

perspective, the sum of both consumer surplus and producer surplus¹² is a more appropriate measure of economic efficiency. Vertical restraints that increase producer surplus and offset any reduction in consumer surplus would still improve economic efficiency.

Most economists today would agree that efficiency rationales for vertical restraints are valid in various circumstances. Consequently, one must proceed to determine economic harm only after a comprehensive analysis of the facts surrounding a particular case.

● *A legal view*

One view, more common in the past than today, holds on legal grounds that vertical restrictions are injurious because they override the right of a retailer to make decisions about how and where it will compete on a case-by-case basis. Underlying this view is the notion that what is at stake is the property right in the product being resold and that this property right has passed on sale from the manufacturer to the retailer. The contrary legal view holds that the manufacturer should have the right to offer the retailer whatever contracts it wishes. The retailer is free to drum out contracts that are unattractive. Voluntary vertical contracts, in this view, should not be prohibited.

The view that vertical restraints are primarily agreed upon to perform an allocation function points out two tests for evaluating vertical restraints. First, horizontal restraints which masquerade as vertical restraints should be screened out. Second, the focus of vertical relationship law must be on deciding when and why there should be intervention into private agreements which parties in the distribution system have entered into in order to structure their own affairs. In other words, we need to identify significant economic risks in private agreements in the absence of government intervention.

In general, evaluating the net welfare effects of vertical practices may be extremely difficult. Any given restraint may enhance or reduce efficiency. For instance, there is an unresolved debate over whether promotional activities should be viewed as the provision of information (assumed to be good), or as a way to create false image differentiation (assumed to be bad). In practice, the focus is on the effects of vertical restraints on competition and whether they do economic harm or not.

In this Paper, economic efficiency is taken as the objective of competition policy (and of trade policy).

¹² A proxy for producer surplus can be producer profits.