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Patrick A. McNutt, *Law, Economics and Antitrust Towards a New Perspective*. Cheltenham: Edward Elgar, 2005. 432 pages. ISBN 1-85898-785-7. GBP 75.

Law, Economics and Antitrust Towards a New Perspective does indeed provide a refreshing new look at the economic analysis of law and in particular its application to market behaviour. The book clearly draws on the author's expertise as an economic consultant, seeking to provide a conceptual overview of different economic perspectives of law. The book also benefits from his experience at the helm of the Irish and Jersey competition authorities and seeks to offer new ways in which the competitive process should be understood. McNutt argues that "competition authorities may have to re-evaluate their approach to firm conduct by interpreting conduct in a dynamic context and may have to

recognize that firms can compete on dimensions other than prices, such as innovation, product variety and product quality..." (p. 195). Of course economic criteria and a proper economic analysis are essential in contemporary competition law enforcement. Equally, one of the key points made in the book is that one should not focus exclusively on the microeconomic "structure-conduct-performance" (SCP) paradigm which is embedded in classical antitrust analysis (p. 207). Microeconomic models are but one tool to understand and analyse the competitive process, they cannot sufficiently take account of all important welfare considerations and they are not the "absolute truth" as developments in economic thinking have shown over time (Schaub, European Competition Law Annual 1997, p. 126).

In McNutt's view, "firm behaviour can no longer be understood as emerging from the Stigler-Bain world but has to be seen as emerging from a more complex world of strategic interaction" (p. 278). The existing "toolkit" for competition law enforcement, which remain centred around structural criteria such as market shares, argues McNutt, is deficient. However "we are not completely at a loss, for the formal tools of game theory and the critical analysis of non-market economics offers us a starting place for understanding the forces that are at work in situation in which firms behave strategically." Game theory – "the economic study of strategy" – should be used to better understand, explain and predict the strategies and behaviour of "players" seeking to secure the best outcomes for themselves in any "game". In competition policy terms, McNutt suggests that market failure can be avoided and competitive markets can be maintained by paying more attention to the implications of asymmetric and imperfect information on firm behaviour, competition for the market (pp. 192, 212 and 326) and dynamic interactions between competitors (pp. 194 and 272), citing the CFI judgments in *Gencor* v. *Commission* and *Airtours* v. *Commission* as good examples of judicial economic literacy and sophistication (pp. 247–250 and p. 273).

The book comprises 12 chapters and begins in chapter 1 with a discussion of how "law and economics", or more accurately described as "economic analysis of law", can and should be used to analyse market behaviour and a range of social phenomena. Economic theory provides a way of thinking about legal rules as a "system of incentives" intended to affect all types of behaviour. In seeking to clarify certain economic concepts – rent-seeking, imperfect information, how institutions affect trade and exchange – McNutt hopes to merge the economic concern for a "more efficient law" (p. 2) and the legal interest in greater fidelity to law (p. 16). As is the case throughout the book, McNutt uses case studies and parables to illustrate and review how ethical norms, information asymmetry, and institutions shape individual preferences by influencing who interacts with whom, who performs which tasks, and with what payoffs. Alongside neo-classical and neo-institutional economics, McNutt also considers behavioural economics and the fact that morality, altruism or fairness may be important in explaining behaviour, even though they would be irrelevant to *Homo economicus*. The frequently observed rejection of substantial positive offers in the so-called "ultimatum game" confirms this point (p. 23). Rational self-interest cannot always explain how individuals react to legal rules and what the likely consequences will be.

Chapters 2 and 3 deal with the inter-related issues of the existence and function of property rights, the theory of the firm and the law and economics of contracting. Incorporating the insights of Ronald Coase and Karl Marx, McNutt explains the role and importance of incomplete contracts and transaction costs in allocating resources within a firm (rather than through a market exchange). McNutt moves beyond the hierarchical theory of the firm, however, using his hypothetical "s-firm", in which property rights and economic rents are efficiently allocated between workers and management in order to maximize joint work-effort. Chapter 3 then seeks to provide an "evaluation of the economic dynamics of a legal contract" by explaining how the law ought to offer parties the right incentives, help them overcome imperfect information, reduce transaction costs and ultimately encourage the enforcement of efficient exchanges (whilst discouraging the performance of contracts which do not satisfy the criterion of optimal efficiency). When considering the economics of contracting, it would have been interesting to move beyond the "allocation" question facing

contracting parties and consider the "distribution" implications, in particular on the welfare of consumers who have been priced out of the market (a group of stakeholders often ignored by modern antitrust).

McNutt also considers the economics of liability with a view to identifying a set of rules which is efficient in the sense of minimizing the costs of abating accidents, either measured in terms of the effort of the tortfeasor to prevent harm or the effort of the victim to avoid harm. Chapter 4 discusses the moral hazard-type problems in assessing liability and accident deterrence as well as the Calabresi principle that liability ought to be placed on the party who is the "least-cost avoider." The cost-benefit analysis and efficiency of liability rules is of interest beyond tort law and reminds one of similar calculi underlying the grant of leniency and the imposition of optimal fines in antitrust cases.

Chapter 5 deals with the vexed question of whether, and if so under what conditions, property rights can be expropriated under the auspices of antitrust law. Making novel use of Isaiah Berlin's concepts of positive liberty (a right to do something) and negative liberty (freedom from restraint), McNutt analyses the so-called "essential facilities doctrine" in European competition law. He cogently observes that "there is an unmistakable tendency amongst regulators to focus on the positive liberty of the entrant at the expense of protecting the negative liberty of the incumbent" (p. 121) and scathingly notes that "the treatment of property rights is traditionally silent in competition assessment" (p. 123). Whilst this chapter is full of useful ideas on avoiding inefficient entry assistance, conditions of efficient entry, workable competition and the like; it is probably best reserved for a reader who is already familiar with the underlying issues. The chapter does contain a short discussion of the key jurisprudence (albeit omitting the *IMS* and *Microsoft* decisions in Europe), but is meant to be a normative discussion of how a regulator should balance investment incentives and free riding concerns, on the one hand, with the bottleneck problem, on the other hand.

Consistent with the central theme of the book, chapters 6–8 seek to expand the lexicon of contemporary antitrust analysis. Chapter 6 introduces us to the idea of firms collaborating as "clubs" in order to prevent "rent-destroying competition" and avoid the costs of inefficient entry, in the same way as property rights provide a solution to the well-known "tragedy of the Commons" problem (p. 167). Chapter 7 then highlights the importance of "signals" which authorities send to the firms through their action (and inaction) and how those signals, in turn, inform and influence market behaviour. This regulatory signalling and firm response gives rise to a central conundrum of competition law and policy: "each national competition agency will have to find a judicious balance between adopting expansive prohibitions and facilitating aggressive but efficient economic activity, between deregulatory measure and competition, whilst ensuring that the benefits of effective enforcement are not diffuse" (p. 204). Chapter 8 develops this point in discussing "competitive harm and public policy" and in particular how Williamson-type transaction cost economics may supplement, and one day replace, the conventional SCP approach. For example, McNutt is very keen to avoid structural antitrust policies obsessing about the number of firms in the marketplace at the possible expense of realizing economies of scale (p. 222).

Chapters 9–12 respectively seek to explore the relevance to competition policy of non-market economics (the study of rational choice), evolving market dynamics, different types of competition and moral hazard problem arising from public competition law enforcement. Applying non-market economics to antitrust, McNutt argues, would base enforcement on workable (and not perfect) competition and require the competitive process to be analysed in dynamic (and not static) terms. In this respect, McNutt draws attention to the importance of product differentiation, excess capacity and the "Schumpeterian" rewards for innovation. Together with the point made in chapter 10 that competition should be analysed as a strategic and multi-dimensional process, the author has high hopes that competition agencies would be more likely to "adopt an analysis of efficient and wealth maximization – and make use of the advance in industrial organization theory and strategic game theory to better predict the effects of mergers and assess the impact of specific business practices" (p. 254). In

trying to explain the strategic interaction that underpins market competition, chapter 11 explains three types or models of competition. Chapter 12 is a particularly interesting discourse of the "value of competition", emphasizing the pro-competitive and benign nature of vertical relationships, the importance of competition for the market (as occurred in the OFT draft Opinion on Newspaper and Magazine distribution), avoiding the use of "magic" market shares and the interaction between corporate structures and competition. His clarion call is for competition law and policy to be responsive to the nature and dynamics of real-world markets and not just the textbook models of perfect competition.

All in all, this is an interesting and thought-provoking book. As the Chief Economist for DG Competition, Lars-Hendrik Röller has cogently observed: "the question for effective enforcement is not of 'more' or 'less' economics, but rather what kind of economics and especially how the economic analysis is used." This book provides a useful contribution to helping one answer that question. In places it is akin to a patchwork quilt of ideas and case studies, but certain themes – the importance of moving beyond SCP and embracing the insights of transaction cost economics and game theory in particular – are clearly presented. It is probably more suited to a reader who is well-versed in the literature on the economic analysis of law or antitrust law, or ideally, both. The influence of economics and its various schools of thought – neatly highlighted in this book – reminds one of the prescience of Keynes when he remarked: "The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else."

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