

Office Depot competed before the merger. The court disallowed the merger.

A more recent merger trial, on the Justice Department's challenge to the merger of Oracle and PeopleSoft, has important lessons as well, but is not included in Whinston's discussion. The products at issue were software packages sold to large businesses. A customer buys a set of packages in what amounts to an informal auction, first qualifying several potential suppliers and then soliciting repeated bids until the bidding stops, as in an English auction. The Justice Department engaged a leading auction economics specialist to re-run the actual auctions under the assumption that PeopleSoft and Oracle coordinated their bids rather than acting as rivals. He found important price elevation in those instances where the two companies bid against each other, especially where there was little involvement of other potential suppliers. The court found the government's case unconvincing, not because it departed from the relevant market formula but because it did not go far enough in restating the environment under the hypothetical merger. The court approved the merger, despite the court's other finding that Oracle had failed to demonstrate any efficiencies from the merger.

Both merger trials demonstrate that the agencies and the courts actually put a good deal of weight on analyses that tackle the central issue: What will a merger do to prices?

Whinston's last chapter, on exclusive contracts, has rather a different character because this topic is where he has made most of his many contributions to competition analysis. The *ah, but no* propositions come in layers. The Chicago School (now seen as oversimplifiers even at Chicago and certainly at Northwestern, twenty-seven miles north) analyzed exclusivity as a paid-for element of a purchase. Under the assumption of no externality, the purchaser and seller will bargain to the socially optimal combination of price and exclusivity. Where exclusivity is observed, there must be some efficiency payoff that enlarges the pie enough so that the seller comes out ahead, even after paying the customer for exclusivity.

*Ah, but no<sub>1</sub>* say Aghion and Bolton in an important 1987 paper that is the starting point for Whinston's analysis. By signing a contract that requires buyers to compensate the seller for lost profit if a buyer decides to buy from an entrant, the buyers and incumbent seller can take away

any prospective profit from an entrant. Microsoft used such a contract with computer makers prior to the 1995 consent decree with the Justice Department. Inefficiently little entry will occur. Chicago is wrong because there is no intrinsic joint benefit to exclusivity. *Ah, but no<sub>2</sub>* says Whinston, because this analysis makes the unpleasant assumption that the buyer and seller commit to the action in advance, despite the mutually profitable opportunity to renegotiate once entry has occurred. The renegotiation—as so often!—vitiates the power of the threat.

*Ah, but no<sub>3</sub>* follows right on: Whinston's work with Ilya Segal adds increasing returns, with the implication of negative externalities across buyers. In this setting, the seller can purchase exclusivity and its attendant barrier to entry at little or no cost. As Whinston states, "The protection of competition is, in a sense, a public good" (p. 143). Under some conditions, exclusivity may not cost the seller anything.

The reader may not find Whinston's ensuing discussion of the intricacies of modern exclusive dealing theory as fascinating as he does, and may want to sample selectively from the many variants he discusses. His focus is entirely on exclusive contracts and he does not go the additional step to study vertical integration by merger.

The book ends with an interesting discussion of the limited empirical research on the consequences of exclusive contracts. Event studies of legal changes suggest that customers are harmed by changes that permit more exclusivity. In beer distribution, where exclusivity is required in some states and banned in others, exclusivity results in slightly higher prices and substantially higher quantity, suggesting that exclusivity causes some reduction in competition by raising barriers to entry and a lot more sales effort by exclusive distributors.

Anyone who has passed Economics 202 and has a practical or theoretical interest in modern competition issues will benefit enormously by spending time with Whinston's excellent book.

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*Government Failure versus Market Failure: Microeconomics Policy Research and Government Performance.* By Clifford Winston. Washington, D.C.: Brookings Institution Press, Washington, D.C.: American

Enterprise Institute for Public Policy Research, 2006. Pp. xi, 130. \$39.95, cloth; \$16.95, paper. ISBN 978-0-8157-9390-8, cloth; 978-0-8157-9389-2, pbk.

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When policymakers spot a market failure or, in some cases, imagine that there is some market failure even if there is not, they often assume that government intervention will necessarily improve things. Unfortunately, that is not often the case, as many government programs fall short using the same yardstick one might use to assess the performance of markets. In his classic essay, Charles Wolf Jr. used the term “nonmarket failure” to characterize public policies that also underperform on efficiency grounds. In my textbook with Joseph E. Harrington Jr. and John M. Vernon, we coined the term “government failure” to characterize these failures of government policy, and Clifford Winston uses this label as well.

In this thoroughly researched and well-written book, Clifford Winston takes the government failure concept and explores the wide range of insights that can be derived from examining the systematic failures of government policy. His analysis cuts a broad swath through the entire domestic policy area, ranging from regulatory policy to antitrust efforts and public expenditure programs. Because of the breadth of scope, the treatment of some topics is often relatively brief. In many passages, every new paragraph reviews another failure of government policies. Despite the somewhat breathless pace of the book, it functions superbly as a summary of the key contributions by economists across an extremely wide range of policy domains.

Winston’s treatment focuses on what most economists would recognize as a generally accepted efficiency goal: “To what extent does a market failure policy improve social welfare?” (p. 11). While this objective may be compelling to economists, the controversy surrounding the nominations of the directors for the U.S. Office of Management and Budget Office of Information and Regulatory Affairs during the Bush administration suggests that many interest groups remain strongly opposed to a meaningful comparison of policy benefits and costs.

Chapter 3 begins a series of case studies of government policy failures. This chapter focuses on antitrust policy, which is perhaps the most well-established policy area that he considers.

Winston notes that many antitrust actions have not enhanced competition significantly or decreased prices, with the possible exception of the breakup of AT&T. For empirical assessments such as this, Winston is on firm ground.

The more controversial claims pertain to mergers, in which Winston observes that the federal authorities have often attacked mergers that would have enhanced efficiency and might have benefited consumers as well. This claim may be true. Unfortunately, a retrospective policy assessment such as this is much easier to make than it would be at the time of the merger approval decision. The cost savings from mergers are often quite speculative, as are the effects on competition in the market. While the direction of the effects is often clear, the magnitude of the consequences from shifts in the HHI index is less well-established.

A major benefit of Winston’s comprehensive analysis is that many of the insights generalize to efforts that are high on the current policy agenda. His detailed critique of agricultural price supports is particularly timely given the current rush to subsidize ethanol, which is the questionable but much acclaimed solution to our energy dependence and pollution problems.

In chapter 4, Winston turns his attention to the more contemporaneous social regulations. This entire body of regulatory policy has had quite mixed performance, with costs per expected life saved well out of line with any reasonable benefit–cost balance. Indeed, this imbalance is so great that many of these regulations may be counterproductive, in that the opportunity costs from profligate expenditures may lead to more increases in risk than the risk decreases that result directly from the regulation. Thus, if the regulations had not been issued, the savings in costs to consumers and the public generally would have had a more beneficial effect in reducing risk than the regulations themselves.

Winston does not focus on the more widely discussed cost-per-life-saved estimates or risk-risk analyses, but instead addresses a series of case studies designed to provide general lessons for social regulation policies. In the context of labeling, he observes that hazard communication efforts of various types can play a productive role and can be effective. For example, the dolphin-safe tuna labeling, which was subsequently standardized through the Dolphin Protection

Consumer Information Act of 1990, was a major success for eco-labeling. On the other hand, labeling regulations can have a counterproductive effect. For example, John Calfee and I view cigarette advertising regulations as having an unintended effect of discouraging the introduction of safer cigarettes.

A classic regulatory failure is with respect to the drug approval process for new drugs. Winston's review indicates that many economists have long argued that the Food and Drug Administration (FDA) strikes an inappropriate balance between type I and type II errors. The agency is much too concerned with the risks of approving a harmful drug as opposed to the risks associated with failing to approve a beneficial drug. Moreover, current pressures on the FDA are in the opposite direction. The most vocal critics urge more black box warnings for dangerous drugs, not an expedited approval process.

How one can change this policy emphasis is unclear because the identified lives associated with the harmful, bad drug that is approved often loom much larger than the statistical lives that would be saved by approving a beneficial drug. Identifiable victims such as those harmed by a new drug, or a well established constituency such as AIDS patients who can benefit from expedited approval of AIDS drugs, fare well in the political process. However, the prospective beneficiaries of heart medicines may not yet know that they belong to the class of people who will benefit from drug approvals.

The analysis of automobile and transportation related regulation is especially strong. Clifford Winston explores the many government policies that address externalities, such as the Corporate Average Fuel Economy standards. His conclusion that the most influential factors in promoting the purchase of fuel-efficient cars have been the rising price of gasoline and profit-maximizing incentives stemming from the market provides a valuable lesson for current policymakers who are grappling with the task of selecting the most effective policy option to limit greenhouse gas emissions.

The book then turns to the public production area, for which Clifford Winston has been a leading contributor on a wide variety of topics. Winston is an advocate of congestion tolls to make more efficient use of roads and decrease the delays in traffic. As the London experience

suggests, these policies have some promise inside the Beltway and in large urban areas such as New York. But for parts of the country where traffic congestion means being stuck behind a slow truck in a no-passing zone, higher gas taxes might be a better solution to our broader transportation policy problems.

Throughout the book, Winston flags policy areas, indicates possible solutions, and gives a guide to the pertinent literature, but does not explore individual policy areas fully. The book aims for breadth rather than depth on particular topics. Winston's volume delivers an incredible wealth of case study vignettes but is not a substitute for more in-depth analysis of the particular topic areas.

Nevertheless, readers will be rewarded with an astounding array of interesting economic results. For example, with the exception of BART in the San Francisco Bay Area, Winston concludes that "every U.S. transit system actually reduced social welfare" (p. 70). Less surprising is his critique of the U.S. Postal Service, although the extent to which the Postal Service is inefficient or is being adversely affected by cream-skimming by Federal Express and United Parcel Service is not examined within the context of this relatively brief treatment.

What are we to make of this rather daunting array of government failures? Clifford Winston offers a variety of theories and explores the role of interest groups. What I found to be particularly valuable was his table that compiled the welfare costs of market failure policies. By giving tallies of the costs across different areas of government intervention, we can get a sense of what the big losers are and where we should put our emphasis in terms of policy reform. Although some of the cost estimates are gross costs, often because net cost figures are not readily available, many of his cost figures are deadweight losses. Commodity price support programs, tariffs and quotas, inefficient pricing and investment in highways, and inefficient pricing and investment in airports all impose quite staggering losses on the economy, well in excess of \$10 billion each.

Winston's perceptive analysis also emphasizes three reasons other than these multi-billion dollar price tags for why his concerns about government failure are of fundamental policy importance. First, because government efforts to address market failures comprise a major portion

of what the government does on the economic front, the poor performance of these diverse government interventions constitutes a substantial drag on economic growth. Second, as Winston's thorough critique makes clear, empirical evidence on the performance of government policies provides a sounder guidance for structuring our policy approach than the ideological arguments that often dominate such debates. Popular commentators and economists engaged in policy debates would benefit from drawing on the empirical lessons regarding the performance of policies to address purported market failures rather than assuming that all government policies will be effective, regardless of how ill-conceived or mismanaged these policies might be. Instead of relying on ideology, Winston's book provides a framework for reframing current policy debates in an empirically based, scientific manner. Third, *Government Failure versus Market Failure* highlights policy areas where more empirical research is needed. Winston's excellent volume concludes with a compelling general plea for more policy-oriented economics research.

Even if some well intentioned policymakers are armed with the wealth of case studies documented in this book, they will find that bad government policies are difficult to alter. Once policies are in place, constituencies in favor of the status quo resist change. For example, once companies have complied with costly government regulations, they often want those requirements to continue as a barrier to the entry of competitors. Reform is much more likely to be successful in altering new initiatives on the policy agenda.

Reform advocates will find in this book a manageable checklist of economic insights to apply to policy design. Winston's policy recommendations draw on mainstream economic principles, combined with a keen empirical sense of the types of policies that have proven to be successful. He advocates efficiency tests for antitrust policies, opposes agricultural price supports and quotas, supports deregulation in many economic regulation contexts, and supports emissions trading to address environmental externalities. Advocates of current failed government policies are usually well aware of these more efficient policy approaches. But the concerns that drive policy often bear little relation to the naive and hopeful notion that the government maximizes social welfare. Although reforming government policy will

not be a simple task, economists and policymakers who are searching for ways to improve social welfare will find this book to be a valuable starting point.

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### M Business Administration and Business Economics • Marketing • Accounting

*Personnel Economics in Imperfect Labour Markets*. By Pietro Garibaldi. Oxford and New York: Oxford University Press, 2006. Pp. xvii, 258. \$99.00, cloth; \$45.00, paper. ISBN 0–19–928066–5, cloth; 0–19–928067–3, pbk.

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This book is an attempt to consolidate what we know about Personnel Economics by focusing on *Personnel Economics in Imperfect Labor Markets*. Even on the first page of the book, the author is clear about this mission. In particular he notes that "The view of personnel economics analyzed in this book is based on two key properties of . . . labour markets: labour markets are imperfect and jobs are associated to [sic] rents; labour market institutions interact with personnel policies. Notably, wages are partly set outside the firm–worker pair (minimum wages and collective agreements are widespread)" and "job termination policies are affected by a sizeable and binding employment protection legislation." This is a worthy goal and the idea for writing a book that focuses on imperfect labor markets is a very good one.

The book contains thirteen chapters. In the first, "Personnel Economics and Non-Competitive Labour Markets," the author outlines the book by nicely describing that market imperfections create some interesting complications in personnel economics that are absent in perfect labor markets. This includes some motivation with basic statistics from the OECD on differences in union density and employment protection legislation in a set of six countries and the