to respond to high prices by reducing consumption.”).
for them to continue distributing electricity profitably. Instead, they had to sell at a loss. Even though the utilities are required to meet all of their customers’ needs for power, their financial difficulties have forced them to curtail service on several occasions (through brownouts and blackouts). Second, the price freeze probably discouraged new retail sellers from entering the market. Third, the freeze diminished whatever incentive retail customers would otherwise have had to reduce their electricity use.²⁶

By mid-2001, one of the utilities had filed for bankruptcy, California was faced with rolling blackouts, and the federal government had to issue an emergency order to keep natural gas deliveries flowing into California.

**Modern Price Regulation and the Role of Antitrust**

Notwithstanding widespread economic criticism of price regulation, it remains a component of the regulatory approaches to non-natural monopoly industries in the United States today. The Antitrust Division’s mission includes the promotion of competition through education about antitrust laws and its principles. The Antitrust Division can play an important role in identifying potentially anticompetitive regulations and advocating competition as superior to price control.

For example, the Durbin Amendment to the Dodd-Frank Act caps debit card interchange fees for large banks.²⁷ The debit card interchange fee is the amount a bank

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²⁶ *CBO Report, supra* note 23, at 19.

²⁷ The Durbin Amendment was passed as part of the 2009 Dodd-Frank Wall Street Reform and Consumer Protection Act. The law states that the amount covered banks may charge on an interchange transaction fee on a debit card must be “reasonable and proportional to the cost incurred by the issuer with respect to the transaction.” Subsequently, the Federal Reserve Board interpreted this language in a rule issued in June 2011
collects from a merchant when a consumer uses a debit card to pay. The Durbin Amendment was premised upon the idea that merchants would pass their cost savings on to consumers. The effect of the rule was to cut the average interchange fee for covered banks from $0.50 to $0.24 per transaction.\textsuperscript{28} Indeed, the Amendment resulted in a wealth transfer to merchants of approximately $7.3 billion in 2012 alone.\textsuperscript{29} For covered banks, this amounts to a loss of between $6 and $8 billion in annual revenues\textsuperscript{30}—losses that those banks have sought to recoup through reduced offerings in ancillary services (for example, a reduction in free checking accounts and debit card rewards), to the detriment of consumers.

As a result of the price regulation, banks have increased other fees, reduced access to free current accounts, and increased the minimum balance necessary to avoid account maintenance fees.\textsuperscript{31} Similar regulations resulted in similar anticompetitive effects in other countries. For example, in Canada, the debit card system has been regulated as a

\begin{enumerate}
\item to mean the allowable interchange fee on a debit transaction is $0.21 plus 5 basis points of the transaction value, plus and additional $.01 for fraud protection. Debit Card Interchange Fees and Routing, 12 CFR § 235.5 (2012).
\item Fumiko Hayashi, The New Debit Card Regulations: Initial Effects on Networks and Banks, in FEDERAL RESERVE BANK OF KANSAS CITY ECONOMIC REVIEW FOURTH QUARTER 90-91 (2012).
\end{enumerate}
government sponsored monopoly since 1996 that is able to recover only its operating costs per transaction. \(^{32}\) Thus, the costs of developing and maintaining the network fall upon banks and debit cardholders; as a result, free current accounts and accounts that feature unlimited free debit transactions are extremely rare. \(^{33}\) Similarly, multiple studies demonstrate that the net effect of the Durbin Amendment is harm to consumer welfare.\(^{34}\)

A more clear-cut example of modern price regulation — where the Antitrust Division may be an important voice for reform — is the price ceiling currently imposed by the Department of Commerce (DOC) and the DOJ onto .com domain name registrations. The Domain Name System (“DNS”) operates by mapping IP addresses to domain names. Registries operate the infrastructure that makes it possible to access a particular IP address by creating and maintaining databases that enable this mapping on their respective top level domains (“TLDs”). In other words, registries — defined by their specific TLDs (e.g., .com, .biz, .edu, etc.) — ensure the proper framework and functioning of domain names.


\(^{33}\) Zywicki, supra note 31, at 8.

\(^{34}\) See, e.g., David S. Evans & Howard H. Chang, The Impact of the U.S. Debit Card Interchange Fee Caps on Consumer Welfare: An Event Study (Working Paper No. 658, 2013), https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1651&context=law_and_economics (event study showed that consumers lost more on the bank side than they gained on the merchant side); Todd J. Zywicki, Geoffrey A. Manne & Julian Morris, Unreasonable and Disproportionate: How the Durbin Amendment Harms Poorer Americans and Small Businesses (ICLE Working Paper, Apr. 2017), http://laweconcenter.org/images/articles/icle-durbin_update_2017_final.pdf (“That a forced reduction in interchange fees would result in higher bank fees for consumers is a matter of basic economics. Retail banking in the United States is a highly competitive industry and there is no evidence of supra-normal profitability for retail banks. As such and over time, cost increases or revenue reductions will be passed on to bank customers in the form of higher bank fees or reduced services.”).
within their TLD. In addition to offering different TLDs on which to map domain names, these registry companies differentiate themselves based on the consistency, reliability (including security), and efficiency of their mapping and databases.

The government has a longstanding policy of deregulating and privatizing DNS management and registry services. In 1997, President Clinton explained that “[t]he Internet should develop as a market driven arena, not a regulated industry . . . [w]here government intervention is necessary, its role should be to ensure competition, protect intellectual property and privacy, prevent fraud, foster transparency, and facilitate dispute resolution, not to regulate.”35 Along those lines, the DOC transitioned oversight of the DNS to the Internet Corporation for Assigned Names and Numbers (“ICANN”), a private nonprofit entity. As a result, all generic TLDs and their associated registries have been freed from government interference except for the .com TLD. Verisign is the registry responsible for the .com TLD, which today is subject to government-directed fixed wholesale pricing for .com domain names.36 The .com TLD is subject to an agreement between ICANN and Verisign, but the DOC has the right to review the extension or renewal of that agreement, which occurs every 6 years. After a period of limited pricing deregulation in 2006, the Obama administration reversed the gradual loosening of pricing regulation during its

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36 Professor Wright is Senior of Counsel at Wilson Sonsini Goodrich & Rosati (WSGR), which represents VeriSign. The views expressed here are our own.
review of the .com renewal agreement in 2012, and imposed a price cap on .com registrations.

Thus, the government’s significant progress in deregulating pricing on the Internet was interrupted in 2012 and remains incomplete. The price regulation imposed on .com supplants the forces of competition and no longer makes economic sense. Today, the registries do not exhibit either of the two characteristics required for a natural monopoly (substantial economies of scale relative to consumer demand and substantial barriers to entry). In fact, more than 1,500 generic TLD registries have been introduced since 2012. New TLDs should continue to show robust growth and exert competitive force on prices under unregulated market conditions. Additionally, ICANN may authorize new TLDs at any time.

Furthermore, .com domain names may not be sold directly to end users, and the price caps do not apply to the retail price charged by retailers, such as Go Daddy, that purchase .com domain names from the registry and resell them. The re-imposition of the .com price cap in 2012 interfered with the gradual deregulation that would ultimately unleash natural competitive forces, and therefore has deprived consumers from the benefits of a competitive market for registry services. Allowing market forces, rather than a government mandate, to determine the wholesale price of .com registrations would provide incentives for competitors to shift investments in the supply of substitute TLD
services. Those changes in supply would constrain retail price increases and encourage innovation, ultimately increasing competition for new registrants among competing suppliers based on differences in price and quality.\textsuperscript{37}

Conclusion

The role of the antitrust agencies is to enforce the antitrust laws, and not to guide the market to any particular outcome.\textsuperscript{38} As Assistant Attorney General Makan Delrahim has observed, antitrust law, “[a]t its best…supports reducing regulation, by encouraging competitive markets that, as a result require less government intervention…in other words, competition law enforcement contributes to a well-functioning free market economy.”\textsuperscript{39} We applaud the DOJ for acknowledging the limitations of price regulation and the unintended consequences that can arise when competitive forces are displaced.

\textsuperscript{37} Legacy registrants are protected against unforeseen price increases because they are able to lock in their current pricing for up to ten years.

\textsuperscript{38} Nor does the DOJ have the expertise or resources that would be necessary to implement the type of price regulation practiced by public utility commissions in natural monopoly situations. The DOJ has long considered government regulation as inferior to the free market.

\textsuperscript{39} Delrahim, supra note 6.