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Continuous Regulatory Reform at the Federal Trade Commission

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"CONTINUOUS" REGULATORY REFORM AT THE FEDERAL TRADE COMMISSION

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INTRODUCTION

For more than two decades, Congress and the President have pressed administrative agencies to provide relief from unnecessarily burdensome regulations and to provide greater accountability for agency decisionmaking.[1] According to one leading commentator, we may be witnessing the emergence of a "cost-benefit state," in which governmental "performance will be assessed, both in particular and in general, by comparing the costs of government action against the benefits of government action."[2]

In this climate, the Federal Trade Commission (FTC or Commission), like other agencies, has "reinvented" its internal processes and reformed its

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* Director, Bureau of Economics, Federal Trade Commission. The views expressed herein are those of the author and are not necessarily those of the Commission or any individual Commissioner. The author is grateful to Ronald Bond, Stephen Calkins, and Paul Pautler.

1. *See, e.g.*, Exec. Order No. 11,821, 3 C.F.R. 926 (1971-1975), *reprinted as amended in* 12 U.S.C. § 1904 (1994) (involving President Ford's call for systematic preparation of inflation impact analysis); AL GORE, FROM RED TAPE TO RESULTS: CREATING A GOVERNMENT THAT WORKS, ACCOMPANYING REPORT OF THE NATIONAL PERFORMANCE REVIEW (1993) (implementing President Clinton's call to "reinvent" government); *cf.* American Textile Mfrs. Inst., Inc. v. Donovan, 452 U.S. 490, 510-11 n.30 (1981) (identifying statutes requiring cost-benefit analysis).

2. CASS R. SUNSTEIN, FREE MARKETS AND SOCIAL JUSTICE 348 (1997).

substantive regulations. The FTC is systematically reviewing old rules, and when the review discloses they are no longer needed, is terminating them.[3] The FTC has incorporated "sunset" provisions into new orders and adopted rules that will terminate existing orders after twenty years.[4] New FTC rules will simplify administrative processes, and a new "fast-track" procedure is being used to complete major merger trials and other administrative cases more quickly.[5] In many ways — from guidelines to staff advisory opinions to conferences and speeches — the FTC encourages private sector compliance with its rules through means short of burdensome enforcement.[6]

This Article highlights an organizational feature of the FTC's approach to regulatory reform, a feature that motivates what might be termed "continuous" regulatory reform by analogy to the process of continuous improvement ("*kaizen*") that is characteristic of Japanese manufacturing systems.[7] That organizational feature, which is nearly unique in government, is the role played by the FTC's Bureau of Economics in internal agency decisionmaking. Through the role of the Bureau of Economics, the FTC nears one goal of contemporary economic regulation: the routine and genuine application of cost-benefit analysis as a decisionmaking tool.

Section I describes the central role that cost-benefit analysis plays in regulatory reform and describes the variety of means by which Congress and the President have induced agencies to routinely employ cost-benefit analysis in promulgating rules. Section II describes the types of costs and benefits that should be evaluated in assessing the work of the FTC. This section highlights the subtle but potentially large benefits to the economy that result from the FTC's role as a referee for the private marketplace — a role that synthesizes the Commission's competition (antitrust) and con-

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3. In 1992, the Commission instituted a systematic regulatory review program to ensure that the continuing usefulness, benefits and costs of every Commission rule and industry guide were reviewed at least once every ten years. As a result of this program, at least eight rules have been repealed, and at least six have been amended to reduce compliance burdens or to adjust for developments since the rule was issued. The program has also resulted in the withdrawal or revision of nearly half of the Commission's industry guides.

4. *See* Policy Statement Regarding Duration of Competition and Consumer Protection Orders, 60 Fed. Reg. 42,569 (1995); Termination of Existing Orders, 16 C.F.R. § 3.72(b)(3) (1997).

5. Rules of Practice Amendments, 61 Fed. Reg. 50,640 (1996) (to be codified at 16 C.F.R. pts. 2-4).

6. *See, e.g.*, Guides for the Use of Environmental Marketing Claims, 16 C.F.R. pt. 260 (1997); Dept. of Justice and FTC Statements of Antitrust Enforcement Policy in Health Care, 4 Trade Reg. Rep. (CCH) ¶ 13,153 (1996); Antitrust Guidelines for the Licensing of Intellectual Property, 4 Trade Reg. Rep. (CCH) ¶ 13,132 (1995).

7. *See* Jonathan B. Baker, *Fringe Firms and Incentives to Innovate*, 63 ANTITRUST L.J. 621, 631 (1995) (describing process as "incremental cost reduction" and "organizational learning").

sumer protection missions. Section III describes how costs and benefits are weighed at the FTC. Focusing on the institutional role of the FTC's Bureau of Economics, this section argues that this organizational structure commits the FTC to making economic analysis a routine part of the evaluation of every enforcement matter and that doing so creates the functional equivalent of conducting a formal cost-benefit analysis. The FTC also conducts reviews of past actions in order to improve future decisions. By placing a cost-benefit focus on every decision, albeit informally, the FTC's organizational structure institutionalizes continuous regulatory reform.

I. COST-BENEFIT ANALYSIS IN REGULATORY REFORM

Cost-benefit analysis plays a central role in contemporary political discussions of regulatory reform because it encapsulates the ideal that federal agencies should comprehensively and systematically analyze the impact of proposed actions in order to make informed choices and decisions.[8] Moreover, this methodological tool addresses some common criticisms of agency decisionmaking from the political perspectives of both the left and the right.[9] For some, the attraction may be in leading agencies to focus on costs as well as benefits. Agencies have a natural tendency to focus on the good they can accomplish by correcting market failures. Cost-benefit analysis encourages agencies to acknowledge the burden regulations place on private actors and the possibility that government action can cause costly, unintended consequences.[10] It leads agencies to focus on outcomes

8 *See generally* Economic Analysis of Federal Regulations Under Executive Order 12,866 (last modified Jan. 11, 1996) <http://www.whitehouse.gov/WH/EOP/OMB/html/miscdoc/riaguide.html>.

9. *Cf.* SUNSTEIN, *supra* note 2, at 380:

> At least since 1980, the executive branch has attempted to embrace a form of cost-benefit analysis for specific purposes — to promote better priority-setting, to move toward market-oriented tools, to exempt insignificant risks, to attend to informed public judgements, to foster voluntary and least-cost compliance, and to focus on ultimate results rather than methods and processes.

To be sure, conservatives have embraced cost-benefit analysis more than liberals. *Id.* Some liberal critics view cost-benefit analysis as a tool by which industry subverts critical environmental, health and safety regulations. *E.g.*, *id.* at 374 tbl. 14.1 (noting hostility of 1970s environmentalism to cost-benefit analysis); MARK GREEN, WINNING BACK AMERICA 128-29 (1982) (overstating consistently costs and undervaluing benefits biases cost-benefit analyses against appropriate, worthwhile public health regulation).

10. *See, e.g.*, Christopher C. DeMuth & Douglas H. Ginsburg, *White House Review of Agency Rulemaking*, 99 HARV. L. REV. 1075, 1981 (1986) (touting cost-benefit analysis as way to increase political accountability and encourage more balanced regulatory decisions); THOMAS O. MCGARITY, REINVENTING RATIONALITY: THE ROLE OF REGULATORY ANALYSIS IN THE FEDERAL BUREAUCRACY 15 (1991) (presuming that "the goal of regulatory reform is to bring comprehensive analytical rationality to bear on a preexisting rulemaking process

rather than solely on the regulatory method. Others may look to cost-benefit analysis as a counter to rent-seeking: cost-benefit analysis calls on agencies to look beyond the concerns of the most organized and politically active interest groups and consider the impact of their decisions on the rest of the polity.[11]

Since 1978, executive branch agencies have been required to provide the Office of Management and Budget (OMB) with a systematic analysis of major rules before they are promulgated. The first comprehensive requirement was the product of the Ford-Carter era where the interest was in streamlining regulations to make them less burdensome and more effective and in employing incentives and other market mechanisms, rather than command-and-control methods, to accomplish regulatory objectives. The Carter administration's strategy called for regulation to be simple, clear, effective, and efficient, imposing no unnecessary burdens on the economy, on individuals or organizations, or on state or local governments.[12] Agencies were charged with considering and analyzing alternative ways to achieve their goals and then choosing the least burdensome ones identified.[13] The Reagan administration revised this approach, principally by adding the specific requirement that proposed rules pass a cost-benefit test.[14] This requirement was also continued by the Bush administration.

The Clinton administration has restated similar goals, though it requires consideration of a more comprehensive set of costs and benefits.[15] Under the present scheme, regulations are to be adopted only if they are required by law, necessary to correct market failures, or otherwise called for by compelling public need.[16] In promulgating regulations, agencies must assess the costs and benefits of alternatives, including the alternative of doing nothing.[17] The costs and benefits that must be weighed include both quan-

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that has been dominated by techno-bureaucratic rationality"); *but cf.* Alan B. Morrison, *OMB Interference with Agency Rulemaking: The Wrong Way to Write a Regulation*, 99 HARV. L. REV. 1059, 1065 (1986) (criticizing implementation of Reagan-era Executive Order mandating application of cost-benefit test to proposed agency regulation as going too far in the reverse direction by "implement[ing] a myopic vision of the regulatory process which places the elimination of cost to industry above all other considerations").

11. *See* DeMuth and Ginsburg, *supra* note 10, at 1081 (highlighting cost-benefit analysis as way to consider needs of those other than interest groups).

12. *See* Exec. Order No. 12,044, 3 C.F.R. 152 (1979), *reprinted as amended in* 5 U.S.C. § 553 (1994).

13. *See* Exec. Order No. 12,291, 3 C.F.R. 127 (1981), *reprinted as amended in* 5 U.S.C. § 601.

14. *Id.*

15. *See* Exec. Order No. 12,866, 3 C.F.R. 638 (1994), *reprinted as amended in* 5 U.S.C. § 601.

16. 5 U.S.C. § 1(a).

17. *Id.*

tifiable measures and qualitative issues that are difficult to quantify, but nonetheless essential.[18] The Clinton program differs from its predecessors chiefly in its explicit listing of a broad set of items that are to be considered benefits: potential economic, environmental, public health and safety, and other advantages, as well as distributive impacts and equity.[19] The overall goal is the maximization of net benefits.[20]

All of the approaches to rulemaking by the various administrations have required a similar process of self-evaluation. Agencies are to identify the problem to be addressed, the failure of private markets or other institutions for example, and assess the problem's significance. They must determine whether existing regulations have created or exacerbated the problem, and thus whether changing those regulations might provide a solution. They must identify alternatives to direct regulation, including using economic incentives or providing information to encourage individual choice. Wherever possible, they should specify performance objectives rather than prescribe behaviors. Fundamentally, they must design regulation that is (1) cost-effective, (2) tailored to impose the least burden on society consistent with obtaining the objective, and (3) based upon "a reasoned determination that the benefits of the intended regulation justify its costs."[21]

Technically, the OMB programs apply only to offices and agencies within the executive branch of government. They do not impose obligations on independent agencies such as the FTC. The principles underlying these schemes, namely ensuring that regulation is effective and that burdens as well as benefits are considered in making decisions, are, however, of general application and value. Thus, it is not surprising that independent agencies often conform to the requirements of executive orders in spirit, if not precisely in form.

Notwithstanding this long bipartisan Presidential commitment to implementing cost-benefit analysis, the activist Republican Congress, elected in 1994, called for even more cost-benefit analysis as one element of its broad regulatory reform program.[22] Congress may have believed that agencies

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18. *Id.*

19. The contemporary debate between liberals and conservatives over how to regulate is increasingly framed not in terms of whether government actions should pass a cost-benefit test, but rather over what the terms "cost" and "benefit" should include: should they be limited to conventional economic data, or should they be understood more broadly, to take into account the type of non-economic values incorporated in the Clinton Executive Order? *See* SUNSTEIN, *supra* note 2, at 380-81 (calling for terms to be specified "by some theory of value").

20. *See* Exec. Order No. 12,866, 3 C.F.R. 638 (1994), *reprinted as amended in* 5 U.S.C. § 601 (1994).

21. 5 U.S.C. § 638(1)(b)(6) (1994).

22. *See* Cass R. Sunstein, *Congress, Constitutional Movements, and the Cost-Benefit*

used cost-benefit analysis more for *ex post* justification than for actual decisionmaking. Thus, the regulatory reform legislation that was proposed in the "Contract with America"[23] required more stringent cost-benefit analysis and risk assessment for a wider range of proposed regulatory actions.[24]

II. SUBTLE AND NOT-SO-SUBTLE COSTS AND BENEFITS OF FTC DECISIONS

The value of applying an analytical framework like cost-benefit analysis to regulatory decisions is demonstrated through a concrete look at the substantive work of the agency that the author knows best, the FTC. The FTC is commonly considered a consumer agency in carrying out both its competition (antitrust) and consumer protection missions. Thus, it might be said that the principal beneficiaries of FTC actions are consumers. The benefits of FTC actions are, however, more pervasive than what the "consumer agency" concept implies.

The most immediate, direct beneficiaries of particular FTC actions are indeed those individuals or firms that buy (or perhaps sell) in the affected market. But the indirect benefits of FTC actions, namely the effects on all consumers and producers in the rest of the economy, may substantially exceed the direct benefits. This is because keeping markets open and honest reduces the private transaction costs of participating in market exchanges and relationships, and thereby leads to greater economic growth. Lowering transaction costs is much like replacing a ferry with a bridge: greater predictability, smoother operation, and decreased dependence on coordination with others for each interaction lead to much greater output. Increased marketplace activity benefits sellers and buyers alike, and benefits society as well by increasing the ability of markets to put private property to socially more valuable uses.

Three examples, from the areas of consumer protection, antitrust, and public advocacy of competitive policies, will illustrate the breadth of the social benefits that arise from FTC actions that keep markets honest and competitive.

The first example, one of consumer protection, is *Dahlberg Electronics*.[25] At issue in this case was a hearing-aid manufacturer's advertisement that its "Miracle-Ear" product helped consumers understand speech in

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State, 48 STAN. L. REV. 247, 269 (1990) (remarking that "cost-benefit balancing dominated the debate" in the 104th Congress).

23. *Id.*

24. *See id.* at 274-77, 290 (discussing importance of cost-benefit mandates in wide-ranging regulatory reform efforts of the 104th Congress).

25. *See* Dahlberg Electronics, Inc., Complaints and Orders 1976-83, Trade Reg. Rep. (CCH) ¶ 21,163 (1976) (civil penalty consent order); *In re* Dahlberg, 1 Trade Cases (CCH) ¶ 70, 963 (1995) (enforcement of civil penalty consent order).

noisy environments like restaurants. The FTC challenged the claim as false and settled with the company,[26] which paid a $2.75 million civil penalty for violating an FTC order, and promised not to make the claim in the future.[27] To illustrate that the benefit of this action was greater than merely the transfer of funds to the Treasury of the United States, let us examine the harm that would have ensued absent FTC action to stop this claim. First, there would have been continued and direct harm to consumers who bought the misrepresented product. Thinking they were buying a product that clarified speech by reducing background noise, consumers would not have received a product with those features. The direct harm to consumers here would be that they spent their money without getting in return the value for which they had paid.

The indirect harm resulting from a widespread and obvious failure to take action against false advertising likely would be even greater, albeit more subtle. False advertisements are the rotten fruit that can spoil the barrel if not removed. The benefit of the FTC's action extends, at a minimum, to the entire hearing-aid market. By stopping this firm from making false representations, the FTC's action gives consumers confidence that similar representations they encounter are likely true. More importantly, the impact of clear and consistent action against false advertising extends beyond hearing-aids to other advertised goods. Policing and prohibiting false advertising increases buyer confidence in advertising in general.

If there were no such policing of false advertising — if the FTC did not exist[28] — buyers soon would learn that not all advertising claims could be trusted. Firms would have to find some other way to inform consumers about the qualities of their products, and buyers would have to find other ways to learn about the availability of products they might want or need.[29] Cautious, wary buyers would buy less and waste expenditure on self-protection. Sellers, in turn, would have to waste expenditure on less efficient ways to prove their credibility. A principal benefit of having the FTC

26. *See In re Dahlberg*, 1 Trade Cases at 74,385.

27. *See* Dahlberg Electronics, Inc., Complaints and Orders, 1976-83 Trade Reg. Rep. at 21,078 (preventing company from claiming that hearing aids would "enable all persons with hearing loss to consistently distinguish or understand speech in groups or noisy situations").

28. Although private actions for false advertising can be brought by competitors under the Lanham Act, 15 U.S.C. § 1051 (1994), this remedy is unavailable to buyers.

29. Some marketplace responses can be imagined. For example, some retailers might perform the role of certifying product quality, either by putting the product on their shelves to share in the retailers' reputations, or perhaps by giving consumers a chance to sample the product with a money-back guarantee. But these alternatives to advertising would be costly for sellers. Sellers would have to convince a retailer to take their products before consumer demand for them is demonstrated. Sellers might do so by persuasion, or by the equivalent of payment; for example, by committing to pay for returned products.

on the job is that it acts as a referee to prevent and remedy the kinds of distractions that disrupt the market.

The second example, one of an antitrust action, is the *Time Warner/Turner* merger.[30] This complex transaction would have created a community of interest among the largest producer of cable television programming, the largest distributor of that programming, and the largest operator of cable television systems. The transaction was allowed to proceed, but subject to a consent order.[31] Because of the order, direct harms were potentially prevented. For example, Time Warner might have charged cable systems higher fees for CNN and other marquee channels, and that could have led cable systems in turn to charge higher prices to consumers. Here again, however, the indirect harms that were prevented are also substantial. If the FTC had not acted, the merged firm could have kept attractive new channels that presented competition to Turner programming off the air. This in turn could have reduced entrepreneurs' incentives to develop creative new programming.

The *Time Warner* example illustrates a general point: permitting anticompetitive practices tends to deter competition that is based on the merits of the competing products or services. Such practices can discourage entry into markets and innovation.[32] To preserve these benefits of free and open markets, a referee is needed. The FTC fulfills this role.

The third example, one of public advocacy of competitive policies, concerns electric power. The FTC staff submitted comments to the Federal Energy Regulatory Commission (FERC) regarding FERC's proposed rule to promote competition in the generation of electricity.[33] The FTC's economists shared their expertise in the functioning of markets, and provided FERC with suggestions on more effective promotion of "open access" to electric power transmission services. The direct beneficiaries of

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30. *See* Time Warner, Inc., 5 Trade Reg. Rep. (CCH) ¶ 24,104 (1997) (complaint and consent order).

31. *See id.* at 23,911 (stating that Time Warner, Turner, TCI, and Liberty Media Corp. "agreed to make a number of structural changes and abide by certain restrictions designed to break down the entry barriers created by the deal").

32. *See generally* OFFICE OF PLANNING AND POLICY, FED TRADE COMM'N, ANTICIPATING THE 21ST CENTURY: COMPETITION POLICY IN THE NEW HIGH-TECH GLOBAL MARKETPLACE (1996); Richard J. Gilbert & Steven C. Sunshine, *Incorporating Dynamic Efficiency Concerns in Merger Analysis: The Use of Innovation Markets*, 63 ANTITRUST L. J. 569 (1995) (reviewing economic literature on effects of competition on innovation and describing how innovation can be incorporated into analysis of mergers and acquisitions).

33. *See* Comments of the Staff of the Bureau of Economics of the Federal Trade Commission, Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities (last modified Aug. 7, 1995) <http://www.ftc.gov/be/v950008.htm>.

FERC's pro-competitive action are buyers, including consumers, as greater competition leads to lower electricity prices. The FTC staff's comments also noted the indirect aspects of a system of open access. The comments discussed how the system should be constructed so that vertically integrated incumbents, which own both transmission and generation assets, would be prevented from favoring their own operations and discriminating against other firms' generation facilities. If that discrimination is prevented, then entry is facilitated. Although FERC's final rule[34] did not adopt all of the methods the FTC staff comments recommended, FERC appeared to agree with the FTC staff about the nature of the basic problem, and about the benefits that would flow from a competitive, non-discriminatory, open access system.

Although the FTC produces clear benefits to the economy, to individual consumers and even producers affected by FTC action, as these three examples illustrate, it also imposes some costs. The most obvious cost is the FTC's annual budget. The more significant costs, however, are those borne by businesses and others who are subject to the laws that the FTC enforces. Many businesses that want to ensure their conduct complies with those laws hire lawyers to advise them about how to do so, and may even change their ways of doing business. Those businesses, and sometimes individuals, that have to respond to the FTC's law enforcement process, incur costs in doing so. And if the FTC performs its internal cost-benefit analyses poorly, its actions could chill efficient economic activity.[35]

A few controversies have arisen over the years about the extent of the costs that the FTC imposes. Twenty years ago, the Commission embarked on the Line of Business reporting program. Proponents hoped to compile disaggregated data about large firms' operations and profitability and then identify competitively significant conditions and trends. Because so many large firms were engaged in multiple, disparate businesses, public accounting data was usually insufficient. Another reason for the program was to test then-current economic theories linking industry structure to business conduct and competitive performance. Many businesses, however, objected to the costs of providing the required information. After

34. *See* Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), *order on reh'g* Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 14, 1997).

35. *Cf.* ROBERT BORK, THE ANTITRUST PARADOX 4 (1978) (arguing that prior Supreme Court antitrust decisions chill beneficial business conduct); Richard Craswell, *"Compared to What?": The Use of Control Ads in Deceptive Advertising Litigation*, 65 ANTITRUST L.J. 757 (1997) (explaining inappropriate methodology for copy testing deceptive advertising allegations could chill beneficial advertising claims).

several years of controversy, the program was dropped, in part because of the perception that the costs it had imposed exceeded the benefits of having the information.[36]

At about the same time, Congress acted to reform and regularize the FTC's rulemaking processes. The first reform, the Magnusson-Moss rulemaking amendments of 1975,[37] established new procedures and gave the Commission's consumer protection rules a stronger legislative base. One reason for strengthening the FTC's rulemaking power was a belief that, in the long run, it would cost less to develop clear rules about permissible behaviors through a rulemaking process rather than through time-consuming and uncertain enforcement litigation. Just five years later, though, Congress created new restrictions that made it more difficult for the Commission to issue rules.[38] One of those requirements was to undertake a regulatory analysis of proposed rules, using language reminiscent of the regulatory analysis requirements in executive orders that apply to executive branch agencies.[39] Congress even instructed the Commission to stop several specific rulemaking proceedings. Congress was evidently responding to complaints that the FTC's rules imposed undue costs on some businesses, particularly small businesses that were subject to them.[40]

Costs and benefits are often difficult to measure precisely. On this very large scale — the benefits and costs of the agency as a whole — measurement may be virtually impossible. But having a referee to keep markets open, honest, and competitive is a prerequisite for a healthy, growing economy. By comparison, the costs of having the FTC in place, though real, are undoubtedly modest by any reasonable estimate.

III. COMPARING COSTS AND BENEFITS AT THE FTC

A. Individual Enforcement Decisions

The most striking feature of cost-benefit analyses at the FTC is that, at

36. *See generally* F. M. Scherer, *Sunlight and Sunset at the Federal Trade Commission*, 42 ADMIN. L. REV. 461, 476-83 (1990) (reviewing events accompanying FTC's "sunshine" mandate and examining denouement of 1980s).

37. *See* Federal Trade Commission Act § 18, 15 U.S.C. § 57a (1997).

38. *See* Federal Trade Commission Improvements Act of 1980, Pub. L. No. 96-252, 94 Stat. 374 (1980).

39. 94 Stat. 388 (1980).

40. *See generally* Quentin Riegel, *FTC in the 1980s: An Analysis of the FTC Improvements Act of 1980*, 26 ANTITRUST BULL. 449, 469-78 (1981) (recounting development of several specific provisions of FTC Improvements Act of 1980); RICHARD J. PIERCE ET AL., ADMINISTRATIVE LAW AND PROCESS 43-45 (2d ed. 1992) (reviewing congressional oversight practices of the FTC).

least to outward appearances, there are none. Yet the Commission seeks, is provided with, and uses the information necessary to determine whether firm or industry conduct harms the public on balance, and whether a proposed remedy increases economic welfare. This occurs in part because the Commission has created an organizational structure and information-gathering process that involves economists in every stage of substantive decisionmaking, and gives them an independent voice in that process.[41]

The roughly sixty-five Ph.D. economists in the FTC's Bureau of Economics review and participate in every substantive matter before the Commission.[42] The economist assigned to an investigation works in partnership with the antitrust or consumer protection lawyers on the case. Together, the legal and economic staff review documents, interview witnesses, develop theories explaining how the conduct under review might be beneficial or harmful to the public, and identify possible remedies. The economic staff and the legal staff typically write independent memoranda to the Commission evaluating the conduct at issue and recommending a course of action. This is done both at an early stage in a major investigation, when a decision to go forward is made, and at a late stage when the matter is ripe for a final decision by the Commission.[43] Although this does not describe a conventional, formal cost-benefit analysis, the typical result of the process — a Commission fully informed about costs and benefits when it makes decisions — is roughly equivalent to it.

Economists provide the Commission with independent advice in both competition and consumer protection cases. Their role is well entrenched in antitrust. Indeed, economic analysis has become the essence of antitrust in the courts and the enforcement agencies, independent of the political party occupying the White House. Republican presidents have appointed economically-oriented antitrust scholars like Judges Posner, Bork, Breyer and Easterbrook to the circuit courts, and President Clinton has followed suit by elevating Justice Breyer to the Supreme Court.

In antitrust matters before the Commission, the parties under investigation routinely hire economists to help them respond to the Commission's concerns. Courts are led by antitrust precedent to evaluate the economics of the conduct before them, often with the assistance of expert witnesses.[44]

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41. *See Report of the ABA Section of Antitrust Law, Special Committee to Study Role of FTC*, 58 ANTITRUST L.J. 43, 97 (1989).

42. Although the discussion below focuses on adjudicative matters, the economist's role is similar in rulemakings.

43. In the event the matter proceeds to litigation, economists provide litigation support and, in some cases, expert testimony.

44. *See generally* JOHN E. KWOKA & LAWRENCE J. WHITE, THE ANTITRUST REVOLUTION (1989) (providing examples of analyses economists undertake in antitrust

In consumer protection, the Commission relies on its economists to help set the penalties it imposes on violators. The economic staff offers what is implicitly a cost-benefit analysis by evaluating the proposed remedy against a penalty derived from a method recommended by economic literature on optimal deterrence.

A law-and-economics literature advises enforcement agencies on setting penalties that achieve the right amount of general deterrence in the economy — penalties that deter harmful conduct by inducing efficient levels of compliance expenditure by firms. This body of literature holds that if penalties are limited to the levying of fines, agencies should set the penalties by reference to the injuries the lawbreakers have caused third parties.[45] The right penalty, conceptually, is the cost of the injury to the victim increased by a multiple that is directly related to the detectability and difficulty of proving the violation in court. The multiple is highest for the violations that are the most difficult to detect and prove, and lowest, near one, for violations that are easily detected and proven.

The Commission may not adhere rigidly to this method of computing penalties, in part because it frequently does not have the authority to assess penalties. It may require consumer redress, but that amount would not be subject to a multiple and hence is unlikely to be the optimal deterrent amount.[46] Fencing-in relief may substitute for monetary assessments, but it is often difficult to place a dollar value on the deterrent effect of such provisions. Many defendants would lack the financial resources to pay the penalty this calculation would require, so other deterrents are necessary. In some cases, it is difficult to estimate the dollar value of the injury to the victim. Nevertheless, computing the penalty with the use of multiples can be instructive, because it implicitly provides the information that a cost-benefit analysis would yield. Accordingly, the economic staff routinely attempts to use this method in advising the Commission.

For example, our experience with computing penalties using the injury times a multiple method suggests that the Commission should be extremely tough in fraud cases because they often involve large consumer injury, and because fraud is necessarily surreptitious and therefore commonly difficult

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matters).

45. *See* Gary Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968). If specific deterrence is instead the goal (deterring these particular lawbreakers), the penalty base would be the gain to the violator — a quantity often more easily estimated than injury to the victims. *Id.*

46. For redress in cases of violations of Commission rules or practices covered by cease and desist orders, *see* 15 U.S.C. §§ 57b(b), 57a(2) (1994). The Commission has also routinely obtained equitable relief, including damages, rescission, and restitution, in actions seeking injunctions under Section 13(b) of the Federal Trade Commission Act. *See* Federal Trade Commission Act § 13(b), 15 U.S.C. § 45.

to detect and prove. The appropriate multiple may be large if fraud is surreptitious. The resulting penalty target (injury times multiple) can be very large.[47]

The economist's penalty model is also useful in assessing the costs and benefits of seeking relief against agents as well as principals for deception, such as in deciding whether to challenge an advertising agency in addition to an advertiser in a deceptive advertising case. The economist's initial instinct is that it should not matter who in the agency relationship is assessed the penalty. The threat of penalty to either principal or agent is expected to lead the contracting parties to arrange their affairs to avoid lawbreaking by monitoring each other's compliance. But when one party in the chain can more cheaply detect and prevent deception, deceptive advertising should be deterred at the lowest social cost by imposing a monetary penalty or injunctive order on that party. Therefore, in a deceptive advertising case, the Commission should focus on the advertiser when it has provided the ad agency with unsubstantiated information. But when the advertiser and the ad agency have developed ads together with correct information but have conveyed the message so as to make the ad misleading, the ad agency might reasonably be named as well as the advertiser.[48]

The independent analyses of proposed enforcement actions conducted by staff economists have an indirect effect on Commission decisionmaking that is at least as important as their direct influence on Commissioner views. By institutionalizing an information-gathering and advisory role for economists, the Commission has created a dialogue between lawyers and economists during investigations that encourages the legal staff to undertake a balanced assessment of costs and benefits before recommending proposed enforcement actions. Thus, when a proposal seems likely to fail a cost-benefit test, the Bureaus of Competition and Consumer Protection commonly reconsider or revise their recommendation before forwarding it to the Commission.[49] Perhaps as a result, agency lawyers and economists make identical recommendations to the Commission concerning the vast majority of proposed enforcement actions.

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47. Even when the Commission is unable to levy a fine, it can deploy an array of tough remedies, including requiring consumer redress and tough fencing-in provisions, such as bans on continuing in related businesses or bonds to provide the means for paying consumer redress in the event violations continue.

48. *Cf.* Ford Motor Co., 5 Trade Reg. Rep. (CCH) ¶ 24,012 (1996); Young & Rubicam, Inc., 5 Trade Reg. Rep. (CCH) ¶ 24,012 (1996) (consent agreements accepted for comment April 6, 1996).

49. *See* ROBERT A. KATZMANN, REGULATORY BUREAUCRACY: THE FEDERAL TRADE COMMISSION AND ANTITRUST POLICY 52-54 (1980) (describing how Commission's interest in economic perspective encourages similar interest by legal bureau).

B. Seeking Out Lessons from the Past

The FTC also tries to improve its performance by evaluating the effectiveness of what it has done in the past. An example is an ongoing study of a number of the Commission's past divestiture efforts. The Bureau of Economics has combined forces with the FTC's Bureau of Competition to see what can be learned about improving the prospects of successful restoration of competition through divestitures. The preliminary results of this study are instructive. They show that some respondents have been able to undermine the FTC's ability to find a strong potential buyer or have hampered the buyer's ability to succeed. That is, these respondents have used the divestiture process to increase the costs of achieving the Commission's objectives.

Based on these preliminary results, the Bureau of Competition has implemented new policies in negotiating consent orders.[50] The time permitted for divestiture is shorter, and merging firms are encouraged to identify a buyer when proposing settlement. These steps reduce the time in which the merged firm will have control over the assets that it must divest, and help the Commission ensure that the buyer is viable. If the buyer appears weak, and the Commission staff has learned about potentially superior alternatives during the investigation, the merging firms can expect some hard questions about their settlement proposal.

In addition, proposed relief that requires discretionary post-divestiture actions by the respondent, for example when the divestiture involves technology transfer or a supply contract, will be treated skeptically. In such cases, "crown jewel" provisions are demanded, calling for divestiture of a broader group of assets when the initial divestiture is not effected within the prescribed time. Such provisions increase the respondent's incentive to sell the initial package during the initial period. They also provide a bigger, and presumably more attractive, package for the trustee to market if the respondent is unsuccessful. In order to enhance the stand-alone viability of divestiture packages, proposals to divest a narrow package of assets will also be treated with some skepticism. Instead, the required divestiture packages may go beyond the narrowest conceivable set of assets that would restore competition where there is a competitive overlap.

Another example of reviewing our experience to find lessons for the future is a study conducted by FTC economists of three horizontal mergers.[51] In one case, the FTC initially tried to prevent the merger but eventually

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50. *See generally* George S. Cary and Marian R. Bruno, *Merger Remedies*, 49 ADMIN. L. REV. 875 (1997).

51. *See* LAURENCE SCHUMANN ET AL., FED. TRADE COMM'N, CASE STUDIES OF THE PRICE EFFECTS OF HORIZONTAL MERGERS (1992).

dismissed its complaint.[52] The merger was allowed to proceed during the litigation, subject to the requirement that the acquired firm be held separate from the acquiring company.[53] The study found that, during the period of this "hold separate," prices for the product — corrugating medium used to make cardboard boxes — increased in ways that indicated the exercise of market power.[54] But after the "hold separate" ended, prices declined.[55] The likely explanation is that, while the "hold separate" was in effect, the plant's managers ran the business with an eye to the buyer's long-run investment interest. But because the order prevented them from doing business with the buyer, except at arms length, it was not possible to achieve efficiencies that combined operations offer.[56] The lesson drawn from this is that a "hold separate" order may have unwanted effects, and thus should be used with caution.[57]

The two other cases were also instructive about how the FTC's usual merger analysis is likely to work. In one, the only two cement plants in Hawaii combined to form what might appear to have been a "monopoly."[58] Their prices, however, were disciplined by imports, and, in fact, fell after the merger, probably reflecting the efficiencies of combined operations.[59] This acquisition was not challenged by the federal antitrust agencies. In the third case, a combination of firms producing titanium dioxide, a commodity chemical used in paints, apparently led to a significant increase in price that could not be explained by increased costs or other factors.[60] Despite the relatively modest change in industry concentration, the evidence is consistent with the merger having lessened competition in the U.S. market.[61] This acquisition was not challenged, but the FTC did block the next one in the industry a year later.[62]

CONCLUSION

The contemporary role of economic analysis at the FTC had begun to emerge by the early 1970s.[63] Since at least that time — two decades and

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52. *See id.* at 13.
53. *See id.* at 12.
54. *See id.* at 27.
55. *See id.* at 29.
56. *See id.* at 16.
57. *See* SCHUMANN, *supra* note 51, at 16-17.
58. *See id.* at 35.
59. *See id.* at 36.
60. *See id.* at 76.
61. *See id.* at 77.
62. *See id.* at 4 n.7.
63. *See* KATZMANN, *supra* note 49, at 52-54.

one Chicago school revolution in antitrust thinking ago — the FTC has employed an organizational structure and information-gathering process that gives it the information needed to determine whether firm or industry conduct is harmful, taking into account both costs and benefits, and whether a proposed remedy or penalty increases economic welfare. The availability of economic advice has by no means ended disputes among Commissioners, however, because enforcement actions often involve policy questions as well as technical issues about the probability and valuation of effects.

Notwithstanding shifts in the political composition of agency leadership, or fluctuations in the temperature of policy disputes (and resulting disagreements over how to weigh evidence), the FTC has created an organizational structure that helps it accomplish what cost-benefit analysis is intended to provide. By creating a large role for the Bureau of Economics — both in ongoing investigations and systematic evaluations of past regulatory efforts — the FTC attempts to achieve better results with fewer burdens on private parties. Economic advice helps the Commission make informed decisions in individual cases, target enforcement resources on the most serious business practices, and focus compulsory process requests and remedies to maximize net benefit to the public. Through the Bureau of Economics, in short, the FTC attempts to conduct regulatory reform in every individual case.