

**The Legacy of *Matsushita*:  
Has this Thing Called Economics Gotten Way out of Hand?**

**by**

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**Matsushita at 20  
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The opinions expressed are those of the author and do not necessarily reflect the views of the Federal Trade Commission or any individual Commissioner.



One of the roles was that the theory of a case has to be subjected to an economic sense screen in which economic theory plays or at least could play a prominent role. Recall the basic facts of the case. Two U.S. electronics companies brought suit against, in effect, seven Japanese electronics manufacturers for collusively engaging in predatory pricing. Despite the compilation of a massive record, there was no direct evidence of the sort of conspiracy that could have led to damages to be owed to plaintiffs. The Court found for the appellants and granted the motion for summary judgment in their favor. In doing so, it ruled, “If the factual context renders respondents’ claims implausible – *if the claim is one that simply makes no economic sense* – respondents must come forward with more persuasive evidence to support their claim than would otherwise be necessary...”<sup>5</sup> (emphasis added). There were two aspects of the case that, according to the Court, were particularly implausible. The period of predation was supposed to have begun in 1953, more than twenty years before the case was filed. Even if the Japanese companies were eventually to drive U.S. firms from the market, the present value of the entire strategy had to have been negative. Moreover, however implausible the predation strategy would have been for a single dominant firm, the allegation was that the companies had colluded in the predatory scheme. This would have required the cartel to be stable for decades. The members would have had to agree on both the allocation of losses during the predation period and the allocation of gains in the post-predation period.

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As important as *Matsushita* was, it left some important unanswered questions. It set out a two-pronged test for demonstrating predation. Plaintiffs must demonstrate pricing below the “relevant measure of cost,” and it must demonstrate that the alleged predator had a reasonable prospect of recoupment.<sup>9</sup>

The appropriate measure of cost remains a large open question. I will return to that later when I discuss the airlines cases.

The Court also gave little guidance as to the standards for demonstrating the plausibility of recoupment. The claims in *Matsushita* were so preposterous that there was no need to discuss details at that time. Any of the remotely plausible approaches would give the answer that recoupment after a twenty-year predation period was implausible. From the decision itself, it is hard to know whether the “economic sense” screen was intended as a very tight screen in which a professional economist would be needed to make the call, or whether it would be a kind of “sanity check” that would not require much in the way of formal economic tools.

Recall that in *Matsushita*, there was no evidence of the alleged conspiracy. A related big question is what would happen if there were evidence of the alleged anticompetitive behavior alleged. Presumably, if there was evidence of an actual conspiracy, it would have been deemed per se illegal; and economics would not have played a major role in determining liability. What if the case involved predation by a single company and there was evidence that it actually attempted predato

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The question raised by *Brooke Group* is, if evidence of actual expectations of recoupment are not sufficient to demonstrate recoupment, then what in addition to company documents would be necessary? One possibility is that plaintiff must demonstrate actual recoupment. Another possibility is that plaintiff would have to show that the expectations make economic sense.

A fundamental difficulty with this latter position is that what it means for expectations to “make economic sense” is not as clear as one might hope. The economic approach to understanding expectations would be to assume that each firm expects other firms to behave in their own economic interest. But the behavior of other firms in turn depends on their own expectations. The problem is the province of game theory. Some economists would argue that the solution is to look for the suitable Nash equilibrium. Despite the extensive effort economists have devoted have de

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Still, *Brooke Group* would seem

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One problem is that, as the Areeda-Turner rule is implemented, average variable cost means average variable *accounting* costs, which is different from average variable economic costs. To take a specific example, the government proposed various cost measures that included airplane expense. The district court in the case ruled, "Aircraft ownership costs are properly considered fixed costs in the industry, and are not an avoidable cost of changing capacity in a route."<sup>19</sup> This statement is simply wrong as a matter of economics. If American increased the number of available seat miles as part of its response, then the airplanes were an input that varied with the level of output. Exactly how those costs should be measured may not be a simple matter. The answer would be different in a period like the late 1980's, when airlines had invested in far too much capacity and were "parking" their planes in pl

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I began by asking whether “this thing called economics has gotten way out of hand.” When economists testify on subjects where the economics is inherently inconclusive, there is a real risk that it will get out of hand. It won’t, though, if economists focus on the basic issues like the proper measurement of cost.

Thank you.