

Vertical Restraints and the Retail Free Riding Problem: An Austrian Perspective

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Vertical restraints are restrictions that manufacturers place on the retailers who carry their products regarding to whom those dealers may resell the goods, or on the retail prices they may set. Although there exists a variety of economic explanations as to why rational manufacturers might wish to impose such downstream restrictions under different market conditions, perhaps the one which garners the most attention within the economics profession is that vertical restraints can help combat free riding problems within the retail sector.

The examination of vertical restraints as important pieces of the manufacturer's arsenal against free riding, however, like much of industrial organization based on neoclassical price theory, is steeped in equilibrium analysis. Ignored almost entirely in the literature is the dynamic nature of the free riding problem, and the critical roles that knowledge and discovery play in its evolution. Moreover, because the leading analyses consider a closed world of manufacturers and retailers in an isolated state of equilibrium, there exists no room for entrepreneurial activity.

In this article, I apply standard Austrian economic concepts—including the competitive market process and the roles played by knowledge, discovery, and the entrepreneur—to the analysis of vertical restraints in combating the retail free rider problem. The exposition is emphatically not meant as a thorough and exhaustive analysis of all vertical restraints from an Austrian viewpoint. Nor do I propose any new theoretical rationales for the employment of vertical restrictions. Rather, the paper

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seeks to establish two points. First, an Austrian analysis of retail free riding provides meaningful insight into the problem beyond that incumbent in conventional neoclassical equilibrium models. Second, much of the often bitter debate over the welfare implications of vertical restrictions, by ignoring the market process, is substantially misguided. By presenting vertical restraints and retail free riding in an Austrian light, perhaps those who debate the welfare properties of vertical restrictions will begin incorporating the importance of the competitive market process into their arguments.

The first section of the paper briefly outlines the general retail free riding problem and discusses the standard analysis of how it can be fought with vertical restraints. The next section critiques the neoclassical analysis of vertical restrictions in combating free riding and applies the tools of Austrian economics to the problem. The third section addresses welfare, and the current policy debate over vertical restrictions. The final section provides commentary and a brief conclusion.

The Retail Free Riding Problem

A newly introduced, high quality product is not guaranteed market success. To compete successfully, the manufacturer must inform potential consumers of the product's existence, as well as supply at least a modicum of information regarding basic product characteristics, attributes, or capabilities. Although advertising can and often does effectively convey much of the most basic product information to potential consumers,¹ not all demand-enhancing, product-specific information can be efficiently provided by manufacturer advertising, or by other manufacturer actions. Rather, certain information is best imparted at retail establishments, including information gleaned from product demonstrations or especially knowledgeable salespersons. Because such pre-sale information is costly, the information-supplying retailer must recover the costs of information provision through the markup over its wholesale cost.

However, nothing prevents a retailer, or set of retailers, from opportunistically abandoning the pre-sale information services, thereby lowering cost, and luring consumers away with the resultant lower retail prices from the information-providing dealers.

¹See the thorough examination in Robert B. Ekelund and David S. Saurman, *Advertising and the Market Process: A Modern Economic View* (San Francisco: Pacific Research Institute for Public Policy, 1988).

That is, rational consumers can freely absorb the information offered by a "full-service" retailer, yet purchase from a "no-frills," discounting dealer to receive a lower retail price. In effect, these no-frills dealers can "free ride" on the information-supplying retailers. If this free riding activity continues unchecked, the full-service retailers, no longer able to recover their information costs due to reduced sales volume, will be forced to discontinue information service provision. Because these services are demand-enhancing, elimination of or reduction in the level of services offered at retail is harmful to the manufacturer.

Not all retailer-provided services are subject to this type of free riding. If the retailer is able to charge separately for the demand-enhancing services it offers, the additional costs associated with service provision can be adequately covered by a separate service price. For example, some specialty tennis retailers allow a customer to take one or more tennis racquet models home overnight to try out the equipment at the customer's leisure. If these high-service dealers charge separately for this service, as many do, then even if a customer discovers one model which she particularly fancies yet chooses to purchase it from a discounter at a reduced retail price, the specialty store will still be compensated for the service it offered. No free riding will have occurred.

Moreover, free riding will only be a problem to the extent that the retail services are offered *prior* to the sale. Post-sale services, since they are provided only to paying customers, are not subject to free riding. For instance, a home improvement store which provides substantial assistance to customers during the remodeling process *after the products have already been purchased* is likely to find free riding less of a problem than a retailer who only provides pre-sale services.

It is entirely possible that some subset of consumers will, over time, become fully informed and therefore find the information services offered by high-service retailers superfluous. Such customers will seek out discount retailers for their purchases. Nevertheless, so long as some not insignificant number of potential consumers still find retailer-provided information meaningful, free riding will remain a potential problem for those full-service dealers who provide complimentary pre-sale services.

The extent to which retail free riding is a pervasive and widespread problem is an open empirical question about which little has been written in the industrial organization literature. Free riding activity is not easily documented, and no systematic

inquiry has been made into the magnitude of the problem. The majority of the limited analysis which has been performed involves examination of individual litigated cases of vertical restraints.² Although the frequency and severity of retail free riding is uncertain, there is no question that the problem receives substantial attention in virtually every industrial organization textbook. If the resources of the profession devoted to the study of a particular problem serve as a proxy for its importance, then the retail free riding problem merits additional examination.

In any event, when retail free riding is of concern to a particular manufacturer, it has a clear incentive to undertake actions which can prevent, or at least ameliorate, the problem. One such set of actions is vertical restrictions.

Vertical Restraints and Retail Free Riding

It is the prospect of lower retail prices that entices consumers away from full-service retailers to discounting, no-frills dealers. The manufacturer can prevent such price cutting by imposing minimum resale price maintenance (RPM) on its dealer network.³ By setting a retail price floor below which no retailer may sell the

²See, for example, the discussion of the case involving Lenox china in V. Goldberg, "Enforcing Resale Price Maintenance: The FTC Investigation of Lenox," *American Business Law Journal* 18 (1980): 225-58; and H. P. Marvel and S. McCafferty, "Resale Price Maintenance and Quality Certification," *Rand Journal of Economics* 15 (1984): 346-59; or S. Oster, "Levi Strauss," in *Impact Evaluations of Federal Trade Commission Vertical Restraints Cases*, R. N. Lafferty, R. H. Lande, and J. B. Kirkwood, eds. (Washington, D.C.: Federal Trade Commission, 1984), an examination of the case of Levi Strauss jeans.

³Technically, RPM is a *per se* violation of the antitrust laws, under the standard set forth in *Dr. Miles Medical Company v. John D. Park & Sons Company*, 220 U.S. 373 (1911). The Supreme Court has, however, over the past few years, significantly narrowed the scope of *per se* illegal activity. See the Court's decisions in *Monsanto Company v. Spray-Rite Service Corporation* (1984) and *Business Electronics Corporation v. Sharp Electronics Corporation* (1988). In *Monsanto*, the Court ruled that a *per se* violation could not be inferred solely from evidence that a manufacturer had terminated a price-cutting distributor after having received complaints from the distributor's competitors. In *Sharp*, the Court went even further, holding that an agreement between a manufacturer and a dealer whereby the manufacturer would terminate any price-cutting dealer was not the same as an RPM agreement. Rather, *per se* illegality required an agreement between the manufacturer and all dealers. For a thorough legal history of RPM, see T. R. Overstreet, *Resale Price Maintenance: Economic Theories and Empirical Evidence* (Washington, D.C.: Federal Trade Commission, 1983); P. Ippolito, *Resale Price Maintenance: Economic Evidence from Litigation* (Washington, D.C.: Federal Trade Commission, 1988); or M. C. Katz, "Vertical Contractual Relations," in *Handbook of Industrial Organization*, Richard Schmalensee and Robert W. Willing, eds. (New York: North Holland, 1989).

product, the standard argument goes, the manufacturer deflects the ruinous price competition into non-price competition in information provision.

Of course, RPM can and is used for reasons other than combating the retail free riding problem. A number of other rationales for the practice have withstood scholarly scrutiny, and still receive substantive attention in the literature. For example, RPM may facilitate dealer and/or manufacturer collusion, serve as an aid to price discrimination, or provide an incentive device to promote the establishment of additional retail outlets.⁴ Nevertheless, the limited empirical record seems to suggest that, at least for litigated cases involving RPM, the practice is predominantly used to minimize free riding. Ippolito in her systematic examination of all public and private cases filed between 1976 and 1982 alleging vertical price restraints, finds that the collusion theories are plausible explanations for no more than 15 percent of all case filings, and an even smaller percentage of the private cases. Yet roughly 70 percent of the cases appear to be situations where retail free riding could have occurred. In fact, virtually all of the cases she examined are consistent with one or more of the "special services" theories of RPM.⁵

Resale price maintenance is not the only vertical restraint option open to the manufacturer. Alternatively, the manufacturer could remove any potential free riding activity by granting to a single dealer in each geographical market an exclusive territory. Since the retailer granted the exclusive territory is insulated from any potential free riders, the manufacturer's incentive to have information services provided is perfectly transferred to the dealer.

⁴A number of authors have written on these and other justifications for RPM. See, for example, the classic works of B. Yamey, "Origins of Resale Price Maintenance: A Study of Three Branches of Retail Trade," *Economic Journal* 62 (1952): 552 and *Resale Price Maintenance*, Yamey, ed. (Chicago: Aldine Publishing, 1966); or, more recently, G. F. Mathewson and R. A. Winter, "An Economic Theory of Vertical Restraints," *Rand Journal of Economics* 15 (1984): 27-38; or S. I. Ornstein, "Resale Price Maintenance and Cartels," *The Antitrust Bulletin* 35 (1985): 1-18; on the collusion theories, W. S. Bowman, "The Prerequisites and Effects of Resale Price Maintenance," *University of Chicago Law Review* 22 (1955): 825; or R. E. Caves, "Vertical Restraints as Integration by Contract: Evidence and Policy Implications," Harvard Institute of Economic Research Discussion Paper No. 754 (1980) on price discrimination; and J. R. Gould and L. E. Preston, "Resale Price Maintenance and Retail Outlets," *Economica* 302 (1965): 302-12 on the outlets rationale. For a thorough summary of all economic justifications for RPM, see Overstreet, *Resale Price Maintenance: Economic Theories and Empirical Evidence*; or Ippolito, *Resale Price Maintenance: Economic Evidence from Litigation*.

⁵Ippolito, *Resale Price Maintenance: Economic Evidence from Litigation*.

Neither of these vertical restraints, however, completely solves the manufacturer's free riding problem. Because consumers do not always make locational purchase decisions based solely on the quantity and quality of the information provided by dealers, the uniform retail prices guaranteed by RPM do not necessarily generate a pure incentive for dealers to provide the level of information manufacturers desire. In particular, residual free riding can occur, causing retailers to select a quantity of information provision strictly less than the manufacturer's preferred level.⁶ Since these information services are demand-enhancing, insufficient information investment by retailers reduces aggregate sales and hence manufacturer profitability.

On the other hand, the artificial elimination of retail competition spawned by the geographical restrictions associated with exclusive territories confers to the dealer sufficient market power to mark up retail prices accordingly. The higher retail prices constrict the manufacturer's derived demand, also reducing profitability.

The conventional analysis, then, suggests that the retail free riding problem must be fought with one of these two imperfect strategies. An Austrian insight into the problem and these two proposed remedies, however, reveals not only that the vertical restraint solutions are likely to be much less effective than the orthodox analysis allows, but that a third solution can, and often does, help mitigate the retail free riding problem.

Vertical Restraints and the Retail Free Riding Problem: An Austrian Critique

Knowledge

To compare the relative efficacy of RPM and exclusive territories in combating the retail free riding problem, and to implement the better strategy, requires that the manufacturer possess a set of market knowledge that is impressive in both its breadth and depth. Under RPM, the manufacturer must devise an optimal retail price, below which it desires no retailer to offer the product to consumers. To determine this retail price floor, the manufacturer must be thoroughly acquainted with the demand schedule for its product. But as Mises made clear,⁷ the manufacturer is

⁶See, David W. Boyd, "The Choice Between Resale Price Maintenance and Exclusive Territories," *Review of Industrial Organization* 8 (1993): 755-63, for a more extended analysis of residual free riding under RPM.

⁷Ludwig von Mises, *Human Action* (Chicago: Henry Regnery, 1966), p. 378.

unlikely to know the shape of its demand curve. This knowledge problem is multiplied dramatically under exclusive territories, where the manufacturer must know the demand for its product in *each separate geographical market* in order to efficiently design the territories themselves and set an appropriate wholesale price in each.

The knowledge problem is likely to be especially acute for the manufacturers of newly introduced products—precisely those products for which the information supplied by retailers is most critical. The assumption that a manufacturer of a new product never before marketed possesses sufficient knowledge of a *hypothetical* demand curve to make meaningful decisions about optimal wholesale and retail prices certainly strains the bounds of credibility.

Furthermore, for RPM to prevent sales from bleeding to lower priced outlets, the retail price floor set by the manufacturer must be uniform across the entire retail network. But a single retail price will be optimal only if all retailers incur identical costs, a popular assumption within the literature. However, the actual costs which affect retailer decision making are subjective opportunity costs,⁸ known only to each individual dealer. Even if the manufacturer were somehow able to magically learn of all these subjective retailer opportunity costs, it is exceedingly unlikely that they would all be exactly the same. In all actuality, no single optimal retail price exists for the manufacturer to set.

The Information Entrepreneur

The most often cited analyses of vertical restraints in fighting retail free riding consist of insulated manufacturers and retailers operating within a closed world. Solutions involving other parties are not considered as options. In an open universe of decision makers, however, the free riding problem for the manufacturer is, at the same time, an opportunity for an alert entrepreneur. Kirzner opens the entrepreneurial door when discussing the information content of advertising.

If producers did not offer "free" information jointly with the product, consumers would be forced to use other techniques of purchasing information. In fact, the provision of free information through advertising has, in this line of ideas, come more recently

⁸James M. Buchanan, "What Should Economists Do?," *Southern Economic Journal* (1964): 213-223.

to be integrated into the broader theory of the economics of information. In this theory, the provision of information is treated as a service separated from the products to which market information is relevant. Moreover, it is a service whose usefulness is *valued* by the consumer *separately* from that of the relevant products.⁹ (emphasis in original)

Any reduction in information offered by full-service dealers as a response to free riding activity provides an opportunity for alert entrepreneurs to fill the information lacuna with their own information services. Since, as Kirzner pointed out above, product information is often valued by the consumer distinctly from the product itself, "information entrepreneurs" can bundle information packages and market them separately and directly to the consuming public. In fact, as argued below, the information supplied by third party information entrepreneurs is likely to be superior to that offered by retailers.

Consider, for example, the markets for bicycles and bicycle equipment. In the last decade or so, bicycles and bicycle equipment have become increasingly complex, due in part to specialization and advances in technology. Today, sporting goods dealers and specialty bicycle shops sell a broad assortment of racing bikes, road bikes, mountain bikes, and so called "hybrid" bikes, which combine features of racing and mountain bikes. Each type of bicycle requires its own assortment of specialized parts, components, and accessories. To make an intelligent purchasing decision, a consumer requires information about the various products available, as well as assistance in arriving at an appropriate type and model of bike, given the manner in which he or she is apt to use it. Much of this information is provided by full-service retailers via bicycle displays and specially trained salespeople. However, discount outlets and mail-order marketers often distribute many of the same products, without offering a commensurate level of information services, at lower retail prices. Consequently, free riding activity in this market is distinctly possible. Indeed, many manufacturers appear to attempt to combat the problem by, for example, setting "manufacturers' suggested retail prices" to discourage price cutting, and imposing a degree of territorial exclusivity in retail networks. Nevertheless, some free riding certainly does occur, with the result that the information

⁹Israel M. Kirzner, *Competition and Entrepreneurship* (Chicago: University of Chicago Press, 1973), p. 152.

services offered by full-service dealers are, in all likelihood, insufficient from both the manufacturer's and the consumer's point of view.

In this setting, a variety of information entrepreneurs have developed products and services to help fill the information gap spawned by retail free riding. For example, magazines, books, and cable television programming all provide consumers with information about bicycles and bicycling. A host of magazines appear on the shelves of any newsstand covering bicycle racing and mountain biking. For more general information, a variety of books describe the different kinds of bicycles available in the market today, and offer advice to consumers regarding which type of bicycle might be most appropriate. Sports channels on cable television regularly televise both road and mountain bike races. All of these media are potentially important sources of information for anyone imperfectly informed about the products offered in today's bicycle market.

The number and variety of information entrepreneurs will vary with the product's value and complexity. Consumers of expensive, complicated, and highly technological products are apt to demand more information than the purchasers of less inexpensive, mundane products. Though product information is important for potential buyers of both computers and running shoes, for example, the demand for computer information is likely to exceed in depth and breadth the demand for information about running shoes. Thus, while one can obtain information about running shoes and computers from different magazine publications, information entrepreneurs have developed an assortment of additional information services—e.g., seminars and other classroom offerings—directed toward computer purchasers.

The ability of third-party entrepreneurs to offer successful information services depends critically on how quickly the information they provide depreciates. If the manufactured products in question are relatively stable—they do not change significantly over time—then consumers will quickly reach the point where the marginal cost of additional information acquisition exceeds the marginal benefit, and any market for information services will soon evaporate. However, if the product of concern is in a steady state of flux—that is, if the product is regularly altered, or if new and improved versions are constantly appearing on the market—then information entrepreneurs can provide a regularly updated stream of information services which the information-consuming public will readily demand. Indeed, if one subscribes

to the market process view of imperfect competition,¹⁰ most manufacturers, seeking to better satisfy evolving consumer wants and desires, will constantly update their products' qualities and characteristics. This view suggests that, at least in many contexts, markets will persist for the services provided by information entrepreneurs.

Market Process

The most oft-cited and influential analyses of vertical restraints as ammunition against retail free riding are neoclassical equilibrium models. In addition to overlooking the roles played by knowledge and entrepreneurship, these analyses ignore the competitive market process so essential to a thorough understanding of the free riding problem. In reality, a consumer neither enters the market as the *tabula rasa* many models initially assume, nor remains in the fully informed state of final equilibrium many of these very same models eventually reach. Instead, a consumer's knowledge base is in a constant state of flux, as he discovers new information, and forgets some as well. Neither is the relevant pool of information stable. New knowledge is constantly available, and other information becomes obsolete. To truly understand the retail free riding problem, one must at least acknowledge the dynamic process of knowledge acquisition.

Manufacturers themselves often respond to the evolving state of consumer information. Recognizing that many of their traditional customers have, over time, accumulated a body of knowledge about their products and services sufficient to make much of the information provided by traditional retailers unnecessary, Apple Computer, Inc. recently expanded their operations into the mail-order business, distributing a catalog offering for sale a wide variety of Apple hardware and software products. The company also seemed to address those consumers at the opposite end of the knowledge-base spectrum—people with little aversion to remaining relatively ignorant of personal computers and their workings. Apple's Performa™ line of machines, bundled with special software which make the computers easier, but less flexible, to use are distributed through discount outlets and department stores. Both of these distribution expansions reflect changes in the knowledge bases of consumers, and in the process by which

¹⁰Ibid., pp. 112–19.

they acquire information. Neither move enamored Apple with its traditional retailers, but market forces required the company to respond to the changing states of consumers' knowledge and preferences.

Information entrepreneurs must compete against one another, as well as with the information services provided by retailers and/or manufacturers. In the competitive market process, entrepreneurs offer a constantly changing information package, trying to better serve consumer demands and responding to evolving consumer knowledge bases. In many ways, the information provided by third party information entrepreneurs is likely to be superior to that offered by traditional retailers. While the information supplied by retailers is primarily ancillary to the actual product being distributed, the product being marketed by the information entrepreneur is the *information itself*. A retailer might consummate a transaction even if the information services offered there are quite poor. Information entrepreneurs are not so fortunate. Because the product *is* the information, inferior quality information translates directly into reduced sales. Furthermore, because the services offered by entrepreneurs often include information on the products of a number of manufacturers, the information is less likely to be biased than that offered by retailers, who many have an incentive to steer consumers towards those brands for which the dealer receives the largest retail margin.

Moreover, the competition between traditional retailers usually is constrained to some extent by transportation costs. Dealers generally only compete against other retailers within a relatively small geographic proximity. In the extreme case of exclusive territories, competition between dealers is virtually eliminated. Information entrepreneurs, on the other hand, are typically able to compete in a larger range of markets, since their products are often broadly available via bookstores, newsstands, mail services, electronic networks, or public broadcast spectrums. Because the competition between information entrepreneurs is more intense than the competition between retailers, the information products supplied by third-party entrepreneurs are likely to be of a higher quality.

This is not to say that all information is best provided by information entrepreneurs. Rather, the competitive market process will tend to impose efficiency in information distribution. At any point in time, the types of information most productively provided by retailers will tend to be supplied by them. Market forces

will discipline entrepreneurs to offer the information services that they can more efficiently supply. And the mix between all types of information providers will constantly sway, reflecting changes in consumer demands and the state of consumer knowledge. In short, the competitive market process will determine which information will be provided by whom.

The Welfare Debate

Even though both RPM and exclusive territories can at least partially solve the retail free riding problem, they are currently subject to different legal treatments. Vertical price restrictions, including RPM, are technically *per se* violations of the antitrust laws, although manufacturers may legally engage in activity which is nearly indistinguishable from RPM.¹¹ Vertical non-price restraints, including exclusive territories, are presently judged under the more lenient rule-of-reason standard.¹² Much of the public policy debate over the retail free riding problem has concentrated on this disparity in legal treatments, and, in particular, on the seemingly overly stringent *per se* standard applied to RPM.¹³

Central in this debate is the effect RPM has on retail prices and, therefore, social welfare. Opponents of RPM argue that the practice, by artificially precluding price reductions, raises retail prices to consumers and therefore reduces welfare. RPM proponents counter that the larger retail margin, necessary for retailers to pay for information services, comes from lower wholesale prices, not higher retail prices. Furthermore, because RPM increases the information available to consumers via retailers, welfare is enhanced.

Using prices as a barometer for welfare and efficiency, however, requires an interpersonal comparison between the benefits and costs to consumer and producer. Since these benefits and costs are subjective, such a comparison is meaningless. Buchanan provides a more sensible approach to analyzing the welfare properties of vertical restraints and other activities: any activity,

¹¹See note 3 above.

¹²The current legal standard to be applied to vertical non-price restraints is set forth in *Continental TV, Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

¹³See the exchange between David W. Boyd, "The Resale Price Maintenance Struggle: A Comment," *American Journal of Economics and Sociology* (October 1993): 447-54 and Anthony J. Greco, "Response of Professor Anthony J. Greco," *American Journal of Economics and Sociology* (October 1993): 454-58.

institution, or legal rule which facilitates mutually advantageous, voluntary exchange is efficient, or welfare-enhancing.¹⁴

The information entrepreneur measures up particularly well using Buchanan's welfare yardstick. When the retail free riding problem is solved by vertical restraints, and information is only provided by dealers, the consumer is forced to pay for information services, via the elevated retail price, whether he or she desires them or not. By unbundling the information from the product, the information entrepreneur makes the information available to the consumer without forcing all consumers to pay for information dissemination. Those consumers who demand information services are free to purchase them. Those who prefer to remain rationally ignorant or who already possess sufficient knowledge are not forced to subsidize information collection and dissemination.

Furthermore, by marketing the information products directly to the consumer, the information entrepreneur is likely to reduce consumer search costs, and therefore the effective price paid by consumers. Information provided by retailers nearly always necessarily entails a trip to the dealer. The transportation costs and the opportunity costs of the time forgone to acquire this information can be substantial, especially when a number of dealers are visited. Information entrepreneurs, on the other hand, typically deliver the information services directly to the consumer. Although they entail their own prices, acquisition costs are apt to be minor.

The information entrepreneur, therefore, is clearly a welfare-enhancing actor. Yet his place in the welfare debate over the retail free riding problem is notoriously absent. The welfare discussion should be expanded to include the roles played by the information entrepreneur and the institutions that affect how well he can perform his tasks. For example, the establishment of property rights in information influences the types of products and services the information entrepreneur can provide in a competitive market. By more concretely defining such rights, the third-party information provider can develop his products in a less uncertain environment. In general, attention in the debate should be paid to institutions and legal rules which affect the ability of the information entrepreneur to engage in his welfare-enhancing activities.

¹⁴James M. Buchanan, "Introduction: L. S. E. Cost Theory in Retrospect," in *L. S. E. Essays on Cost*, Buchanan and G. F. Thirlby, eds. (New York: New York University Press, 1981).

Conclusion

Despite a revival of Austrian economics since the middle 1970s, the school has made insufficient progress in injecting its ideas into mainstream economic thought. In a recent paper expanding on his work on the competitive market process, Kirzner conveys the sentiments of many Austrians: "Although this fundamental difference (between the perfectly competitive model and the competitive market process) has been articulated by the Austrians now for several decades, there has been disappointingly little impact upon mainstream contemporary theory."¹⁵ This failure may be due in part to an overly zealous concentration on theory at the expense of application. Indeed, W. Duncan Reekie largely agrees with this lament in his commentary on Kirzner's article,

students want either to study industrial organization and normative implications thereof for public policy toward business, or they want to study managerial economics to obtain normative insights on how to maximize profits. . . . To a degree, this coupling of student demands into "relevancy" and "low cost" may be mutually inconsistent; but that is the nature of the market and if we fail to meet this demand we, of all people, should not be surprised if others step in to fill it. . . . I believe Austrians have been frightened that . . . they will fling the baby out with the bathwater, but, in fear of doing so, the bath has gone cold and the baby is freezing to death.¹⁶

In this paper, I have attempted to respond to this criticism by applying well established Austrian economic notions to retail free riding, a significant problem in industrial organization. Examining the problem from an Austrian perspective reveals that the traditional neoclassical analysis ignores many of the most salient characteristics of the issue, and that much of the public policy debate on retail free riding is substantially misguided. If Austrian economists continue to illustrate that their

¹⁵Israel M. Kirzner, "The Driving Force of the Market: The Idea of 'Competition' in Contemporary Economic Theory and in the Austrian Theory of Market Process," in *Austrian Economics: Perspectives on the Past and Prospects for the Future*, Richard M. Ebeling, ed. (Hillsdale, Mich.: Hillsdale College Press, 1991), p. 139.

¹⁶W. Duncan Reekie, "The Driving Force of the Market: The Idea of 'Competition' in Contemporary Economic Theory and in the Austrian Theory of Market Process: Commentary," in *Austrian Economics: Perspectives on the Past and Prospects for the Future*, Richard M. Ebeling, ed. (Hillsdale, Mich.: Hillsdale College Press, 1991), pp. 169-70.

principles provide insight into everyday economic applications beyond that generated by mainstream economic thinking, perhaps the Austrian school will eventually make much needed inroads into mainstream economic thought.

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