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Who Determines the Optimal Trade-Off Between Quality and Price?

Barbara Ann White*

I. Introduction

Two of the papers presented for these proceedings focus on the antitrust effect (or lack thereof) of market forces on two groups of professionals, each one possessing a high degree of expertise not readily accessible to the consumer at large: the medical profession¹ and the providers of legal education.² The third paper focuses on another group of professionals possessing a high degree of expertise, but whose expertise is not readily accessible to the public and not even accessible (many feel) to their professional brethren; that is, the antitrust experts of the legal community.³

A predominant characteristic of all three groups is what has classically come to be known as asymmetric information. In other words, the members of each professional group possess knowledge critical for a layman passing judgment, but the nature of which is too technical and specialized for the typical layman to comprehend.⁴ One

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¹ See Peter J. Hammer, *How Doctors Became Distributors: A Fabled Story of Vertical Relations*, 14 LOY. CONSUMER L. REV. 411 (2002).

² See Marina Lao, *Law School Accreditation: The Applicability of State Action and Noerr Exemptions and First Amendment Principles*, 14 LOY. CONSUMER L. REV. 439 (2002).

³ See Stephen Calkins, *The Organized Bar and Antitrust: Change, Continuity, and Influence*, 14 LOY. CONSUMER L. REV. 393 (2002).

⁴ See generally Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L.

question pervading antitrust in the last several decades has been: How to evaluate the regulation of professionals when cognitive information about their profession is so asymmetrically distributed?⁵

The focus of this comment is not on the typical antitrust questions regarding regulating professionals in the face of asymmetric information or, in particular, how to cope with the potential anticompetitive effects of allowing the professions to regulate themselves. That issue is explicated quite cogently and extensively by the other commentator on this panel.⁶ Rather, the purpose here is to draw attention to another problem submerged within and yet intertwined with these discussions – the determination of the socially optimal trade-off between quality and price in the context of professional regulation. Co-extensively, this comment raises the question as to what antitrust's role should be in making such important price-quality trade-off decisions.

II. The Optimal Trade-Off Between Quality and Price

The question of the optimal trade-off between quality and price has become increasingly important as well as complex in recent times, as the advances of modern technology permit a far more refined range of choices. These subtleties among choices allow an individual, a group, or a society to titrate more precisely degrees of quality with almost any product or service, coupled, of course, with counterbalancing price consequences.

So for example, in the field of medicine, we can ask what dosage do we really need of anthrax vaccine in the face of possible anthrax attacks, what frequency of pap smears is advisable to sufficiently reduce the risk of cervical cancer, and how many days in the hospital, if any at all, is appropriate for any particular medical procedure? Answering these questions involve measuring fairly refined degrees of risk (i.e., a measure of quality of care) against the price of reducing the risk. These questions exist more plentifully yet starkly today because advancing technology has made more complicated choices possible.

A similar trade-off now confronts legal education as well.

REV. 630 (1979).

⁵ See generally Peter J. Hammer, *Antitrust Beyond Competition: Market Failures, Total Welfare, and the Challenge of Intramarket Second-best Tradeoffs*, 98 MICH. L. REV. 849 (2000).

⁶ See generally Thomas L. Greaney, *A Perfect Storm on a Sea of Doubt: Physicians, Professionalism and Antitrust*, 14 LOY. CONSUMER L. REV. 481 (2002).

Questions such as the need for extensive libraries in the face of on-line access to legal databases, the need for classroom time in the face of distance learning, and even the number of years necessary for a “good” legal education given the routineness of much legal activity, have all been raised recently as technology provides lower cost substitutes that many argue serve as (or nearly as) well as the original requirements.⁷

When we ask such questions, whether regarding the medical field, legal educators, the engineering profession, or any good or service, we are asking basic questions of cost-benefit analyses. Is the gain in quality commensurate with the additional cost? These questions acknowledge that, by and large, increases in quality come at a price – a higher price. Since resources are limited and society’s goods and services not boundless, these questions then translate for each good and service into how to determine what level of quality is optimal to achieve, given the trade-off with price. Or, as economists would state it: What level yields the optimal trade-off between price and quality?⁸

Traditionally for antitrust, the solution for determining the socially optimal trade-off point is to be found by the marketplace. Clearly, tastes and preferences among individuals differ widely so that any one individual would make different choices. Thus there is no unique solution. On the other hand, the field of economics has spent decades, if not centuries, demonstrating that if the market place is left unfettered, people acting in their own self-interest would produce global solutions that would create “the greatest number (and quality) of goods for the greatest number of people.”⁹ Antitrust law, in general, subscribes to this means of selecting the “optimal” trade-offs between price and quantity and/or quality.

However, reliance on the market place is premised on the free-flow of information regarding goods, costs, and quality. Asymmetric information problems are famously examples of one type of market failure, when the market place cannot be relied upon

⁷ These issues, among others, are discussed in the Symposium on Accreditation, whose proceedings were published in the *Journal of Legal Education*. See 45 J. LEGAL EDUC. 415, 415-56 (1995).

⁸ See generally Hayne E. Leland, *Quacks, Lemons, and Licensing: A Theory of Minimum Quality Standards*, 87 J. POL. ECON. 1328 (1979).

⁹ See generally PAUL A. SAMUELSON, *ECONOMICS: AN INTRODUCTORY ANALYSIS* (1948).

to yield the “socially optimal” result.¹⁰ People cannot act in their own best self-interest if they do not know what they are dealing with. A whole sub-discipline in economics studies optimal decision-making with imperfect information.¹¹ For practical purposes when it comes to the professions, which are steeped in asymmetric information problems, how should the assurance of quality be achieved?

Historically, society’s view has been to let the “learned professions” ensure the public of quality by allowing the professions to regulate themselves. Clearly, this is one solution to the problem of asymmetric information since the professionals possess the knowledge to evaluate the conduct of their peers.¹² Furthermore, in the last century or so, as the professional groups grew in skill and expertise, the professions certainly had strong motivations to invoke rules and regulations to ensure some minimal quality of performance among their members so as to avoid the profession being branded as one of charlatans, quacks or at best, incompetent.¹³ Thus, the professional communities have historically not been subject to much antitrust scrutiny.¹⁴

¹⁰ See generally Kenneth J. Arrow, *Uncertainty and the Welfare Economics of Medical Care*, 53 AM. ECON. REV. 941 (1963).

¹¹ See generally John J. McCall, *The Economics of Information and Optimal Stopping Rules*, 38 J. BUS. 300 (1965); Joseph L. Gastwirth, *On Probabilistic Models of Consumer Search For Information*, 90 Q.J. ECON. 38 (1976).

¹² *Semler v. Or. State Bd. of Dental Exam’rs*, 294 U.S. 608, 612 (1935) (“What is generally called the ‘ethics’ of the profession is but the consensus of expert opinion as to the necessity of such standards.”).

¹³ See, e.g., *Semler*, 294 U.S. at 612 (“The community is concerned with the maintenance of professional standards which will insure not only competency in individual practitioners, but protection against those who would prey upon a public peculiarly susceptible to imposition through alluring promises of physical relief.”); *Cal. Dental Ass’n v. FTC*, 526 U.S. 756, 760 (1999) (“In order to properly serve the public, dentists should represent themselves in a manner that contributes to the esteem of the public.”).

¹⁴ *Semler*, 294 U.S. at 612 (“[T]he community is concerned in providing safeguards not only against deception, but against practices which would tend to demoralize the profession by forcing its members into an unseemly rivalry which would enlarge the opportunities of the least scrupulous.”); *Goldfarb v. Va. State Bar*, 421 U.S. 773, 788 n.17 (1975) (“It would be unrealistic to view the practice of professions as interchangeable with other business activities, and automatically to apply to the professions antitrust concepts which originated in other areas. The public service aspect, and other features of the professions, may require that a particular practice, which could properly be viewed as a violation of the Sherman Act in another context, be treated differently.”).

Over the last quarter century, however, trust in the professionals' altruistic motives regarding their self-regulation transformed when suspicions grew that the professions were taking advantage of their self-regulatory power. Some of the rules and regulations emerging from different professional groups seemed to induce more than the maintenance of what one might believe was appropriate quality conduct. Indeed, there was an increased sense that various professions were invoking rules and regulations that served more to increase its members' income and other benefits, rather than to enhance or assure quality of service to the consumer or society as a whole.¹⁵

The reaction to the apparent exercise of concerted power by the professions to raise their incomes manifested itself in two ways. One was economically, through the rise of countervailing market forces. The other was legally, through the progeny of the Supreme Court pronouncement in *Goldfarb v. Virginia State Bar*¹⁶ that Congress never in fact intended any "sweeping exclusion" of "learned professions" from coverage of the Sherman Act.¹⁷

The market manifestations of countervailing power in the medical profession are clear in Professor Hammer's paper, as he describes the changing role of doctors from one of a status-based profession to one as a distributor of medical services. The doctor's function has been incorporated into a structure of vertical relations and contracts as hospitals have taken over the role of organizing, collecting and dispensing many medical services as a way of cutting costs. We have also witnessed the rise of managed-health-care and insurance-controlled medical decision-making, all with the view of reducing costs of medical treatment in face of what were considered spiraling rising medical costs.¹⁸

Now, even the legal education profession is facing countervailing market forces that provide lower cost legal education by not abiding by the American Bar Association's accrediting requirements. As another of Professor Lao's articles points out, one

¹⁵ See generally Malcolm Getz et al., *Competition at the Bar: The Correlation Between the Bar Examination Pass Rate and the Profitability of Practice*, 67 VA. L. REV. 863 (1981).

¹⁶ 421 U.S. 773 (1975).

¹⁷ *Id.* at 787.

¹⁸ See generally Russell Korobkin, *The Efficiency of Managed Care "Patient Protection" Laws: Incomplete Contracts, Bounded Rationality, and Market Failure*, 85 CORNELL L. REV. 1 (1999).

institution, the Massachusetts School of Law, increased significantly the use of adjunct faculty (whose salaries are a fraction of full-time faculty's) and required full-time faculty to teach course overloads while having fewer sabbaticals.¹⁹ The school also included bar-review courses as part of the credit curriculum while reducing plant facilities. These all served to dramatically cut the cost of legal education at Massachusetts School of Law to nearly half of the average of ABA accredited law schools. Another institution, Concord Law School, taking advantage of Internet technology, provides on-line legal education at about a fourth of the average cost of ABA accredited law schools. Concord Law School, even more so than Massachusetts Law School, is far from meeting the ABA accreditation requirements.

Judicially, the erosion of antitrust's deference to professional societies' self-regulatory decisions is exemplified by a series of Supreme Court cases that scrutinized challenged professional associations' rules and regulations on the grounds that they were indeed anticompetitive. *Goldfarb* found that a state Bar's published minimum fee recommendations for certain legal activities, coupled with indications of disciplinary action if not conformed with, was found to be illegal price-fixing without any examination into whether these schedules served as "a conscientious effort to show lawyers in their true perspective of dignity, training and integrity."²⁰ This contrasts significantly with *Semler v. Oregon State Board of Dental Examiners*,²¹ a case 40 years earlier that upheld severe restrictions on price and quality advertising by dentists, stating that "the community is concerned. . . [with] providing safeguards. . . against practices which would tend to demoralize the profession by forcing its members into an unseemly rivalry. . . ."²²

Similar to *Goldfarb*, in *FTC v. Indiana Federation of Dentists*²³ in 1986, the Supreme Court held that the Federation's members' concerted refusal to send their dental patients' x-rays to insurance companies was an unreasonable restraint of trade.²⁴ The

¹⁹ See generally Marina Lao, *Discrediting Accreditation: Antitrust and Legal Education*, 79 WASH. U. L.Q. 1035 (2001).

²⁰ 421 U.S. at 787.

²¹ 294 U.S. 608 (1935).

²² *Id.* at 612.

²³ 476 U.S. 447 (1986).

²⁴ *Id.* at 466.

Court was unconvinced by the Federation's argument that the quality of dental treatment would be compromised because evaluations of coverage would be made by lay persons employed by the insurance companies,²⁵ an argument that appears in hindsight somewhat prophetic these days. Other cases over the years have shown the courts' increasing emphasis on what the market effects are of rules and regulations with respect to costs and price and a decline from earlier positions of accepting justifications for rules based on quality arguments.²⁶

The point here is not to assert that these cases have been decided wrongly (or rightly). Nor is it to argue that there was no need to examine the conduct of professional associations' concerted efforts more closely.²⁷ Rather, the point is to alert the antitrust community that antitrust's increased attention on the market dynamics of various professional restraints has a wider ramification than merely helping the marketplace to exert its forces unfettered. It still is the case that professional services are steeped in asymmetric information problems; this means that focusing solely on removing piecemeal impediments to market dynamics may not lead to the optimal trade-off between quality and price that society might wish to choose.

Antitrust decisions have impacts broader than merely promoting market-force results on the allocation of society's resources. The resulting allocation of resources is determined not just by the marketplace itself, but more importantly by how resources are distributed initially. In other words, the outcome of any market process is constrained by who owns the resources at the start. Asymmetric information problems are a cause for concern because information is "privately" owned and it is distributed unevenly. Who gets to exert the use of that power will affect what levels and types of quality will be deemed optimal in the quality-price trade-off.

The question then is: Who do we want to make the decision of what is socially optimal when relying on the marketplace itself does not assure the usual measure of social optimality? In the case of medical services, do we want doctors, lawyers, or insurance companies making the decision? In the case of legal education, do we want legal educators, the professional association of lawyers (i.e., the ABA), or a common denominator determined by costs and profits

²⁵ *Id.* at 461-463.

²⁶ *See, e.g., Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679 (1978); *United States v. Brown Univ.*, 5 F.3d 658 (1993); *Cal. Dental*, 526 U.S. at 760.

²⁷ *See generally* Greaney, *supra* note 6.

based on the goal of passing a state's bar exam to make the decision? Each group has their own criteria for determining what constitutes the optimal choice, any set of which has its merits and drawbacks. Whose influence do we want to dominate? Do we want to allow for a mix – an interaction among the competing forces?

III. Asymmetric Information and Antitrust Market Analysis

When antitrust makes a decision about permissible and impermissible restraints, it is making a decision about allocating the power to decide. When problems such as asymmetric information are not present, as stated earlier, the typical antitrust approach to let the "market" decide is a valid approach. But when problems such as asymmetric information are present – leading to what is known as "market failure" – then it behooves antitrust analysis to go beyond mere market restraint analysis. It needs to examine the consequences of the choice of power its decision makes. This is something antitrust decisions rarely do. This is a criteria that antitrust needs to consider with the onslaught of increasing information and the concomitant asymmetric distribution of it.

Market analyses of the antitrust impact of various restraints in general are already quite complex. For every restraint examined, one can always offer arguments asserting the restraint's pro-competitive effect as well as its anti-competitive consequences. Sorting through which argument should be persuasive is the inherent burden that is antitrust's.

In the context of asymmetric information regarding quality, however, sorting through the arguments regarding pro- and anti-competitive effects becomes even more complicated. Generally, the most commonly agreed upon criteria for judging whether a restraint unduly restricts trade is whether it unduly constrains supply so as to raise price.²⁸ Of course, the litigated issues are what constitutes "unduly."

The complication that asymmetric information creates in the context of regulating the quality of professionals is that raising or maintaining quality inherently restricts entry into the profession (and

²⁸ See generally ROBERT H. BORK, *THE ANTITRUST PARADOX* (1978); *Cal. Dental*, 526 U.S. at 777 ("[I]t is of course the producers' supply of a good in relation to demand that is normally relevant in determining whether a producer-imposed output limitation has the anticompetitive effect of artificially raising prices.").

thereby the supply of services) and therefore, of necessity, causes a rise in the price of (or fees for) those services. Not only do the higher quality standards exclude lesser-qualified individuals, but the higher fees generated thereby mean higher income for the providers of the service and induce better qualified individuals to choose that profession. Thus, the higher the quality standards, the more restriction on the supply and the higher the fees paid for the services supplied. One must ask: How high should that standard be?

Choosing that standard of quality is the underlying struggle in determining the optimal trade-off between quality and price. Furthermore, the importance of choosing that standard also makes the traditional antitrust examination of rules and regulations – based merely on their restrictions to supply that increase price – too parochial.

IV. Conclusion

Perhaps it is true that the deference antitrust paid to the expert opinion of the professions was once too great or became anachronistic as the commercial aspects of the professions grew over time. But moving to the other extreme of merely scrutinizing for traditional restraints of trade may be unsuitably narrow in perspective as well.

The overt theme in the first two articles, Professor Hammer's and Professor Lao's, is the impact market forces have had on the professions they examine in recent times, considered in the context of antitrust decisions. The third article, Professor Calkins', gives a view of the antitrust legal profession's own use of the marketplace – "the marketplace of ideas" – through the use of professional meetings to exchange perspectives and form opinions to influence further developments in antitrust law. Perhaps in that marketplace of ideas we can consider possible solutions to this dilemma. Perhaps it is time for antitrust to develop more sophisticated criteria for judging professional regulations than merely choosing between deference to the profession's quality arguments or examining the regulation's restraint on market forces.
