

Law, Policy, and the Convergence of Telecommunications and Computing Technologies

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THE 2001 WILLIAM W. COOK LECTURE ON AMERICAN INSTITUTIONS: "THE ROLE OF GOVERNMENT IN THE EMERGING HIGH TECH GLOBAL ECONOMY"

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JOEL KLEIN: Thank you, Jeff, for that very warm, generous introduction. You do not know how honored and pleased I am to be here and to deliver this truly prestigious lecture. And I want to thank all the people you thanked by name, but whose names I don't know for having made this possible, but I especially want to thank you for your efforts in bringing me here and asking me to think about America's institutions.

I've been out of the government for about six months, and I've had a lot of time to think about those things. And I want to agree with a couple of points you made in your introduction and pivot from those into some remarks.

First, I think the changes brought about by the revolution in information technologies and biotechnologies are so profound that none of us alive today can truly appreciate their implications. I think we are at an inflection point in history. And at such times, understanding of the significance and endurability of institutions can be very critical because rapid change, as much as it bangs against individuals, can bang against institutions.

Second, something you said that I think is very important now, and that is that we are at a time in an intersection between wealth creation and other institutional values that are being generated by this particular set of technological revolutions that's going to pose some great challenges. And there is a tendency, in many quarters, to seek refuge in complexity as a way to obscure. And I hope if my remarks achieve nothing else today, they bring a certain simplicity to that which is enduring even though we move through a time of rapid transformation and change.

And finally, I couldn't help but note that you mentioned that I have become a household name, but how quickly that fades! I left the Justice Department in October, and the following . . . I left on a Friday, the following Monday I was walking to make a speech at a television museum, and as I walked in I heard one person lean over to another and say, "You see that guy? He used to be Joel Klein!" And I compared that with four years earlier, and you know, there's that old great song, now that I'm in the media business, "Used to Be's Don't Count Anymore," and I compared that with four years earlier, and about three days, literally four years earlier, three days after I took my job I had the good fortune to announce a settlement with Archer Daniels Midland for \$100 million for a cartel case. We had never seen anything like it in the history of antitrust--up until then the largest judgment or fine was about \$10 million. And it was a big deal. Of course I had nothing to do with it, I just happened to be there to announce it. And I was on all the news and everything that night. And I heard from everyone, old girlfriends who said, "My mother was right, you did amount to something!" All of that! And it was about three days. I mean it was a cartel, nobody would defend it, it was about three days as good as it gets. And then of course on the fourth day there's an op ed piece in one of our nation's leading newspapers entitled, "Hey Joel, This is the Land of the Free." And it goes on to take a pretty heavy whack at me for

interfering in a free market economy and not understanding business practices and so forth and so on. So that Friday I came home from work, sat down, and was having a stiff drink when my daughter came home from school. She was then 12 1/2. She said to me, "Hey, Daddy, I saw you in the newspaper today." You know, my first thought was what kind of 12-year-old reads the Wall Street Journal? But then I thought, "Well this is the price you pay if you send your kid to private school with lots of Republicans!" But I was worried about it because she was 12 1/2 and very impressionistic, and I was worried about how she would take the article because it was quite harsh (hi Chris!) it was quite harsh about me. And I was trying to think of how to explain to her about the media comments about which I'll make a little later. And before I could say anything she said, "You know, Daddy," she said, "you're just like Madonna." And I said, "Julia, I don't understand, what do you mean just like Madonna?" She said, "Well look at that headline, it says, 'Hey, Joel, This is the Land of the Free.'" She says, "You know how few people in America are known only by their first name Daddy?" She said, "You, Madonna, and Cher!" So my view is that if my daughter thinks I'm in the same league with Madonna and Cher, have at me Wall Street Journal!

What I want to talk about today is really trying to think about the experiences I had during the last seven years--first as Deputy Counsel to the President and then for the past four years as head of the antitrust decisions. And especially in that last period, I arrived at a time of enormous challenge and complexity, and I made numerous decisions about . . . as I say in the theaters you should keep your cell phones off and all that! I made numerous decisions about mergers and anticompetitive practices that had a significant bearing on our economy at a transformational time in economic history-- decisions involving many major US corporations--from Microsoft to American Airlines, to Archer Daniels Midland, to the telephone companies, the banks, and lots and lots of others. I got to look at tons and tons of documents, meet with numerous CEOs of our leading companies, and talk to endless experts-- industrial experts and academic experts who are generous with their time. And I watched and observed our economy during an enormous transitional period--from one that went from perhaps what we used to call the old economy, to something that we now call the new economy that makes a conference like this possible. And just think about it--when I started in government, no one but a few propeller-heads at DARPA (Defense Advanced Research Projects Agency) really knew what the Internet was all about. And it was a remarkable personal as well as professional experience, and I am grateful beyond measure for having had the opportunity. And based on that experience and the time I've had to think about it (and I spent about four and a half months between jobs), I've come to the conclusion that we as a nation put too much faith in the free market, and not enough faith in government. And let me be clear, I say that with enormous respect and admiration for markets, and some real disdain for certain government actions that we have observed, including some in the antitrust arena. And to me the argument is not about what I will characterize as the false dichotomy between free markets and government regulation--a sort of left/right issue. That's not what this is about. Rather, it is about getting it right--how we create a society in which markets are allowed to do what they do best while government is allowed to do what it does best.

And in that regard, I want to summarize the three points that I'd like to develop here today. First, I believe that competitive markets do provide the best way to maximize wealth creation and that therefore as an operational principle, government ought to be very careful about imposing regulation that tends to make markets less competitive. Second, I also believe that in the absence of consumer-driven antitrust enforcement, markets will not remain competitive, but instead will

be regulated (if I can use that word in this context) by dominant companies exercising market power to their advantage and at the expense of the economy and consumers. And third, and to me this is the critical point I want to get across today, in my view I believe even if, even if we get the intersection between one and two (that is between . . . if antitrust enforcement turned out to be perfect), even if we get that right, what we will have done, which is important in itself, is to have maximized wealth creation. We will not have answered certainly the [inaudible] if not the more important question of how we allocate the wealth that we have created--how much that we as a society spend on a safety net to protect the less fortunate, how much we spend on education and healthcare, which rights we protect, and which interests we advance or retard. All of these questions at myriad levels must be resolved one way or another by some form of government and not resolving them and abandoning them is a resolution in itself. The Market, bless its many virtues, no matter how efficient and effective it might be, will not resolve those fundamental issues for our society. And how we resolve those issues of allocation and values, I submit, probably even more than how big a pie we bake, will say a great deal of what kind of people we are and what kind of people we will be.

In sum, the thesis I want to discuss with you today is that as far as America's institutions go, as we stand here now, at the dawn of a new century, and in many ways as this conference reflects, a new era, a high-tech era, information and biological, a globalized era unprecedented in economic organization, we are at serious risk as a people of undervaluing government and perhaps relatedly overvaluing the free market. This can have significant consequences for our nation, our children, and our lives, and I don't think this is a partisan point in any way, shape, or form.

But first, let me start by giving markets their due, which is plenty. And I think it is probably going to surprise some people, but I really do have a great respect for the free market, and I'm quite skeptical, quite skeptical about a lot that takes place today in the name of governmental regulation. I believe that the best market regulator there can be is competition by free, and independent competitors. And when that exists, the government ought to stay out. I don't think the government ought to try to improve the competition that competitors are likely to bring. Most importantly, I think government ought to be careful about creating or improving competition through measures like forced access and price regulation. There may be times, as I'll come to, when they are necessary, but one ought to be skeptical about them. Such measures by and large are either ineffective or worse, they distort incentives in a way that ultimately will harm the economy. For example, by forestalling or eliminating research and development that could lead to new innovation and new services or products.

The reason competition works so well is precisely because it's atomistic--because it keeps everyone focused on bringing value to the customer or the consumer. I remember a conference I was at where somebody did a takeoff on James Carville's, "It's the economy, stupid," and said, "It's the customer, stupid," and I think that's right. But where regulatory impositions, hurdles exist, economic players necessarily focus, at least in part, on how to deal with those hurdles to their own self-advantage, how to position themselves in the political/regulatory process, to secure the benefits of hurdles, to try to reduce those hurdles, and this can have all sorts of unintended and I think economically inefficient effects. It was a day not so long ago when we had a lot of this kind of what I like to call "top-down" regulation--that is where government was by and large in the business of price and access regulation. Washington had numerous agencies like the ICC (Interstate Commerce Commission) and the CAB (Civil Aeronautics Board), which

used to regulate surface and air transportation. Today there is still some. The FCC (Federal Communications Commission) and FERC (Federal Energy Regulatory Commission) probably the most prominent, but even they, I believe, are not likely to be long for this 21st century world. Technology, driven by our ever-vigilant entrepreneurial spirit, will bring us competition and local service and local telephone and energy service, and that will be, I believe, the end of price and access regulation.

Now I want to make . . . as I said, everything should have its appropriate caveats, I want to make a point here, and that is the problem which leads to things like price and access regulation, is often these transitional periods. And again, I think we need to be cautious as we approach them, but as you take the local telephone monopoly or the local utility monopoly in energy and try to transform it to competitive markets, you can't just say, "Let the games begin." And so inevitably we get a fair amount of the kind of regulation that we've seen, for example, under the 1996 Telecom Act. The truth is while I think it's necessary and I certainly supported the approach that was taken, the fact is here we are almost five years later, and it's been rather limited effects in this process. And it seems to me and it's always seemed to me (and I've said this previously), that if we're going to have, for example, meaningful competition in telephony, it's going to be through different wire, wireless structures to the same home, it's not going to be through an endless series of litigations and regulations trying to figure out the right price point for competitors to gain access to the local loop that's controlled by the monopolist. It may be necessary, but it's certainly going to be ineffective. And in the end it seems to me that whether it's DSL, cable-modem, satellite transmission--the new technologies--with the ability to transform, not just access to the home, but to create a whole new business model, the thing that all these people who are leading these panels are out there trying to figure out, those will be the driver. And unfortunately for all of us, there are going to be these in-the-meantime debates that have to take place, that will be frustrating, and my own advice to policymakers is in that arena, give the Market as much free . . . as much headway, as much leeway as you can, because it is probably (not always but probably) a better way to lead to good outcomes than through top-down regulation. The amazing thing about what I've just said, it's actually enormously important, and yet it's not very controversial. You know, 20/30/40 years ago, when I was sort of in college was . . . certainly 30 or 40 years ago, when I was college and law school, there were serious debates about the best way to organize one's economy. People actually talked about socialism, managed capitalism, free and independent markets and so forth, but it was a serious set of debates. Interestingly, there's very little of that as we stand here today. I mean a decade ago, at conferences I used to attend, people talked about the European model of national champions and heavy regulation. Even more important, the Asian model of sort of government-managed capitalism--the Keiretsu type structure, the Chaebol structure in Korea--as being the juggernaut that would rule the economy of the 21st century. And remarkably now there's almost universal consensus throughout Europe, Asia, and America, that atomistic capitalistic competitive markets are probably the best way for wealth creation, pure and simple. That is a remarkable fact and a critical fact in understanding where we are in a world history today.

Now this brings me to my second point, and now, at least, we'll start to get a little controversial, and I see this as a conundrum, and that is that free and competitive markets work, but markets won't remain free if left alone. Especially this is true in the areas in which we're going through deregulation. The reason they were regulated in the first place is because typically there were very few competitors, often times one, and there were significant barriers to entry. And as a

result, that's why we had to have regulated monopolies. In any case (and this is something people seem prepared to debate and I find it astonishing) that if the government simply abandoned antitrust enforcement, that our markets would remain free and competitive. And I can give you several different examples that come to mind, but it seems so obvious to me. If you were in business, you would rather eliminate competition, sell your products at a higher price, and make greater profits. And everybody admits that an unregulated monopolist . . . if the local tel. co.'s didn't have price regulation over the last 30 years, they certainly would have been able to charge much higher prices and made much more profits. And yet do people think if the government went away, that people wouldn't fix prices or merge to monopoly. Today, for example, Boeing and Airbus--two titan competitors--only two of them--create civilian aircraft. It's a highly competitive market because these are huge purchasers from there, two big competitors. Why wouldn't they merge if there was no merger policy? And do you know the significance that would have in terms of cost of civilian aircraft and in terms of innovation in civilian aircraft if we move from two to one? People are all over the news these days about the airlines going from six to three in America today as a possible scenario as we watch several pending mergers. Why wouldn't they go to one if there were no antitrust enforcement? And I could go through example after example that make this obvious point. So therefore I think we're not debating whether there should be government intervention in a free market economy, we're simply debating how much, how often, and what circumstances. I think that's an important debate. But that's a regrettable conclusion, let me be very candid with you. I would rather a world in which competitive markets were truly self-sustaining--in which people wouldn't price-fix or merge in their self-interest to monopoly power, because when there is government intervention, necessarily people will be making important decisions--these were difficult decisions I made when I blocked the WorldCom/ Sprint merger, when I blocked the Lockheed Martin/Northrop Grumman merger. And of course nobody has perfect foresight much less perfect . . . I mean perfect hindsight much less perfect foresight in this kind of world, and so necessarily the art of government intervention is imperfect. People used to ask me "What is the most important quality for the job you're now in?" I used to always say "a thick skin and a heavy dose of humility." But the truth is human imperfectability cannot be a prescription for abdication here.

Sound antitrust enforcement I believe is doable, frankly I think is less difficult than some of the newspaper discussions might suggest. And actually in my view I think it can be reduced to two simple principles about which the facts may make their application complicated in specific incidences, but the principals I don't think are essentially that complex. And basically we focus on these words I've used before, it's a well-understood microeconomic concept called market power. And what is market power? Market power is simply in the absence of competition, what a business would price its product out or what innovation it would do. And to give you the simple, trivial example (and you can think of millions of others), if in a town there were two gas stations and those gas stations have to compete, it will drive the price of gasoline pretty close to the costs of the two competitors. And you might have a cost advantage that would allow you to charge a little more or a little less, and you also need to get some return on capital to pay for your time and so forth. If those two gas stations were to merge or be allowed to set prices, and for some reason there was a zoning ordinance and you said you couldn't have anymore gas stations, those two gas stations would raise the price immediately, they would figure out the intersection of their price and demand curves in a way that would allow them to maximize profit and not compete it away in the process. That's all that market power is about, and that is what drives business. When you're in business (which I now am), what you're interested in is getting market power--brand

recognition, a little bit of a differentiated product so that somebody will stick with you through some period of time, pay a little more for your name, you want a first-mover advantage if you can get it, you want to have barriers to entry around your position if they can be had, and so forth and so on. And the only question we need to focus on in this debate is how you go about getting market power. There are good ways to get it and bad ways to get it.

And in my view, the first principle that we need to assure (not complex) is that government cannot allow businesses to gain market power through merger or through cartel-like agreements, that is price-fixing or market allocation agreements. Rather, market power should be allowed under one circumstance-- should be earned the old-fashioned way through what antitrust laws generally call "superior skill, foresight, or industry." If you develop a computer program that everyone wants, go ahead, make a bundle, that's the American way. But don't make a bundle by agreeing on prices with your competitors or merging with them to eliminate competition. And if government doesn't prevent these kinds of things, that is agreements or mergers, no one else will. People will make a bundle and just as theft would be prevalent in the absence of law enforcement, so too would agreements to eliminate competition.

Now the second and admittedly more controversial thing that governments need to do to protect competitive markets is to make sure that market power, even if legitimately earned through superior skill, foresight, and industry, is not used to prevent new entrance and thereby prevent competition from reemerging. Let me give you an example of what I'm talking about here. Suppose that a company through lawful means gains a monopoly on personal computer operating systems, which in practical terms means that no computer manufacturer can sell a PC without using that operating system. That's a good position for a company to be in, and not surprisingly, a company having such a monopoly would not want to give it up. And so that I'm clear with everybody here, that's a perfectly reasonable thing for a business to want. But how it goes about protecting itself can be absolutely critical to our economy, to innovation, and to consumer welfare. If it does it by improving its product, by bringing some new innovation to the market, that's all the good for consumers and for the economy. On the other hand, there are a couple of things that a monopolist might do to protect and extend its monopoly, which without government intervention would harm our economy, lead to higher prices, and less innovation. I don't want to use jargon here, but after all this is a law school, so let me say at least this much.

The two activities I'm about to describe are classic anticompetitive tactics that have long been condemned and must continue to be condemned in a new economy as well as the old. The first is generally called exclusionary behavior, and the second generally called predatory behavior. And as for exclusionary behavior, this is simply behavior that prevents others from getting product out, which in no way benefits consumers. The simplest example (and let's just take this example that I started with before), suppose our operating system monopolist said to all the computer manufacturers, that "You can't get my operating system unless you agree not to buy software-- any kind of software (word processing, any kind of software) from any other company." In other words, "If you want my operating system, which you need to run your computer, you've got to get all your software from me." There's nothing good, absolutely nothing good about that for our economy or consumers. But it might well be good for an OS (Operating System) manufacturer who wants to extend its one monopoly into multiple monopolies. It's exclusionary and the government should step in to prevent it.

Now let me shift to the second type of behavior--predatory behavior. It's a little more complicated because this is a way where you create a short-term benefit for consumers, but the only purpose is to kill competition and then recoup much more in the long-term. So let me change the facts a bit. Suppose this operating manufacturer sees a potentially competitive product (let's just call it a browser for this discussion) that's being manufactured by another company. And suppose the operating system manufacturer thinks this new piece of software could undermine his operating system monopoly because it will be on virtually all computers. In order to create a platform, you need ubiquitous distribution. Very few pieces of software are going to be on all computers-- operating systems are one; in our history the second one that's as close to operating systems in ubiquity are browsers. And the fear is if you have ubiquity, applications writers can now write to your software, so the reason that an operating system monopoly has real power is because all the apps writers write to it, that makes the operating system more in demand, which makes the apps writers write to it. And so a strategy to defeat that kind of market power would involve finding another type of software--the browser--for the potential for ubiquitous distribution and the exposure of API's (Application Programming Interface) so that other programmers could write at least in part to your system, your new browser, that you have out there. Now faced with that kind of challenge, a business might well decide that they would develop their own browser, even if it cost a lot to develop and sell, and give it away for free. Now why would anyone do that--spend all this money and give it away for free? That's exactly what happened in the case I brought. Think about it. When your browser is free, it drives all the profit out of this potentially threatening browser--this piece of software that could become a platform that could erode your current monopoly, because people understandably prefer free to some positive price. But think about it. Now there's a free browser, even though it costs you some money, and it drives all the profit out of browsers. So your competitor's business has now been wrecked. What's going to go on? Where are his or her revenues coming from to pay staff, to distribute their new browser, to develop it, to upgrade it, and so forth? You suck the profit out, and in the meantime you have your OS monopoly to sustain you through this transition, and then there's no threat remaining to your OS monopoly. That's predatory behavior in my view, and it harms consumers even though in the short run the price of browsers is lowered. After all, this is a clear deterrent to innovation, because once you see that these kind of practices occur, who's going to spend their money to do the R&D to develop a new piece of software when the oxygen can be sucked out of the market?

Now what's remarkable to me (and I don't have a personal attachment anymore) is that serious, thoughtful economists somehow have been urging the various media that these kinds of behaviors--the predatory and the exclusionary behaviors that I just described--should not be barred by law. Just a couple of weeks ago, in fact, Nobel laureate, Gary Becker, from the University of Chicago, along with one of his colleagues there, wrote an op ed piece arguing that antitrust should be limited to a narrow category of offenses, like price fixing, and it shouldn't deal with exclusionary or predatory behavior at all. And they said (and I quote), "As to predatory activities, there is very little empirical evidence to support theories of such behavior, and we know of no historical example where economists are in broad agreement that alleged predatory behavior led to consumer harm." Now to be candid, that kind of quote reminds me of the old saying, that when you tell an economist that his theory doesn't square with reality, and ask him what he plans to do, his response is, "Well I better recheck reality." Let me be clear. I tend to be skeptical about allegations of predation, and in my years in the Justice Department, I heard hundreds of them and virtually almost without exception rejected them. But that doesn't mean it

doesn't happen, and indeed we brought a case that I think is as clear a case and as important a case to our economy as one might imagine. And it deals with an issue that's on everybody's minds.

As I flew here today from New York to Detroit, everybody in the audience knows what airline I took! And if I had gone from New York to Atlanta, you'd know what airline I took. And if I had gone from New York to Dallas, probably as well would know what airline I took. In the airline industry, 30 years ago . . . fewer than that, 28 years . . . 23/24 years ago, we deregulated. We had the kind of price output regulation, price access regulation I talked about before, and we deregulated. I supported that effort at the time, I continue to think it's the right thing today. But the way the industry evolved, because of economies of scale and scope and the efficiency of the hub system, the way it evolved, we now essentially have six dominant airlines that don't compete head-to-head, but have a fair amount of shelter in terms of their hub traffic. And I believe they're extracting monopoly rents as a result of that. Now the one significant exception to this dominant carrier hub-based model that's emerged, has been Southwest Airlines, which was a new entrant with low costs and an efficient business model. Southwest has increased travel throughout the United States, lowered costs, and has put competitive pressure on the majors as it began to get some of the efficiencies of scope and scale that enabled it to build out its network. Other entrepreneurs observing Southwest's success decided to do the same thing. The major airlines obviously didn't like this, and so they set out to defeat these new entrants, and they did it with remarkable success. And one of the things they figured was remember how I said it all clustered around a hub--there's real efficiencies in bringing all these people to a single airport and letting them switch planes and move on, because you can then move people to lots of different cities rather quickly if they have to transfer. And one of the things the major figured out is if these new upstarts actually begin to grow up, throw off a revenue stream, they can then develop some of the efficiencies that will enable them to be truly powerful competitors. And so essentially what we have witnessed is efforts to kill these new upstarts very, very quickly before they begin to get the kind of traction like Southwest has, which makes it almost impossible now to take it out because it's in too many markets with too much traffic.

Now a case we filed against American I think demonstrates as classic an example of predatory behavior as one might see. American basically employed a strategy of lowering its prices and flooding the market where there was a new entry. So, for example, if somebody entered from Dallas to Wichita and had a price that was significantly below American's, American lowers its price to that number and just kept adding capacity until it takes the new entrant down below 40 percent, which is his breakeven point. And obviously for the same price, and with endless amounts of opportunity, people will prefer American (frequent flyers, etc.) to the new entrant. You take them below 40 percent and it shuts down. And I think it's clear from this case, from the Department of Justice's complaint and the data we now have, that this is going to create long-term harm if it's not stopped to the American economy.

Now it's usually rare to be able to demonstrate this kind of harm. That doesn't mean it doesn't occur. It doesn't mean that if innovation is deterred . . . you can't see what innovations are deterred, but that's at least at some level speculative. In this case, there are real data that demonstrate, I think, the nature and scope of the problem.

Let's take the three cities that were involved with these new low-cost entrants. Start with Colorado Springs. Before the new entrant came into this market (this is Dallas-Colorado Springs), we were looking at a situation where about 4,000 passengers flew a month and the cost of the transportation was \$155 one way. The new entrant comes into the market, we went from 4,000 to 20,000, and the price went from \$155 on average down to \$88. So we got 20,000 people flying at \$88, and the new entrant charges that price. It could fly all of those people at that price and remain profitable. It had to come down below 40 percent to lose its market. The new entrant couldn't survive in that market because American flooded it, and then after it left the price went back up to \$135 and fewer than half the people (9,000 people) travel. That is by any economic analysis a significant output effect. That is there are 10,000 people a month that could be flying that route who are no longer flying that route because of this predatory practice. And there were similar numbers on Wichita and Kansas City. And the impact of this, I think, is to have not just simply an effect on passengers, but actually on some of these cities where in terms of new business, when the number of people have that fly in and out and the number of businesses that you can build in those cities, is affected and so forth. And I think that is a classic example, one that would take place if the law didn't prohibit it, and the only reason for it is to drive the new entrant out. It wouldn't have made sense for American to drop its price and flood the market for any other reason, because it was admittedly lowering its profitability during the time that it took these activities in order to knock the entrant out and recoup its monopoly profits afterward. And frankly you don't have to take my word for it. The CEO of American Airlines came right out and said while they were developing this plan, "If you're not going to get them," (meaning the new entrants), "out of the market, then there's no point to diminish our profit." So let me be very blunt here, this case concerns me a great deal, because I think there is economic skepticism that's legitimate, but skepticism and nihilism are very different things. There's a great deal that concerns me because I think we are faced with a serious problem in airline competition in the United States today, and I think the growth of new low-cost carriers could have a significant impact. But if the law allows people to drop their price to match and then flood in a way that is clearly uneconomical in the short-run but economical in the long-run, then that is precisely what will happen, and we will see this continued single carrier hub dominance model.

So let me sum up here. There's ultimately one principle that I believe should guide the regulatory intersection between government and a free market economy. Government should enforce a coherent, competition-based antitrust regime that focuses on agreements between competitors to acquire market power or the misuse of market power by single firms engaging in the kinds of exclusionary and predatory practices that I just described. In attempting to achieve this balance, I think we need to be vigilant to ensure that we do not overvalue the workings of markets without antitrust enforcement. In the end, I believe the greatest impediment to efficient and effective markets is not likely to be overly zealous government intervention (although that could happen), but rather the absence of competition that is sure to result without government intervention.

Now to turn specifically to some of the issues that you're going to discuss. "That may all be true," people have told me for several years, "in the old economy. But we now face a new economy--a technologically-driven economy, and so the antitrust enforcers should stay their hands." Well, I find that argument wholly unpersuasive. Let me say why. First of all, the economy may change, but human nature doesn't change. The economic incentives to make more money, to accumulate more wealth, that drives the entrepreneurial spirit, which is perfectly desirable in order to build a strong economy. That human nature will be every bit as true in the

new economy, if anything more true, because the potential returns are so extraordinary, as it was in the old economy. Now it's true that technology changes, and that may affect the way we think about these issues in terms of how the government intervenes on given facts, but that doesn't mean that the government simply stays its hand. When I was head of the Antitrust Division, Larry Summers (a friend of mine, a person I know and admire) delivered a lecture, he was Secretary of the Treasury. And he talked about how in the new economy partially because of interconnection, partially because of the nature of software, we were likely to see short-term monopoly power exist. And a lot of people thought that somehow this was a criticism of the Justice Department. They said that in our case against Microsoft. And the truth is that Larry and I have talked and others talked to me about it, and I completely agree with his thesis. I think we may well see what he called short-term monopoly profits because of the nature of needing the single standard and the way software (all the expense is in the R&D (Research and Development) and not in the marginal cost of another operating system or another word processor). But the question is even if you assume that model, the question is not whether, therefore, since we're going to have a series of monopolies, the antitrust people ought to stay out.

There are two answers to the question. First of all, you could have a situation of serial monopoly-one practice replacing another in the new economy. But that's absolutely critical to innovation. You don't want the first monopolist to control the innovation trajectory. You want to allow somebody in that browser scenario that I gave you, to come in behind and challenge the first monopolist, because after all, it's going to be consumer choice that decides whether the second monopolist will replace the first. And I believe in a highly entrepreneurial society that if people are not blockaded, if they're not excluded, or if they're not faced with predatory practices, you could see that kind of leapfrog which would be perfectly fine--and that seems to be fully consistent with the view I have. The other possibility may be before people have an all-out standards war to decide whether their video player will be a VHS (Video Home System) or Sony, they may decide to adopt an open standard. Today the Internet is an open standard. It could be proprietized (I could show you how to proprietize it if you wanted to know how, and we could all have to pay a fee simply to get on it), but right now it's an open standard with access that is for free. So basically the question of how this plays itself out is a question of technology, but it's not a question of the need for or the absence of antitrust enforcement. The fact of the matter is contrary to any suggestion about short-term monopoly, Microsoft's operating system monopoly on a desktop has been in effect for a decade, and there's no end in sight. There's no diminution of market share. And it did exactly what we predicted it would do in our case--it used that monopoly and as a result of it, there's now a second monopoly in browsers. During the course of that period, essentially the browser wars are over, and Microsoft's IE (Internet Explorer), through the practices I believe we alleged, basically has become a second monopoly.

So I think there is a serious error of thought, if people somehow think the new economy needs less antitrust enforcement in some generic sense than in the old. In my view you need to focus on the facts in any antitrust case, but that the measure of intervention is always going to be based on those principles I gave you before--people shouldn't be allowed to merge or collude to market power, and they shouldn't use market power as a barrier for new entrants to come into the market.

Now let me turn in the remaining time to what I see as the most significant part of the discussion in this Cook lecture, and that is my concern about the decline of government as an institution and

its potential consequences for our nation. Because even if we achieve the perfect level of antitrust enforcement, as I said before, that will only assure that we maximize wealth creation. It's no small feat, it's very significant, and we shouldn't underestimate its importance to the future of the globe. But it is something actually that we in America have generally done quite well. We're an extremely wealthy nation, and we have been for a long time. Sure, we should strive to do better, and we should eliminate unnecessary regulation and not enforce the antitrust laws improperly, but whatever else we may say here today, I think it's fair to say that wealth creation is not likely to be our greatest challenge in the 21st century. In my view, the challenge that will be most difficult (and they're becoming increasingly difficult) is how we divide that pie--how will we attempt to address an issue that technology is now going to present us with, which is an increasing gap between the have's and the have-not's--what they call now at fancy conferences the "digital divide." And what will our values be as a people? Will we be tolerant of differences, or will we seek to be an exclusionary society? Technology can serve either end, and biotechnology threatens to elevate those stakes exponentially. Will our borders remain open, or will we try to shut our borders to keep what we have for those who are here?

I think our history with respect to those kinds of issues has been one of which we can be proud, although it certainly has been far from perfect. Our treatment of minorities has certainly been troubling at times, but when you look across the world and throughout history, I think America stands as one that has been more open and inclusive, and one that has shown a real concern for the less fortunate. We have been brought at times kicking and screaming to this point, but there's no question. We made real progress with respect to eliminating discrimination, increasing tolerance and sharing the wealth. But there's much to be done and technology, as I said, will not make those challenges easier, they will make them more difficult.

But for all these and other reasons, just as in the past, we will need strong and well-respected government institutions to bring the collective will to bear on these terribly, terribly difficult techno-generated increasing social problems. History has taught us, whether it was *Brown v. Board of Education* or Lyndon Johnson's Civil Rights agenda in the 1960's, that leadership by government matters. These instincts--which some have called, the call to our better angels, are not always spontaneous. And we do need governmental leadership to get us where we need to go. And here is my greatest concern, because I believe, frankly, our governmental institutions are increasingly in disfavor. It's not just clear from the polls, but you cannot be in government as I was for the last seven years without feeling this sense of decline day in and day out. And while it was an enormously gratifying opportunity for me, the hardest part of the job was feeling that sense that I was affiliated with an institution that was on the decline in some collective sense. I grew up, as many of you did, at a time when America believed that public service was the highest, the noblest calling, and that those of us (and I especially count myself among this group), like many of you in the audience today, those of us to whom so much has been given by this great country, we have an obligation to give back. When President John Kennedy said, "Ask not what your country can do for you, ask what you can do for your country," it resonated with a nation and inspired an era where we made great strides in civil rights and creating a safety net for the less fortunate. Today that spirit has been displaced, I fear, by a collective sense of "it's time to get mine." I've spent a lot of time talking to college students, law school students, high school students, because I think that's the shot you get, is when they're young, and I have encountered many who care about public issues, but I am stunned, stunned, by the amount of disdain for government, qua government, that I encountered among people too young, I should have

thought, to be so cynical. It's probably best summed up by an experience that--I generally don't have particularly good memory--but best summed up by experience that's indelibly etched on my mind when I spoke to a computer science class at a leading university--all sort of terribly talented people. And after about 35 minutes into teaching this class, one of the students raises his hand and says, "I don't get it Mr. Klein." He says, "You actually appear to be smart, and yet you're in government. Why would you do that?" The obvious inference being why wasn't I out there making millions and millions like all his dot-com friends? I worry a lot about that. I've experienced it personally, I carry it with me. And I thought, "Why is it? Why did I grow up at a time when I stood for hours at 59th Street and Columbus Circle to watch John Kennedy speak? And why does it still resonate in my bones when he said, 'Ask not what your country can do for you?'" And I think there are probably two reasons that are part of the social transformation that's inevitably being driven by the technological transformation, and I'm not sure how successful we will be in combating these forces.

First, I believe that our politics have become so awash in money--that the average citizen rightfully can't help but think that the rich are different, not just in terms of what they can buy in private, but actually what they can buy in the public sector as well. That will obviously build a great deal of cynicism and increasing non-engagement by the citizenry. [John McCain](#), a man I admire, actually tapped into this sentiment during his campaign last year, and I truly hope that he and others continue to push for measures that will help restore a sense that not everything in America is for sale. This is not going to be an easy problem to remedy, it costs a great deal to run for office, people are obviously entitled to try to affect policy through lobbying and all sorts of other ways. But I don't think it's undoable and indeed one of the reasons I don't think it's undoable is because of this little miracle I call the Justice Department, which people really don't particularly understand or appreciate, and that is even today, somewhat uniquely, I believe, in America, we have a law enforcement agency that even in the current situation is really pretty immune from money and political pressure. My sense is that both parties and the people from both parties who serve, view themselves as guardians of that particular responsibility.

And not since the Dita Beard--ITT scandal in '74 during the Nixon Administration where money did change hands and it appeared to affect an antitrust decision, I don't think there's been a credible charge that a law enforcement decision's been made by the Justice Department on the basis of campaign contributions or political influence. Now remember, this is no small miracle. During my tenure I sued some of the most powerful corporations in the globe--Archer Daniels Midland, General Electric, Lockheed, WorldCom, Microsoft. Almost without exception, none of them ever attempted to bring political pressure to bear. People on the hill wouldn't call and say, "What are you doing to my company?" People in the executive branch wouldn't call. And that is something that people don't understand how important that is to the way we go forward. And I want to tell you, during this ADM thing (Archer Daniels Midland--one of the most powerful companies in the whole country with a great deal of political influence), we were prosecuting them for a serious cartel. We imposed, as I said before, a \$100 million fine on them, we sent the son of the CEO to prison for more than two years, and before all of that happened, my friends in Europe and my friends in Asia would say to me time and again, "There is no way in the world you will be able to do that--the politics in America will not allow it."

So I think this is an amazing thing. And I think if you think back on it, it's something that should lead us to go forward with a belief that, yes, we can restore some faith. There are going to be

significant disputes about policy--there should be--but just as Bill Baxter (Ronald Reagan's antitrust chief) was able to break up AT&T, even in the face of political noise, because he thought it was the right call under the antitrust laws, I continue to believe that future Departments of Justice--Democrat and Republican--will be able to operate effectively outside the sphere of crass political influence. But unfortunately, I think that is the exception. It's an important exception and one worth bearing in mind. But even today, unfortunately, many Americans don't believe that's true of the Justice Department.

And this brings me to my final concern, and that is among the reasons that I think government is generally in decline, is that the politics of personal destruction fueled by the media is very much a part of our modern political culture, and this greatly affects both the way the public views public service, and the way people view serving as government officials. For whatever reasons, I'll leave this for others to figure out, life is becoming increasingly a soap opera, in which the popular media are dominated by Jerry Springer-like shows, even when it comes to political discourse. We seem to like a food fight much more than a discussion. Entertainment rather than policy is what drives ratings. And what could be more entertaining than some dogged media pursuit of some high-government official. Now this kind of journalism may be good for the bottom line, and I understand that, but it certainly takes a toll on people who are caught in the crosshairs. And I want to be clear. It's not to say that government officials somehow shouldn't be called to the carpet for wrongdoing and held accountable, but I think it's clear that the press ought to focus a little bit too on making sure that they have the facts, and not be too quick to jump from one inference to another by calling motives, much less people's integrity, rapidly into question. In my experience, people who are quick to impugn motive are usually a little slow in their ability to debate merit.

I have a little personal experience in this as well, and I don't think of myself as unduly thin-skinned, but I find these kinds of attacks (you have a family, you have friends) quite painful. And there were two kinds that I experienced--one bothered me a little less than the other. The first was somehow I would bring a case (the Microsoft case) because I was trying to help the competitors for some political reason. Never mind the fact that I had been asked to bring six or seven different cases against Microsoft that I didn't bring by different competitors. But the logic of it makes no sense. It was publicly known (not through anything that I did) that these so-called competitors (the two principal ones in this case--Netscape and Sun) were headed by prominent Republicans who were very strong supporters of Republican candidates. But that didn't stop people from trying to push the argument. And the one that was much more troubling, on serious newspaper editorial pages, was that somehow we brought this case because the Attorney General had refused to prosecute political contribution cases, and this was a way to kind of mask that fact, and therefore we brought this kind of case. And as I say, these are serious op ed pages, editorial pages. Absolutely no basis in fact for that kind of allegation. I can tell you it seems self-serving but it didn't happen. It didn't happen. But there is absolutely no basis in fact for that allegation.

And I will tell you the following couple of things that would seem obvious here. Number one, whatever else one thinks, the Attorney General's decision not to prosecute some of these campaign contribution issues hardly escaped public press or congressional notice. So if our scheme was to divert attention, it was not a particularly effective scheme. Second of all, in the time that I was in the Justice Department, not once did the Attorney General ever ask me my

views on any of those issues, and I not once shared any of those views with her. Yet, people are willing to make that kind of analysis rather than to engage the merits. And let me be clear, in all the major cases I brought, I think there are arguments on the other side, I don't think we had a monopoly on the correct legal analysis, but this effort to go after people's motives, to challenge people's integrity, is the kind of thing that I think is corrosive and insidious over time. And I don't think this is going to be an easy one to reverse as well, but I do want to say in concluding, that I think President Bush is on to something, when he attempts to introduce a new civility into our political discourse. Let me be clear--civility is not a substitute for sound policy. And there will be legitimate disagreements about policy, but our nation (and to bring it back to this lecture), the most important institution in our nation, our government, which has served us so well for all its flaws, will be a whole lot better off if the politics of personal destruction on both sides, by both parties, and the media is moved to the back, and the merits of tough and important issues become the measure of public discourse. At a minimum I believe, that should help to foster a climate that attracts our most talented people--be they Republicans, Democrats, or some third party--to serve in government. And we as a people will be better served by that no matter what happens every four years in an election and by any other change that we could imagine right now. Thank you.

DEAN JEFFREY S. LEHMAN: Mr. Klein has agreed to take a couple of questions. We are scheduled for a break at 3:15. Yes, right down here.

QUESTION: I have a question about what happens when laws cross international boundaries. I have two examples. One is there is a fellow in England who is about 40 years old and would come to the University of Minnesota web sites and quote racist things about certain racial groups. Some 19-year-old kids in these groups would then post very mean things about this fellow, but they would post it about him, not about this ethnic group. He then sued in English court, saying that the University of Minnesota was publishing these quotes and we were advised by lawyers there that we would probably lose if we fought it.

The second example is shorter. France is fighting the GE Honeywell merger. How do we deal with that kind of issue?

ANSWER: Yeah, the second I actually know a little bit about, although I'm not personally involved. This has become a serious set of problems you've put your finger on. As a matter of policy, this is not as a matter of institutions, but as a matter of policy, how we figure out how nation states regulate a global economy is going to be enormously complicated, and both of the examples you give are illustrative of that.

Obviously, in the GE Honeywell case, the European Union, which is looking at it along with the United States Department of Justice, is concerned because of the implications for aircraft in Europe. They have a legitimate concern; it's not a fanciful thing. They're not just sort of meddling in our economy. And what essentially is going to go on is the following: It's gonna be basically at first through working together. We've spent more time on Worldcom Sprint working with the Europeans to make sure we've stayed on the same page; to make sure our analysis where congruent didn't diverge. And you'll see more of that.

Second, we're going to see more and more treaties with more and more laws that emerge regulating the global economy. It's gotta be jet-lagged because people are not quick to yield sovereignty. The last formal act I did before I left the Department of Justice was to call for a global competition initiative precisely to address these issues. The Attorney General and I appointed a 12- person outside advisory committee for a two-year study. This is the third time in American history that ever happened at the Justice Department, antitrust division, for a two-year study of these issues, and they came up with some important, but by no means definitive, conclusions. So there's going to be a great deal of work and attention on this, but we will slowly evolve toward treaties, toward a greater role for the WTO (World Trade Organization) in the world economy, and in the meantime, responsible agencies will redouble their efforts to stay on the same page in particular transactions. And I'm not involved, but I'm sure in the GE Honeywell matter there is a lot of discussion between the Department of Justice--I got no horse in the race--between the Department of Justice and the European Union.

QUESTION: You talked a little bit about the fact that the browser wars were over and essentially that Microsoft had a second monopoly. Do you think that there was anything, looking back, that you would have done, that you could have done, differently to prevent that outcome?

ANSWER: It's very hard to say in the following sense: The one thing I agree with is the world moves remarkably quickly. I mean, one of the wonderful things I thought about in the old Standard Oil case is the oil sat in the ground long enough for us to take a very, very hard look at what to do with it. That's not going to be true in technology. In the end, I don't think it's absolutely critical that you reverse course on a particular event, and I don't think we were likely to be able to find a way to influence that particular event.

I think what's critical is one, you establish the rules so that people are clear, and two, that you prevent that thing from happening a second, third--For example, one would worry about a same kind of development with respect to voice recognition, which could be a transforming platform technology on personal computers. So to some extent, that seems to me that there's going to be an inevitable lag between a lawsuit and the economy that you're trying to intervene in, but it's not a fatal lag because if the problem never would recur again, it doesn't matter that you missed it once. And if it would recur again, having a modus vivendi from being able to tackle it is critical.

QUESTION: Do you think there's a need for any legislative reform that would ensure [inaudible]?

ANSWER: I don't. I honestly believe these principles I've articulated, if they are enforced and they are bedrock antitrust principles, I think we'll get where we want to go. The antitrust laws-- There have been a couple of times-- Sometimes they were under-enforced, and a few times and certainly in the Sixties, they were over-enforced. They had a big is bad kind of connotation. By and large, they have been rather well-enforced on a bipartisan basis. It was, after all, Bill Baxter who did take the action to break up AT&T and brought some other important antitrust matters. So and we, frankly, allowed more merger activity to go through in America, even though people

perceive us as being, if you will, a somewhat activist antitrust enforcers. I think the colorations are typically not accurate, and I think by and large, we've seen a pretty steady bipartisan support for the kind of predatory, exclusionary, anti-collusive, anti-merger to market power analysis that I put forward here. And I think we'll continue to see that.

QUESTION: I was a patent attorney at one time in the 1960's; that was my first law job, at that time, I remember [inaudible] there was a surprising statement made by, I think it was the head of the Antitrust Division of the Justice Department. He went on record as saying he was going to abolish the United States patent system. In other words, [inaudible]. I don't know how he proposed to go about this, but they did-they were very active in taking on [inaudible]. I wondered, since I've been out of touch with that for so long, I've wondered if you have a feeling on what the antitrust [inaudible].

ANSWER: Sure, I think--far from abolishing--I think we're quite respectful of patents, and I think patent law and intellectual property law in general is an essential compliment to antitrust enforcement because obviously without some protection for intellectual property, nobody's going to do the research to be able to bring product to market. I mean, you can make a lot of money if you find a drug that cures cancer, but you gotta spend a lot, a lot of money--and a lot of people are doing that, in order to make the bet. And if people could then copy your formula the day you brought it to market, you couldn't recoup any of your R&D, nobody would go into the game.

Seems to me, though, that technology will require us to start to think through how we protect intellectual property. The role of copyright is very different in a software-driven universe than it is, for example, in a books & music-driven universe. Cases like Napster are going to challenge us in that respect, and that doesn't mean challenge us to abandon intellectual property; on the contrary. But we're going to have to think about it. And the other issue, which the National Academy of Science has just put together a commission to look at, which I think is a fascinating issue, is how we deal with this whole set of issues of patenting business practices. The double-click kinds of issues--I mean, the single-click kinds of issues and so forth. So my own guess is, generally speaking in America today, technology is going to make us take a look at intellectual property protection, patent protection and copyright protection, but there is no place that sensibly thinks that we ought to eliminate or seriously curtail it.

DEAN JEFFREY S. LEHMAN: We have time for just one more question.

QUESTION: You made a couple of references to biotechnology as being transformative in ways that you really didn't elaborate. I was wondering what you had in mind there; if you had something in particular in mind about the role of antitrust law or the convergence of --

ANSWER: I think in several ways--I don't know about antitrust law, but I think--I mean, you'll find this hard to believe, but I actually think there are a few things in the world more important than antitrust law! One of them is what's going on in biotechnology. I think, first of all, you're going to raise the following kinds of moral, ethical and other issues, and no one knows quite how

to deal with them: The whole issue of cloning, the whole issue of being able to select how you want to recreate yourself or not recreate yourself--all of this is going to be out there--the question of allocation of who gets access to which of these new technologies, some of which--I mean, in a world in which we don't have universal health care and health services, some of these technologies are gonna be very expensive. And finally, I mean, it's going to be transformative in our lives in the sense that people may live--I have a friend who's got a major biotech company. He says, "If I make it to seventy-five, I can be here forever." He said, "The hard part may be to make it to seventy-five," he tells me, "but if I can just ride it out!" You know, forever is a long time, I must say. I probably have a more mellow view of antitrust enforcement, but I think those are transformative social questions. I mean, how one thinks--I don't mean this facetiously, but if you think about living a life for 150 years, it's a different enterprise than the enterprise that one might live for less. And when you say--When people get married and say "for better, for worse and for richer or poorer," it's hard enough to do it for the times we now operate in, but can you imagine --

(Laughter) (Applause)

DEAN JEFFREY S. LEHMAN: Okay, we have a ten-minute stretch break, and then we will reconvene at 3:30 with the first full panel.