

Princeton University
Woodrow Wilson School

Spring Term 2005
Revised Preliminary Syllabus

WWS 523 Legal and Regulatory Policy Towards Markets
Lecturer F. M. Scherer
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Thursdays, 1:00 – 4:00pm; Robertson 012

This course develops and applies concepts and methodologies in microeconomics relevant to the formulation and analysis of public policy toward specific markets. It picks up where the various flavors of WWS 511 left off. It will delve into greater detail and depth on such matters as competition policy (i.e., in the United States, antitrust), consumer information and advertising, aspects of intellectual property policy, the regulation of public utilities (including telecommunications, energy, and transportation), and the privatization of public enterprises.

The course will proceed through lectures laying out the relevant theory and institutional background augmented by specific case studies, many of which have been prepared as teaching cases. A major aim is to develop participants' skills in applying economic analysis to concrete policy problems. Toward this goal, each student will (1) participate as prosecution or defense economic expert in orally arguing (and preparing a 1500 word brief on) an antitrust case; (2) writing a case analysis of the Pacific Gas & Electric Bypass problem; (3) writing one other short issues paper on a topic to be chosen; and (4) completing a longer term paper (roughly 15-20 double-spaced pages, due May 11) on any topic, domestic or foreign, within the scope of the course. For the case arguments original documents such as complaints and declassified experts' reports will be provided to the individuals responsible. Course grade components will include the antitrust case argument (20 percent), the PG&E case analysis (10 percent), the issues paper (20 percent), and the term paper (to be anticipated orally in class the week of April 25 (50 percent).

It is recommended that you purchase Stephen Martin, Industrial Economics: Economic Analysis and Public Policy, second edition (paperback). It will be available at the Princeton University Store, although Amazon.Com suggests that bargain used copy prices may be available. Other texts can be substituted after discussion. The least costly way to retrieve the numbered Kennedy School case studies (marked DL) is through downloading; instructions will be provided. Readings marked WWB will be available in packets at the Woodrow Wilson School business office (Robertson Hall ground floor). Other readings will be on shelf or electronic reserve; details to be provided. Readings with ** are of a relatively high level of mathematical difficulty and are considered optional.

Week
beginning:

Jan. 31 **Competition, Monopoly, and Oligopoly: Theory**

Martin, Industrial Economics, Chapters 1, 2, 3, 5, Chapter 6, pp. 150-169, Chapter 7; and pp. 547-561.

Feb. 7 **Antitrust Policy: Cartels and Collusion.**

Martin, Industrial Economics, pp. 169-193.

F. M. Scherer, Industry Structure, Strategy, and Public Policy, pp. 81-94 and 122-133.

John M. Connor, Global Price Fixing, Chapters 1, 2, 11, 12, pp. 368-379, and pp. 405-407.

Federal Trade Commission Complaint in re Polygram Holding, Inc., et al., Docket No. 9298 (The Three Tenors Case); and Transcript of Proceedings before the Court of Appeals for the District of Columbia Circuit, Sept. 16, 2004 (WWB). (Additional documents will be provided to the case arguers.)

Case Argument: The Three Tenors Case.

Feb. 14 **Antitrust Policy: Mergers.**

Martin, Industrial Economics, pp. 257-285 and Chapter 10.

U.S. Department of Justice et al., Merger Guidelines, April 1997 revision, pp. 1-30 (WWB).

Robert Willig, "Merger Analysis, Industrial Organization Theory, and Merger Guidelines," Brookings Papers on Economic Activity: Microeconomics, 1991, pp. 281-332 (including discussion).

Kennedy School Case Study CR15-99-1484.0, "Sagasco Holdings Limited" (DL).

Case Argument: Sagasco.

Feb. 21 **Antitrust Policy: Mergers and Efficiency.**

U.S. Department of Justice, Merger Guidelines, pp. 30-34 (WWB).

F. M. Scherer, "The Merger Puzzle," in Wolfgang Franz et al., eds., Fusionen, pp. 1-26 (WWB).

F. M. Scherer, "Memorandum to Attorney General Griffin Bell on the Proposed Merger of Two Steel Companies," in Scherer, Competition Policy, Domestic and International, pp. 253-258.

David Ravenscraft and F. M. Scherer, Mergers, Sell-offs, and Economic Efficiency, pp. 275-279 (WWB).

Kennedy School Case Study (draft version), "Archer-Daniels-Midland and Clinton Corn Processing" (WWB).

Case Argument: ADM-CCP.

Feb. 28 **Antitrust Policy: Dominant Firms.**

Martin, Industrial Economics, Chapters 4, 8, 15, and 16.

Michael Katz and Carl Shapiro, "Systems Competition and Network Effects," Journal of Economic Perspectives, Spring 1994, pp. 93-115 (WWB).

Kennedy School Case Study, "Microsoft on Trial" (draft version) (WWB).

John Heilemann, "The Truth the Whole Truth and Nothing But the Truth: The Untold Story of the Microsoft Antitrust Case," Wired, November 2000, pp. 260-311 (skim for flavor).

Case Argument: Microsoft: The U.S. Case: Liability, Remedies (readings should include the Litan et al. remedies brief, found by searching Google on "litan amici microsoft"; and the symposium in the Journal of Economic Perspectives, Spring 2001). Judge Jackson's findings of fact are found at www.usdoj.gov/atr/cases/f3800/msjudgex.htm.

March 7 **Antitrust Policy: Vertical Relations, Patents.**

Martin, Industrial Economics, Chapters 12 and 17.

Dennis Carlton, "Market Power and Vertical Restraints in Retailing: An Analysis of FTC v. Toys 'R' Us," in Daniel J. Slottje, ed., The Role of the Academic Economist in Litigation Support, pp. 67-96.

F. M. Scherer, "Retailer-Instigated Restraints on Suppliers' Sales: Toys 'R' Us;" in John E. Kwoka and Lawrence J. White, eds., The Antitrust Revolution, fourth edition (2003), pp. 373-387.

Federal Trade Commission, Generic Drug Entry Prior to Patent Expiration (July 2002), Executive Summary plus Chapters 1 and 2 (WWB).

Second Amended Class Action Complaint, Bernstein et al. v. Abbott Laboratories et al. (the Hytrin case), CV-72974 (August 2000) (WWB).

Case Argument: The Hytrin Case.

March 13-20 **Spring Break.**

March 21 **Regulation: Basic Theory.**

Ronald R. Braeutigam, "Optimal Policies for Natural Monopolies," in Schmalensee and Willig, eds., Handbook of Industrial Organization, vol. 2, Chapter 23.

Edward E. Zajac, Fairness or Efficiency: An Introduction to Public Utility Pricing (1978), pp. 21-32 and 73-93.

Harold Demsetz, "Why Regulate Utilities?" Journal of Law & Economics, vol. 16 (April 1968), pp.55-66.

F. M. Scherer, Industrial Market Structure and Economic Performance, first edition (1970), Chapter 22 plus **pp. 551-555.

Peter O. Steiner, "Peak Loads and Efficient Pricing," Quarterly Journal of Economics, vol. 71 (November 1957), pp. 585-610.

Kennedy School Case Study C15-86-713.0, "Competitive Bypass of Pacific Gas & Electric," plus C15-86-714.0, "Note on Competitive Bypass" (DL). Analytic paper to be prepared by each participant.

March 28 **Regulation: Access: Telecommunications, Electricity.**

Gerald W. Brock, The Second Information Revolution (2003), Chapters 12-14.

William J. Baumol and Gregory Sidak, "The Pricing of Inputs Sold to Competitors," Yale Journal on Regulation, vol. 11 (Winter 1994), plus comments by William Tye and Alfred Kahn, pp. 170-240.

**Mark Armstrong, Chris Doyle, and John Vickers, "The Access Pricing Problem: A Synthesis," Journal of Industrial Economics, vol. 44 (June 1996), pp. 131-150.

Kennedy School Case Study C16-93-1227.0, "The California-Oregon Transmission Project" (DL).

Kennedy School Case Studies CR14-01-1632.0 and 1633.0, "Disaster By Design: California's Experience with Electricity Restructuring" (DL).

April 4 **Regulation: Information, Health, and Safety.**

Martin, Industrial Economics, Chapter 11.

F. M. Scherer, Industry Structure, Strategy, and Public Policy, pp. 336-357.

Sam Peltzman, "The Health Effects of Mandatory Prescriptions," Journal of Law & Economics, vol. 30 (October 1987), pp. 207-238.

David Kessler and Karyn Feiden, "Faster Evaluation of Vital Drugs," Scientific American, March 1995, pp. 48-54.

Frontline Videotape, "Dangerous Prescription," November 2003 (screening arrangements to be worked out).

Marcia Angell, The Truth About the Drug Companies, Chapters 6, and 7, pp. 208-214, and Chapter 13.

April 11 **Privatization of Nationalized Industries I.**

John Vickers and George Yarrow, Privatization: An Economic Analysis, Chapters 2, 5, 6, and 12.

Kennedy School Case Study CR14-99-1533.3, "Office of the Rail Regulator (Abridged)" (DL).

April 18 **Privatization of Nationalized Industries II.**

Florencio Lopez de Silanes, "The Benefits of Privatization: Evidence from Mexico," Quarterly Journal of Economics, vol. 114 (November 1999), pp. 1193-1242.

John Donahue, The Privatization Decision, Chapters 4 and 6.

Additional privatization case study to be added, depending upon class size and interests.

Paper prospectus presentations to commence if class size is greater than eight.

April 25 **Presentation of Term Paper Prospecti.**

May 11 **Term Papers Due.**

Details on Course Assignments

Antitrust Case Arguments

Each participant is expected to argue orally and write a brief expert report presenting one side of an antitrust case, with the choices of cases and sides to be determined by a bidding process. Since the first case argument comes in the second week in the course, volunteers are requested, preferably in advance of the first course meeting but not later than the first meeting. (If there are no volunteers, the choice will be randomized.) All members of the class will be provided with either a copy of the case-initiating complaint or a formal case study presenting the facts in a decision-oriented framework. To the maximum extent possible, the arguing experts will be provided with additional materials and may download additional documents from the relevant web sites -- e.g., for the Department of Justice Antitrust Division, www.usdoj.gov/atr/cases.html, and searching the alphabetic case index; and for the Federal Trade Commission, www.ftc.gov/os/caselist/index.htm, same search procedure. The format of the oral argument will be (1) case for prosecution, 20 minutes; (2) case for defense, 20 minutes; (3) prosecution rebuttal, 5 minutes; (4) defense rejoinder, 5 minutes; (5) questions from class, 10 minutes. Written briefs (approximately 1500 words) are due at the end of class the day of the argument, except that an additional week will be allowed for the first (Three Tenors) case.

Pacific Gas & Electric Bypass Case

For class the week of March 21, each participant is expected to write a report (1) estimating from the case data, especially Exhibits 4 and 9, PG&E's supply function, assuming, not in all generality, availability of all electricity sources; (2) estimating (e.g., from Appendix 1) the long-run and short-run average costs of the most likely bypass generators; and (3) proposing changes in PG&E's rate structure to minimize the bypass problem. Class members may cooperate to work out their conceptual approaches, but the final estimates and the papers themselves should be prepared independently.

Issues Paper

During the period following the spring break, each participant is expected to write an "issues paper" not to exceed 1500 words on some issue raised by the course materials. It can be an analysis of one of the assigned Kennedy School case studies. Or alternatively, it could be on any of the following topics, stated in order of their chronological appearance, or on any other relevant topic of your choice:

- 1) Was the breakup of AT&T in 1983 an economic success? Why or why not?
- 2) Should access to bottleneck facilities be priced according to the efficient component rule, some measure of incremental cost, average cost, or by some other criterion? When is each rule most appropriate?
- 3) What went wrong with California's electricity supply in 2000-2001? How could it have been prevented?
- 4) "America as Third World:" Preventing electric power blackouts (such as the August 13, 2003 blackout).
- 5) Encouraging entry into last-mile fiber optical cable installation.

- 6) The U.S. airline crisis: sequitur of deregulation?
- 7) Reforming the regulation of new pharmaceutical entities.
- 8) The Vioxx crisis of September 2004.
- 9) Regulating direct-to-consumer drug advertising.
- 10) Regulating childrens' television advertising.
- 11) Maintaining information media diversity.
- 12) Keeping the railroad tracks in good condition under divided ownership (e.g., the British Rail experience, or Conrail).
- 13) How to privatize a public utility in the ... field.

Papers are due the week after the relevant substance is covered in class, but students are advised to begin well enough in advance to participate actively in class discussion.

Term Paper

Each participant is expected to write a longer (15-20 double-spaced pages) term paper due May 11. It can be on any topic covered by the course or to which the analytic tools developed in the course are relevant. It could be an expansion of one of the antitrust case analyses or some other antitrust case (for a range of alternatives, see various editions of John Kwoka and Lawrence J. White, The Antitrust Revolution), or an expansion on one of the topics listed above. Or to add a non-exclusive list of other possible topics: determining whether natural monopoly exists, trucking company mergers (e.g., Yellow-Roadway 2003), ocean shipping cartels, the European Microsoft case, determining whether pricing is predatory in monopolization cases, European blockage of the proposed General Electric - Honeywell merger or Europe's intervention into the Boeing - McDonnell Douglas merger, reversing the trend away from nuclear power, pipeline price cap regulation, telephone-over-cable services, vaccine supply shortages, Ramsey-Baumol-Bradford pricing of pharmaceuticals, how much interface information should Microsoft be required to disclose?, keeping AMTRAK or commuter trains running, restructuring the defense industry, etc. For most of these topics, leads to relevant source materials can be provided.