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ON THE POTENTIAL IMPACT OF VALUE PRICING BY DEVELOPING
COUNTRIES ON ALLOCATIVE AND DYNAMIC EFFICIENCY IN THE
GLOBAL PHARMACEUTICAL INDUSTRY

*JP Sevilla**

INTRODUCTION

The question: How can we reconcile LMIC access to patented pharmaceuticals while facilitating dynamic efficiency with respect to pharmaceutical Research & Development?

A central question in global health, and indeed in global economic policy, is how to reconcile low- and middle-income countries' (LMICs) access to patented pharmaceuticals, while facilitating dynamic efficiency with respect to pharmaceutical research and development (henceforth, I refer to pharmaceutical research and development as simply "R&D"). On the one hand, if pharmaceutical firms (henceforth just "firms") are to recoup their fixed costs of R&D, they must mark up the prices of patented drugs above their marginal costs. On the other hand, such markups make them less affordable to LMICs.

Tirole, for example, says that:

[F]ew issues are as controversial as the impact of intellectual property on health in developing countries [P]oor countries' governments have, for example, long claimed that patents on antiretroviral drugs make AIDS treatments unaffordable in Africa and other low-income areas Finger-pointing with regard to the AIDS problem is but one of the many symptoms of the overall tension over intellectual property rights (IPRs) between high-income countries, on the one hand, and middle- and low-income ones, on the other hand.¹

As Jack and Lanjouw point out, the problem is how to globally allocate the fixed costs of pharmaceutical R&D across consumers of drugs spread out across countries at different levels: "The most contentious issue in the pharmaceutical sector is . . . how the financing research and development incentives should be shared among consumers. How much of the total cost should a U.S. retiree, a French worker, or an Ethiopian peasant be

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¹ Jean Tirole, *Intellectual Property and Health in Developing Countries*, in UNDERSTANDING POVERTY 303, 303 (Abhijit Banerjee et al. eds., 2006) [hereinafter Tirole].

expected to contribute?”² Obviously, the LMICs want to shift the burden of these costs onto the developed countries. But the developed countries are themselves concerned about their share of the burden. Senior citizens in the U.S. lobbied Congress for Medicare Part D benefits precisely to shift costs from pharmaceutical consumers to the general taxpayer.³ Efforts to legalize the importation of cheaper Canadian drugs reflect the desire to shift these costs away from the U.S. towards Canada.⁴ Former FDA Commissioner McClellan once expressed the view that U.S. pharmaceutical prices were too high precisely because the U.S. bore too much of the fixed costs of R&D and that other countries should bear some of this burden.⁵

The issue has become even more controversial in the wake of the World Trade Organization’s (WTO) TRIPS agreement, which requires all WTO member countries, including LMICs, to put into place minimum standards for protecting IPRs, giving developing countries until 2006 to do so, and the least developed countries until 2016.⁶ LMICs were concerned that putting such protections in place would simply raise prices without creating any incentives for increased R&D into neglected diseases, that is, diseases prevalent in the developing countries but not in the developed ones.⁷

This global policy controversy has both efficiency and equity related aspects. The equity aspect involves the premise that LMIC consumers of drugs have lower marginal utility of income than wealthy country consumers, so that it is welfare maximizing to shift the burden of paying for the fixed costs of R&D from the former to the latter. However, I shall not address equity in this paper and shall instead focus solely on efficiency. Seen from the point of view of efficiency, this policy controversy is nothing more than an exemplification of the standard tension at the heart of the patent system: the trade-off between allocative and dynamic efficiency.

On the one hand, some scholars and policy makers have concluded that the global regime of intellectual property rights (IPRs) is a fundamentally flawed way of reconciling dynamic efficiency with allocative efficiency or equity. For example, Boldrin and Levine argue that (1) “there is no empirical evidence that [patents] serve to increase innovation and productivity,”⁸ (2) patents are simply mechanisms for holding up and extracting

² William Jack & Jean Lanjouw, *Financing Pharmaceutical Innovation: How Much Should Poor Countries Contribute?* 19 WORLD BANK ECON. REV. 45, 45 (2005) [hereinafter Jack & Lanjouw].

³ *Id.* at 45.

⁴ *Id.* at 45-46.

⁵ *Id.* at 46.

⁶ Tirole, *supra* note 1, at 303.

⁷ Margaret Kyle & Anita McGahan, *Investment in Pharmaceuticals Before and After TRIPS 2* (Nat’l Bureau of Econ. Research, Working Paper No. 15468, 2009), <http://www.margaretkyle.net/TRIPS.pdf>.

⁸ Michele Boldrin & David Levine, *The Case Against Patents 1* (Federal Reserve Bank of St. Louis, Working Paper 2012-035A, 2012), <https://research.stlouisfed.org/wp/2012/2012-035.pdf>.

rents from subsequent innovators,⁹ and (3) first-mover advantage is typically sufficient incentive for innovation.¹⁰ Other scholars have proposed greater reliance on non-IPR mechanisms for addressing the question, such as prizes and advanced market commitments.¹¹

On the other hand, others have argued that the reconciliation between LMIC access and dynamic efficiency does not require going beyond the regime of IPRs. They argue that an IPR-centric global regime is perfectly capable of promoting both access and dynamic efficiency. One important plank in such a view is an argument by Lakdawalla and Sood. According to them, health insurance “operates like a conventional two-part pricing contract that allows monopolists to extract profits without inefficiently constraining quantity.”¹² It is well known that a two-part tariff can, in principle, reconcile dynamic and allocative efficiency in a monopolistic setting. The first part of the tariff serves as an upfront payment made by the customer whose size is invariant with respect to the quantity that a customer purchases, while the second part of the tariff is a fixed price per unit quantity that the customer purchases. The second part of the tariff can be set equal to the monopolist’s marginal cost (I will assume throughout this paper that all marginal costs are constant), inducing allocatively efficient consumption of the monopoly good. The first part of the tariff can be set equal to the consumer surplus that is realized at that allocatively efficient level of consumption.

A health insurance plan can work as a two-part tariff if the copayment paid by the customer per unit of health service consumed is equal to the marginal cost of that service, and the premium is set to extract the entirety of the customer’s consumer surplus from the resulting allocatively efficient consumption across all insured services. A monopolist firm producing that service can, in turn, sell the service to health insurance plans using a two-part tariff, extracting the premium using the upfront tariff, and offering the service at a per-unit tariff equal to the marginal cost of producing the service.

⁹ *Id.* at 2. Ouellette finds that although drugs are thought to involve a low number of patents per product, it is in fact the case that “most small-molecule drugs are protected by multiple patents. The average was nearly 3.5 patents per drug in 2005, with over five patents per drug for the best-selling pharmaceuticals; these numbers have increased over time.” Lisa Ouellette, *How Many Patents Does It Take to Make a Drug – Follow-On Pharmaceutical Patents and University Licensing*, 17 MICH. TELECOMM. & TECH. REV. 299, 300 (2010), <http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1044&context=mttlr>.

¹⁰ Boldrin & Levine, *supra* note 8, at 1.

¹¹ See generally Michael Kremer & Heidi Williams, *Incentivizing Innovation: Adding to the Toolkit*, in INNOVATION POLICY & THE ECONOMY, VOLUME 10 1 (Josh Lerner & Scott Stern, eds., 2010).

¹² Darius Lakdawalla & Neeraj Sood, *Health Insurance as a Two-Part Pricing Contract*, 102 J. PUB. ECON. 1, 1 (2013).

The idea of two-part tariffs is potentially very empirically relevant to LMICs. About 37% of health care financing in the low income countries and 56% in middle income countries are accounted for by the sum of tax-financed publicly provided health care and social/public health insurance.¹³ This indicates that large public sector payers deploy vast quantities of health care resources in LMICs, and are in principle capable of negotiating with pharmaceutical companies to implement two-part pricing (or licensing to produce) schemes.¹⁴ There is, furthermore, a growing emphasis in LMICs whereby public payers are changing their roles from being mere passive allocators of funds towards taking a more active role in making decisions regarding which health technologies should be paid for and which not.¹⁵ If such payers begin to take a more sophisticated and rational role in making funding decisions, this may make them consider more sophisticated approaches to pricing like two-part tariffs.

In this paper, I pursue another important plank in the argument that allocative and dynamic efficiency can be obtained within the bounds of the current patent system. This plank is Danzon et al.'s idea that global implementation of "value-based differential pricing" (henceforth "value pricing") can provide a "comprehensive approach to global [pharmaceutical] pricing that simultaneously achieves second-best static and dynamic efficiency within and between countries."¹⁶ Value pricing occurs when large-scale payers (like national governments, social health insurance plans, and private insurers) give some, if not necessarily exclusive, weight to cost-effectiveness criteria in deciding what drugs—or, in general, what health services or technologies—to reimburse.

I depart from Danzon et al.'s analysis in two ways. First, I consider value pricing in light of the fact that there remain vastly underutilized cost-effective health technologies in LMICs. If LMICs were to adopt value pricing, this will induce greater utilization of such technologies and a substitution effect away from relatively cost ineffective patented drugs. Such substitution will clearly improve allocative efficiency because it will bring prices closer to marginal costs, and because it will improve efficiency-enhancing price discrimination especially when there are multiple payers within a country catering to sub-populations with different marginal willingness to pay for health. Second, in contrast to Danzon et al. who argue

¹³ Anne Mills, *Health Care Systems in Low- and Middle-Income Countries*, 370 NEW ENG. J. MED. 552, 553 (2014).

¹⁴ See Jack & Lanjouw, *supra* note 2, at 46.

¹⁵ Anne Mills & M. Kent Ranson, *The Design of Health Systems*, in GLOBAL HEALTH: DISEASES, PROGRAMS, SYSTEMS, AND POL'Y 615, 634-35 (Michael Merson et al., eds., 2012).

¹⁶ Patricia Danzon et al., *Value-Based Differential Pricing: Efficient Prices for Drugs in a Global Context*, 24 HEALTH ECON. 294, 295 (2015),

<http://onlinelibrary.wiley.com/store/10.1002/hec.3021/asset/hec3021.pdf;jsessionid=F49B87CFD2B22D2A1D988C5693EB8599.f03t04?v=1&t=i9k1r3d0&s=97d6c6f08d0866186256dfb87e7fad3cbe519663> [hereinafter Danzon et al.].

that value pricing contributes to dynamic efficiency by allowing pharmaceutical companies to extract surplus, I argue that the substitution effects just described can contribute to dynamic efficiency by limiting that extraction. Because we live in a second-best world and will continue to do so as long as patent durations are bounded, value pricing can improve dynamic efficiency by improving the quality of invention (in the sense of reducing fixed costs per unit of social surplus produced), and by reducing rent extraction without necessarily impairing incentives to innovate. I show how this argument constitutes an effective response to Jena and Philipson's view that value pricing is necessarily inimical to dynamic efficiency.

In section I, I provide a brief theoretical introduction to quality-adjusted life years, cost-effectiveness analysis, burdens of disease, value pricing, and Danzon et al.'s microeconomic model of global value pricing. In section II, I discuss the literature on cost-effective health technologies and burdens of disease and present evidence that there remain vastly underutilized cost-effective health technologies in LMICs. In section III, I discuss how value pricing in the presence of such underutilized technologies should lead to substitution effects towards those technologies and away from relatively cost ineffective patented drugs. I discuss the implications of that substitution effect for allocative and dynamic efficiency. Section IV concludes.

I. THEORETICAL PRELIMINARIES

A. *Quality-Adjusted Life Year (QALY)*

In what follows, we will be concerned with decision-makers who are faced with a budget constraint and must allocate that budget to maximize some health-related objective. For example, where the decision-maker is a public or private sector payer, the budget constraint is given by some pool of tax revenues or premiums, and the decision-maker's goal is to maximize the health gains generated from that pool where those gains are weighted by the marginal willingness to pay for those health gains of the individuals in the pool. And where the decision-maker is an individual consumer of health services, the budget constraint is lifetime wealth, the objective function is lifetime utility, and wealth is allocated among competing health-related and non-health-related goods and services.

Modeling such decision-makers requires a measure of health, and the standard tool for this purpose is the quality-adjusted life year (QALY). The concept of a QALY is generated from expected utility theory.¹⁷ It presumes

¹⁷ Milton Weinstein et al., *QALYs: The Basics*, 12 *VALUE IN HEALTH* S5, S5 (2009), <http://onlinelibrary.wiley.com/doi/10.1111/j.1524-4733.2009.00515.x/epdf>.

that, at any moment in time, an individual is in one or another health state, where the best health state called “perfect health” is assigned a value of 1, and the worst health state called “death” is assigned a value of 0. In other words, the individual’s “quality of life” at any given moment can be represented by a scalar variable $q \in [0,1]$. If we consider an individual’s health over his or her life as a whole, we can summarize this health by how much time is spent in each health state, weighted by the quality of life in each of those states. For example, if an individual lives for 82 years, and is in perfect health the whole time, then that individual’s lifetime health equals $82 * 1 = 82$ QALYs. And if an individual lives the first ten years of life in perfect health, then lives the next five years of life with only a quality of life of 0.5, and then dies after fifteen years of life, then that person’s lifetime health is $10 * 1 + 5 * 0.5 = 12.5$ QALYs. Thus, QALYs literally measure duration of life, where each moment is weighed by the quality of life at that moment, hence the name “quality-adjusted life year.” QALYs can therefore be used to measure the health benefits of some health technology. So, if some cancer drug extends a person’s life by half a year and prevents a quality of life decline of 0.2 during those 6 months, then the QALY benefit from the drug equals $0.5 * 0.2 = 0.10$ QALYs.

In order for QALY benefits to be aggregated across persons, the quality of life measure q must have interval-scale properties so that, for example, a quality of life improvement from 0.1 to 0.2 has the same value as an improvement from 0.8 to 0.9. These quality of life measures are therefore typically derived using a standard gamble,¹⁸ which produces quality of life measures with such interval-scale properties. In a standard gamble, an individual who is in some particular less-than-perfect health state h (say, experiencing some amount of pain) is asked: assuming there is some health technology that with probability q will restore your quality of life to perfect health, and with probability $1 - q$ will kill you, what is the lowest probability q you would tolerate to use such a health technology? So, for example, if an individual is in some pain, and is indifferent between staying at that state and a gamble with a 0.9 probability of restoring him to perfect health but 0.1 probability of killing him, then the pain state has a quality of life of 0.9. The higher the risk of death an individual is willing to face to be cured of some disease (i.e., the higher is $1 - q$), the lower is the quality of life with that disease. This method assigns to every health state some quality of life index between 0 and 1, with 1 assigned to perfect health and 0 to death. In general, the standard gamble represents utility in health state h by u_h and equates it to:

$$u_h = q * u_{\text{perfect health}} + (1 - q) * u_{\text{death}} = q * 1 + (1 - q) * 0 = q$$

¹⁸ Michael F. Drummond et al., *Methods for the Economic Evaluation of Health Care Programmes* 139-41 (5th ed. 2015).

Thus, the generation of such quality of life measures requires the assumption of risk neutrality over health shocks.

B. *Burdens of Disease*

An individual's "burden of disease" is that individual's shortfall from some estimate of a lifetime of perfect health. For example, if we adopt as a normative baseline that a lifetime of perfect health corresponds to 82.5 QALYs (that is, 82.5 years lived in perfect health), then the last individual discussed in the previous paragraph has a burden of disease equal to $82.5 - 12.5 = 70$ QALYs. In other words, this individual lost a total of 70 QALYs to the combined effect of morbidity (periods during which quality of life was below 1) and premature mortality (a lifespan below 82.5 years). The normative baseline level of perfect lifetime health is typically constructed by taking the life expectancy of the country with the highest life expectancy in the world (it was 82.5 for females in Japan in the early 1990s when burdens of disease were first calculated),¹⁹ and constructing a hypothetical individual who lives that long in perfect health.

Burdens of disease can be aggregated and disaggregated in various ways. They can be summed up across all individuals in a country to generate a burden of disease for the entire country as a whole, reflecting the average per capita shortfall from perfect health multiplied by population size. They can be disaggregated by disease, so that we can, in principle, measure just the burden of disease from cancer, reflecting the shortfall from perfect health caused by cancer-related morbidity and premature mortality. The burden can also be disaggregated into morbidity and mortality components. For example, we can measure the quality of life burden of cancer as well as its impact on the non-quality-weighted duration of life. The World Health Organization computes that the burden of disease across all LMICs was 1.4 billion QALYs in 2001, out of which communicable diseases, pregnancies, and nutritional deficiencies accounted for 39.8%, non-communicable diseases for 48.9% and injuries for 11.2%.²⁰

C. *Value of a Statistical Life Year (VSLY) as Measure of Marginal Willingness to Pay for QALYs*

Health economists measure the Value of a Statistical Life (VSL) by measuring how much individuals are willing to pay to avoid risks of death, or how much they are willing to accept to face higher risks of death. For

¹⁹ GREG BOGNAR & IWAO HIROSE, *THE ETHICS OF HEALTH CARE RATIONING* 45 (2014).

²⁰ Dean Jamison, *Investing in Health, in DISEASE CONTROL PRIORITIES IN DEVELOPING COUNTRIES* 3, 31 (Dean Jamison et al., eds., 2d ed. 2006).

example, if each individual in a population of 10,000 is willing to pay \$500 for a safety device that reduces mortality risk by 1/10,000, then the VSL is \$5 million. Such VSL estimates are typically derived from wages earned in hazardous employment, prices paid for safer consumer goods, as well as surveys.²¹ VSL estimates typically exist for developed countries, but are less well measured in developing countries, though scholars typically extrapolate VSL across countries using an estimate from Viscusi and Aldy²² that the income elasticity of VSL is somewhere in the neighborhood of unity.²³

The Value of a Statistical Life Year (VSLY) is an estimate of a representative individual's willingness to pay for a health technology that improves health by 1 QALY. Given an estimate of VSL, an estimate of VSLY can be backed out on the basis of a formula such as:²⁴

$$VSLY \sum_{t=1}^T \frac{q_t}{(1+r)^t} = VSL$$

In the UK, the National Institute for Health and Clinical Excellence (NICE) assesses the value of health technologies using a VSLY threshold in the range of between \$33,000-\$50,000 per QALY. Although there is no comparable institute or practice within the US of assessing such value, health economics scholars typically value a QALY at VSLY=\$100,000.²⁵ A rule of thumb used by the WHO is to value a QALY at between two to four times per capita income.²⁶

D. *Cost-effectiveness and Value Pricing*

QALYs were designed to help decision-makers allocate a fixed budget across competing health technologies so as to maximize health benefits. For any given unit of health technology (say, a dose of a drug), the deci-

²¹ See, e.g., W. Kip Viscusi, *The Value of Life: Estimates with Risks by Occupation and Industry*, 42 ECON. INQUIRY 29 (2004).

²² See generally W. Kip Viscusi & Joseph Aldy, *The Value of a Statistical Life: A Critical Review of Market Estimates Throughout the World*, 27 J. RISK & UNCERTAINTY 5 (2003).

²³ Ramanan Laxminarayan et al., *Global Investments in TB Control: Economic Benefits*, 28 HEALTH AFFAIRS w730, w733 (2009).

²⁴ Don Kenkel, *WTP- and QALY-based Approaches to Valuing Health for Policy: Common Ground and Disputed Territory*, 34 ENV'T'L & RESOURCE ECON. 419, 427 (2006).

²⁵ David Cutler & Elizabeth Richardson, *The Value of Health: 1970-1990*, 88 AM. ECON. REV. 97, 97-100 (1998).

²⁶ Dean Jamison et al., *Infectious Disease, Injury and Reproductive Health* (Copenhagen Consensus 2012 Challenge Paper, 2012), <http://www.copenhagenconsensus.com/sites/default/files/infectiousdisease.pdf>.

sion-maker can compute the incremental cost-effectiveness ratio (ICER) of that technology, which measures the dollar cost per QALY benefit by deploying an extra unit of that technology. The smaller this dollar cost, the more cost-effective the technology is. A decision-maker who allocates the budget so as to maximize the health gains from that budget will therefore spend on the cost-effective technologies but not on the cost-ineffective ones. A payer adopts value pricing when it gives some, if not necessarily exclusive, weight to cost-effectiveness criteria in deciding what drugs—or, in general, what health services or technologies—to reimburse. However, for simplicity and relying on the rule of thumb I mentioned in Section I-C, I shall assume that a payer who adopts value pricing simply measures the income level Y of the individuals in the pool it represents and adopts a hard threshold of reimbursing some unit usage of a health technology only if that usage involves an expenditure of no more than $2Y$ per QALY benefit derived.

E. *Danzon et al. Microeconomic Model of Value Pricing*

The micro-foundation of their idea builds on an earlier model by Garber and Phelps.²⁷ Following Danzon et al.,²⁸ imagine a utility-maximizing risk neutral individual whose lifetime utility is additively separable across times, whose period utility is a multiplicative function of goods consumption and health, and who is perfectly healthy at present, but whose health in future periods may vary depending on the consumption of health services in the present. That is, utility in period t discounted to the present equals:

$$\rho^t V(c_t) q_t$$

where ρ is a discount factor less than 1, $V(c_t)$ is the utility in period t of non-health goods consumption in period t and q_t is expected health status or quality of life in period t measured in QALYs. Note that period utility is multiplicative in goods consumption and health. Imagine that in every period, this individual receives an exogenous income Y , which is uniform across periods. This income can be allocated across two health services a, b and the numeraire non-health consumption good c . However, the health services (I shall also sometimes refer to health services as health technologies) are only available for purchase in one period—the present—and at prices given by w_a, w_b . And these services yield all their expected QALY benefits in future periods. Expected quality of life q_t during any future period $t > 0$ is wholly determined by health services consumed in

²⁷ See generally Alan Garber & Charles Phelps, *Economic Foundations of Cost-effectiveness Analysis*, 16 J. HEALTH ECON. 1 (1997).

²⁸ Danzon et al., *supra* note 16, at 295-96.

the first period. Assume finally that this individual has perfect health in the present period, which corresponds to $q_0 = 1$, but can be in various potentially diseased health states in future periods $t > 0$ so that $0 \leq q_t \leq 1$, where death corresponds to $q_t = 0$ and where there is no positive quality of life any period after death occurs. Then this individual's lifetime expected utility equals:

$$EU = V(Y - w_a a - w_b b) + \sum_{t>0} \rho^t V(Y) q_t(a, b)$$

Note in this expression that consumption of the numeraire good in the present period equals income minus health expenditure, that the $V(Y)$ term in the summation is constant across future periods and so can be pulled outside the summation, and that expected quality of life in future periods is wholly a function of health services consumption in the present. Since $V(Y)$ can be pulled out of the summation, we can rewrite expected utility as:

$$EU = V(Y - w_a a - w_b b) + V(Y)Q$$

where Q equals the present discounted value of expected future health and is given by:

$$Q = \sum_{t>0} \rho^t q_t(a, b)$$

Maximizing expected utility with respect to present consumption of health service a requires differentiating expected utility with respect to a and setting the differential to zero, which gives us (note that the budget constraint is already integrated into utility in the present period):

$$V'(-w_a) = V\left(\frac{dQ}{da}\right)$$

The left hand side is the marginal utility cost in the present of purchasing an extra unit of a in the present period, and the right hand side is the marginal utility in the present of the discounted expected future health benefit of purchasing an extra unit of a in the present period. Rearranging gives us the following optimality condition (OC_a):

$$\frac{w_a}{\left(\frac{dQ}{da}\right)} = \frac{V(Y)}{V'}$$

The left hand side of OC_a is the dollar cost per marginal discounted expected health gain from a or equivalently a 's incremental cost-effectiveness ratio (ICER). Its right hand side is period marginal utility of health, which is constant across all future periods, divided by the marginal utility of income in the present period, or equivalently the individual's marginal willingness to pay in the present for future health benefits (I shall refer to the marginal willingness to pay for health as WTP). Assume that there is diminishing marginal health benefit to consumption of every health service. So each unit of health service raises health, but the first unit raises it more than the second unit, and so on. Since each health service is available at a fixed per unit price, this implies that the first unit of a health service consumed is more cost-effective than the second, and so on.

OC_a implies that given the per unit price w_a , the individual will utilize a up until the point that the incremental cost-effectiveness ratio equals her marginal willingness to pay (WTP) per QALY. The substantive assumptions regarding individual preferences that generate this result are risk neutrality, additive separability of utility across time, and multiplicative period utility. Linking this with the discussions in the previous section, we can identify the WTP per QALY with the individual's value of a statistical life year (VSLY), which by the WHO's rule of thumb is approximated by $2Y$. Thus it will be true of every unit of health service consumed by this individual that the ICER of this unit is no less than $2Y$. There will of course be an analogous condition OC_b for the health service b . Note that since the right-hand sides of OC_a and OC_b are the same, they jointly imply that the ICER will be equalized across the two health services. Solving the model for optimal a and b simply involves jointly solving the equations OC_a and OC_b . I shall sometimes refer to the optimal quantity of a health service as the optimal degree of utilization of that service.

Now assume that there is a population of individuals all ex ante identical to the individual just discussed, including the same per period income Y . The "health benefit plan" characterized by the optimal consumption of health services is implemented by a payer who accepts premium payments from the individuals, and who purchases the relevant quantities of a and b at the relevant prices w_a and w_b from the respective producers of these health technologies, and who enforces the optimality conditions by reimbursing only those uses of a and b satisfying the cost-effectiveness thresholds embedded in those conditions.

Given such demand side behavior, the producers of the health services a and b will face downward sloping demand curves for these services $a(w_a)$ and $b(w_b)$ respectively. That is, whenever a producer raises the price of a health service—and recall the assumption of diminishing marginal health benefits to the consumption of a health service—the individual consumer and the payer will drop what has now become relatively cost-ineffective uses of that service until it reaches some lower quantity of utilization at which the marginal use yields a sufficiently high QALY benefit

per dollar of expenditure that it meets the old cost-effectiveness threshold at the new higher price. And facing such downward sloping demand curves, monopoly producers of the health services will price using the standard monopoly pricing rules. In describing the efficiency properties of this equilibrium, Danzon et al. state that:

This outcome is second-best efficient. Static and dynamic efficiency could be enhanced and, at the limit, would be first best, if the firm could vary prices by indication/subgroup, reflecting the drug's differential effectiveness, and the payer could costlessly distinguish and pay the appropriate prices for each indication. Such differential pricing within product may become increasingly feasible as drugs become more 'personalized' on the basis of patient biomarkers, and data systems are improved to provide the necessary information at reasonable administrative cost.²⁹

Describing the implications of their model for dynamic efficiency, they say that, "our approach permits prices that transfer all surplus to manufacturers for the duration of the patent, to achieve optimal R&D incentives."³⁰

I note two things about Danzon et al.'s results. First, value pricing in their model constrains allocative inefficiency but cannot eliminate it. Value pricing constrains allocative inefficiency because an individual's WTP per QALY limits the price a firm can charge for its product. On the other hand, it cannot eliminate allocative inefficiency because a firm's marginal costs could nevertheless fall below that price limit. There are no competitive forces in the model that guarantee the equality of WTP and marginal costs required for allocative efficiency. The only mechanism Danzon et al. hint at that could in principle eliminate allocative inefficiency is the highly unlikely prospect of perfect first-degree price discrimination, whereby the monopolist charges a different price for each distinct unit of health service sold, choosing the price for each unit such that the incremental cost-effectiveness ratio of using that unit at that price equals WTP. Thus, I take away from this that while value pricing constrains allocative inefficiency, progress towards eliminating it will most likely also require (ignoring the highly improbable mechanism of first-degree price discrimination) reliance on a mechanism like Lakdawalla and Sood's two-part tariff.

Second, I note that Danzon et al. associate dynamic efficiency with firms' ability to extract consumer surplus. The more surplus firms can extract, the closer to optimal their R&D incentives become: "our approach permits prices that transfer all surplus to manufacturers for the duration of the patent, to achieve optimal R&D incentives."³¹ They imply that optimal

²⁹ Danzon et al., *supra* note 16, at 296.

³⁰ *Id.* at 297.

³¹ *Id.*

R&D incentives would result if a firm could implement perfect first-degree price discrimination, that is, if “the firm could vary prices by indication/subgroup, reflecting the drug’s differential effectiveness, and the payer could costlessly distinguish and pay the appropriate prices for each indication.”³²

However, given their view that dynamic efficiency depends on surplus extraction, it is not clear to me how, in their view, value pricing *itself* contributes to dynamic efficiency. After all, as previously stated, value pricing sets limits on the prices firms can charge and therefore limits on surplus extraction. Within their view, then, it seems more natural to conclude that value pricing is inimical to dynamic efficiency. They say that their model is compatible with first-degree price discrimination, which can of course result in complete surplus extraction, which in their view conduces to dynamic efficiency. But, such price discrimination has little to do with value pricing per se and can result in complete surplus extraction even in standard monopoly models that do not contemplate value pricing. Thus, it is not clear to me that Danzon et al. show how value pricing can make a distinctive contribution to dynamic efficiency. Indeed, it seems more natural to conclude that, within their view, value pricing is inimical to dynamic efficiency.

I think that value pricing has implications for allocative and dynamic efficiency beyond those implied by the Danzon et al. model. However, building towards these implications involves introducing extensions into their model, which is explored in the next sub-section.

F. *An Extension Showing How Competition from Cost-effective Health Services can Constrain the Extent to Which a Two-Part-Tariff-Charging Monopolist can Extract Consumer Surplus*

To maximize value pricing’s contribution to allocative efficiency, it should be wedded to Lakdawalla and Sood’s idea of payers and drug companies negotiating two-part tariffs. The payer can offer to pay for drugs according to a two-part tariff, and a drug company’s profit maximizing response will be to offer a per-unit tariff equal to the marginal cost of producing the unit (which assume is just some constant) and the largest upfront tariff the individual will tolerate. And, given such a tariff, the individual will set the quantity of utilization at the level such that ICER of that unit, evaluated at the marginal cost of that unit, equals WTP. To see how the upfront tariff can be modeled, consider the following extension of the Danzon et al. model to a two-part tariff.

Consider the case where health service a is still sold at a constant price per unit w_a (so a is not sold using a two-part tariff), but the other health

³² *Id.* at 296.

service b is now sold under a two-part tariff F_b, w_b consisting of the upfront fixed tariff F_b and per-unit tariff w_b , respectively. Under this tariff structure, the individual must pay the upfront tariff F_b if she decides to purchase any positive quantity of b , but can avoid it by not purchasing any b . After paying the upfront tariff, the individual can purchase units of b at a fixed per unit price of w_b . This change complicates the optimality conditions somewhat since it now involves an element of discrete as opposed to continuous optimization: should the individual choose to buy any positive quantity of b at all?

Theoretically, we find the optimum for this extended model by (1) asking what the maximized utility would be *if* the individual bought both a and b , incurring the upfront tariff, (2) asking what the maximized utility would be *if* the individual only bought a , escaping the upfront tariff, and then (3) deducing whether it is optimal to buy both goods or just one on the basis of whether (1) is larger than (2). Scenario (2) is easy to picture: set $b = 0$, solve OC_a for the optimal level of a , then plug these values of b and a into EU . Such a scenario is plausible in real life: there are many kinds of health services that we choose not to purchase at all.

Now consider (1). On the assumption that the individual purchases both health services, she would still purchase each of these services up until the point that each service's ICER equals her WTP. In other words, the optimality conditions OC_a, OC_b both apply. The only difference is that when we solve these conditions for optimal utilization of the health services, consumption of the numeraire non-health good in the present period has to fall by the size of the fixed cost F_b so that its level equals $Y - w_a a - w_b b - F_b$. In other words, in scenario (1), the upfront tariff F_b acts like a negative income shock in the present period.

We can find a plausible set of assumptions such that when F_b is sufficiently small (say, near zero) it will be optimal for the individual to purchase both goods, but when F_b is sufficiently high (say, near per period income Y) it will be optimal for the individual to purchase only a . In other words, it is plausible that for small F_b utility in (1) will be higher but for large F_b utility in (2) will be higher. For example, imagine assuming that the marginal utility of consumption of the non-health good goes to infinity as the amount of that good consumed goes to zero. This assumption simply implies that in the present period, the individual cannot spend all her income on health but must purchase at least some of the non-health consumption good. This, in turn, implies that if F_b is sufficiently high, its negative effect on non-health consumption will be too severe and the individual will choose not to purchase any b . Now imagine assuming that the two health services a and b are like inputs into a production function where the output is expected health Q . Imagine assuming as well that the isoquants of this production function are sufficiently convex that for most relative input prices w_a/w_b the cost-minimizing input combination uses a positive amount of each input. This would imply that, in the absence of an upfront tariff on b ,

the individual would use positive amounts of both inputs. This, in turn, implies that if the upfront tariff F_b is sufficiently low, the individual will purchase positive amounts of both health services.

Thus, if I make the assumptions in the previous paragraph, then when F_b is very high the individual will purchase only a , but when F_b is very low the individual will purchase both a and b . This implies there will be some threshold value of F_b at which the individual will be indifferent between (1) and (2), that is, between buying both goods and buying only a . This, in turn, implies that a firm selling b according to a two-part tariff cannot charge an upfront tariff exceeding that threshold value, on pain of inducing the individual to abandon b entirely. This threshold value is the individual's *willingness to pay* for the opportunity to buy b at a per-unit price of w_b , or equivalently the negative of the *compensating variation* of that opportunity.³³ It is related to but smaller than the *consumer surplus* from buying b at that price.³⁴

But, note that the model also implies that the threshold value of F_b will depend on the cost-effectiveness of the competing health service a . This is because the more cost-effective a is, the higher the expected utility of (2) where the individual relies solely on a . And, the higher this reservation utility, the smaller the upfront tariff F_b this individual will tolerate to have access to b . So, what I have at the end of this extension of the Danzon et al. model is that the existence of cost-effective competing health services like a constrains the ability of a two-part-tariff-charging monopolist producer of b to extract the individual's consumer surplus from utilizing b . The more cost-effective the competitor, the smaller the surplus the monopolist can extract.

Later on, I shall discuss the empirical fact that there exist vastly underutilized unpatented cost-effective health technologies available to LMICs. Such underutilized health technologies are analogous to the health service a in this model because these services are unpatented and are sold at a per unit price w_a equal to their (constant) marginal costs. Patented drugs that could be sold to LMICs by monopoly patent holders according to Lakdawalla and Sood's two-part tariffs are analogous to the health service b in this model. Viewing the situation of a value pricing LMIC through the lens of this extension of the Danzon et al. model, I get my basic result: if an LMIC payer employs value pricing, then that payer's access to unpatented cost-effective health services will limit the extent to which patent monopolists can extract consumer surplus from LMIC utilization of patented health services.

³³ See, e.g., WILLIAM K. BELLINGER, THE ECONOMIC ANALYSIS OF PUBLIC POLICY 54-57 (2015).

³⁴ *Id.*

G. *Extension to Heterogeneous Incomes Across Pools of Individuals*

The above holds for a pool of individuals, each with the same per period income Y . Now imagine that there are many such pools so that income is the same among individuals within pools but varies across pools, and that the distribution of income is represented by a density function $f(Y)$, where the value of the density function at a given level of income is an index of the size of the pool (i.e., the number of individuals within the pool) at that level of income. We might think of each pool as a separate country, where there is relatively uniform distribution of income within countries but heterogeneity in income across countries. Or, we might alternatively allow within-country income inequality, but assume that multiple pools form within such countries, each pool catering to a sub-population with relatively homogeneous incomes. Assuming every individual behaves according to the model, there is a payer representing each pool, income Y is observable, and health services sold to one pool cannot be resold to a different pool.

This extension to heterogeneous incomes is relevant for what it implies for global pharmaceutical R&D. Consider the patent monopolist selling good b to all these different pools using a two-part tariff scheme. Assume also that this patent monopolist can price discriminate across pools because drugs cannot be resold across pools and because the monopolist observes Y in each pool and can therefore estimate each pool's WTP for QALYs using the rule-of-thumb value $2Y$.

This profit-maximizing patent monopolist will set the upfront tariff F_b in each pool equal to its maximum feasible value within that pool, that is, the value that makes the individuals in that pool indifferent to buying and not buying b . This threshold value of F_b should vary across pools and be higher in wealthier pools. This is because, given the assumption of diminishing marginal health benefits to utilization of a , the equilibrium (2) in which the individual consumes only a will be relatively less attractive when the individual is wealthy than when the individual is poor. And the less attractive (2) is, the larger the threshold upfront tariff in (1) can be while still making the individual indifferent between (1) and (2). This implies that the patent monopolist can charge each pool a different upfront tariff per individual $F_b(Y)$, which is a positive function of the income in that pool, or $F'_b > 0$.

There are a few salient features to these results. First, the patent monopolist has ample opportunity to price discriminate across different pools of individuals at different levels of income. These opportunities are summarized by the function $F_b(Y)$. Note that because the monopolist is using a two-part tariff rather than a constant per-unit price, this price discrimination does not involve Ramsey-type elasticity-driven pricing. This is, in fact, a good thing since it eliminates the allocative inefficiencies associated with Ramsey mark-ups, while preserving the monopolist's ability to price discriminate.

Second, the monopolist can collect upfront tariffs that globally sum up to $\sum_{t=0}^T \int F_b(Y)f(Y)dy$. In this expression, the integral ranges over the global distribution of income and represents the total upfront tariff the monopolist can take in during a particular period. The summation extends over periods indexed by t and reflects the fact that tariffs can be collected over a number of periods equal to the duration T of the patent right, which according to TRIPS should equal 20. It is from this global sum that the monopolist can finance the R&D that goes into the invention of b . So, this expression is the maximum R&D fixed cost that can be financed under this model.

Note that this global sum is not expressly a function of the cost-effectiveness of competing health services like a . However, recall that such cost-effective competition implicitly imposes a constraint on this global sum by limiting the magnitude of F_b that the monopolist can extract from any given pool of individuals. Thus, the monopolist's ability to finance R&D does, in fact, depend on the existence of cost-effective competing health services like a . The more cost-effective competition there is, the smaller the global sum from which the monopolist can finance R&D.

II. UNDERUTILIZED UNPATENTED COST-EFFECTIVE HEALTH SERVICES IN LMICS

Since the early 1990s, the WHO led an effort to systematically measure the cost-effectiveness of various health technologies and to assess the extent of their underutilization. Not surprisingly, it found that there are many cost-effective technologies that are vastly underutilized.

The following table lists disease categories for which there are highly underutilized non-patented cost-effective technologies in South Asia and Sub-Saharan Africa:³⁵

³⁵ This table is based on Table 2.2. in Ramanan Laxminarayan et al., *Intervention Cost-Effectiveness: Overview of Main Messages*, in *DISEASE CONTROL PRIORITIES IN DEVELOPING COUNTRIES* 35, 54-55 (Dean Jamison et al., eds., 2d ed. 2006). The original table in the reference is not expressed in terms of QALYs but rather in terms of "disability-adjusted life years" or DALYs, which for my purposes are equivalent to QALYs.

Disease Category	Cost per QALY (in US dollars)	Burden of disease (in millions of QALYs)	Region
Childhood Immunization	8	28.4	South Asia
	1-5	13.5-31.3	SS Africa
HIV/AIDS	9-126	7.4	South Asia
	6-377	56.8	SS Africa
Surgery and ER Care	6-212	48-146.3	South Asia
	7-215	25-134.2	SS Africa
TB	8-263	13.9	South Asia
Lower Acute Respiratory Infections	28-264	9.7-26.4	South Asia
Heart disease	9-304	25.9-39.1	South Asia
	9-273	4.6	SS Africa
Tobacco	14-374	15.7	South Asia
Maternal and neonatal care	127-394	37.7-47.8	South Asia
	82-409	29.8-37.7	SS Africa
Traffic accidents	2-12	6.4	SS Africa
Malaria	2-24	35.4	SS Africa
Childhood illnesses	9-218	9.6-45.1	SS Africa

Consider, for example, the first row in this table. It says that there are health technologies addressing childhood immunization issues that cost only \$8 per QALY benefit, and that there are, in principle, up to 28.4 mil-

lion QALYs that could be saved using this technology in South Asia. In Sub-Saharan Africa, the same technologies cost between \$1 to \$5 per QALY benefit, and there are between 13.5 to 31.3 million QALYs that could be saved using this technology. Thus, the low numbers in the “Cost per QALY” column measure the degree of cost-effectiveness of the relevant technologies, and the high numbers in the “Burden of Disease” column measure the degree of underutilization of the technology. The overall message of this table is that there are many highly cost-effective health technologies, and very large disease burdens that these technologies could be used to address but are not. To compare these cost-effectiveness figures, recall the WHO’s rule of thumb that the value of a statistical life year (VSLY) is roughly twice per capita income. Per capita income in the LMICs in the year 2013 equals \$4,168,³⁶ so VSLY should be over \$8,000, but all the cost-effectiveness numbers in the table are less than 5% of this figure, and often much less.

The idea that cost-effectiveness analysis could be used in the design of publicly-financed health benefits plans influenced the famous Oregon Health Plan experiment of the 1990s, in which Oregon expanded Medicaid to all individuals with incomes below the federal poverty level by offering them a basic health package consisting only of cost-effective services.³⁷ In 1993, the World Bank’s World Development Report argued that LMIC governments should design their basic health benefits packages by focusing on those health services that were both cost-effective and targeted at diseases with huge burdens of disease.³⁸ Since then, at least sixty-four LMICs have designed health benefit plans according to prioritization criteria of varying degrees of explicitness and dependence on cost-effectiveness.³⁹

The same approach has been followed in some wealthy countries other than the U.S. According to Jena and Philipson:

The extensive role of [cost-effectiveness] criteria is particularly stark in many non-US Westernized countries—for example, the United Kingdom’s National Institute for Health and Clinical Excellence (NICE) and Australia’s Pharmaceutical Benefits Advisory Committee, both of which have been reported to follow implicit [cost-effectiveness] thresholds in technology adoption decisions. Such thresholds dictate that technologies

³⁶ *Low & Middle Income*, THE WORLD BANK: DATA (2014), <http://data.worldbank.org/income-level/LMY?display=default>.

³⁷ See, e.g., Jonathan Oberlander, *Health Reform Interrupted: The Unraveling of the Oregon Health Plan*, in 26 HEALTH AFFAIRS W96, W97 (2007), <http://content.healthaffairs.org/content/26/1/w96.full.pdf+html>.

³⁸ WORLD BANK, WORLD DEVELOPMENT REPORT 1993: INVESTING IN HEALTH (Oxford University Press 1993).

³⁹ Amanda Glassman & Kalipso Chalkidou, *Priority Setting*, in HEALTH: BUILDING INSTITUTIONS FOR SMARTER PUBLIC SPENDING 21 (2012), <http://www.cgdev.org/publication/priority-setting-health-building-institutions-smarter-public-spending>.

will be adopted if their benefits, as often measured by the quality-adjusted life years (QALYs) they provide, outweigh a given level of costs. In Australia, for example, only two of twenty-six submissions with a cost per life year saved greater than \$57,000 were accepted for reimbursement. Similarly only one of twenty-six submissions with a cost per life-year saved less than \$32,000 was rejected. Although explicit considerations of cost-effectiveness are not used by the U.S. Centers for Medicare and Medicaid Services (CMS), it appears a reasonable prediction that technologies that cost more and have less of a health impact compared with other technologies will get greater scrutiny before adoption.⁴⁰

III. VALUE PRICING AND ALLOCATIVE AND DYNAMIC EFFICIENCY

A. *Value Pricing*

Value pricing, therefore, consists of a payer—who may be designing a tax-financed health benefits package or a large public- or private-sector insurer—designing a health benefits package using cost-effectiveness criteria linked to the WTP for QALYs of the individuals in the pool the payer represents.

An individual who purchases health insurance must commit to a benefits package *ex ante*, that is, before knowing what specific disease will strike her. There is, of course, a vast variety of diseases, as well as a vast variety of health services or technologies that address those diseases. The QALY metric provides a way to collapse the whole range of diseases and health services/technologies into a single-dimensional inquiry: each disease simply involves some QALY loss and each health technology involves some QALY gain. Thus, from the *ex ante* perspective, all prospective diseases and health technologies are comparable to each other using the QALY metric.

Given some allocation of wealth between the consumption of health services and of non-health goods, the multiplicative structure of period utility in section 2.5 implies that the individual will allocate her health care budget so as to maximize the QALY benefits across all the health services consumed out of that budget. So, all else equal, if there are cost-effective treatments for depression but not for cancer, then the individual will choose a benefit plan that contains more of the former treatments but less of the latter. Or if some lifestyle change therapy produces larger gains than some drug, then the benefit plan will give more priority to the former than the latter. And if some unpatented drug for high blood pressure is more cost-

⁴⁰ Anupam Jena & Thomas Philipson, *Cost-effectiveness as Price Control*, 26 HEALTH AFFAIRS 696, 696-97 (2007).

effective than some patented drug for stage 4 cancer, then the plan will also give more priority to the former than the latter.

There is, of course, an important element of rationing in all of this. However, this rationing is not at all economically problematic, and simply reflects the existence of a budget constraint and the fact that the benefits plan must be designed *ex ante*. At any rate, as I briefly mention later on, most if not all LMICs also allow individuals to purchase health services on the private market and pay for them out-of-pocket, which they can do *ex post* (i.e., after they learn what diseases they actually have), thereby providing some release from the limits imposed by the *ex ante* designed benefits package.

B. *Impact on Allocative Efficiency*

The impact of value pricing on allocative efficiency is simple. Since every health technology is simply one among many competing sources of QALY benefits, they are all effectively competing in the same market. The QALYs produced by one health technology are, *ex ante*, perfect substitutes for the QALYs produced by any other. Thus, a value-pricing payer is one who will freely substitute among competing health technologies on the basis of their relative cost-effectiveness. Such substitution will tend to make payers' demand for health technologies highly elastic with respect to the per-unit price of such technologies, which in turn should push per-unit prices of technologies toward their marginal costs. This pressure will be especially strong if there is a large and underutilized collection of unpatented and extremely cost-effective health services accessible to the payer, which seems to be the case in the LMICs as shown in Section II.

C. *Impact on Price Discrimination*

The value pricing model described in Section I leaves ample room for price discrimination across pools. Since individuals with similar incomes will have similar WTP for health services (roughly $2Y$ per QALY), such individuals will at least *ex ante* have similar optimal health benefits packages, and will be willing to pay the same upfront tariffs like F_b on patented drugs like b . Thus the patent monopolist producing b can charge a different F_b per pool that rises with the level of income Y within that pool.

One possibility is that each country, given its average income, will constitute a separate pool. But it is also highly possible that separate pools may emerge within countries. In many LMICs, there are mixed health systems in which there is a national health plan (either tax financed or through social health insurance contributions) that covers a core set of health ser-

vices available to everyone. Such a health plan will typically be pitched to address the health care needs of the poorest segments of the population.

However, on top of this basic national plan can exist supplementary insurance plans that individuals who want more generous insurance coverage can purchase on the private market. Such plans are not very prevalent. They constitute only 9% of health care financing in the upper- middle-income countries and hardly exist in the low- and lower-middle-income countries.⁴¹ Still, where such opportunities exist, individuals whose WTP for health are higher than those of individuals who are covered in the national plan have opportunities to design and purchase health benefits plans with higher cost-effectiveness thresholds.

On top of these prepaid publicly and privately provided benefits plans are health services purchased out of pocket, which constitute a significant proportion of health care financing: 48% in low income countries and about 31% in middle income countries.⁴² Thus, value pricing allows a monopolist to vary prices across countries depending on their average income, but also within countries depending on whether the payer represents the basic national plan, a private supplementary insurance plan, or is simply an out-of-pocket individual consumer of health services. We should expect WTP to be lower in the basic national plan and higher in the private supplementary insurance plan. While the out-of-pocket market will be a mix of very poor and very rich individuals, the monopolist can presumably choose to cater only to the latter if this is profit maximizing, in which case the out-of-pocket purchasers (likely consisting mainly of the very wealth and very sick) will have the highest WTP of all the pools in the country.

D. *Dynamic Efficiency*

It is uncontroversial that value pricing will lead to greater allocative efficiency. The more controversial question is the impact it will have on dynamic efficiency, which I address now. Philipson and Jena⁴³ provide the most on-point expression of skepticism on this issue. It is well known that first-best dynamic efficiency roughly requires that every R&D prospect whose expected social surplus (the area below the demand curve and above the marginal cost curve, multiplied by the number of periods for which demand exists) exceeds the fixed costs of R&D be undertaken. This, in turn,

⁴¹ Mills, *supra* note 13, at 555.

⁴² *Id.*

⁴³ Thomas Philipson & Anupam Jena, *Surplus Appropriation from R&D and Health Care Technology Assessment Procedures* 5-6 (Nat'l Bureau of Econ. Research, Working Paper No. 12106, 2006), <http://www.nber.org/papers/w12016> [hereinafter Philipson & Jena]; Anupam Jena & Thomas Philipson, *Cost-Effectiveness as a Price Control*, 26 HEALTH AFF. 696, 701-02 (2007), <http://content.healthaffairs.org/content/26/3/696.full.pdf+html> [hereinafter Jena & Philipson].

requires that the monopolist be able to extract the entire social surplus from this innovation so that it can conduct any R&D project whose fixed costs fall below the expected amount extracted. Philipson and Jena argue that value pricing pushes the monopolist in the *opposite* direction from this first-best outcome. While value pricing *protects* consumer surplus from appropriation by the monopolist, dynamic efficiency *requires* that appropriation.

Philipson and Jena provide some empirical evidence of just how far monopolists are from being able to appropriate the full social surplus of their innovations.⁴⁴ For example, in the case of HIV/AIDS, they find that treatment drugs have raised life expectancy of AIDS patients by about five years. Assuming a value of a statistical life year of \$100,000 and 1.5 million such patients receiving the drugs in the past, this amounts to a \$500,000 gain per person and \$750 billion gain across all patients. Further, they estimate that this gain exceeds \$1 trillion after accounting for future patients. In contrast, they estimate that lifetime profits from these AIDS drugs are about \$56 billion, which is only about 5% of their estimated \$1 trillion in social surplus. Thus, the pharmaceutical firms that invented these drugs were only able to appropriate 5% of the social surplus of their inventions, which is, of course, far short of the 100% required by first-best dynamic efficiency.

Philipson and Jena also go beyond HIV/AIDS to provide similar evidence for a more representative sample of drugs. They used data from over 200 cost-effectiveness analyses in the Harvard Cost-Effectiveness Analysis Registry.⁴⁵ From this registry, they estimate that, on average across the 200 analyses, the ICER is \$19,000 of expenditure per marginal QALY gained. Assuming marginal production costs are 20% of this expenditure, this yields a per unit profit of $\$19,000 \times 0.8 = \$15,200$. And assuming a value per QALY of \$100,000, this implies that the pharmaceutical firms are able to appropriate only $\$15,200 / \$100,000 = 15.2\%$ of social surplus created. While this is three times as large a proportion as that corresponding to HIV, it remains far below the first-best optimum of 100%. Thus, Philipson and Jena are concerned that value pricing will make these outcomes worse.

Recall that Danzon et al. also discuss dynamic efficiency in the context of value pricing.⁴⁶ At first glance, they say something that seems contrary to Philipson and Jena. They say that, “our approach permits prices that transfer all surplus to manufacturers for the duration of the patent, to achieve optimal R&D incentives.”⁴⁷ However, it seems fairly clear from a reading of this article that the ability to transfer all surplus comes exclusively from the possibility of first-degree price discrimination, that is, from the monopolist being able to charge a different price per unit of the service

⁴⁴ Jena & Philipson, *supra* note 43, at 701-02.

⁴⁵ See Jena & Philipson, *supra* note 43, at 702; Philipson & Jena, *supra* note 43, at 15-17.

⁴⁶ Danzon et al., *supra* note 16, at 296.

⁴⁷ *Id.* at 297.

sold, with that price set so that ICER of that unit equals the WTP of the user of that unit. Absent first-degree price discrimination, there is no mechanism in their model whereby the monopolist can extract the surplus other than through the typical monopoly mark-up. Thus, absent first-degree price discrimination, Danzon et al. also need some response to the Philipson and Jena critique.

Furthermore, first-degree price discrimination is also not a particularly interesting way to defuse the Philipson and Jena critique because it has very little to do with value pricing in the first place. If the monopolist can implement such discrimination, it really does not matter whether the payer is value pricing or not because the monopolist will be able to extract the surplus from every unit of the health service consumed, regardless of whether the consumption of that unit passes some cost-effectiveness threshold or not. Finally, I should note that even the ability to first-degree price discriminate *during the patent term* is insufficient for first-best dynamic efficiency, which requires appropriating the entire social surplus not only during the patent term, but also during the entire duration there is demand for the drug.

I think the core response to Jena and Philipson has to be a second-best argument, building on the fact that even the ability to first-degree price discriminate during the patent term is insufficient for first-best. So long as the patent term is shorter than the duration for which there is demand for the drug, even first-degree price discrimination will be incapable of achieving first-best. Thus, we are living in a second-best world *regardless* of whether LMICs value price or not. And it is a standard result of second-best theory that a policy that has a negative impact on welfare in an otherwise first-best world can have a positive impact on welfare in an otherwise second-best world.

For example, imagine there are a number n of R&D prospects satisfying the first-best criterion of having fixed R&D costs below the total social surplus created. If $n-1$ of these prospects will be implemented, then clearly a failure to implement the n^{th} prospect reduces social welfare. In other words, a failure to implement the n^{th} prospect in an otherwise first-best world reduces social welfare. But what if, for some independent reason, we are nowhere near a first-best world? For example, in the actual world, the independent reason we are nowhere near first-best is that patents have shorter durations than the horizon over which there is demand for the patented good. This prevents monopolists from even considering R&D prospects whose fixed costs exceed total surplus realized during the patent term, even if they don't exceed total surplus realized during the entire period there is demand for the good.

So in this second-best world, perhaps only half of the n projects are currently being pursued. In such a context, is it necessarily the case that implementing the n^{th} project raises social welfare? Not if we take opportunity costs into consideration, because this n^{th} project now has to compete for priority with the rest of the half of the n projects that aren't being pur-

sued yet. In this second-best world, we maximize social welfare not by implementing just any prospect satisfying the first-best criterion, but rather by prioritizing among all these prospects, giving higher priority to prospects that maximize social surplus produced per dollar of fixed R&D costs incurred.

Here is a numerical example building on Jena and Philipson's discussion of AIDS drugs. Consider a hypothetical drug that—like the AIDS drugs they discuss—would yield \$1 trillion in social surplus during the entirety of the time horizon over which there is demand for the drug. Imagine that the fixed costs of R&D for these drugs are \$500 billion (or roughly 500 times the average R&D cost for a patented pharmaceutical, which is \$1 billion), but that a monopolist able to perform perfect first-degree price discrimination (like Danzon et al.'s monopolist) over the life of the patent term across every single AIDS patient around the globe can only thereby recoup \$250 billion.

In a first-best world, R&D into this drug should take place, since its fixed costs are below—and indeed only half—of total social surplus. But this R&D would not take place even under the monopolist's best-case scenario under the current patent system: perfect first-degree price discrimination globally during the patent term. In other words, so long as we have a patent system with relatively short patent terms, we are necessarily in a second-best world, regardless of whether payers value price or not.

Now assume that in such a second-best world, LMICs *start* value pricing according to the model of the previous sections. Then, as I described above, such value pricing will set limits on the extent to which the monopolist can extract surplus. So perhaps although a perfect price discriminating monopolist can recoup \$250 billion, a monopolist facing value pricing payers can only recoup \$100 billion. What is the marginal effect of the shift toward the value pricing policy upon the present discounted value of future global welfare?

Well, since we are in a second-best world, we cannot know for sure unless we canvass what the alternatives open to the LMIC payers are. What if there already exist, in the public domain, underutilized health technologies perfectly capable of yielding \$1 trillion in social surplus without having to incur *any* R&D costs? Or what if there exist potential drugs also perfectly capable of yielding \$1 trillion in social surplus, but with R&D costs falling below the \$100 billion threshold that the monopolist can recoup under value pricing? If such opportunities exist, then value pricing would push LMICs towards realizing them, and push the monopolist away from spending \$500 billion to realize a drug whose contribution to social surplus can be enjoyed by the globe for much less.

Thus in a second-best world, value pricing could potentially raise rather than harm dynamic efficiency by differentially selecting R&D prospects in such a way that minimizes the R&D costs of attaining a certain

level of social welfare. We might say that in a second-best world, value pricing contributes to dynamic efficiency by raising the *quality* of R&D.

There are other reasons to suppose that value pricing may help dynamic efficiency or at least not harm it. First, recall that value pricing will make LMIC demand for patented drugs more price elastic, reducing monopolists' ability to extract LMIC consumer surplus. But given the fixed costs of R&D that the monopolist must recoup, all this greater elasticity implies is that the monopolist should raise the proportion of these fixed costs that it recoups from the wealthy countries. For example, if the monopolist uses a single price in each country as opposed to a two-part tariff, then it should reduce markups in LMICs and raise them in the wealthy countries, thereby still allowing the monopolist to recoup its fixed costs. So, LMIC value pricing simply implies that the burden of financing R&D fixed costs will shift to the wealthy countries.

Second, it may be that monopolists' incentives to innovate are fairly inelastic with respect to the magnitude of consumer surplus appropriated from the LMICs. Such inelasticity might result from the fact that such appropriated surplus is really just economic rent, that is revenue in excess of what is required to incentivize the R&D. For example, Lerner documents the so-called "patent puzzle," whereby the number and strength of patents seem to bear little correlation to productivity or technical progress.⁴⁸ For another example, Kyle and McGahan study the effect of patent protection on R&D effort, where patent protection in a particular country is measured by its compliance with TRIPS requirements for minimum levels of IP protection, and where R&D effort is measured "in the form of [the number of] clinical trials [occurring] on specific diseases over time."⁴⁹ Their identification strategy "relies on the fact that disease prevalence varies across countries, and countries complied with TRIPS at different times. [They] exploit cross-sectional variation over time in both the adoption of TRIPS and the potential market size of diseases to estimate the [causal impact on] R&D effort [of] patent protection."⁵⁰ They find:

. . . [A] strong association between pharmaceutical patents and R&D effort for diseases that are prevalent in high-income countries, but not for neglected diseases. The establishment of patent protection in poorer countries is not linked to greater R&D effort for diseases that have no market in developed countries. In other words, the introduction of patent protection has not been followed by an increase in R&D on [neglected] diseases

⁴⁸ Josh Lerner, *The Empirical Impact of Intellectual Property Rights on Innovation: Puzzles and Clues*, 99 AM. ECON. REV.: PAPERS & PROC. 343, 347 (2009).

⁴⁹ Margaret Kyle & Anita McGahan, *Investment in Pharmaceuticals Before and After TRIPS* 3 (Nat'l Bureau of Econ. Research, Working Paper No. 15468, 2009), http://www.margaretkyle.net/TRIP_S.pdf.

⁵⁰ *Id.*

that primarily affect the world's poor The results suggest that the trade-off between incentives for innovation (i.e. dynamic efficiency) and access to treatments (i.e., static efficiency) is quite different for rich countries than for the developing world.⁵¹

They further conclude that “[t]he existence of a market in rich countries allows firms to recover their R&D investments . . . in global diseases[which are] present in countries of all income levels” However, patent protection is not sufficient to induce R&D for diseases that have no significant potential market in high-income countries.⁵² Thus, for diseases that afflict both developed and developing countries (so-called “global diseases”), pharmaceutical companies are able to recoup their R&D costs from just the developed countries. And for diseases only afflicting developing countries (so-called “neglected diseases”), what can be recouped from just those countries are insufficient to incentivize R&D. This suggests that any consumer surplus appropriated from LMICs is economic rent, and does not contribute to innovation. In such a context, value pricing by LMICs may well have no adverse effect on innovation.

Third, although as Jena and Philipson find, pharmaceutical companies are only able to appropriate on the order of 15% of the social surplus of their innovations, such levels of appropriation may be more than adequate incentive to induce the marginal R&D prospects currently open to these companies. Consider the following illustration. Dimasi and Grabowski find that “[t]he highest estimate to date in the literature of the expected, fully capitalized cost of developing a single approved drug was \$1.8 billion in year 2008 dollars⁵³ and that “DiMasi et al. (2003) reported an average R&D cost of \$802 million in year 2000 dollars.”⁵⁴ Recall Jena and Philipson’s example of AIDS drugs, which produce a social surplus of \$1 trillion dollars, but pharmaceutical company profits of only \$56 billion or about 5% of the social surplus produced. Now assume, for the sake of argument and relying on the types of R&D cost estimates provided by DiMasi and Grabowski, that the R&D cost for these AIDS drugs was \$2 billion, and that these drugs had only a 10% ex ante chance of success. These assumptions jointly imply that a profit of \$2 billion/0.10=\$20 billion would have been sufficient incentive to induce the R&D, which is less than half actual

⁵¹ *Id.*

⁵² *Id.* at 29.

⁵³ Joseph Dimasi & Henry Grabowski, *R&D Costs and Returns to New Drug Development: A Review of the Evidence*, in THE OXFORD HANDBOOK OF THE ECONOMICS OF THE BIOPHARMACEUTICAL INDUSTRY 21, 23 (Patricia Danzon & Sean Nicholson eds., 2012) (summarizing Steven Paul et al., *How to Improve R&D Productivity: the Pharmaceutical Industry’s Grand Challenge*, 9 NATURE REV. DRUG DISCOVERY 203, 204-05 (2010)).

⁵⁴ *Id.* (summarizing Joseph Dimasi et al., *The Price of Innovation: New Estimates of Drug Development Costs*, 22 J. HEALTH ECON. 151, 180 (2003)).

profits. Thus the fact that pharmaceutical companies could only appropriate 5% of the social surplus of AIDS drugs as opposed to 100% is irrelevant: the 5% was more than enough risk-adjusted return to incentivize the R&D. This suggests more generally that given the type of R&D prospects currently faced by pharmaceutical firms—about \$1 billion in R&D costs and about a one-third ex ante chance of success, providing an acceptable risk-adjusted return sufficient to incentivize the R&D may not require the ability to appropriate 100% of the social surplus created by the drug over the entire duration of demand for it. \$20 billion dollars in global profits should be sufficient.

A critic of my line of argument could respond by saying that supranormal profits on blockbuster drugs are necessary to compensate pharmaceutical companies for the many R&D efforts that do *not* result in success. There are, of course, two responses to this criticism. First, in the AIDS example, the compensation for risk is already priced into the \$20 billion, which we obtained by dividing the R&D costs of \$2 billion by the 10% ex ante chance of success. Second, perhaps the problem is precisely that the pharmaceutical companies are being too indiscriminate in their R&D choices and therefore investing in too many failures. Perhaps imposing a ceiling on the amount of social surplus they can appropriate will force them to limit their R&D efforts to higher quality prospects. There is some indirect evidence that financial constraints force pharmaceutical companies to choose their R&D projects more carefully. Nicholson reports that,

Both Metrick and Nicholson (2009) and Guedj and Scharfstein (2004) found that small [pharmaceutical] firms that are financially constrained [i.e., which cannot finance all their R&D from internal funds] are more likely to develop high-quality drugs, defined as those that advance toward market approval. These results are consistent with constrained firms' choosing to focus resources on a smaller number of high-quality projects.⁵⁵

In light of my earlier argument that we necessarily live in a second-best world, more careful selection of “high quality projects” may well improve, rather than worsen, dynamic efficiency.

In sum, the argument in favor of value pricing's contribution to dynamic efficiency is based on the extent to which it induces selection of

⁵⁵ Sean Nicholson, *Financing Research and Development*, in THE OXFORD HANDBOOK OF THE ECONOMICS OF THE BIOPHARMACEUTICAL INDUSTRY 47, 71 (Patricia Danzon & Sean Nicholson eds., 2012) (summarizing Andrew Metrick & Sean Nicholson, *Does Financing Have Real Effects? Evidence From Drug Development* (Working Paper, 2009), http://www.human.cornell.edu/pam/people/upload/Finance_Jul_2009.pdf; Ilan Guedj & David Scharfstein, *Organizational Scope and Investment: Evidence from the Drug Development Strategies and Performance of Biopharmaceutical Firms* (Nat'l Bureau of Econ. Research, Working Paper No. 10933, 2004), <http://www.nber.org/papers/w10933>).

higher quality R&D prospects in a second-best world. It is also based on the extent to which, in such a world, innovation has little to do with patent strength or the ability to extract 100% of social surplus. In such case, value pricing in fact serves as a kind of partial cure for the rent-seeking excesses of the patent system.

E. *Some Public Choice Considerations*

One advantage of cost-effectiveness principles is that priority setting on the basis of such principles is relatively transparent and intuitively simple for individual consumers of health services to understand. This reduces decision costs on the part of consumers, and it reduces agency costs because the transparency of the principle makes it easier for such consumers to monitor payers to make sure the latter are conforming to such principles. It becomes more difficult, for example, for pharmaceutical companies to lobby for the inclusion of their drugs in basic benefits packages when such drugs fail to satisfy cost-effectiveness criteria. Furthermore, estimates of the cost-effectiveness of health technologies are a global public good: LMICs can depend on published results of clinical trials, the academic literature, and on the health technology assessments by wealthy country institutions like the UK's NICE or multilateral institutions such as the World Health Organization. There are well-developed methodologies grounded in the decision sciences, economics, and causal inference that facilitate the measurement of the relevant quantities. And the global scrutiny to which this information is exposed raises its quality and helps insulate it from manipulation.

An advantage of value pricing is that there is, in principle, no reason to limit its practice to the public sector. It can be implemented by any large-scale payer, including by private insurance plans such as already exist in some of the upper middle-income countries. Such private plans can exercise some market discipline on their public sector counterparts. Indeed, value pricing is a viable strategy regardless of whether a particular LMIC country decides to move in the direction of predominantly public or privately financed care. Furthermore, as previously mentioned, all LMICs have markets in which health services can be purchased ex post and paid for out of pocket, providing an escape hatch from the rationing implicit in an ex ante-designed health benefits package.

Publicly provided and financed health services in LMICs can be notoriously inefficient. Such inefficiency will certainly afflict the implementation of value pricing. It remains an open question whether, if value pricing is introduced into an inefficient health system, such value pricing will reduce the inefficiency, exacerbate it, or simply be rendered futile by it. However, addressing that question would require an extended institutional and public choice analysis that is beyond the scope of this paper.

CONCLUSION

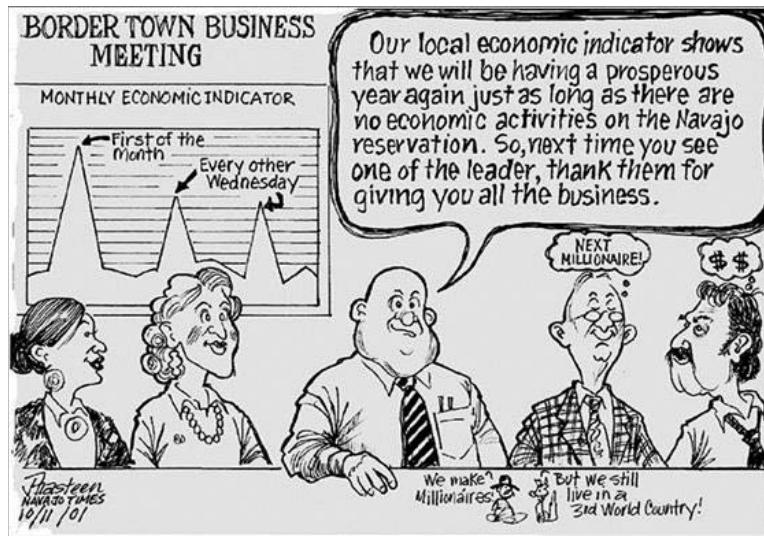
I have examined the potential impact of value pricing by large public and private sector payers in low- and middle-income countries (LMICs) on allocative and dynamic efficiency in the global pharmaceutical industry, especially in light of the fact that there remain vastly underutilized cost-effective health technologies in such countries. If LMICs were to adopt value pricing, this will induce greater utilization of such technologies and a substitution effect away from relatively cost ineffective patented drugs. Such substitution will clearly improve allocative efficiency because it will bring prices closer to marginal costs, and because it will not harm and may improve efficiency-enhancing price discrimination. And because we live in a second best world and will continue to do so as long as patent durations are bounded, value pricing can improve rather than worsen dynamic efficiency by improving the quality of invention (in the sense of reducing fixed costs per unit of social surplus produced) and by reducing rent extraction without necessarily impairing incentives to innovate.

TRIBAL LEAKAGE: HOW THE CURSE OF TRUST LAND IMPEDES TRIBAL ECONOMIC SELF-SUSTAINABILITY

Gavin Clarkson & Alisha Murphy***

I. INTRODUCTION

Gallup, New Mexico, is a border town just outside the Navajo Nation reservation with an estimated 22,000 residents;¹ however, that number nearly triples on the first of the month. Social Security checks are distributed to elders and veterans on the first of the month, and most tribal members have neither access to a local bank nor sufficient consumer spending options on the reservation. Therefore, most Navajos end up driving for an hour or more to purchase much needed groceries, lumber, auto-parts, and kid's school clothes in border towns such as Gallup. According to the University of New Mexico Bureau of Business and Economic Analysis study, significant competition for retail dollars from the Navajo Nation is spread among several surrounding non-Indian communities, such as Gallup, Grants, Farmington, Show Low, and Winslow.²



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¹ U.S. CENSUS BUREAU, U.S. CENSUS QUICK FACTS, GALLUP CITY, NEW MEXICO (2010), <http://quickfacts.census.gov/qfd/states/35/3528460.html>.

² JEFFEREY MITCHELL, GALLUP MAINSTREET COMMUNITY ECONOMIC ASSESSMENT 6 (2006).

The 2014 Diné Policy Institute Food Sovereignty Report³ found that 60% of respondents needed food items that were not available locally.⁴ The Navajo Nation Department of Economic Development reports that 71% of Navajo dollars are spent off the reservation,⁵ and nearly 80% of tribal consumers purchased their groceries off reservation.⁶ This economic leakage happens despite the long drives off-reservation to the grocery store, some drives as long as 240 miles.⁷ These startling statistics not only demonstrate the magnitude of the economic leakage that pervades the Navajo Nation but also explains why the Wal-Mart in Gallup is one of the largest in the world. Such leakage is not unique to the Navajo Nation.

The former Chairman of the Crow Nation in Montana suggested that if “anyone doubts that money flows into Billings [from the Crow Nation,] go to Wal-Mart today after members receive their per-capita check from the tribe. ‘We don’t call it Wal-Mart, we call it Crow-Mart.’”⁸ According to the *Billings Gazette*, that quarter per-capita payment from the tribe’s coal mining royalties was \$310.⁹ Of the Crow Nation’s nearly 12,000 tribal members, approximately 8,000 live on the reservation and were highly likely to spend their per-capita checks in Billings.¹⁰

The Crow Nation and the six other federally recognized tribes in Montana also conducted a study that found that tribal and BIA salaries pump more than \$200 million directly into the state economy, and “since every dollar turns at least five times in a local economy, the total annual contribution may reach \$1 billion.”¹¹ When private sector wages, as well as goods and services purchased by tribal and BIA entities are considered, the contribution to the state of Montana “could reach \$3 billion to \$5 billion a year.”¹² In his book, *Reservation Capitalism*, Professor Robert Miller identifies several studies on leakage from various reservations in addition to the

³ DINE POLICY INSTITUTE, A REPORT ON THE NAVAJO NATION FOOD SYSTEM AND THE CASE TO REBUILD A SELF-SUFFICIENT FOOD SYSTEM FOR THE DINE PEOPLE 17 (2014) [hereinafter Food Sovereignty Report].

⁴ Food Sovereignty Report, *supra* note 3, at 17.

⁵ TRIB CHOUDHARY, 2002-2003 COMPREHENSIVE ECONOMIC DEVELOPMENT STRATEGY OF THE NAVAJO NATION 13 (2003); NAVAJO NATION DIVISION OF DEVELOPMENT, NAVAJO ECONOMIC DATA BULLETIN 001-0212 1 (2012), http://navajobusiness.com/pdf/Ads/NavEconomicDataBulletinFinal_030212.pdf.

⁶ NAVAJO NATION DIVISION OF ECONOMIC, NAVAJO ECONOMIC DATA BULLETIN 001-0212 (2012), http://navajobusiness.com/pdf/Ads/NavEconomicDataBulletinFinal_030212.pdf.

⁷ Food Sovereignty Report, *supra* note 3, at 17.

⁸ Becky Shay, *Crow Leader Outlines Plan for Fuel Plant*, BILLINGS GAZETTE (Dec. 6, 2007), http://billingsgazette.com/news/local/crow-leader-outlines-plan-for-fuel-plant/article_d0207741-cc01-51a6-9596-c2a3bacd2f1f.html.

⁹ *Id.*

¹⁰ *Id.*

¹¹ Ron Selden, *Economic development attitudes must change*, INDIAN COUNTRY TODAY (June 13, 2001).

¹² *Id.*

Montana tribal study, such as research on the Zuni Pueblo economy that found that 84% of all individual income was spent off reservation.¹³ Former Commissioner of Indian Affairs, Robert L. Bennett, perhaps best summarized the problem of leakage, “[w]hen a million dollars is invested in most communities, it generates approximately ten million dollars of cash flow. But in Indian communities, one million dollars generates just one million dollars of cash flow.”¹⁴

The authors have seen firsthand how this economic leakage operates in Crownpoint, New Mexico, on the eastern edge of the Navajo Nation. Crownpoint has over 2,000 residents who live and work in the area but leave the reservation to spend their paycheck. Other than one overpriced grocery store,¹⁵ a non-Indian-owned Mexican restaurant next door, and two gas station convenience stores, Crownpoint has no other stores, shops, or restaurants.

Tim and Kathy Murphy have lived in Crownpoint most of their lives, and the hour-long drive to Gallup has been a normal bi-weekly trip for as long as they can remember.¹⁶ They shop off-reservation in order to get affordable produce and meats because the local grocery store is too expensive. Although demand exists for multiple grocery stores, and competition would certainly reduce grocery store prices,¹⁷ the Murphys routinely make the decision not to shop at the non-Indian-owned grocery store in Crownpoint except in emergencies, and their experience mirrors that of most families in Crownpoint. Thus, their earnings, and the earnings of the entire community, routinely leave the reservation and never cycle back—a classic case of economic leakage.

But why is economic leakage so pervasive on reservation communities and yet the towns bordering those communities consistently see a net monetary inflow from tribal members? This article argues that a primary cause for the lack of on-reservation consumer options is the cumbersome and onerous policy of the United States government holding tribal land in trust. An artifact of a long since discredited congressional policy called Allotment, federally-imposed restrictions on trust land make it nearly impossible for on-reservation entrepreneurs to secure startup financing, as they cannot borrow against the equity they have in their homes. As a result, there are fewer entrepreneurial ventures on reservations and thus fewer options for on-reservation consumers to spend their money on the reservation. The inevitable consequence of such a lack of consumer spending options on-reservation is leakage.

¹³ ROBERT MILLER, RESERVATION CAPITALISM 136 (2012).

¹⁴ Robert L. Bennett, *The War on Poverty*, in *Indian Self-Rule: First Hand Accounts of Indian-White Relations from Roosevelt To Reagan* 224 (Kenneth R. Philp ed., 1986).

¹⁵ Food Sovereignty Report, *supra* note 3, at 16.

¹⁶ Telephone interview with Tim Murphy (May 5, 2014).

¹⁷ See *infra* Part III.

Part I of this article explores the interplay between economic leakage and trust land, and Part II explores the historical origins of trust land as part of the overarching history of federal Indian policy. Part III returns to the interplay of economic leakage and trust land, focusing on both micro- and macroeconomic perspectives. Having explored both the legal and economic underpinnings of trust land and its concomitant consequences, Part IV of the article makes the argument that title to trust land can and should be returned to tribes and individuals in fee under a new tribal status that confers permanent jurisdiction, complete with full taxation powers, to the tribe. The core premise of this article is that ending the current trust land system will eliminate a primary cause of economic leaking while ensuring that the newly transferred land will always be subject to tribal jurisdiction regardless of the race of the landowner. We conclude with some final thoughts as well as suggestions for further research.

I. ECONOMIC LEAKAGE AND THE CURSE OF TRUST LAND

Miller lists three reasons why economic leakage in tribal communities like Pine Ridge, Rosebud Sioux (and Crownpoint) lead to disastrous economic situations for Indian reservations. First, the lack of community development

[l]eads to more poverty and overall lower Indian family incomes. Second, having so few employers and jobs available in Indian Country leads to high unemployment rates. And, third, the absence of thriving economies, characterized by a sufficient number of privately and publically owned businesses in Indian Country, adds to the impoverishment of Indians and their families.¹⁸

Although the trust land issue is not specifically emphasized by Miller, this article focuses on trust land as a primary impediment for entrepreneurs who want to start up small businesses or pursue entrepreneurial endeavors on the Navajo reservation. Because Navajo land is held in trust, the United States government has legal ownership of the land, and tribes and individual Indians are merely beneficial owners. Selling and leasing Navajo land, even for community development, must be approved by the United States. In his article, "Ending the Curse of Trust," noted tribal entrepreneur Lance Morgan says:

Trust status hurts individual American Indians. It prevents us from using our land as collateral, which has effectively killed Native-owned agricul-

¹⁸ MILLER, *supra* note 13, at 113.

ture. This system left us with almost no choice but to lease out our land, primarily to non-Indians. That's why we are land rich, but still dirt poor.¹⁹

Professor Miller echoes this sentiment when he points out that:

[T]ribes and Indian owners cannot sell, lease, develop, or mortgage [trust land] for loans without the express approval of the federal government. Needless to say, having the United States looking over the shoulders of tribal governments and requiring federal approvals of most economic decisions, and the time it takes to gain these bureaucratic approvals, adds enormous costs and inefficiencies to tribal and Indian economic endeavors. The inefficient and non-business-oriented federal bureaucracy creates serious obstacles for tribal governments and Indians in using trust assets for economic purposes, and for non-Indian companies who want to work in Indian Country.²⁰

The policy of restricting tribal land as trust land means that potential entrepreneurs do not have access to a prime source of capital for business startup. Without entrepreneurship, a tribal economy cannot be self-sustaining, yet tribal members still must meet their basic consumption needs. In an interview with the *Farmington Daily Times* in 2011, Navajo Nation president, Ben Shelly, pointed out the need to reverse economic leakage. President Shelly said “every weekend we come to town, into Farmington, especially the first of the month . . . same with Gallup, same with Page, same with Flagstaff”²¹ and spend money earned on the reservation. Professor Miller similarly points out:

[T]he money Indians spend does not circulate on their reservations between various public and private business opportunities and jobs. Clearly, if there are no businesses on reservations where residents can buy necessary and luxury goods, they will make those purchases off reservation. The lack, then, of small businesses on reservations leads to many negative economic impacts.²²

The legal origins of trust land come, in part, from *Cherokee Nation v. Georgia*,²³ the first Supreme Court opinion involving an American Indian

¹⁹ Lance Morgan, *Ending the Curse of Trust*, INDIAN COUNTRY TODAY (Mar. 25, 2005), <http://indiancountrytodaymedianetwork.com/2005/03/23/ending-curse-trust-94626>.

²⁰ MILLER, *supra* note 13, at 40.

²¹ Alysa Landry, *Navajos break ground on third casino*, FARMINGTON DAILY TIMES (Feb. 26, 2011).

²² Miller, *supra* note 13, at 114.

²³ *Cherokee Nation v. Georgia*, 30 U.S. (5 Peters) 1 (1831).

tribe,²⁴ where Chief Justice Marshall wrote that “the relation of the Indians to the United States is marked by peculiar and cardinal distinctions which exist nowhere else.”²⁵ One of those “peculiar and cardinal distinctions” was the notion that Indian tribes were

[d]omestic dependent nations . . . in a state of pupilage. Their relation to the United States resembles that of a ward to his guardian. . . . They look to our government for protection; rely upon its kindness and its power; appeal to it for relief to their wants; and address the president as their great father. They and their country are considered by foreign nations, as well as by ourselves, as being . . . completely under the sovereignty and dominion of the United States.²⁶

Part of that guardian ward relationship was the notion that the federal government would be the protector of Indian lands, both from avaricious settlers and land speculators as well from the Indian himself. It was this sense of paternalism from the “Great White Father” that led to the disastrous policy of tribal trust land. In order to fully understand where that policy came from, it is necessary to go further back into history.

II. A BRIEF HISTORY OF TRIBAL LAW AND POLICY²⁷

The paternalistic notions of tribal inferiority that led to the various restrictions of tribal economic development, such as tribal trust land, are not new and traces predate the origins of the United States itself. The year before Congress passed the Allotment Act, the Supreme Court would opine that “the relation of the Indian tribes living within the borders of the United States, both before and since the Revolution, to the people of the United States has always been an anomalous one and of a complex character.”²⁸

The Court’s temporal lens needed to extend much earlier, however, as the legal principles that existed when Europeans first made contact with the Indians had their origins in legal theories developed to justify the Crusades.²⁹ As the competing European nations began to expand their empires,

²⁴ An earlier Supreme Court case, *Johnson v. McIntosh*, 21 U.S. (8 Wheat.) 543 (1823), dealt with the issue of who could acquire title to land from Indian tribes, but no tribe was a party to the case.

²⁵ *Cherokee Nation*, 30 U.S. (5 Peters) at 16.

²⁶ *Id.* at 17.

²⁷ An expanded discussion of Indian Country Economics can be found in Gavin Clarkson, *Tribal Bonds: Statutory Shackles and Regulatory Restraints on Tribal Economic Development*, 85 N.C. L. Rev. 1009, 1019–30 (2007).

²⁸ *United States v. Kagama*, 118 U.S. 375, 381 (1886).

²⁹ See, e.g., Pope Innocent IV, *Commentaria Doctissima in Quinque Libros Decretalium*, reprinted in *THE EXPANSION OF EUROPE: THE FIRST PHASE* 191, 191–92 (James Muldoon ed. & trans., 1977) (“[I]s it licit to invade a land that infidels possess or which belong to them? . . . [I]t is licit for the pope

the papacy began to grant exclusive rights to lands as they were “discovered,” including rights of sovereignty over the indigenous populations.³⁰ Even after England broke away from the authority of Rome, English law still supported this “Doctrine of Discovery,”³¹ although the validity of the doctrine was a subject of debate among early colonial settlers.³² Irrespective of conflicting religious interpretations of Indian rights, “practical realities shaped legal relations between the Indians and colonists.”³³ The necessity of getting along with powerful and militarily capable Indian tribes³⁴ dictated that the settlers seek Indian consent to settle if they wished to live

to [demand allegiance, and] if the infidels do not obey, they ought to be compelled by the secular arm and war may be declared against them by the pope and not by anyone else.”); see also ROBERT A. WILLIAMS, JR., *THE AMERICAN INDIAN IN WESTERN LEGAL THOUGHT: THE DISCOURSES OF CONQUEST* 14 (1990) (discussing the crusading era origins of the legal doctrines which governed European land claims in the Americas).

³⁰ See, e.g., Bull “Inter caetera Divinae” of Pope Alexander VI dividing the New Continents and granting America to Spain, (May 4, 1493), in *CHURCH AND STATE THROUGH THE CENTURIES* 153, 156–57 (Sidney Z. Ehler & John B. Morrall trans. and eds., 1967) (“Wherefore, all things considered maturely and, as it becomes Catholic kings and princes . . . you have decided to subdue the said mainlands and islands, and their natives and inhabitants, . . . with the proviso, however, that these mainlands and islands found or to be found, discovered or to be discovered . . . be not actually possessed by some other Christian king or prince.”); see also Bull “Romanus Pontifex” of Pope Nicholas V granting the Territories discovered in Africa to Portugal, (January 8, 1455), in *CHURCH AND STATE THROUGH THE CENTURIES*, *supra* at 144, 145; WILLIAMS, *supra* note 29, at 14; see also generally Felix S. Cohen, *The Spanish Origin of Indian Rights in the Law of the United States*, 31 *GEO. L.J.* 1 (1942).

³¹ See, e.g., Calvin’s Case, 77 Eng. Rep. 377, 397–98 (K.B. 1608). “All infidels are in law *perpetui inimici*, perpetual enemies (for the law presumes not that they will be converted, that being *remota potentia*, a remote possibility) for between them, as with the devils, whose subjects they be, and the Christian, there is perpetual hostility, and can be no peace; . . . And upon this ground there is a diversity between a conquest of a kingdom of a Christian King, and the conquest of a kingdom of an infidel; for if a King come to a Christian kingdom by conquest, . . . he may at his pleasure alter and change the laws of that kingdom: but until he doth make an alteration of those laws the ancient laws of that kingdom remain. But if a Christian King should conquer a kingdom of an infidel, and bring them under his subjection, there *ipso facto* the laws of the infidel are abrogated, for that they be not only against Christianity, but against the law of God and of nature, contained in the decalogue; and in that case, until certain laws be established amongst them, the King by himself, and such Judges as he shall appoint, shall judge them and their causes according to natural equity.” This opinion was authored by Lord Chief Justice Edward Coke who, coincidentally, wrote the charter for the Virginia Company in 1606; see WILLIAMS, *supra* note 29, at 44.

³² Compare the arguments of John Winthrop (as “for the Natives in New England they inclose noe land neither have any settled habitation nor any tame cattle to improve the land by, & soe have noe other but a naturall right to those countries.”) with those of Roger Williams (“I have knowne them make bargaine and sale amongst themselves for a small piece, or quantity of Ground [and this they do] notwithstanding a sinfull opinion amongst many that Christians have right to *Heathens Lands*.”) recounted in Cheister E. Eisinger, *The Puritan’s Justification for Taking the Land*, 84 *ESSEX INST. HIST. COLLECTIONS* 135, 135–41 (1948).

³³ COHEN’S HANDBOOK OF FEDERAL INDIAN LAW § 1.02 (2005).

³⁴ *Id.* Despite devastating outbreaks of disease, the Indians would continue to outnumber the European settlers for several decades.

in peace and safety, buying lands that the Indians were willing to sell rather than displacing them by other methods.

At the outbreak of the French and Indian War in 1754, treaty making assumed a new dimension, as each of the competing European powers sought to form alliances with the various tribes. The military importance of treaty alliances would continue throughout the Revolutionary War period as well. After the war, however, a powerful group of tribes who had sided with the British during the war directly confronted the founding fathers. Those tribes still maintained claims to the territory between the Appalachian Mountains and the Mississippi River. President George Washington detailed his proposed policy for dealing with the Indians in a letter to James Duane, the head of the Committee of Indian Affairs of the Continental Congress:

Policy and [economy] point very strongly to the expediency of being upon good terms with the Indians, and the propriety of purchasing their Lands in preference to attempting to drive them by force of arms out of their Country; which as we have already experienced is like driving the Wild Beasts of the Forest which will return as soon as the pursuit is at an end and fall perhaps on those that are left there; when the gradual extension of our Settlements will as certainly cause the Savage as the Wolf to retire; both being beasts of prey tho' they differ in shape. In a word there is nothing to be obtained by an Indian War but the Soil they live on and this can be had by purchase at less expence [sic], and without that bloodshed, and those distresses which helpless Women and Children are made partakers of in all kinds of disputes with them.³⁵

Although many consider Washington's letter the founding document of American Indian policy,³⁶ its notion of Indians as "Savages" sits alongside the pragmatic necessity of entering into treaties with the Indians. As the newly formed United States began its inexorable march westward, the Indian lands usually were not taken by force but were instead ceded by treaty in return for, among other things, the establishment of a trust relationship,³⁷ often in specific consideration for the Indians' relinquishment of land.³⁸

³⁵ Letter from George Washington to James Duane (Sept. 7, 1783), in DOCUMENTS OF UNITED STATES INDIAN POLICY 1, 2 (Francis Paul Prucha ed., 3rd ed. 2000).

³⁶ See, e.g., WILLIAMS, *supra* note 29, at 44.

³⁷ The scope of the trust relationship is multi-faceted. "Many treaties explicitly provided for protection by the United States." COHEN, *supra* note 33, at §1.03[1]. See, e.g., Treaty with the Creeks, Aug. 7, 1790, art. II, 7 Stat. 35. Treaty Between the U.S.A. and the Kaskaskia Tribe of Indians, Aug. 13, 1803, art. II, 7 Stat. 78. Other treaties provided the means for subsistence. See, e.g., Fort Laramie Treaty, Sept. 17, 1851, art. VII, 11 Stat. 749 (providing for subsistence rations for the Sioux.); Treaty with the Western Cherokees, May 6, 1828, art. VIII, 7 Stat. 311. ("[E]ach Head of a Cherokee family . . . who may desire to remove West, shall be given, on enrolling himself for emigration, a good Rifle, a Blanket,

Various political factions disagreed over whether tribalism could survive contact with white civilization and whether the appropriate course of action was to make the Indians assimilate into that society or to remove them beyond the reaches of that society.³⁹ Ultimately, notions of tribal inferiority prevailed, and Congress passed the 1830 Removal Act,⁴⁰ sending dozens of tribes to the Indian Territory, often by force.⁴¹

While the formal existence of the United States began at a point when the prevailing policy recognized tribal sovereignty through the treaty-making process, such an orientation was not permanent. Once the removal process was essentially complete, responsibility for Indian affairs, along with the authority to negotiate on a government-to-government basis with the tribes, moved from the War Department to the Interior Department,⁴² although such treaties still had to be ratified by Congress. In the 1870s, however, Congress ceased making treaties with the Indians⁴³ and instead developed a policy of allotting tribal lands to individual Indians,⁴⁴ characterizing the allotment program as a “mighty pulverizing engine”⁴⁵ that

and Kettle, and five pounds of Tobacco: (and to each member of his family one Blanket,) . . . a just compensation for the property he may abandon.”)

³⁸ See, e.g., Treaty with the Creeks, *supra* note 37, at 35; Treaty with the Kaskaskia, *supra* note 37, at 78; Treaty with the Western Cherokees, *supra* note 37; Fort Laramie Treaty, *supra* note 37.

³⁹ See Letter from President Jefferson to William Henry Harrison (Feb. 27, 1803), *reprinted in* Prucha, *supra* note 35, at 22. (“[O]ur settlements will gradually circumscribe and approach the Indians, and they will in time either incorporate with us as citizens of the United States, or remove beyond the Mississippi.”)

⁴⁰ Removal Act, ch. 148, 4 Stat. 411 (1830) (current version codified at 25 U.S.C. § 174 (2012)).

⁴¹ The Choctaws were one of the first tribes to be removed along what one of their chiefs described as a “trail of tears and death.” See, e.g., Gavin Clarkson, *Reclaiming Jurisprudential Sovereignty*, 50 KAN. L. REV. 473, 475 n.14 (2002).

⁴² See VINE DELORIA, JR. & CLIFFORD M. LYTLE, *AMERICAN INDIANS, AMERICAN JUSTICE* 113 (Univ. of Tex. Press 1983).

⁴³ Treaty making with the Indians was ended by Congress in 1871: “[H]ereafter no Indian nation or tribe within the territory of the United States shall be acknowledged or recognized as an independent nation, tribe, or power with whom the United States may contract by treaty.” Abolition of Treaty Making, 16 Stat. 544, 566 (1871), *reprinted in* Prucha, *supra* note 35, at 135.

⁴⁴ General Allotment Act of 1887, ch.119, §1, 24 Stat. 388. The statute is also known as the Dawes Act after Senator Henry L. Dawes of Massachusetts. While the Dawes Act represented the final, full-scale realization of the allotment policy, many treaties made with western tribes from 1865 to 1868 provided for allotment in severalty of tribal lands. See ROBERT WINSTON MARDOCK, *THE REFORMERS AND THE AMERICAN INDIAN* 213 (Univ. of Mo. Press 1971).

⁴⁵ In an address to Congress in 1901, President Theodore Roosevelt expressed his sense of the assimilation policy: “the time has arrived when we should definitely make up our minds to recognize the Indian as an individual and not as a member of a tribe. The General Allotment Act is a mighty pulverizing engine to break up the tribal mass [acting] directly upon the family and the individual.” Theodore Roosevelt, President of the U.S., Message to Congress (Dec. 3, 1901), *in* A COMPILATION OF THE MESSAGES AND PAPERS OF THE PRESIDENTS 1789–1902, at 315, 348 (George Raywood Devitt ed., Supp. 1903).

would destroy tribalism and force Indians to assimilate into dominant society as individuals.⁴⁶

This theory of assimilation justified the legislation as beneficial to Indians. Some proponents of assimilation policies argued that if Indians adopted the habits of civilized life, tribes would need less land and the surplus land would be available for white settlers.⁴⁷

Although anti-Indian prejudices undoubtedly contributed to the passage of the General Allotment Act of 1887,⁴⁸ historians agree that the Act was primarily “pushed through Congress, not by western interests greedy for Indian lands, but by eastern [liberals] who deeply believed that communal landholding was an obstacle to the civilization they wanted the Indians to acquire”⁴⁹ These liberals believed that “[p]ride of ownership . . . would generate individual initiative . . . and bring material and cultural advancement” for the Indians.⁵⁰ Prominent liberal James Bradley Thayer of Harvard Law School enthusiastically praised the Dawes Act—designed to sever the individual from the tribal collective—as a “great, far-reaching, and beneficent” achievement.⁵¹ These so-called “friends of the Indian,” demanded that Indians be absorbed into the mainstream of American life and the “savagery” of tribal autonomy be destroyed.⁵²

As the “mighty pulverizing engine” began its work, tribal members under the Act surrendered their undivided interest in the tribally owned lands for a personally assigned divided interest, usually held in trust for a limited number of years, but “allotted” to them individually.⁵³ The Allotment Act was the first statute to specifically mention the notion of trust land, and from this point forward, trust lands, whether owned by the tribe or an individual Indian, were subject to onerous and cumbersome federal oversight. At best, that oversight would turn out to be benevolently incompetent, but often it would prove insidiously exploitative of Indian interest for the benefit of non-Indians.⁵⁴

The oscillating pattern of alternating congressional support and then hostility for tribal sovereignty would continue for the next century. By the

⁴⁶ See Gavin Clarkson, *Not Because They are Brown, but Because of Ea: Why the Good Guys Lost in Rice v. Cayetano, and Why They Didn't Have to Lose*, 7 MICH. J. RACE & L. 317, 325 (2002).

⁴⁷ COHEN, *supra* note 33, at § 1.04.

⁴⁸ General Allotment Act of 1887, *supra* note 44.

⁴⁹ 1 & 2 FRANCIS PAUL PRUCHA, *THE GREAT FATHER: THE UNITED STATES GOVERNMENT AND THE AMERICAN INDIANS* 669 (Univ. of Neb. Press unabr. 1995) (1984).

⁵⁰ Mardock, *supra* note 484, at 22.

⁵¹ James Bradley Thayer, *The Dawes Bill and the Indians*, THE ATLANTIC MONTHLY, Mar. 1888, at 315.

⁵² COHEN, *supra* note 33, at § 1.04.

⁵³ *Id.*

⁵⁴ See e.g. *Peabody Coal Co. v. Navajo Nation*, 375 F.3d 945 (9th Cir. 2004).

1930s it was clear that the Allotment Act was a colossal failure,⁵⁵ and Congress passed the Indian Reorganization Act of 1934 (IRA).⁵⁶ Although Congressional policy had completely reversed itself with the passage of the IRA—tribal sovereignty was now to be encouraged rather than destroyed—federal Indian policy would oscillate through one more cycle in the next half century⁵⁷ before President Nixon issued a landmark statement calling for a new federal policy of “self-determination” for Indian nations.⁵⁸ By “self-determination,” President Nixon sought “to strengthen the Indian’s sense of autonomy without threatening his sense of community.”⁵⁹ Self-determination⁶⁰ led to an increase in economic development activity, but access to capital remained an impediment.⁶¹ President Reagan also made an American Indian policy statement on January 24, 1983, stating his support for “self-determination.”⁶² In attempting to define “self-determination,” he stated:

Instead of fostering and encouraging self-government, federal policies have, by and large, inhibited the political and economic development of the tribes. Excessive regulation and self-perpetuating bureaucracy have

⁵⁵ See, e.g., BROOKINGS INSTITUTION, INSTITUTE FOR GOVT. RESEARCH, *THE PROBLEM OF INDIAN ADMINISTRATION* (1928) (documenting the failure of federal Indian policy during the allotment period).

⁵⁶ 25 U.S.C. §§ 461-79 (2000).

⁵⁷ The period between 1945 and 1970 is referred to as the Termination Era, and was characterized by the passage of number of statutes that “terminated” individual tribes—“these acts distributed the tribes’ assets by analogy to corporate dissolution and afforded the states an opportunity to modify, merge or abolish the tribe’s government functions.” BARSH & HENDERSON, *THE ROAD: INDIAN TRIBES AND POLITICAL LIBERTY* 132. Examples of this legislative activity include Act of August 13, 1954, ch. 732, 68 Stat. 718, and Act of August 3, 1956, ch. 909, 70 Stat. 963 (repealed 1978).

⁵⁸ RICHARD NIXON, *PROPOSED RECOMMENDATIONS RELATING TO THE AMERICAN INDIANS—MESSAGE FROM THE PRESIDENT*, H.R. Doc. No. 91-363, at 116 CONG. REC. 23258 (July 8, 1970). See also *The Indian Financing Act of 1974*, Pub. L. No. 93-262, 88 Stat. 77 (1974) (codified as 25 U.S.C. §§ 1451–1453). Perhaps the greatest of Nixon’s contributions to Indian tribal sovereignty was Public Law 638, which expressly authorized the Secretaries of Interior and Health and Human Services to contract with and make grants to Indian tribes and other Indian organizations for the delivery of federal services. *The Indian Self-Determination and Education Assistance Act of 1975*, Pub. L. No. 93-638, §3, 88 Stat. 2203 (codified as amended in scattered sections of 25 U.S.C.).

⁵⁹ SAMUEL R. COOK, *What is Indian Self-Determination?*, RED INK, May 1, 1994, <http://faculty.smu.edu/twalker/samrcook.htm>.

⁶⁰ The key legislation of this era includes: *The Indian Self-Determination and Education Assistance Act of 1975* §3; *The Indian Civil Rights Act of 1968* (current version at 25 U.S.C. §§ 1301–1341 (2000)); *The Indian Financing Act of 1974* (current version at 25 U.S.C. § 1451) (2000); and *The Indian Child Welfare Act of 1978* (current version at 25 U.S.C. §§ 1901–1963) (2000). See generally COHEN, *supra* note 33, at § 1.07.

⁶¹ COHEN, *supra* note 33, at § 21.03[1].

⁶² PRESIDENTIAL COMMISSION ON INDIAN RESERVATION ECONOMIES, *REPORT AND RECOMMENDATIONS TO THE PRESIDENT OF THE UNITED STATES* 7 (1984).

stifled local decision making, thwarted Indian control of Indian resources and promoted dependency rather than self-sufficiency.⁶³

In 1983, President Reagan established the Presidential Commission on Indian Reservation Economies. In 1984, the Commission published its Report and Recommendations, again calling for a major shift in federal Indian policy.⁶⁴ The report identified “trust land” as the single greatest federal impediment to tribal economic development.

Trust status constraints operate as an obstacle to Indian reservation economic development in a number of ways since these constraints constitute a complex framework of regulatory control over Indian assets. The constraints are authorized in treaties, statutes, regulations, procedures, and manuals governing specific resources such as land, minerals, timber, water, hunting and fishing, and trust funds. The trust status of Indian resources is not just an obstacle to economic development from the perspective of collateral for financing. Bureaucratic regulation and control of Indian asset management is also a problem.

Trust status means that Indian tribes lack the same property revenue base that local governments have. It also means that capital which they already have cannot be flexibly used for tribal investment. Trust status freezes tribal assets in a pre-capitalist state.⁶⁵

III. MICRO- AND MACROECONOMIC PERSPECTIVES

Lance Morgan suggests that the trust land policy “serves as the single largest impediment to Indian country’s economic growth and tribal sovereignty,”⁶⁶ but how does the interplay between trust land and economic leakage manifest itself in economic terms? A primary source of market failure in the sense of economic development within Indian country is the severe restrictions imposed on any market for tribal trust land. The restrictions on tribes regarding land ownership and activity are not conducive for business; therefore few, if any, entrepreneurs attempt to start a business. As Lance Morgan points out:

Back in the late 1800s, in order to stop scam land sales and egregious tax seizures by state governments, the federal government took title to all tribal and individual American Indian land. The side effect of creating trust land practically guaranteed our poverty as tribes and as a people. Trust land can’t be sold, taxed, mortgaged or used as collateral. Trust status se-

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.* at 31.

⁶⁶ Morgan, *supra* at note 19.

verely restricts the tribe's and an individual's ability to use our largest asset, our land and its resources.⁶⁷

According to the 2012 summary of the Board of Governors of the Federal Reserve System, "the inability or difficulty in using trust or restricted land as collateral to access financing for business development eliminates a major source of equity and security for loans."⁶⁸

Individual Indian entrepreneurs are excluded holistically from opportunity for advancement. The Federal Reserve summary also identifies an important disincentive to small businesses in Indian Country, pointing out that "the title status reports process, typically administered by the U.S. Department of Interior, is often burdensome and time-consuming, which interferes with the efficient use of land for business development."⁶⁹ Navajo entrepreneurs are already at a disadvantage, coming from a low socioeconomic status. They do not have the time to wait for the Department of Interior to make a move.

Although the problem of economic leakage is a macroeconomic concept, the problem also manifests itself in microeconomic terms as well. Since Crownpoint has only one grocery store, despite being next to a state highway that connects directly to Interstate 40, prices at this grocery store are significantly higher than comparable stores in Gallup and Farmington and are also higher than grocery stores owned by the same company at one other location in the Navajo Nation. The *Navajo Times* recently reported that:

According to the U.S. Department of Agriculture, most of the Navajo reservation is considered a food desert. Being designated as a food desert means people have little access or no access to large supermarkets on their land to maintain a healthy diet.⁷⁰

Because of the trust-land issues, it is harder for a competitor to open up in Crownpoint, and therefore that grocer has a local monopoly and can price accordingly. In microeconomic terms, demand remains the same, but supply is restricted, thus driving up prices. Certain consumers are unable to afford the local prices and will spend the money to drive to Gallup to purchase groceries. Given the difficulty of starting up a small Navajo owned, affordable, grocery store in Crownpoint, how are other business startups to

⁶⁷ *Id.*

⁶⁸ BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *Growing Economies in Indian Country: Taking Stock of Progress and Partnerships* 8 (2012).

⁶⁹ *Id.* at 9.

⁷⁰ Alastair Lee Bitsoi, *Food Experts: Summit Aimed at Preventing Extinction of Tribe*, NAVAJO TIMES (June 13, 2013), <http://navajotimes.com/news/2013/0613/061313foo.php#.U2G3SPldXh5>.

succeed? Without the opportunity to develop the community, youth residents who attend Navajo Technical University have few local job opportunities after graduation except to leave Crownpoint or leave the reservation all together.

IV. ENDING THE CURSE OF TRUST LAND

Lance Morgan summarizes the impact of the failed policy of tribal trust land when he points out that these “trust-land issues make escaping from poverty very difficult, if not impossible and leave large portions of [Indian Country] stuck in a cycle of dependency.”⁷¹ Land held in trust is a debilitating factor that prevents tribes from having any opportunity to become self-sufficient and self-sustaining, as it restricts a significant source of capital for on-reservation activity. Access to capital provides the necessary means to build and maintain adequate infrastructure to improve the lives of tribal citizens, but tribes do not have access to capital if they do not have the right to mortgage or sell their land-like non-reservation entities. According to the Minneapolis Federal Reserve Bank newsletter, the *Community Dividend*, “a commonly cited barrier to the development of private market in Indian communities is the lack of access to affordable credit and capital.”⁷² This lack of access to capital is clearly affecting all tribes.

Rather than merely lamenting the problem, however, Morgan suggests that the optimal solution is simply to give tribes back their land. He proposes that:

Title to trust land should be returned to tribes and individuals in fee under a new tribal status. This new tribal status must confer permanent jurisdiction, complete with full taxation powers, to the tribe, ensuring that the land will always be subject to tribal jurisdiction regardless of the race of the landowner. In one move, we can liberate Indian country economically and politically. . . . It is clear that there would be many details to work out, but the basic concept is sound.⁷³

Legislation is currently pending before Congress that would allow tribes to take control of their trust assets and implement land ownership systems along the lines of Morgan’s suggestion. Senator Crapo (R-Idaho) has introduced S. 383, the Indian Trust Asset Reform Act, in the 114th

⁷¹ Morgan, *supra* note 19.

⁷² Sue Woodrow, *Turning Equity into Opportunity: Montana Fund Helps Native Entrepreneurs Enter the Financial Mainstream*, FEDERAL RESERVE BANK OF MINNEAPOLIS (Sept. 1, 2008), <https://www.minneapolisfed.org/publications/community-dividend/turning-equity-into-opportunity-montana-fund-helps-native-entrepreneurs-enter-the-financial-mainstream>.

⁷³ Morgan, *supra* note 19.

Congress. Title II of this Act would allow certain tribes to participate in a pilot program that would give them control of their trust land and allow them to implement management strategies as they deem appropriate, subject to certain fiduciary restrictions.

CONCLUSION

Until the core issue of trust land is addressed, alternative strategies for increasing tribal entrepreneurship need to be pursued. One of the co-authors has suggested revisions to the securities laws to increase the availability of private investment capital in Indian Country.⁷⁴ Community Development Financial Institutions (CDFIs), which are already in place, act as incubators for entrepreneurial start-ups by providing micro-loans that enable and encourage small businesses financially. A Native-owned CDFI can act as a catalyst for economic growth participation by finding and enabling accessible capital that will then generate the necessary financial aid or private and communal business development, even when home equity loans are unavailable due to restrictions on trust land. Further research is underway on how Native-owned CDFIs can stand in the gap until more comprehensive economic reforms are in place.

⁷⁴ See Gavin Clarkson, *Accredited Indians: Increasing the Flow of Private Equity into Indian Country as a Domestic Emerging Market*, 80 COLO. L. REV. 285 (2009).

ADOPTION OF ANTITRUST LAWS IN DEVELOPING COUNTRIES: REASONS AND CHALLENGES

*Dina I. Waked**

INTRODUCTION

Starting in the 1990s the developing world has witnessed a massive spread of adoption of competition laws. Today more than half of the world's developing countries have adopted a competition law, compared to less than 10 before 1990. The spread of these laws has many explanations, champion amongst which is pressure by supranational bodies, conditionality in structural adjustment loans and treaties, and promises for development. Developing countries were promised that competition laws were necessary tools needed to assure growth and development to impoverished nations, and that they help undo many of the ills that liberalization and privatization, part of the Washington consensus, brought about. The argument put forth by much of the literature, particularly from the World Bank and the World Trade Organization, was that the neoliberal reforms that were taking shape in many of these countries in the early 1990s did not succeed primarily due to the lack of a proper competitive environment.¹

Competition laws were argued to offer the missing link in these attempts at reform that would assure that the state monopolies would not be simply replaced by private ones. They would also ensure that the failed attempts at lowering barriers to entry would be rectified when non-tariff barriers would be eliminated under a proper competition regime, which assures the empowerment of the domestic firms and access to smaller, less politically-powerful, firms. Without a competition law, many of the developing countries saw, despite their attempts at reform, the local elite still monopolizing their markets, foreign firms abusing their local population, cartelized goods being imported and local population paying higher and higher prices.

These newly adopted competition laws, which were generally modeled on the laws of more advanced countries, would empower a domestic competition authority to serve the following goals: (1) prevent abuses of local

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¹ R. S. Khemani, *Competition Policy and Promotion of Investment, Economic Growth and Poverty Alleviation in Least Developed Countries* (FIAS Occasional Papers No. 19, 2007), <http://www.cuts-ccier.org/pdf/IRPDF-02.pdf>.

and foreign monopolies and dominant firms that impoverished the population through supracompetitive prices; (2) prevent illegal agreements and collusion between domestic and/or foreign firms that among others fix prices, limit output, divide markets and engage in bid-rigging; (3) prevent mergers to monopoly or those that facilitate oligopolistic market structures, which are predicted to increase inefficiencies in the market; (4) engage in competition advocacy to spread awareness of the benefits of competition and assure compliance with the law.

In many instances, developing countries resisted the adoption of these laws, mainly due to the lobbying of the incumbent elite that feared the loss of their rents. Some developing countries were, and many still are, reluctant to give way to more competitive markets that reduce their abilities to shield their domestic firms, national champions, and infant industries from fierce competition. The adoption of competition laws seemed to threaten more protective trade policies and government monopolization of the local markets. Nonetheless, this paper shows, that in spite of these challenges, many developing countries did adopt competition laws after all.

Notwithstanding this reality of adoption and to partially address the local challenges and developing countries' unwillingness to believe the merits of competition laws, many have encouraged that developing countries adopt laws that mirror their local circumstances, needs, and environments. These were predicted to stand in the way of proper antitrust enforcement. Yet, the majority of developing countries adopted laws that were almost identical to the laws developed in more advanced nations. Cut-and-pasting developed countries' laws into the developing world is a phenomenon that is easily discerned from a close reading of these newly adopted laws. This in turn has lead many to predict that developing countries' antitrust laws are nothing but ink on paper and will not be enforced.

This paper analyzes the spread of developing countries' antitrust laws (Part I), why they were adopted (Part II), and the challenges they face adopting and enforcing these laws (Part III). It also addresses the concern of many academics and professionals that developing countries need to adopt specifically tailored antitrust laws to be able to implement them (Part IV). It concludes by showing that the reality is, unfortunately, different from the prescriptions of adopting uniquely tailored laws, which often leaves developing countries with a sole option, namely to adapt their enforcement and overall competition policy to their own needs.

I. THE SPREAD OF ANTITRUST LAWS

Starting in the 1990s, a surge of adoption of antitrust laws emerged in the developing world.² By 2007, out of the world's 151 developing countries³, 77 had an antitrust law in force and an agency set up to enforce the adopted law, a surge from less than 10 before 1990.⁴ By 2012, the estimate is that more than 100 developing countries have adopted a competition law.⁵ This means that more than half of the world's developing countries currently have a law that prohibits certain anticompetitive activities and regulates the market place.

Figure A.1 shows that the trend to adopt these laws in the developing world has been a phenomenon of the 1990s, where the number of countries adopting antitrust laws post 1990 is astonishing, compared to the decades before.⁶ Table A.1 lists all developing countries with a competition law.

The geographical distribution of developing countries with a competition law in place is shown in Figure A.2. Figure A.3 shows the percentage of developing countries with and without a competition law in the respective regions of the world. In Africa only 34% of 53 developing countries have a competition law and agency set up to enforce the competition law; compared to 53% of the 30 developing countries in the Americas; 59% of Asia's 37 developing countries; 95% of Europe's 20 developing countries, and finally 18% of Oceania's 11 developing countries. The percentage is highest for Europe and lowest for Oceania followed by Africa.

² The definition of developing countries that is used in this paper is based on countries' gross national income (GNI) per capita. It follows the World Bank Atlas Method groupings that divide countries according to their GNI/capita into 4 categories: low income economies with GNI/capita of \$975 or less; lower-middle-income economies with GNI/capita between \$976-\$3,855; upper-middle-income economies with GNI/capita between \$3,856-\$11,905; and high income economies with GNI/capita of \$11,906 or more. The categories that are considered developing for the purposes of this paper are all of the low-income, lower-middle-income and upper-middle-income economies.

³ According to the World Bank classifications based on gross national income (GNI) per capita. (Economies are divided according to 2008 GNI per capita, calculated using the World Bank Atlas Method. The groups are: low income, \$975 or less; lower-middle-income, \$976 - \$3,855; and upper-middle-income, \$3,856 - \$11,905).

⁴ These include 7 countries, which are considered developing according to International Monetary Fund (IMF) classification, but are considered high-income economies according to the World Bank. See IMF 2008 World Economic and Financial Surveys, World Economic Outlook, Database – WEO Groups and Aggregate Information. These countries are: Barbados, Croatia, Czech Republic, Estonia, Hungary, Saudi Arabia, and Slovak Republic (where the Czech Republic and the Slovak Republic were considered developing in the 2008 IMF Survey and are no longer so in the 2009 survey).

⁵ The analysis of this paper focuses on antitrust adoption by 2007.

⁶ Joel Davidow, *The Relevance of Antimonopoly Policy for Developing Countries*, 37 ANTITRUST BULL. 277, 278 (1992) (“[L]ess than a half dozen countries adopted competition legislation in the period 1980-1987. Since 1987 there has been an accelerated world trend toward adoption and strengthening of legislative measures designed to create, advance and protect a market economy.”).

One of the explanations for the differences in percentages is the relative development levels of these countries in the various geographies (see Figures A.4 and A.5).⁷ Using both a Pearson Chi² test and a Fisher exact test proves a strong relationship between a country's income level and its adoption of competition law, with Chi² (4, N=151) = 13.1, p = 0.011 and Fisher exact, p = 0.008.

Figure A.4 shows the distribution of countries' income levels in different regions of the world. As can be seen, Africa has the highest percentage of low and lower-middle income economies (82%), followed by Asia (64%) and Oceania (47%). The Americas' low and lower-middle income economies constitute only 23% of their total countries. Finally, Europe has the lowest percentage of low and lower-middle income economies (9%).

Figure A.5 illustrates that the highest percentage of developing countries with competition laws are those that are considered high-income economies by the World Bank but developing according to the IMF (100% of those countries have a competition law in place), followed by upper-middle-economies and then by lower-middle economies. The lowest percentage is amongst countries classified as low-income economies, with only 37% of those countries having a competition law in place.

Seeing that Africa has the highest percentage of low-income economies, and Figure A.5 shows that low-income economies have the lowest percentage of competition law adoption, might explain why the percentage of Africa's developing countries that have adopted a competition law is low. This can be contrasted with Europe, which has the highest percentage of high-income economies, no countries considered low-income economies, and has the highest percentage of developing countries with a competition law in a region. This only proves the strong relationship between a country's level of development and its choice to adopt a competition law.

Figure A.6 shows the breakdown of developing countries adopting competition laws by income distribution according to their region. It shows that the higher the income level of a country the higher the percentage associated with countries adopting competition laws. For example, 44% of Africa's upper-middle-income economies have adopted a competition law, compared to 36% of its lower-middle-income economies, and 30% of its low-income economies. This same trend applies to all the other regions proving the positive relationship between income levels and adoption of competition laws.

The level of development is one of many factors that affect the adoption of antitrust. As discussed in Part II, the reasons why these laws have spread are various. It is, however, important to keep in mind that the rea-

⁷ Mark R. A. Palim, *The Worldwide Growth of Competition Law: An Empirical Analysis*, 43 ANTITRUST BULL. 105, 114 (1998) ("The current literature also suggests that the adoption of a competition law is related to a country's overall economic development.")

sons for the spread of these laws, as will be addressed next, mainly relate to the more developed of the developing countries.

II. REASONS DEVELOPING COUNTRIES ADOPT ANTITRUST LAWS

The unprecedented spread of antitrust laws in the 1990s raises the question of why did developing countries adopt competition laws in the 1990s and not before? Further, why did *so many* of them suddenly become interested in competition law adoption? There is no simple answer, except to say that competition laws were not considered an important addition to their arsenal of laws up until the 1990s. One reason was that many countries had provisions either in their penal codes, civil codes, or commercial legislations dealing with competition law issues before formally adopting legislation that is solely concerned with competition matters.⁸ This made them less interested in adopting particular laws dealing with competition, seeing that they had general provisions in other legislation dealing with the same issues.

Then why did so many suddenly become interested in these kind of laws in the 1990s? It is simplistic to argue, yet probably true, that many countries were entering trade agreements in the 1990s that made the adoption of competition law a prerequisite to the implementation of the trade deals.⁹ These treaties were either trade agreements creating free trade zones or part of structural programs that intended to open up the developing world economies and facilitated the entry of foreign entities that considered a competition law a necessity and guarantee for their work abroad, in particular in a developing country.

More generally, the 1990s are considered the era where developing world countries started to put an end to their former protectionist policies that were either inspired by communist or socialist regimes or simply by efforts to industrialize and strengthen national champions and local producers. The 1990s introduced the new era of international trade, encouraging foreign direct investment, and membership in regional trade agreements or the World Trade Organization (WTO). With the emergence of many of these structural changes, open door policies and participation in world trade relations, competition laws were suddenly prescribed as necessities to fa-

⁸ See, e.g., Egypt's Penal Code of 1937, Article 345 (prohibits raising or lowering prices to achieve illegal benefits); see also Egypt's Law No. 241/1959 (states that it is prohibited for any distributor to have a monopoly in distributing any domestically produced good that is subject to an import ban).

⁹ Francisco Marcos, *Do Developing Countries Need Competition Law and Policy?* 3 (Sep., 2006), <http://ssrn.com/abstract=930562> (“[Competition Policy] mandates are also contained in most of the bilateral trade agreements and Free Trade Agreements in which young and developing countries take part. Parties to those treaties normally are required to have in place a domestic antitrust regime as one of the main conditions before entering into the agreement.”).

cilitate much of the impending changes.¹⁰ It is important to understand the role played by the WTO and other international organizations in encouraging and often requiring new members to adopt these laws in order to understand the surge in the developing world.¹¹ Similarly, the role played by the EU in encouraging new members and trade partners to adopt competition law is even more straightforward.¹² Adopting these laws seemed to many as the missing link to assure growth and development.¹³

Therefore, one could argue that one of the main factors that led to the widespread adoption of competition laws across developing countries is the push exercised by supranational bodies. Another factor is the overwhelming evidence these international bodies were presenting to developing countries illustrating a positive relationship between adopting a competition law and development. Competition laws appeared to be the missing link needed to usher in prosperity and growth. The pressure by international bodies and the development hopes that adopting competition laws carried are discussed in more detail next.

A. *The Push by International Bodies to Adopt Competition Laws*

International and supranational bodies have considered competition laws essential for economic reforms. Ever since competition laws were discussed as part of the agenda of the negotiations to establish an International Trade Organization (ITO) after World War II, competition laws were considered a vital requirement for needed reforms. The General Agreement on Tariffs and Trade (GATT) upheld the rhetoric of the ITO and included competition issues and restrictive business practices in a “best endeavor”

¹⁰ Khemani, *supra* note 1, at 26 (“The adoption of competition law-policy has been driven by a wide range of factors, including economic liberalization and deregulation, loan and policy conditions of the World Bank/IMF, regional and multilateral trade agreements, and aspirations to join the European Union.”).

¹¹ World Trade Organization, Working Group in the Interaction between Trade and Competition Policy, *Synthesis on the Relationship of Trade and Competition Policy to Development and Economic Growth*, WT/WGTCP/W/80 (18 Sept. 1998), <https://docsonline.wto.org/dol2fe/Pages/FormerScriptedSearch/directdoc.aspx?DDFDocuments/t/WT/WGTCP/W80.DOC>.

¹² See, e.g., *Euro-Mediterranean Association Agreements*, <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/regions/euromed/> [hereinafter *Euromed Agreements*]; see, e.g., Euro-Mediterranean Agreement, Establishing an Association, E.C. Egypt, Art. 72 (June 25, 2001), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:304:0039:0208:EN:PDF> (“[A] financial cooperation package shall be made available to Egypt” focused among others on “the accompanying measures for the establishment and implementation of competition legislation.”); *id.* Joint Declaration on Article 34 (“while drafting its law, Egypt will take into account the competition rules developed within the European Union.”). Similar provisions are found in other Euro-Mediterranean Association Agreements, which have been concluded between the EU and each of the following: Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Tunisia, and Turkey.

¹³ See *infra* notes 40-53 and accompanying text.

clause.¹⁴ However, the GATT did not require the adoption of specific provisions dealing with the treatment of private restrictive business practices (RBPs).¹⁵ Therefore, the members of the WTO could freely adopt their own national competition laws so long as they did not infringe the principle of nondiscrimination.¹⁶

The General Council of the WTO created a Working Group in April 1997 on the Interaction Between Trade and Competition Policy. This Working Group strongly called on developing countries to adopt competition rules in the face of the global merger wave underway and the structural changes taking place within the developing countries as a result of their liberalization and free trade policies.¹⁷ The WTO's focus on competition law adoption is due to the widely believed interaction between competition policies and the expansion of free trade.¹⁸

Effective free trade policies require, next to the withdrawal of trade barriers, the elimination of obstacles originating from private restraints resulting from abuse of dominance, monopolization, import and export cartels, horizontal and vertical restraints, and other issues considered to be competition law violations.¹⁹ To achieve these results, the WTO urged developing countries to adopt competition rules, often US or EC type competition policies, while encouraging for time lags in the introduction of these different aspects of competition rules to be able to efficiently implement them.

One can explain the WTO's continuous attempt to influence, encourage, and facilitate the adoption of competition legislation in developing

¹⁴ Bernard Hoekman, *Competition Policy and the Global Trading System: A Developing-Country Perspective 1* (The World Bank Policy Research, Working Paper No. 1735, 1997).

¹⁵ Bernard Hoekman & Petros C. Mavroidis, *Economic Development; Competition Policy and the World Trade Organization 14* (The World Bank Policy Research, Working Paper No. 2917, 2002).

¹⁶ The General Agreement on Tariffs And Trade (GATT 1947) Article III National Treatment on Internal Taxation and Regulation, 5 (III. 4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.). For a variety of readings of the nondiscrimination provision see Einer Elhauge & Damien Geradin, *GLOBAL ANTITRUST LAW AND ECONOMICS 1137* (2d ed. 2011).

¹⁷ Ajit Singh & Rahul Dhumale, *Competition Policy, Development and Developing Countries 3* (T.R.A.D.E. Working Papers No. 50, 1999).

¹⁸ Robert Anderson & Frédéric Jenny, *Competition Policy, Economic Development and the Possible Role of a Multilateral Framework on Competition Policy: Insights from the WTO Working Group on Trade and Competition Policy*, in *COMPETITION POLICY IN EAST ASIA 61*, 61 (Erlinda Medalla ed., 2005) ("The central theme of this chapter is the fundamental complementarity of competition policy, trade liberalisation and domestic economic reform, and their importance for development.").

¹⁹ Damien Geradin, *Competition Law and Regional Economic Integration: An Analysis of the Southern Mediterranean Countries*, *WORLD BANK PAPERS 21* (2004).

countries by its aspirations towards harmonizing competition laws to one day usher in universal competition policies under its umbrella.²⁰ The WTO is repeatedly encouraging agreements on core antitrust principles as a first step towards the achievement of this goal.²¹

When developing countries adopt rules similar to those in more developed countries, the attempt at harmonization seems more realistic and at the same time the effects of global anticompetitive conduct with relation to trade can be better tackled. If laws adopted in developing countries were fundamentally different from those in the advanced world, the ability of the developed countries to protect their interests from anti-competitive practices in developing countries would be limited. Thereby, not only would similar competition laws encourage more effective free trade, but would also give a sense of security for FDIs and MNCs working in developed countries. One can also argue that it would give the host developing country more teeth to prosecute prohibitive conduct emanating from local or foreign entities, and to challenge harmful global mergers.

The WTO is not alone in encouraging competition law adoption across the developing world. Several international financial institutions consider a competition policy dimension when evaluating country risk necessary for lending purposes.²² For example, the International Monetary Fund (IMF) and the International Development Association (IDA) look at a country's competition policy when assessing the situation of borrower countries before deciding to allocate the funds needed.²³ A classic example is the case of Indonesia, where the country was required by the IMF to adopt a competition law in return for rescue money.²⁴ It is worth noting that the first conditionality appeared in a World Bank industrial sector adjustment loan to Argentina in 1991.²⁵

²⁰ Frédéric Jenny, *Competition Law and Policy: Global Governance Issues*, 26(4) WORLD COMPETITION 609, 621 (2003) ("Led by the European Union, a number of WTO Member governments have put forward a proposal for the development, in the context of the new Round of multilateral trade negotiations launched at Doha, of a 'multilateral framework on competition policy'").

²¹ *Id.* ("Such an agreement [on competition policy at the WTO] would have five main elements: [1] A commitment by WTO Members to a set of core principles relating to the application of competition law and policy, including transparency, non-discrimination and procedural fairness in the application of competition law and/or policy.").

²² Marcos, *supra* note 9, at 3.

²³ *Id.*; see also WORLD BANK, *Country Policy and Institutional Assessments 2005 Assessment Questionnaire*, Operations Policy and Country Services, criteria 6, at 16 (Dec. 20, 2005), <http://siteresources.worldbank.org/IDA/Resources/CPIA2005Questionnaire.pdf>.

²⁴ Eleanor M. Fox, *Equality, Discrimination and Competition Law: Lessons from and for South Africa and Indonesia*, 41 HARV. INT'L. L.J. 579, 589 (2000) (quoting J. Oloka-Onyango, *Beyond the Rhetoric: Reinvigorating the Struggle for Economic and Social Rights in Africa*, 26 CAL. W. INT'L. L.J. 1, 22 (1995)).

²⁵ Clive S. Gray & Anthony A. Davis, *Competition Policy in Developing Countries Pursuing Structural Adjustment*, ANTITRUST BULL. 425, 426 (Summer 1993).

Also, the United Nations and the OECD played a role in pushing for the adoption of competition laws across developing countries. Both institutions have adopted and promoted non-legally enforceable “codes of conduct” to prevent anticompetitive practices.²⁶ The United Nations has also set up, under the rubric of the United Nations Commission for Trade and Development (UNCTAD) and the United National Economic and Social Commission for Western Asia (UNESCWA), several projects and initiatives that assist developing countries in the design and implementation of their competition policies.²⁷

The increased interest of international and supranational bodies with regard to encouraging adoption of competition laws in the developing world originated in the wave of neoliberal reforms as part of the Washington consensus, which resulted in privatization and liberalization across developing countries. Some of the goals of these reforms were to put an end to government monopolies and governmental intervention in the economy through liberalizations and privatizations. However, the result of the wave of privatization was that government monopolies were simply replaced by private monopolies yielding the same anti-competitive effects.²⁸

For the past two decades or more, the World Bank Group and other development organizations have encouraged developing and emerging market economies to adopt pro-competition measures such as trade and investment liberalization, privatization, and economic deregulation. These initiatives have been aimed primarily at reducing *public sector* policy-based barriers to entry, regulatory costs, and delays that unnecessarily constrain private sector economic activity They are, however, insufficient—they are complementary to but do not substitute for an effective competition law-policy. They do not address the *private sector* restrictive business practices that can significantly impede competition. Unchecked, anticompetitive practices by dominant and politically connected firms and vested interest groups can capture or significantly reduce the benefits that accrue from competition Competition does not arise or sustain itself

²⁶ Hoekman, *supra* note 14, at 1; *see also* Cassey Lee, *Model Competition Laws: The World Bank-OECD And UNCTAD Approaches Compared* (Center on Regulation and Competition Working Paper Series No. 96, 2005).

²⁷ Palim, *supra* note 7, at 127 (“ . . . UNCTAD has also been active in encouraging and assisting countries in enacting competition laws. In 1980, the United National General Assembly endorsed a model law devised through UNCTAD. Today, UNCTAD provides technical assistance for member states and a forum for research and discussion among experts from member states on issues relating to competition law.”); *see generally* UNCTAD, *Capacity-building on Competition Law and Policy for Development: A Consolidated Report* (2008), http://unctad.org/en/docs/ditccpl20077_en.pdf.

²⁸ Anderson & Jenny, *supra* note 18, at 72 (“[I]n many cases, the potential benefits of market-opening measures will not be realised unless countries simultaneously take steps to address anticompetitive practices/structural barriers to development such as private and public monopolies in infrastructure sectors, domestic and international cartels that raise business input costs, and restrictions on entry, exit and pricing in manufacturing and other industries.”).

automatically. The competitive process needs to be *maintained, protected, and promoted* to strengthen the development of a sound market economy.²⁹

Similar rhetoric was reproduced over and over, not only by these international organizations, but also by lawyers, economists, and policy makers. The result was that adopting competition rules became a priority on the agenda of economic growth in many less developed countries, who pushed forward with the help or pressure of various supranational institutions. Some countries, however, resisted the push to adopt competition laws and continued to prefer concentration to competition. They, thereby, had less of a drive to adopt competition laws based on their own initiatives. Others felt the need to adopt competition laws and to drive their markets towards the perfect competition ideal. Part of this desire was their belief in the rhetoric presented to them, but also due to the increased cross-border influences of anti-competitive practices,³⁰ especially their import of cartel-affected goods.³¹

Trading partners have also requested the adoption of antitrust laws as a condition for signing free trade agreements.³² For example, the EU has been extremely active in the process of spreading its competition law to developing countries. This is to the extent where “some argue that today the EC competition law is the dominant model of competition law in the world.”³³ Treaties, such as the Accession Agreements signed by Eastern European countries to join the EU³⁴ or the Euro-Mediterranean partnership

²⁹ Khemani, *supra* note 1, at 36.

³⁰ Paul Cook, *Competition Policy, Market Power and Collusion in Developing Countries 2* (Center on Regulation and Competition Working Paper Series No. 33, 2002).

³¹ Margaret Levenstein & Valerie Y. Suslow, *Contemporary International Cartels and Developing Countries: Economic Effects and Implications for Competition Policy*, 71 ANTITRUST L.J. 801, 816 (2004) (the authors calculate the imports of “cartel-affected” goods, and find that the developing countries in 1997 imported \$51.1 billion in goods from industries that saw international cartel activity at some point during the 1990s); Jenny, *supra* note 20 (the author presents evidence to show that transnational anticompetitive practices are more prevalent than was previously thought and that the magnitude of the costs that this imposes on developing countries is quite significant).

³² See Euromed Agreements, *supra* note 12; see also Palim *supra* note 7, at 53.

³³ Seppo Reimavuo & Markus Händelin, Establishing a Credible Competition Authority—The Egyptian Case, Trade Enhancement Programme A (TEP-A) Component 2 Egypt-European Association Agreement 40 (Mar. 2005) (unpublished report) (on file with the author); see also Palim, *supra* note 7, at 120 (“[B]y requiring the adoption of E.U.-compatible competition law as a condition for gaining access to its markets, either through trade agreements or outright membership, the E.U. Has been a driving force in the enactment of competition laws beyond its borders.”).

³⁴ Palim, *supra* note 7, at 51 (quoting UNCTAD, *Secretariat Review of All Aspects of the Set of Multilateral Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices* 30 (1995) (United Nations Publication TD/RBP/CONF. 4/8) (“The Czech Republic, Hungary, the Slovak Republic and Poland have also agreed, in their trade and cooperation agreements with the European

agreements signed by various non-European Mediterranean countries and the EU, oblige the signatories to adopt competition laws modeled on Article 101 (formally 81) and 102 (formally 82) of the Treaty on the Functioning of the European Union (TFEU).³⁵

One of the studies on the adoption competition laws across countries suggests that “the impetus for adopting antitrust laws appears related to the imposed guidelines of supranational bodies, in particular the requirements of the European Union.”³⁶ One reason why the EU has been actively involved in shaping the competition laws of developing countries could be the fact that the EU is an important trading partner and, therefore, it is eager to trade with countries that have similar laws. Another reason could be its race with the US on issues relating to harmonization of competition rules, whereby its influence on the competition laws of developing countries is an attempt to diffuse its laws, which could push the balance in its favor when negotiations on harmonized rules are underway.

It is also worth noting that the EU is not the sole entity to require the adoption of competition laws in its bilateral trade agreements with developing countries. Many Free Trade Agreements have endorsed similar requirements, where parties to these agreements are required to have a domestic antitrust regime in place as one of the main conditions before entering into the agreement.³⁷ Other bilateral and regional free trade agreements have also included chapters on competition policy.³⁸ Finally, several non-governmental organizations have also advocated the adoption of these laws and promoted assistance to countries in their implementation phases.³⁹

Union to adopt and apply competition enforcement policy and procedures similar to those applied by the European Commission and to cooperate on this basis.”)

³⁵ See Euromed Agreements, *supra* note 12.

³⁶ Michael W. Nicholson, *Quantifying Antitrust Regimes* 18 (FTC Working Paper No. 267, 2004).

³⁷ Marcos, *supra* note 9, at 3 (referring to treaties that require parties “to have in place a domestic antitrust regime as one of the main conditions before entering into the agreement.”).

³⁸ See generally D. Daniel Sokol, *Order without (Enforceable) Law: Why Countries Enter into Non-Enforceable Competition Policy Chapters in Free Trade Agreements*, 83 CHI. KENT L. REV. 231 (2008); the multilateral RTAs which include a competition provision, according to the World Trade Organization Database for Regional Trade Agreements, and are relevant to the developing countries studied as the following: Caribbean Community and Common Market (CARICOM), Common Market for Eastern and Southern Africa (COMESA), East African Community (EAC), European Community (EC: 27 Enlargement), North American Free Trade Agreement (NAFTA), Southern African Customs Union (SACU), Southern African Development Community (SADC), Southern Common Market (MERCOSUR), Trans-Pacific Strategic Economic Partnership, and the West African Economic and Monetary Union (WAEMU).

³⁹ E.g., International Competition Network (ICN); International Network of Civil Society Organizations of Competition (INCSOC); Consumer Unit and Trust Society (CUTS); Global Competition Forum by the International Bar Association.

B. *Development Hopes Associated with Adopting Competition Laws*

Development hopes have been crucial in the spread of competition laws. The direct impact of adopting competition laws on prosperity, economic growth, and development is often the reason furnished by these international institutions for developing countries to adopt these laws. The heightened interest in competition law adoption “suggests competition law is widely seen as a desirable and worthwhile economic policy.”⁴⁰ Competition policy has often been regarded as a building block of economic development. A paper of the WTO Working Group described that:

The specific benefits that have been attributed to such policy include promoting an efficient allocation of resources, preventing/addressing excessive concentration levels and resulting structural rigidities, addressing anti-competitive practices of enterprises . . . enhancing an economy’s ability to attract foreign investment and to maximize the benefits of such investment, reinforcing the benefits of privatization and regulatory reform initiating and establishing a focal point for the advocacy of pro-competitive reforms and a competition culture.⁴¹

The United Nations has also advocated, on many instances, that competition policy is a key ingredient for growth and development of nations.⁴² The same position has been taken by the OECD. One of its publications based on a survey of OECD members and non-members asserts that:

There are strong links between competition policy and numerous basic pillars of economic development. . . . There is persuasive evidence from all over the world confirming that rising levels of competition have been unambiguously associated with increased economic growth, productivity, investment and increased average living standards.⁴³

These kinds of assumptions are often backed by empirical studies showing that adopting competition laws lead to higher competition intensi-

⁴⁰ John Preston, INVESTMENT CLIMATE REFORM COMPETITION POLICY AND ECONOMIC DEVELOPMENT: SOME COUNTRY EXPERIENCES, DIFID Case Study for WDR, 2 (Nov. 2003).

⁴¹ World Trade Organization, *supra* note 11, at 19.

⁴² See, e.g., UNITED NATIONS CENTER ON TRADE AND DEVELOPMENT (UNCTAD), THE UNITED NATIONS SET OF PRINCIPLES AND RULES ON COMPETITION, TD/RBP/CONF/10/Rev.2 (2000), <http://unctad.org/en/docs/tdrbpconf10r2.en.pdf>.

⁴³ Organization for Economic Cooperation and Development (OECD), *Implementing Competition Policy in Developing Countries* in PROMOTING PRO-POOR GROWTH: PRIVATE SECTOR DEVELOPMENT 39 (2006).

ties,⁴⁴ which is automatically read to mean higher growth levels. The microeconomic fields of industrial organization and endogenous growth present ample material to show how competition is positively associated with growth. For example, one study argued that competition rules help sustain two of the fundamental ingredients of “economic growth: namely competitive markets and a sound legal system.”⁴⁵ Another study stressed the fact that the adoption of competition policy is “positively correlated with the intensity of competition.”⁴⁶

A further empirical study using multi-country regression analysis to explore the correlation between competition and growth rates found a “strong correlation between the effectiveness of competition policy and growth.”⁴⁷ This study also illustrated that the effect of competition on growth is more than that of “trade liberalisation, institutional quality, and a general favourable policy environment.”⁴⁸ This, however, was found to be predominantly true for Far Eastern countries and less so for other developing countries.⁴⁹

Other proponents of the relationship between adopting competition laws and development argue that competition rules are a precondition to the implementation of successful privatization, especially if the goal of privatization is not the substitution of government monopolies by private ones.⁵⁰ Similarly, another study concluded that liberalization alone does not lead to development since “non-tariff barriers to trade will replace tariffs that trade

⁴⁴ See, e.g., Keith N. Hylton & Fei Deng, *Antitrust Around the World: An Empirical Analysis of the Scope of Competition Laws and Their Effects*, 74 ANTITRUST L. REV. 271 (2007); Hiau Looi Kee and Bernard Hoekman, *Imports, Entry, and Competition Law as Market Disciplines*, 51(4) EUR. ECON. REV. 831, 856 (2007) (“[W]e do find statistical evidence suggesting that competition laws have a significant effect in increasing the number of firms in the longer run, which indirectly lowers industry markups, especially in the highly concentrated markets.”); Michael Krakowski, *Competition Policy Works: The Effect of Competition Policy on the Intensity of Competition - An International Cross-Country Comparison*, HWWA Discussion Paper No. 332 (2005); Mark A. Dutz and Maria Vagliasindi, *Competition Policy Implementation in Transition Economies: An Empirical Assessment*, 44(4-6) EUR. ECON. REV. 762, 765 (May 2000); Michael W. Nicholson, *An Antitrust Law Index For Empirical Analysis of International Competition Policy*, 4(4) J. C. L. & ECON. 1009 (2008).

⁴⁵ Bruce M. Owen, *Competition Policy in Emerging Economies 3* (SIEPR Discussion Paper No. 04-10, 2005).

⁴⁶ Maria Vagliasindi, *Competition Across Transition Economies: An Enterprise-level Analysis of the Main Policy and Structural Determinants* 20-21 (European Bank Working Paper No. 68, 2001).

⁴⁷ Aydin Hayri & Mark Dutz, *Does More Intense Competition Lead to Higher Growth?* 14 (World Bank Policy Research Working Paper No. 2320, 1999).

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ Jean-Jacques Laffont, *Competition, Information, and Development*, in ANNUAL WORLD BANK CONFERENCE ON DEVELOPMENT ECONOMICS 237, 253 (Boris Pleskovic & Joseph E. Stiglitz ed., 1998) (“Privatization and formal liberalization are likely to lead to private monopolies, which will generate resources for interest groups apt to resist further development of authentic competition. Efforts to impose these reforms before a credible set of institutions—regulation, competition policy, financial regulation—has been designed will yield disappointing results.”).

liberalization removes because of the political power of rent-seeking special interest groups.”⁵¹

Some also suggest that having competition legislation will deter corruption in transition economies, where “government bodies have tremendous power to affect the competitive process when they issue licenses, permits, franchises, and subsidies.”⁵² When these economies adopt competition laws some of the powers of government officials might be curbed and their responsiveness to bribes in order to facilitate illicit economic privileges might be reduced. This is assuming that the enforcers of the competition laws will not themselves be susceptible to bribes to avoid antitrust enforcement.

Moreover, competition policy is considered essential for developing countries as a tool to increase foreign direct investment (FDI), which is considered essential for growth.⁵³ Adopting antitrust laws creates a more transparent framework that increases investors’ reliance on the economy and reduces transaction costs.⁵⁴

These are only some of the studies testing the relationship between competition law and development. It is important to note that most of the above-mentioned studies either test the correlation between *adopting* competition laws and development or between a proxy called “effectiveness of anti-monopoly policy”⁵⁵ and development. This is drastically different from studying the relationship between *enforcing* the competition laws and development. The latter *should* be the measure used to ascertain whether competition laws lead to development or not. Studying enforcement instead of adoption will not necessarily lead to the same conclusions. Regardless, developing countries have found the promises of development and growth associated with the adoption of competition laws too hard to ignore.

⁵¹ A. E. Rodriguez & Mark D. Williams, *The Effectiveness of Proposed Antitrust Programs for Developing Countries*, 19 N.C. J. INT’L L. & COM. REG. 201, 211-12. (1994).

⁵² William E. Kovacic, *Institutional Foundations for Economic Legal Reform in Transition Economies: The Case of Competition Policy and Antitrust Enforcement*, 77 CHI.-KENT L. REV. 265, 296 (2001).

⁵³ Simon J. Evenett, *Links Between Development and Competition Law in Developing Countries* 8 (2003).

⁵⁴ Franz Kronthaler, *Effectiveness of Competition Law: A Panel Data Analysis* 7 (IWH-Discussion Papers No. 7, 2007), <http://www.iwh-halle.de/e/publik/disc/7-07.pdf>.

⁵⁵ WORLD ECONOMIC FORUM, THE GLOBAL COMPETITIVENESS REPORT (1997-2011) (the measurement is called “Effectiveness of Anti-Monopoly Policy” and is based on a survey of participants in each country asked to rate, on a scale from 1 (lowest value) to 7 (highest value), whether anti-monopoly policy in their country promotes competition); *id.* at 50 (the Report explains the participants in the survey as follows: “In view of reaching out to business executives at national level, the Forum has established a close collaboration with its network of over 150 Partner Institutes that administer the Executive Opinion Survey in their respective countries. The Partner Institutes are, for the most part, recognized economics departments of national universities, independent research institutes, or business organizations.”).

International organizations and academic studies presenting the positive relationship between competition laws and development were made readily available to developing countries. The studies have shown persuasive conclusions that developing countries eagerly accepted. At the same time, these nations encountered numerous challenges, some structurally due their own positions as developing countries and some related to the discourse that competition laws lead to development and growth. Both of these challenges are discussed next.

III. THE OTHER SIDE OF THE COIN: CHALLENGES TO ANTITRUST ADOPTION

This section addresses some of the recurrent challenges articulated in adopting a competition law. Some of these challenges are due to the idiosyncratic nature of developing countries, yet others are more general critiques to the merits of competition laws.

A. *Limited Resources Need Not Be Wasted on a Costly Competition Regime*

Developing countries face numerous challenges with regard to adopting and enforcing competition rules. At the outset, enacting competition legislation was not always considered a priority on their reform agendas. This is due to the high costs and low returns associated with adopting these rules compared to other reform-oriented policies, such as removing trade restrictions.

One of the common arguments is that trade liberalization yields far greater prosperity than adopting laws that attack restraints of trade. The advocates of trade liberalization, as a substitute for antitrust, argue that the mere removal of trade obstacles, such as tariffs and barriers to entry, will effectively discipline domestic producers in transition economies.⁵⁶ They support the notion that “[f]ree trade is, consequently, the best antitrust policy.”⁵⁷ Also, the argument that “[f]ree trade stimulates wealth creation and

⁵⁶ See Hoekman & Mavroidis, *supra* note 15, at 8 (“[t]he implication of the empirical literature is that liberalization . . . is likely to have a much greater direct impact on competition than antitrust enforcement, especially in smaller economies. Importantly, trade and investment liberalization and deregulation of entry barriers are not costly in administrative capacity and do not require the use of scarce technical expertise.”).

⁵⁷ Robert D. Cooter, *The Theory of Market Modernization of Law*, 16 INT’L REV. L. & ECON 141, 162 (1996).

development, and in a small country it makes antitrust concerns largely irrelevant,"⁵⁸ has been made to caution against adoption competition laws.

Another argument in favor of trade liberalization is that the limited public resources of transition economies would produce better outcomes if invested in initiatives improving the flow of goods. For example, improvement in infrastructure would give consumers access to an increased number of sellers.⁵⁹

Similarly, it is argued that economic policy and competition law enforcement divert the scarce resources away from more important priorities on the path to reform and development. The famous quote from one of the fierce opponents to imposing competition laws on transition economies, Paul Godek, is worth noting: "[e]xporting antitrust to Eastern Europe is like giving a silk tie to a starving man. It is superfluous; a starving man has much more immediate needs. And if the tie is knotted too tightly, he will not be able to eat what little there is available to him."⁶⁰

B. *Plenty of Reforms to Accommodate a Competition Enforcement Apparatus Are Needed*

Related to the criticism of spending scarce resources on adopting and enforcing competition laws is the claim that developing countries need also acquire, reform, or implement administrative apparatuses, effective judiciary and appeal systems, independent investigating authorities, and expertise.⁶¹ Most developing countries lack the aforementioned necessities to enforce antitrust laws. To improve the chances of *effective* antitrust implementation, developing countries need serious reforms in these areas. These are all costly endeavors that would deplete their resources further.

In addition to these challenges, developing countries face further obstacles to competition enforcement due to the lack of data collection, which is especially necessary to define market shares. This is evident by the lack of effective "Statistics Offices" in public administrations that provide this information.⁶² The weakness of professional associations and consumer groups are also considered challenges that stand in the way of creating

⁵⁸ Paul E. Godek, *One U.S. Export Eastern Europe Does Not Need*, 15 REGULATION 20, 20 (Winter 1992).

⁵⁹ Laffont, *supra* note 50, at 256.

⁶⁰ Godek, *supra* note 58, at 21.

⁶¹ Khemani, *supra* note 1, at 2 ("developing countries lack strong supporting institutions such as independent judiciary, good governance, independent media, and professional, well paid civil service."); Owen, *supra* note 45, at 1.

⁶² Reimavuo & Händelin, *supra* note 33, at 5.

awareness and a competition culture that are essential to facilitate the smooth spread and implementation of these laws.⁶³

Given these drawbacks in developing economies, what is ultimately feared is that the enforcement authority to be set up will not be able to apply the competition rules. It will lack the necessary funding, technical staff, and supporting environment to effectively enforce the law. It is also often argued, that in a developing country, an administrative body will often lack the necessary independence that is arguably critical for antitrust enforcement.⁶⁴

C. *Corruption, Government Intervention and Crony Capitalism Hamper Effective Competition Policy*

One of the critical challenges that face developing countries is the already high level of government interference in the economy, which is by default increased further when a competition law is adopted and enforced. The government intervention includes government-erected barriers to enter or exit the market,⁶⁵ government monopolies, the various forms of subsidies granted by governments to loss-making enterprises,⁶⁶ and government politicization of the administrative authorities in force of applying and enforcing the law. In most developing countries, governments play an active role in regulating and setting bureaucratic measures to be followed by firms to enter or exit the market, resulting in many instances in rigid barriers that cannot be surpassed. This in turn leads to rent-seeking behavior, cronyism, corruption, and favoritism.⁶⁷

Adopting a competition law is arguably adding another layer of bureaucratic red tape that needs to be surpassed for firms to operate effectively. Similarly, this criticism amounts to the fear that competition policy will be a tool to provide disguised government control and hamper the growth of the often-fragile private sector.

⁶³ Gesner Oliveira, INTERNATIONAL COOPERATION AND COMPETITION POLICY 7, (Textos para discuss No. 121 São Paulo: Fundação Getulio Vargas 2003).

⁶⁴ See Michal S. Gal, *Reality Bites (or Bits): The Political Economy of Competition Policy in Small Economies* 6-10 (N.Y.U. Law & Econ. Research Paper Series Working Paper No. 06-22, 2006), <http://ssrn.com/abstract=901756> (illustrating the importance of creating autonomous agencies that are independent of the government).

⁶⁵ Cook, *supra* note 30, at 13.

⁶⁶ Vagliasindi, *supra* note 46, at 2.

⁶⁷ Eleanor M. Fox, *Economic Development, Poverty, and Antitrust: The Other Path*, 13 SW. J. L. & TRADE AM. 211, 229-30 (2006-2007) (“Developing countries face markets that are much less dynamic and open than markets in developed countries. Moreover the markets are pock-marked by state intervention and control. Whether the intervention is through state measures, state-owned enterprises, or enterprises licensed or privileged by the state, these enterprises are likely to run on principles of privilege, preference, and cronyism.”).

Developing countries also portray a unique political economy, where often government interests and those of the business elite are one and the same.⁶⁸ This casts serious doubt on whether competition law enforcement will not be selectively used to create further obstacles to those players that are not part of this favored club. It may only entrench the powers of the incumbent firms and those that pay the highest rewards to the government apparatus.⁶⁹ It is often argued that developing economies are enmeshed in a “Kafkaesque maze of control”⁷⁰ where large family owners use their influence to limit competition and obtain finances from the government to alter the game in their favor.⁷¹ The poorly functioning capital markets in many developing countries furthers the concentrated ownership of the local elite even more.

The fear is that incumbent firms use their rents to pay for such selective and biased enforcement, which can often not be matched by new entrants and small firms who want a piece of the pie.⁷² Incumbent firms want to maintain the status quo and resist any potential changes that might lower their influence and position in the market.⁷³

Given this political economy “[a]ntitrust policies affected by political considerations may, however, come with a large price tag attached.”⁷⁴ One of which is that “interest groups will follow their incentives and shift resources into monopolization through government protection. Lobbying the government for protection may be highly substitutable for organizing cartels.”⁷⁵ In other words, producers and incumbents will now invest their

⁶⁸ Daron Acemoglu, et al., *Colonial Origins of Comparative Development: An Empirical Investigation*, 91 AM. ECON. REV. 1369, 1376 (Dec. 2001) (“In many cases where European powers set up authoritarian institutions, they delegated the day-to-day running of the state to a small domestic elite. This narrow group often was the one to control the state after independence and favored extractive institutions.”).

⁶⁹ Khemani, *supra* note 1, at 12 (“Incumbent firms often use their political influence to entrench their market and ownership positions.”).

⁷⁰ Jagdish Bhagwati, *INDIA IN TRANSITION: FREEING THE ECONOMY*, 50 (1993).

⁷¹ Erik Berglöf & Ernst-Ludwig von Thadden, *The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries* 18 (Working Paper No. 263, June 1999), <http://www.hec.unil.ch/deep/textes/9912.pdf> (“[L]arge family owners often use their influence to limit competition, obtain favorable finance from the government and in other ways alter the game in their favor.”).

⁷² Gal, *supra* note 64, at 4 (“Political considerations may, however, tilt the balance towards specific markets or firms or shift the investigation away from them.”); Rodriguez & Williams, *supra* note 51, at 214 (“Theories of endogenous protectionism predict that private domestic interest groups will respond to potential loss of rents by intensifying their lobbying efforts. Higher losses of rents cause proportionately greater lobbying activities.”).

⁷³ Frane Adam & Matevz Tomsic, *Elite (Re)configuration and Politico-Economic Performance in Post-Socialist Countries*, 54(3) EUR-ASIA STUD. 435, 448 (May 2002) (“[S]low implementation of certain reforms which could threaten the monopoly and advantages of the retention elite.”).

⁷⁴ Gal, *supra* note 64, at 1.

⁷⁵ Rodriguez & Williams, *supra* note 51, at 225.

rents in lobbying the government to continue their monopoly positions. Rodriguez and Williams argue that “the gain to interest groups of establishing cartels or price-fixing schemes are outweighed by simply soliciting preferential treatment from the state.”⁷⁶ This implies that “antitrust may cause inefficiencies that are worse than the allocative losses that it is designed to defend against.”⁷⁷ Such bureaucratic capture is assumed to make enforcers not able to serve the public interest.⁷⁸ Nonetheless, arguments using interest group theory to qualify antitrust enforcement are not without their own critiques.⁷⁹

Adding high levels of corruption to the mix, it is predictable that empowering the governments in developing countries with a competition law will lead to even more corruption spent to alter the game in the favor of the local elite and friends of the government at the expense of overall welfare. Such political and bureaucratic resistance is arguably among the main problems facing developing countries in terms of implementing their competition laws and creating a competition culture.⁸⁰

D. *Highly Concentrated and Cartelized Markets Make Competition Enforcement Impossible*

A more pervasive obstacle is found in the market structure of many of these countries. Higher levels of concentration, arguably the most powerful challenge for countries wanting to adopt a competition law, persist in developing and small nations, much more than those in industrialized countries.⁸¹ Few firms dominate many sectors and produce the majority of output. “Outside peasant agriculture and some services, perfect competition, or any recognizable semblance thereof—is typically conspicuous by its

⁷⁶ *Id.* at 231.

⁷⁷ *Id.* at 225.

⁷⁸ Fred S. McChesney & William F. Shughart, *THE CAUSES AND CONSEQUENCES OF ANTITRUST: THE PUBLIC CHOICE PERSPECTIVE* 32 (1995); Rodriguez & Williams, *supra* note 51, at 220 (the authors argue that “[In developing countries] it is the executive branch, not the legislative branch, which tends to be the target of those seeking political favors.”).

⁷⁹ See Einer Elhauge, *The Scope of Antitrust Process*, 104 HARV. L. REV. 667, 725 (1991) (“[A]ny proposal to use capture theory to make *collective* judgments to strike down state law must recognize that those judgments will be made not by wise philosopher-kings (with whose philosophy we all agree) but by judges deciding cases.”).

⁸⁰ Oliveira, *supra* note 63, at 7.

⁸¹ Michal S. Gal, *Size Does Matter: The Effect of Market Size on Optimal Competition Policy*, 74 S. CAL. L. REV. 1437, 1445 (2000-2001) (the author argues that because of the low demand and the need for firms to achieve minimum efficient scale of production (MES) to be able to operate efficiently (at lowest cost), the market will not be able to support more than a few number of firms); Cook, *supra* note 30, at 16 (“Concentration levels are higher in developing countries than in industrialized countries.”).

absence [in developing countries].”⁸² This reality necessarily stands in the way of adopting and enforcing a competition law, especially one that is not favorable towards high concentration levels.

The reasons for these high levels of concentration are numerous, mainly including the high barriers to entry and exit. Developing countries’ industrial policies have often been biased towards restricting entry by imposing strict licensing and financing arrangements on newcomers.⁸³ Moreover, trade regimes in developing countries are often highly protective, thus eliminating foreign competition.⁸⁴ Furthermore, because of the weakness of capital markets in developing countries, investment funds are often internally generated, leading to industrial power being concentrated in the hands of few.⁸⁵

Low demand or purchasing power leads to lowering the number of firms that can efficiently operate in these markets.⁸⁶ For firms to operate efficiently, i.e., be able to exploit minimum efficient scale of production, they need high concentration levels to offset this low demand. Firms with lower market shares operate at sub-optimal levels and are not capable of reaching economies of scale.⁸⁷

Furthermore, concentration levels are also high because of technological underdevelopment in these countries. A firm specializing in a newly developed technology entering these markets will by default occupy a large market percentage. Also, the penetration of multinational companies (MNCs) that have large capital investments and worldwide markets, make competition by local firms impossible. Local firms are incapable of even entering such markets or matching the prices of the MNCs. In some of these developing countries the higher concentration levels are not only due

⁸² Dani Rodrik, *Imperfect Competition, Scale Economies, and Trade Policy*, in *TRADE POLICY ISSUES AND EMPIRICAL ANALYSIS* 109, 111-112 (Robert E. Baldwin ed., 1988) (“In a wide range of manufacturing sectors, a few firms tend to dominate and, one assumes, make liberal use of their market power. Or course, the same could be said for the developed countries as well. It appears, however, that imperfect competition is in fact more pervasive in the industrial sectors of the developing countries than of the developed ones.”); see also Khemani, *supra* note 1, at 9 (“[C]haracteristics of most developing countries are [h]igh levels of domestic product market concentration, barriers to entry and trade, and low degree of interfirm rivalry-competition. While the liberalization of markets for goods and services is on the rise, the inherent structural features of high product market concentration tend to change slowly due to past government policies and interventions such as industrial policy, tariff protection, licensing, preferential procurement, and the like, as well as the relatively small size of domestic markets in most developing economies and underdeveloped capital markets.”).

⁸³ Rodrik, *supra* note 82, at 113.

⁸⁴ *Id.*

⁸⁵ *Id.* (“[I]n many developing countries industrial power is concentrated in the hands of minority ethnic groups, such as the Chinese in Southeast Asia and the Indians in East Africa.”).

⁸⁶ See Gal, *supra* note 81.

⁸⁷ Khemani, *supra* note 1, at 10 (“In a number of economies, high levels of industry or product market concentration may be the result of the small size of the domestic market relative to efficient scale of production, so that there is room for only a few firms.”).

to the MNCs operating, but are also due to the local industrial policies that encourage national champions, protections for infant industries, and higher levels of concentrations of their local firms so that they can compete internationally.

Moreover, because many developing countries were state-run economies, many sectors are still occupied by government monopolies. The new wave of privatization and liberalization only meant that these state monopolies are being sold to private entities that still maintain the monopoly status of the former government-run enterprises. These and other factors, mainly concerned with the political economy discussed above, result in higher concentration levels in developing countries.

Not only are concentration levels high, but the lack of merger regulation in some developing countries also works toward increasing these concentration levels even further.⁸⁸ Even the countries that do have merger regulations in place are found to approve almost all the requested mergers. Finally, some have argued that the extensiveness of high concentration levels is due to the non-enforcement of the adopted antitrust laws.⁸⁹

Having more concentrated markets will hamper competition enforcement by making it very difficult for the antitrust authority to break up some of these dominant firms that abuse the market. It will also impact antitrust enforcement negatively by making cartelization much easier. It is easier for few firms to enter market sharing and price fixing agreements than it is for many firms operating in the same industry. Many studies, predominantly by Fredric Jenny, have shown how the markets in developing countries have and still are witnessing extremely high levels of cartel activity.⁹⁰ These cartels are hard to investigate and will for sure present a challenge for a newly formed competition authority.

⁸⁸ Michal S. Gal, *COMPETITION POLICY FOR SMALL MARKET ECONOMIES* 196 (2003) (“Despite its admitted regulatory importance, until recently merger control has been absent from the competition laws of most small economies. [...] many small economies instead opted for no merger control. This policy was based on the assumption that leaving merger control to the market would produce more efficient results than the absolute value of competition approach. [...] This trend has changed profoundly since the mid-1980s as many small economies have added merger control to their competition policies.”).

⁸⁹ Rodrik, *supra* note 82, at 113 (“Even where antitrust legislation does exist, its implementation is rarely a serious bar to the actions of firms collusively inclined.”); Khemani, *supra* note 1, at 10 (“[High levels of concentration in developing countries] could be attributable to lack of an effective competition law-policy that prevents monopolistic business practices and mergers and acquisitions.”).

⁹⁰ Frédéric Jenny, *Cartels and Collusions in Developing Countries*, Presentation for the Fifth United Nations Conference to Review All Aspects of the Set of Multilaterally Agreed Equitable Principles And Rules For the Control of Restrictive Business Practices, (Antalya, Turkey, 14–18 November 2005) (some of the cartel cases the author presents are: Peruvian chicken cartel, milk processor cartel in Chile, Fish processor cartel on Lake Victoria in Kenya, cotton purchasers cartel in Malawi, cement cartel in the Philippines, cement cartel in Egypt, bus cartel in Jordan, bank cartel in Papua New Guinea, insurance cartel in Turkey); *see also* Jenny, *supra* note 20, at 609.

E. *Competition Enforcement Might Scare Away Limited Foreign Investment*

To discourage developing countries from adopting competition laws, it is often argued that misapplying competition rules would hamper the development of free markets.⁹¹ This argument assumes that poorly enforced competition laws would discourage foreign direct investment (FDI), cross-border mergers and acquisitions, and trade in general.⁹²

Another claim is that international firms will generally reduce their various investment activities in developing countries that have a competition law in place. The assumption is that foreign players prefer lax antitrust enforcement whereby their activities, even if contrary to the competition laws of their home-markets, will go unpunished.⁹³

A similar argument is that price-fixing agreements by domestic firms raise prices, which might encourage foreign firms to enter the nation's market. Thus, enforcing antitrust laws against such price-fixing agreements may discourage the potential inflow of FDIs.⁹⁴ These arguments allege that operating in a country that has a strict competition regime will thus be discouraging for these foreign firms, thereby reducing important capital inflow into developing countries. In this scenario, one can say that developing countries are in a 'race-to-the-bottom' to attract FDIs.

It can be easily argued, however, that such abusive conduct by foreign firms will outdo any benefits associated with these firms operating in the developing country in the first place. Fredric Jenny found that developing countries lose about half of the development aid they receive paying for cartel-infected products and overcharges emanating from foreign firms.⁹⁵ In another study, Levenstein and Suslow reported that in 1997, developing countries imported goods from industries, which had seen a price-fixing conspiracy during the 1990s worth US \$51.1 billion.⁹⁶

⁹¹ Paul E. Godek, *A Chicago-school Approach to Antitrust for Developing Economies*, 43 ANTITRUST BULL. 261, 274 (Spring 1998).

⁹² Laffont, *supra* note 50, at 264; Evenett, *supra* note 53, at 8 (quoting S. Cooke & D. Elliott, *Competition Policy Issues for Developing Asian Economies*, Mimeo Prepared for the OECD).

⁹³ Jenny, *supra* note 20, at 610 (argues that Egyptian cement producers, which to a large extent are foreign cement players, have been engaged in cartel activities in the early 2000s. These foreign players would not have been able to undertake such activities in their home markets, which e.g. for Lafarge would have meant heavy fines imposed by the EU Commission).

⁹⁴ Evenett, *supra* note 53, at 8 (quoting M. Noland, *Competition Policy and FDI: A Solution in Search of a Problem?* (Institute for International Economics Working Paper number 99-3)).

⁹⁵ Jenny, *supra* note 20, at 615 ("[T]he order of magnitude of international aid to development is about US\$50 billion per year. Thus, at a minimum, the existence of anti-competitive trans-national cartels implies transfers (in the form of overcharge) from developing countries to cartel members (mostly from firms in developed countries) which represents at least half of the value of the development aid given by the governments of developed countries to developing countries.")

⁹⁶ Levenstein & Suslow, *supra* note 31, at 816.

Despite these critiques, some authors have continued to argue that aggressive competition law enforcement in a transition or developing economy might be detrimental to investment.⁹⁷ Thus, “[t]aken as a whole, antitrust as practiced in the developed world may have adverse effects on a reform policy in the developing world, and may stunt growth.”⁹⁸

F. *Antitrust is Simply Superfluous for Developing Countries*

Last but not least, the literature discouraging the adoption of competition laws in developing countries is not free from the Chicago School critique against the field of antitrust in general. For example, Richard Posner argues that “[t]oo often the antitrust suits [...] were brought by or on behalf of inefficient competitors against their deservedly more successful rivals.”⁹⁹ Similarly, Robert Bork argued that the competition laws reduce efficiency, since the monopolies they oust are in effect increasing output and leading to the reduction of general prices.¹⁰⁰

According to some economists setting perfect competition as the ideal market structure is an impossible target, and leads to the elimination of research and innovation undertaken by the entrepreneurs, which benefits consumers.¹⁰¹ “Attempts to base antitrust judgments on [these models] necessarily leads to economically absurd cases with harmful social consequences.”¹⁰² Those arguing that higher concentration levels are the drivers for growth shy away from advocating competition laws for the developing world. Many look to the East Asian experiment to prove that perfect competition is not the right path for development.¹⁰³

Although their rhetoric stems from a rejection of the free market, capitalism, and perfect competition as the ideal market structure, arguably all

⁹⁷ A.E. Rodriguez & Malcolm B. Coate, *Limits to Antitrust Policy for Reforming Economies*, 18 HOUS. J. INT’L L. 311, 317 (1996).

⁹⁸ *Id.* at 357.

⁹⁹ Richard Posner, *100 Years of Antitrust*, WALL ST. J., June 29, 1990.

¹⁰⁰ Robert H. Bork, *Goals of Antitrust: A Dialogue on Policy*, 65 COLUM. L. REV. 363, 363 (1965) (“This increased efficiency [achieved with higher concentrations] is valuable to society at large, for it means that fewer of our available resources are being used to accomplish the same amount of production and distribution.”); *id.* at 374 (“And law that makes the creation of efficiency the touchstone of illegality can only tend to impoverish us as a nation.”); *id.* at 375 (“To inhibit the creation of efficiency in order to make life easier for other producers or for would-be entrants is to impose a tax upon efficiency for the purpose of subsidizing the inept.”).

¹⁰¹ Joseph A. Schumpeter, CAPITALISM, SOCIALISM AND DEMOCRACY 106 (3d ed. Harper Prenal, 1962) (“[P]erfect competition is not only impossible but inferior, and has no title to being set up as a model of ideal efficiency.”).

¹⁰² See Dominick T. Armentano, ANTITRUST AND MONOPOLY: ANATOMY OF A POLICY FAILURE 271 (2d ed. 1999).

¹⁰³ See Alice H. Amsden & Ajit Singh, *The Optimal Degree of Competition and Dynamic Efficiency in Japan and Korea*, 38 EUR. ECON. REV. 941 (1994).

elements of the Washington Consensus, their conclusions *uncannily* places them in the same policy framework as the Chicago School advocates. This unholy alliance between those found on the left and the right, is in their rejection of perfect competition and their inclination to accept concentration or bigness as more effective dynamisms of growth and development.

For the left, this stance is in support of a government role to puppeteer such bigness as in the socialist model, and in the belief that dynamic efficiency and innovation is only funded through monopolistic rents. Whereas for the right, their support of bigness is enshrined in their belief that business is entitled to the fruits of their labor and their distrust towards any kind of government intervention.¹⁰⁴ They also believe that innovation is generated through concentration, yet they reject competition policies' infringement on the operations of the free market and the intervention of government regulation in the *invisible hand* of the marketplace. "The entire antitrust system," writes Armentano, "allegedly created to protect competition and increase consumer welfare—has worked, instead, to lessen business competition and lessen the efficiency and productivity associated with the free market process. Like many other governmental interventions, antitrust has produced results that are far different from those that were allegedly intended."¹⁰⁵

Others have based their calls for a narrow scope for antitrust enforcement on the indeterminable nature of many of the antitrust issues *ex ante*. For example, they argue that it is near impossible to know in advance the exact effect a merger would have on prices, whether it will indeed realize its promised efficiencies, what benefits will consumers accrue, etc.¹⁰⁶ Accordingly, "[this] is reason enough to confine the application of merger policy (and competition policy generally) to the narrowest possible scope, in order to minimize the cost to the economy of regulatory errors."¹⁰⁷

Those advocating a lesser critique still do not support the adoption of a full-fledged comprehensive competition legislation in developing countries. They would endorse the prohibitions on naked trade restraints but not on complex issues such as abuse of dominance, mergers, vertical restraints,

¹⁰⁴ Bork, *supra* note 100 and accompanying text.

¹⁰⁵ Armentano, *supra* note 102, at 271.

¹⁰⁶ Douglas H. Ginsburg, *The Goals of Antitrust Revisited: Comments*, 147 J. INSTITUTIONAL & THEORETICAL ECON. 24, 26-27 (1991) ("In the merger context, errors of under-enforcement are surely to be preferred to those of over-enforcement. The self-correcting forces of the marketplace will compensate relatively quickly for any inefficiencies following a merger that proves to be anti-competitive. On the other hand, an error of over-enforcement, which prevents a merger that would have enhanced efficiency, may never be corrected.")

¹⁰⁷ *Id.* at 27-28 ("[T]he ignorance from which we suffer is unavoidable. . . . Increasing the emphasis upon economic analysis cannot, therefore, remedy the situation. . . . Just as quantification may create the illusion of certainty, econometric sophistication may provide the illusion of a scientific method.")

and price discrimination.¹⁰⁸ This is again similar to the minimalist Chicago School view of competition law, which “seems to favor little other than prosecuting plain vanilla cartels and mergers to monopoly.”¹⁰⁹

The effect of these challenges on antitrust enforcement in developing countries is rarely tested, but they certainly affect enforcement in one way or the other. What is undeniable is that they challenge the assumptions of a positive relationship between antitrust and growth that everyone took for granted. What is important to point out is that a real assessment of the impact of competition law on development and growth has to be centered around antitrust enforcement instead of adoption, seeing that adopting a law is nothing but ink on paper if it is not implemented. Few have assessed the impact of antitrust enforcement on growth in developing countries, which is necessary to conclude on the merits of such laws with regard to development. Such an analysis would also help discern the impact the challenges laid out here have with regard to implementing competition laws and realizing the promised prosperity.

Given these challenges and despite the lack of agreement on whether competition laws are beneficial or detrimental to developing countries, the reality is that the majority of developing countries have today a competition law in place. As explained before, many of those countries did not choose to adopt antitrust laws based on their own free will, yet, arguably they did have a choice as to how to draft their laws. This will be addressed next in conjunction with arguments that due to these challenges, developing countries need different laws than those developed in the West.¹¹⁰

IV. TYPES OF COMPETITION LAWS ADOPTED BY DEVELOPING COUNTRIES

Developing countries adopted Western-inspired competition legislations. They did not take into account the evolution of these laws within their own origin countries. Instead, they looked to the most advanced versions of these laws. If a historic outlook was taken, a similar approach to transplanting Western law would have resulted in a very different competition legislation. Both competition law and policy in Europe and in the U.S. transformed itself over time to suit locally changing circumstances. For example, at one point in the development of European competition law and

¹⁰⁸ Laffont, *supra* note 50, at 256 (“Although even more desirable in developing countries, the U.S.-type competition policy with its armada of lawyers and economists is not affordable or even implementable. The design of a body of simple and transparent rules for developing countries, in particular for horizontal collusion and abuse of dominant position, remains, I believe, a worthy task.”).

¹⁰⁹ Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696, 1701 (1986).

¹¹⁰ For a similar analysis see Gal, *supra* note 88 (the author argues that the distinctive nature of “smallness”, which is characterized by high industrial concentration, high entry barriers and sub-optimal levels of operation, justifies that these small nations adopt competition laws different from the advanced world).

policy in the 1980s, the European Commission (EC) approved a ‘crises cartels’ to protect local production and shield it against foreign imports.¹¹¹ A practice frowned upon in modern competition laws and policies of the West.

In the 1990s, when developing countries looked to Western competition laws to draft their own, they looked to the most recent versions of these laws. They did that thanks to the push of the international organizations and their own belief that they need to adopt the most advanced, state-of-the-art, model laws. They ended up with a law and competition policy that:

[A]ssumes large numbers of participants in all markets, no public goods, no externalities, no informational asymmetries, complete markets, no natural monopolies or, more generally, convexity of technologies in addition to full rationality of economic agents, a benevolent court system to enforce contracts, and a benevolent government with lump sum transfers to achieve any desirable redistribution. *Developing economies are of course very far from this ideal world*, and the policy question “Should competition be encouraged in developing countries?” must be raised in a more realistic framework.¹¹²

One can easily argue that developing countries face unique conditions and challenges, which require their competition laws to address their local needs. It is well established that in order for obeying laws to become less costly, moral and social norms need to align with state law.¹¹³ If this is the case, then abiding by the law will not only be out of respect and fear, but also social condemnation.¹¹⁴ This mode of the rule of law facilitates economic development.¹¹⁵ The role of law in a society can only be understood by looking at its cultural and political environment, in order to prevent the failure of legal reforms.¹¹⁶

Mere transplantation of laws does not properly address the legal culture and desired outcomes in each country. Transplanted laws must be adapted to the local circumstances for them to be effective, and also to en-

¹¹¹ European Commission Decision 84/380/EEC of 4 July 1984, *Synthetic fibres*, OJ 1984, L 207/17.

¹¹² Laffont, *supra* note 50, at 237 (emphasis added).

¹¹³ Robert D. Cooter, *The Rule of State Law and the Rule-of-Law State: Economic Analysis of the Legal Foundations of Development*, Annual World Bank Conference on Development Economics 191, 192 (1997), http://works.bepress.com/robert_cooter/48.

¹¹⁴ *Id.*

¹¹⁵ *Id.* at 193-201 (this is empirically tested in a study the author conducts where he explores the relationship between state law, effective law, and economic development by using a model of social norms that explains how the internalization of norms strengthens people’s willingness to punish violators informally).

¹¹⁶ Anthony Ogus, *The Importance of Legal Infrastructure for Regulation (And Deregulation) in Developing Countries 4*, (Center on Regulation and Competition Working Paper Series No. 65, 2004).

sure that the legal institutions needed to enforce them will develop.¹¹⁷ If transplanted laws are not tailored to the local environment and their subject made familiar to the local population, then the laws will be not be effective.¹¹⁸ One of the focal problems with this diffusion of law movement is put forward in the following quotation:

Where law develops internally through a process of trial and error, innovation and correction, and with the participation and involvement of users of the law, legal professionals and other interested parties, legal institutions tend to be highly effective. By contrast, where foreign law is imposed and legal evolution is external rather than internal, legal institutions tend to be much weaker.¹¹⁹

The meaning of a transplanted rule does not survive the journey from one legal culture to the other since “the deep structures of law, legal cultures, legal mentalities, legal epistemologies, and the unconsciousness of law as expressed in legal mythologies, remain historically unique and cannot be bridged.”¹²⁰ Therefore, developing countries are often encouraged to develop their own competition laws that address their domestic environment and challenges.¹²¹

Some have argued that for developing countries, the competition policies of the advanced world are not appropriate for their current development stage.¹²² It is alleged that if developing countries adopt modern competition policies followed by the more advanced nations, they would not be able to implement them. This is a recurrent statement and leads to the argument that developing countries fail to enforce their competition laws,

¹¹⁷ Daniel Berkowitz et al., *Economic Development, Legality, and the Transplant Effect*, 51 AM. J. COMP. L. 163, 168 (2003).

¹¹⁸ *Id.*

¹¹⁹ *Id.* at 189-90 (“Our empirical analysis offers strong support for these propositions. Receptive transplants, i.e., those that adapted the imported law, or had a population that was familiar with it show legality ratings that are statistically no different from those of origin countries. Countries without similar predispositions, i.e. unreceptive transplants, perform much worst. These countries suffer from the transplant effect.”).

¹²⁰ Gunther Teubner, *Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences*, 61 MOD. L. REV. 11, 14 (1998).

¹²¹ Eleanor M. Fox, *Competition, Development and Regional Integration: In Search of a Competition Law Fit for Developing Countries 2*, (N.Y.U. Law and Economics Research Paper No. 11-04, 2011), <http://ssrn.com/abstract=1761619> (“[D]eveloping countries must develop their own brand of competition law, resisting pressures to copy ‘international standards’ without regard to fit.”); see also Gal, *supra* note 64, at 11.

¹²² Singh & Dhumale, *supra* note 17, at 9; Fox, *supra* note 24, at 593 (“The design and use of competition law for the developing world is complex. The experience of mature market economies is highly useful but may not be wholly transferable. While the American determination not to mix equality with efficiency may work for the United States in the year 2000, it may not be an obvious truth for the world.”).

partially because of the laws' inadequate fit for their own needs. They will not be able to overcome the challenges mentioned above, which will hinder their ability to apply these laws effectively.

Eleanor Fox has, however, discouraged the notion that each nation entirely invents its own wheel.¹²³ She argues that “[t]he “idiosyncratic” option would produce such atomization of law that it is not seriously offered.”¹²⁴ This will produce a huge cost and might negatively impact a county’s ability to attract investment.¹²⁵ She argues that a combination is the most desirable formula, for example:

“[The] competition-law principles of the South African case-law, informed by EU law, may comprise the best available anchor, on grounds that this set of laws best incorporates the Spence principle of inclusive development while also incorporating important insights of the revised Washington Consensus; and it does so in a way that respects the problem of seriously limited resources.”¹²⁶

She also encourages incorporating competition rules as part of regional agreements.¹²⁷

Despite the calls for drafting special competition laws in developing countries, or at least to modify them to incorporate some local flavor, the reality is very different. Most developing countries adopt laws that do not address their particular conditions, needs, and challenges.¹²⁸ “One size fit all” models of competition laws have spread across the world.¹²⁹ Studies looking at competition laws on the books of many countries conclude that the laws enacted in the developing world are quite similar to those adopted in developed countries.¹³⁰

This similarity is ascertained when looking at studies allocating scores to the presence of key issues of competition features in national laws. These studies measure the comprehensiveness of the breadth of the overall competition law on the books. Two such studies are used to compare the laws on the books across countries. In the first, the “Scope Index” is devel-

¹²³ Fox, *supra* note 121, at 14.

¹²⁴ *Id.*

¹²⁵ *Id.* at 15.

¹²⁶ *Id.* at 19.

¹²⁷ *Id.* at 15-19 (“[C]ompetition law on the regional level holds much promise. The expectation and promise of effective regional competition law may be greater than its delivery in the near term. But for the longer term, the project is vital.”).

¹²⁸ Khemani, *supra* note 1, at 26 (“The competition laws in most developing countries mirror and contain the core provisions found in such legislation in industrial countries.”).

¹²⁹ Gal, *supra* note 81, at 1441 (“The main factor that creates the need to tailor competition law to economic size is that competition laws generally consist of “fit all” formulations that are designed to best achieve the goals of the law in each category of cases to which they apply . . .”).

¹³⁰ Hylton & Deng, *supra* note 44; Nicholson, *supra* note 44.

oped by Hylton and Deng¹³¹ and in the second, the “Antitrust Law Index” is developed by Nicholson.¹³²

Both measurements show strikingly similar scores in developed and developing countries, which can be read to mean that their competition laws are not only very similar but almost identical. For example, in Nicholson’s study, the highest score (21) is given to the U.S., followed by Ukraine (20), then Turkey (19), then Belgium, Latvia, Poland, and Romania (18).¹³³ According to the “Scope Index” the highest score of 25 is allocated to Australia, Barbados, Belarus, Malawi, and the US.¹³⁴ These are followed by a score of 24 allocated to Hungary, Korea, and Kyrgyzstan.¹³⁵ And a score of 23 is given to Indonesia, Mexico, Spain, Ukraine, U.K., and Uzbekistan¹³⁶ (Table A.2 summarizes both sets of scores for developing countries).

When looking at these studies, competition laws on the books are relatively similar in both the developed and developing world. Thereby, the law does not differ depending on the developmental status of a country. Both Malawi’s and Australia’s competition laws have the same breadth, which is enough to show that advanced laws are simply transplanted without significant changes needed to make the law fit local circumstances. This challenges the assumption that laws are enacted to address unique concerns. A close reading of the competition laws of developing countries will show striking similarities with either the U.S. enforcement guidelines or Articles 101 and 102 of the TFEU. These results suggest further that developing countries model their laws on those adopted in the West. It is important to note that the fact that the law is similarly drafted does not mean that they are similarly enforced.

Given this unsettling reality about antitrust laws being cut-and-pasted from advanced countries into developing countries, the only choice that developing countries do have is in setting the overall policy that guides their enforcement. They can choose how to implement these laws, what to promote as their enforcement goal, and how to realize it.¹³⁷ This should be a priority to be addressed by developing countries so that they can contain the setbacks that usually ensue when a country adopts a law that is not suitable for its own needs. This is essential to assure that competition laws do not become one more Western-imposed piece of legislation that has no teeth or that hurdles their attempts at development further.

¹³¹ Hylton & Deng, *supra* note 44.

¹³² Nicholson, *supra* note 44.

¹³³ *Id.* at 1022.

¹³⁴ Hylton & Deng, *supra* note 44, at 332.

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ See Dina I. Waked, *Antitrust Goals in Developing Countries: Policy Alternatives and Normative Choices*, 38 SEATTLE U. L. REV. 945 (2015).

CONCLUSION

This paper provided an in depth analysis of the spread and motives to adopt competition laws across the developing world. It showed that in some instances, competition laws have been adopted over the course of many years in response to local pressures, in order to mend behaviors, imposing social costs on societies. Many of the ills stemming from the ne-liberal reforms undertaken in these countries were promised to be repaired when competition laws were to be adopted. Competition laws were advocated as essential to realize the benefits of these reforms and to achieve growth and development. In other instances, competition laws were adopted following recommendations and conditionality clauses in treaties and international loans. Most developing countries either adopted competition rules in response to such recommendations of international institutions or because of various obliging treaties they signed.

In an attempt to benefit from the experiences of countries preceding them in enacting competition rules and so not to reinvent the wheel, newly adopting countries passed rules modeled on the legislations of developed nations. This mode of adopting competition rules does not always address local needs, legal institutions, or general conceptions of the rule of law. Adopting laws that are not specifically tailored to address the local challenges, which are discussed in the paper in some detail, has often been discouraged. This led many to assume that these laws will never be enforced.

Whether developing countries do enforce their laws, what they aim at achieving with their implementation and what they should target to achieve growth and development are issues that are scarcely addressed in the literature.¹³⁸ This paper provides a starting point to be further extended to address these questions, which are essential to capture a realistic picture of developing countries' experiences with antitrust laws.

¹³⁸ These question are addressed in Waked, *supra* note 137 and other forthcoming articles.

APPENDIX

FIGURE A. 1. TIME LINE OF ADOPTING COMPETITION LAWS IN THE DEVELOPING WORLD

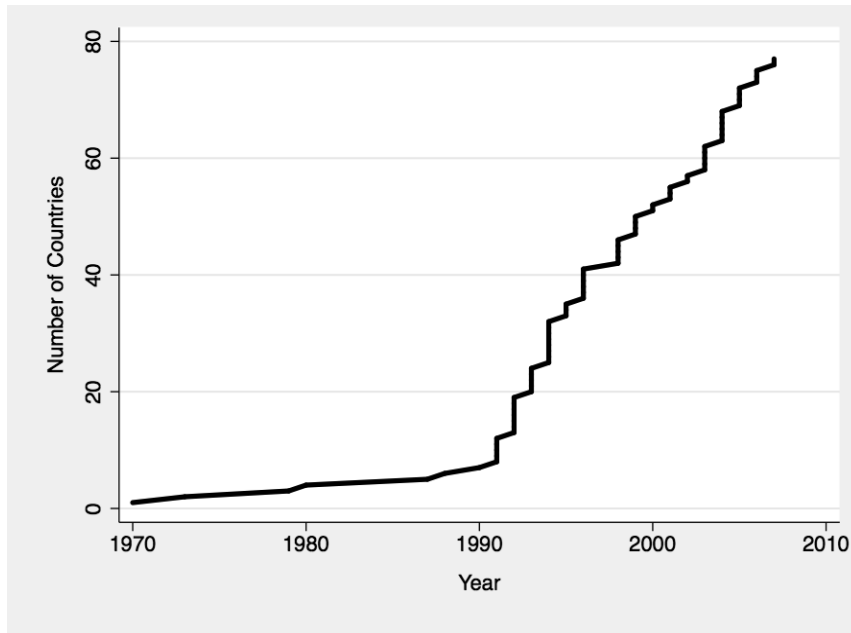


FIGURE A.2. GEOGRAPHICAL DISTRIBUTION OF DEVELOPING COUNTRIES WITH COMPETITION LAWS

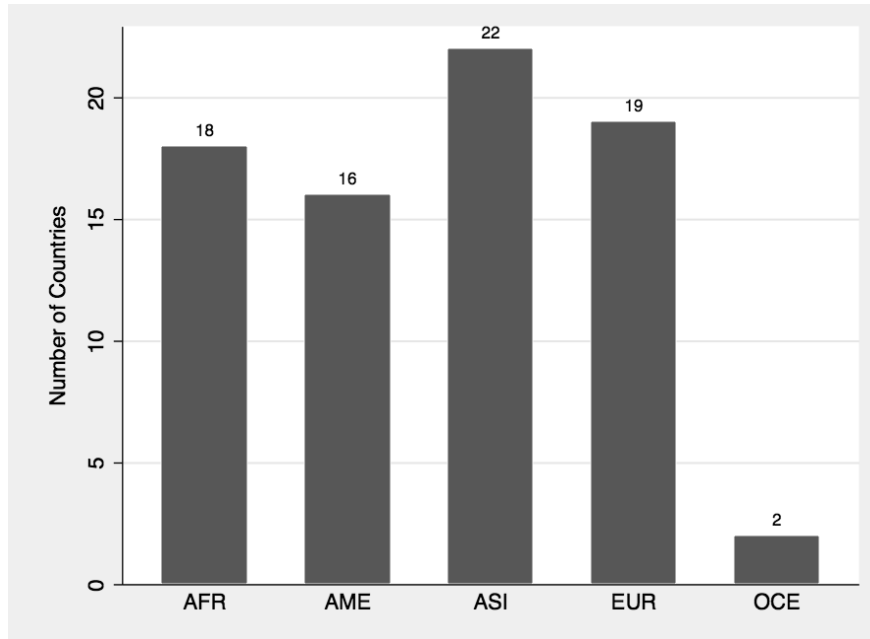


TABLE A.1. BREAKDOWN OF DEVELOPING COUNTRIES WITH A COMPETITION LAW BY 2007*

##	Country	Region	Year of Adoption	Income Group ¹	##	Country	Region	Year of Adoption	Income Group ¹
1	Albania	Europe	1995	LM	40	Mali	Africa	1992	Low
2	Algeria	Africa	1995	UM	41	Mauritius	Africa	2003	UM
3	Argentina	Americas	1980	UM	42	Mexico	Americas	1992	UM
4	Armenia	Asia	2000	LM	43	Moldova	Europe	1992	LM
5	Azerbaijan	Asia	1993	LM	44	Mongolia	Asia	1993	LM
6	Barbados	Americas	2002	IMF ^a	45	Montenegro	Europe	2005	UM
7	Belarus	Europe	1992	UM	46	Morocco	Africa	2001	LM
8	Herzegovina	Bosnia & Europe	2001	UM	47	Namibia	Africa	2003	UM
9	Brazil	Americas	1994	UM	48	Nepal	Asia	2007	Low
10	Bulgaria	Europe	1998	UM	49	Nicaragua	Americas	2006	LM
11	Burkina Faso	Africa	1994	Low	50	Pakistan	Asia	1970	LM
12	Cameroon	Africa	1998	LM	51	Panama	Americas	1996	UM
13	Chile	Americas	1973	UM	52	Papua New Guinea	Oceania	2002	LM
14	Colombia	Americas	1992	UM	53	Peru	Americas	1991	UM
15	Costa Rica	Americas	1994	UM	54	Philippines	Asia	1992	LM
16	Cote d'Ivoire	Africa	1991	LM	55	Poland	Europe	1990	UM
17	Croatia	Europe	1995	IMF	56	Romania	Europe	1996	UM
18	Czech Republic	Europe	1991	IMF	57	Russia	Europe	1991	UM
19	Egypt	Africa	2005	LM	58	Saudi Arabia	Asia	2004	IMF
20	El Salvador	Americas	2006	LM	59	Senegal	Africa	1994	Low
21	Estonia	Europe	1993	IMF	60	Serbia	Europe	2005	UM
22	Ethiopia	Africa	2003	Low	61	Slovakia	Europe	1994	IMF
23	Fiji	Oceania	1998	UM	62	South Africa	Africa	1979	UM
24	Georgia	Asia	1996	LM	63	Sri Lanka	Asia	1987	LM
25	Guyana	Americas	2004	LM	64	Syrian Arab Republic	Asia	2007	LM
26	Honduras	Americas	2005	LM	65	Tajikistan	Asia	2004	Low
27	Hungary	Europe	1996	IMF	66	Tanzania	Africa	2003	Low
28	India	Asia	2003	LM	67	Thailand	Asia	1999	LM
29	Indonesia	Asia	1999	LM	68	Tunisia	Africa	1991	LM
30	Jamaica	Americas	1993	UM	69	Turkey	Asia	1994	UM
31	Jordan	Asia	2004	LM	70	Ukraine	Europe	1993	LM
32	Kazakhstan	Asia	2001	UM	71	Uruguay	Americas	2000	UM
33	Kenya	Africa	1988	Low	72	Uzbekistan	Asia	1996	Low
34	Kyrgystan	Asia	1994	Low	73	Venezuela	Americas	1992	UM
35	Lao, PDR	Asia	2004	Low	74	Vietnam	Asia	2004	Low
36	Latvia	Europe	1998	UM	75	Yemen	Asia	1999	Low
37	Lithuania	Europe	1999	UM	76	Zambia	Africa	1994	Low
38	Macedonia	Europe	2006	UM	77	Zimbabwe	Africa	1996	Low
39	Malawi	Africa	1998	Low					

* *Source:* Global Competition Forum, World Bank Competition Law Database, World Bank Atlas Method, IMF World Economic and Financial Surveys.

¹ Income group according to the World Bank Atlas Method or IMF when indicated. Upper Middle (UP), Lower Middle (LM), and IMF Developing (IMF).

^a IMF: Developing: High Income Economies according to the World Bank, but considered developing according to the IMF 2009 classification.

FIGURE A.3. PERCENTAGE OF DEVELOPING COUNTRIES WITH AND WITHOUT A COMPETITION LAW IN DIFFERENT REGIONS

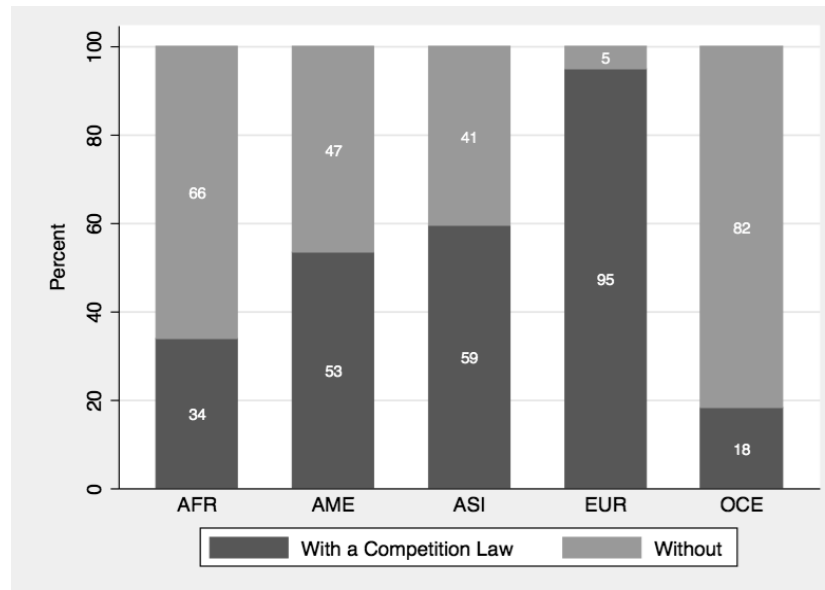


FIGURE A.4. DEVELOPING COUNTRIES' INCOME DISTRIBUTION BY REGION

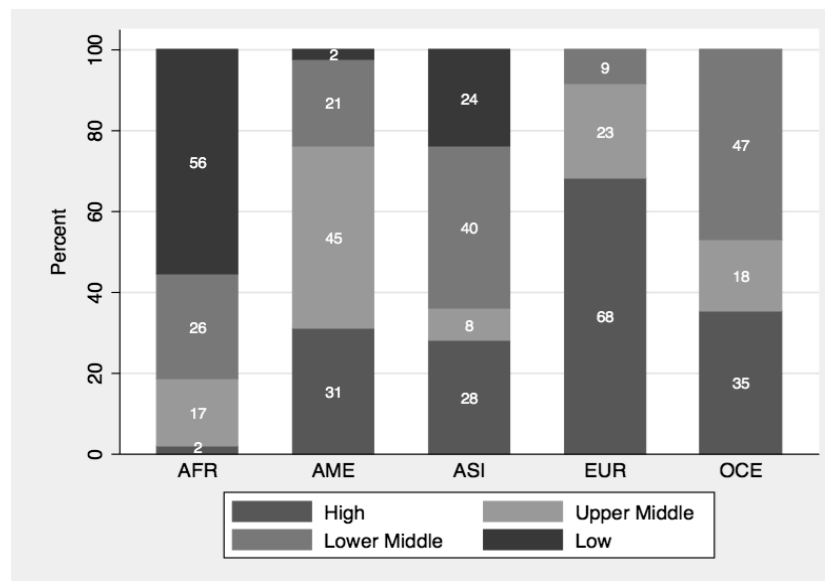
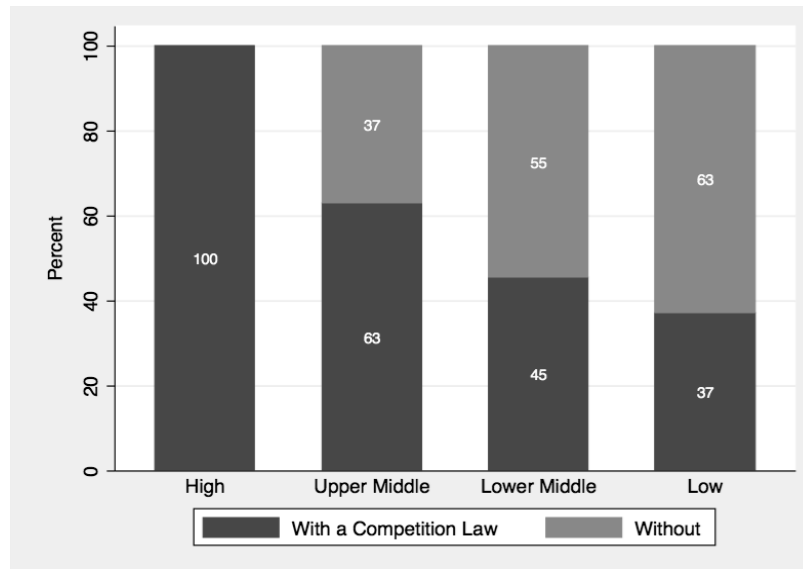


FIGURE A.5. PERCENTAGE OF DEVELOPING COUNTRIES WITH AND WITHOUT A COMPETITION LAW BY INCOME*



* High income economies yet considered developing according to the IMF.

FIGURE A.6. PERCENTAGE OF DEVELOPING COUNTRIES WITH AND WITHOUT A COMPETITION LAW BY INCOME GROUP AND REGION*

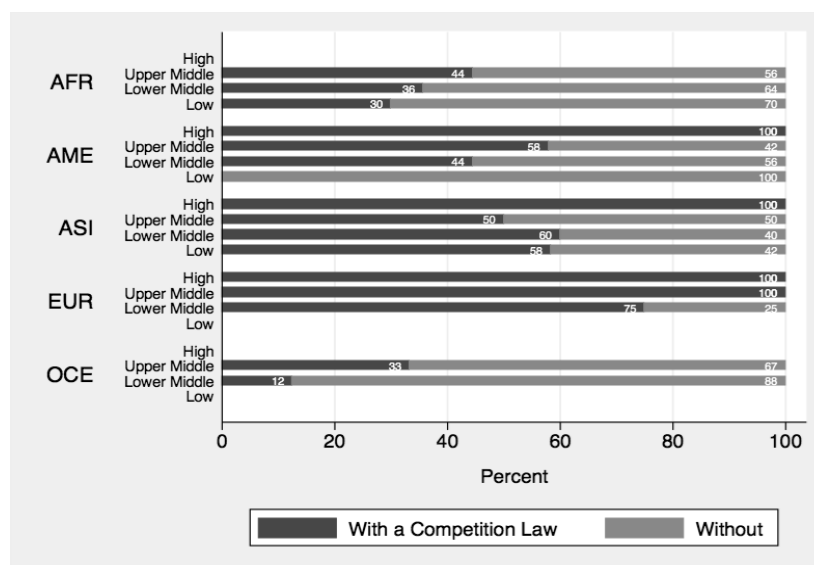


TABLE A.2. LAWS ON THE BOOKS INDICES (FORMAL ENFORCEMENT)**

Country	Scope Index ^a	Antitrust Law Index ^b	Country	Scope Index ^a	Antitrust Law Index ^b
Albania	20	N/A	Moldova	22	N/A
Algeria	15	N/A	Mongolia	18	N/A
Argentina	25	17	Montenegro	19	N/A
Armenia	17	12	Morocco	17	N/A
Azerbaijan	20	N/A	Namibia	22	N/A
Barbados	25	N/A	Nepal	N/A	N/A

* High here once again refers to those countries that are considered high income economies according to the World Bank but are classified as developing according to the IMF.

** Source: Hylton & Deng for the Scope Index; and Nicholson for the Antitrust Law Index.

^a Scope Index (Hylton & Deng): the score is allocated to the latest competition law (including the latest amendments).

^b Antitrust Law Index (Nicholson): for laws in effect in 2003.

Belarus	25	N/A	Nicaragua	20	N/A
Benin	N/A	N/A	Pakistan	14	N/A
Bosnia & Herzegovina	21	N/A	Panama	21	10
Brazil	22	11	Papua New Guinea	13	N/A
Bulgaria	20	N/A	Peru	12	13
Burkina Faso	15	N/A	Philippines	N/A	N/A
Cameroon	17	N/A	Poland	22	18
Chile	13 ^c	4	Romania	22	18
China	23	N/A	Russia	22	N/A
Colombia	19	N/A	Saudi Arabia	20	N/A
Costa Rica	18	11	Senegal	15	N/A
Cote d'Ivoire	12	N/A	Serbia	19	N/A
Croatia	20	15	Slovak Republic	19	16
Czech Republic	20	14	South Africa	24	17
Egypt	13	N/A	Sri Lanka	8	10
El Salvador	18	N/A	Syria	24	N/A
Estonia	21	15	Tajikistan	20	N/A
Georgia	0	N/A	Tanzania	16	N/A
Guyana	15	N/A	Thailand	21	13
Honduras	20	N/A	Tunisia	14	10
Hungary	25	N/A	Turkey	21	19
India	22	N/A	Ukraine	23	20
Indonesia	23	13	Uruguay	22	N/A
Jamaica	20	10	Uzbekistan	26	17
Jordan	23	N/A	Venezuela	13	14
Kazakhstan	24	N/A	Vietnam	22	N/A
Kenya	18	16	Yemen	N/A	N/A
Kyrgyzstan	24	N/A	Zambia	20	14
Lao PDR	13	N/A	Zimbabwe	23	N/A
Latvia	21	18			

^c The SI for Chile is still under construction as it is missing the codification of the merger regulations

THE OVERALL FINANCIAL INTEREST
OF INDIVIDUALS WITH DISABILITIES:
JUSTIFYING THE MOTIVATING FACTOR STANDARD

Elizabeth Dalton

INTRODUCTION

In 1990, Congress enacted the Americans with Disabilities Act (ADA) to address the various forms of discrimination against individuals with disabilities.¹ The ADA is comprised of five titles that each aim to combat critical areas of discrimination. Title I of the ADA specifically focuses on employment discrimination and aims to address persistent unemployment amongst individuals with disabilities.²

When Congress introduced the ADA in 1988, sixty-six percent of Americans with disabilities wanted to work but did not have a job.³ In 2010, twenty years after the ADA was enacted, forty-one percent of individuals with disabilities still reported difficulty gaining or retaining employment.⁴ In 2013, sixty-four percent of people over the age of sixteen had a job but only eighteen percent of individuals with disabilities were employed.⁵ Individuals with disabilities also typically earn less, work fewer hours, and occupy lower level positions than those without disabilities.⁶ In 2010, a study conducted for the Kessler Foundation and the National Organization on Disability to explore the attitudes of employers towards employees with disabilities revealed that while more than half of the employ-

¹ The Americans with Disabilities Act (ADA) of 1990 (42 U.S.C. §§12101-12213 (2008)).

² Michelle Maroto & David Pettinicchio, *The Limitations of Disability Antidiscrimination Legislation: Policymaking and the Economic Well-being of People with Disabilities*, 36 LAW & POLICY 370, 370 (2014).

³ Lisa Schlesinger, *The Social Model's Case for Inclusion: "Motivating Factor" and "But For" Standards of Proof Under the Americans with Disabilities Act and the Impact of the Social Model of Disability on Employees with Disabilities*, 35 CARDOZO L. REV. 2115, 2116 n.3 (2014) (noting that "according to Senate reports prior to the ADA's passing, '[t]wo-thirds of all disabled Americans between the age of 16 and 64 are not working at all; yet, a large majority of those not working say that they want to work. Sixty-six percent of working-age disabled persons, who are not working, say that they would like to have a job'").

⁴ *Id.* at 2116.

⁵ Maroto & Pettinicchio, *supra* note 2, at 371 (citing U.S. Bureau of Labor Statistics 2013) (data from 2012); see also U.S. DEPT. OF LABOR, U.S. BUREAU OF LABOR STATISTICS HANDBOOK OF METHODS 1-2 (Bureau's Division of U.S. Bureau of Labor Statistics Publishing, Office of Publications and Special Studies, 2009), <http://www.bls.gov/opub/hom/pdf/homch1.pdf> (defining "working age" as sixteen and above).

⁶ Maroto & Pettinicchio, *supra* note 2, at 371.

ers surveyed stated that they were willing to hire an individual with a disability, individuals with disabilities accounted for only two percent of new hires.⁷ These statistics reflect the lackluster effect of the ADA on the employment of individuals with disabilities. Given that the ADA is the most “effective weapon” to combat discrimination on the basis of disability,⁸ it remains questionable why Title I has not had a significant effect on the employment of individuals with disabilities.

The ADA is a flawed statute for two reasons. First, the ADA does not contain a uniform causation standard. The congressional intent of the ADA was explicit: “to provide a clear and comprehensive national mandate” to end discrimination against individuals with disabilities and to institute “clear, strong, consistent, enforceable standards addressing discrimination against individuals with disabilities.”⁹ While the purpose of the ADA was to implement a clear path to end discrimination, the drafters of the ADA did not specify a clear causation standard and, thus, there is no uniform causation standard for employment discrimination cases under the ADA.¹⁰ The causation standards are the threshold under which the ADA plaintiff must prove their employer has discriminated against them because of their disability in violation of the ADA.¹¹ There is a circuit split between the “motivating factor” (adopted by the First,¹² Second,¹³ Third,¹⁴ Fourth,¹⁵ Fifth,¹⁶ Eighth,¹⁷ and Ninth¹⁸ Circuits) and the harder to prove “but for” standard (adopted by the Sixth,¹⁹ Seventh,²⁰ Tenth,²¹ and Eleventh²² Circuits). Under

⁷ Harris Interactive, Kessler Foundation/ NOD Survey of Employment of Americans with Disabilities 8 (2010), <http://www.2010disabilitysurveys.org/octsurvey/pdfs/surveyresults.pdf>.

⁸ Samuel R. Bagenstos, *Has the Americans with Disabilities Act Reduced Employment for People with Disabilities*, 25 BERKELEY J. EMP. & LAB. L. 527, 560 (2004).

⁹ 42 U.S.C. §12101(b)(1)-(2) (2008).

¹⁰ Schlesinger, *supra* note 3, at 2116-17.

¹¹ See Seam Park, *Curing Causation: Justifying a Motivating-Factor Standard under the ADA*, 32 FLA. ST. U. L. REV. 257, 257-58 (2004).

¹² See, e.g., *Katz v. City Metal Co.*, 87 F.3d 26, 33 (1st Cir. 1996).

¹³ See, e.g., *Parker v. Columbia Pictures Indus.*, 204 F.3d 326, 336-37 (2d Cir. 2000).

¹⁴ See, e.g., *Shellenberger v. Summit Bancorp, Inc.*, 318 F.3d 183, 187-88 (3d Cir. 2003).

¹⁵ See, e.g., *Baird ex rel Baird v. Rose*, 192 F.3d 462, 470 (4th Cir. 1999).

¹⁶ See, e.g., *Pinkerton v. Spellings*, 529 F.3d 513, 519 (5th Cir. 2008).

¹⁷ See, e.g., *Pedigo v. P.A.M. Transp., Inc.*, 60 F.3d 1300, 1301 (8th Cir. 1995).

¹⁸ See, e.g., *Head v. Glacier Nw., Inc.*, 413 F.3d 1053, 1063-65 (9th Cir. 2005).

¹⁹ See, e.g., *Lewis v. Humboldt Acquisition Corp., Inc.*, 681 F.3d 312, 313 (6th Cir. 2011).

²⁰ See, e.g., *Serwatka v. Rockwell Automation, Inc.*, 591 F.3d 957, 962 (7th Cir. 2010).

²¹ See, e.g., *Bones v. Honeywell Int'l, Inc.*, 366 F.3d 869, 878 (10th Cir. 2004).

²² Whether the Eleventh Circuit follows the “but for” standard is debatable. See, e.g., *McNely v. Ocala Star-Banner Corp.*, 99 F.3d 1068, 1077 (11th Cir. 1996). The court stated that “but for” is the correct standard but the court’s language was more compatible with the “motivating factor” standard. *Id.* However, even though the language in the Eleventh Circuit is more compatible with the “motivating factor” standard, the Sixth Circuit has confirm that the Eleventh Circuit does follow the “motivating factor” standard. See *Lewis v. Humboldt Acquisition Corp.*, 681 F.3d 312, 324-25 (6th Cir. 2012).

the motivating factor standard, ADA plaintiffs only have to prove that discrimination on the basis of their disability was one of the factors for the adverse employment action.²³ In other words, at the time of the adverse employment decision, if one of the reasons for the adverse employment decision was that the applicant or employee was an individual with a disability, then disability was a motivating factor in the employment decision.²⁴ Whereas, under the but for standard, the ADA plaintiffs must prove that but for the disability discrimination, the adverse employment action would not have occurred.²⁵ To put it differently, the “discrimination was a necessary factor for the negative employment result that occurred.”²⁶ While a majority of the circuits have adopted the motivating factor standard, there is no uniform causation standard under the ADA.

Second, the statute does not adequately address the concerns of employers about their liability under the law and thus an unintended consequence of the ADA is that individuals with disabilities are less desirable employees. A subsequent purpose of the ADA was to address, “the declining economic well-being of people with disabilities.”²⁷ The ADA prohibits employers from discriminating against individuals with disabilities and imposes affirmative obligations on employers. As such, it costs more for employers to hire, retain, and/or terminate an employee with a disability.

And these flaws are interconnected. Under the Social Model of Disability framework, the “motivating factor” standard should be the universal or preferred causation standard because of the long-term benefits to all individuals with disabilities that coincide with a stronger enforcement of the ADA. However, universal adoption of the “motivating factor” standard may fuel the unintended consequence of the ADA that individuals with disabilities are less desirable employees.

Part I of this Comment will explore the background of the ADA and why the various causation standards under the ADA is currently a pressing issue. Part II will examine the affirmative obligations placed upon employers under Title I of the ADA and the subsequent unintended consequences of the ADA. Part II will also analyze how the ADA’s prohibition against discrimination on the basis of disability combined with the affirmative obligations placed upon employers results in the unintended consequence of making individuals with disabilities less desirable employees than those without disabilities. Part III will consider that the “motivating factor”

(stating that other circuits have adopted the “motivating factor” standard and then citing *McNely* which is supposed to follow the “but for” standard).

²³ *Park*, *supra* note 11, at 258; *see also* *Schlesinger*, *supra* note 3, at 2124.

²⁴ *See* MICHAEL J. ZIMMER, ET AL., *CASES AND MATERIALS ON EMPLOYMENT DISCRIMINATION* 82-83 (Vicki Been et al. eds., 6th ed. 2013).

²⁵ *See* *Gross v. FBL Fin. Servs., Inc.*, 557 U.S. 167, 168 (2009) (defining “but for” causation).

²⁶ *Schlesinger*, *supra* note 3, at 2123 n.51 (noting the definition of “but for” causation came from *Gross v. FBL Fin. Servs., Inc.*, 557 U.S. 167, 168 (2009)).

²⁷ *Maroto & Pettinicchio*, *supra* note 2, at 370.

standard should not be adopted as the preferred ADA's causation standard, as this form of judicial interpretation may fuel the unintended consequences of the ADA. Part IV will illustrate that while the "motivating factor" standard may fuel the unintended consequence of the ADA, the motivating factor standard should still be the preferred ADA causation standard, because, under the Social Model of Disability framework, there are more long term benefits to individuals with disabilities if the motivating factor standard is universally implemented as opposed to the but for standard. Lastly, Part V will argue that the ADA is a flawed statute and if the motivating factor standard became the preferred causation standard for the ADA then more effective tax incentives could minimize the unintended consequences of the ADA.

I. BACKGROUND

A. *The ADA In General*

The ADA only protects individuals that meet the ADA's definition of disability.²⁸ The ADA defines a disability as a "physical or mental impairment that substantially limits one or more major life activities," a record of such an impairment, or being regarded as having such an impairment.²⁹ In addition to proving (1) that they are disabled under the ADA, when combating employment discrimination ADA plaintiffs must also demonstrate that (2) they were qualified for the job, and (3) they were subject to adverse employment action on the basis of their disability.³⁰ A qualified individual "means an individual who, with or without reasonable accommodation, can perform the essential functions of the employment position that such individual holds or desires."³¹ Under Title I, discrimination includes: "limiting, segregating, or classifying a job applicant or employee in a way that adversely affects the opportunities or status of such applicant or employee

²⁸ See SAMUEL R. BAGENSTOS, *DISABILITY RIGHTS LAW: CASES AND MATERIALS*, 10 (Robert C. Clark et al. eds., Foundation Press 2d ed. 2010) (noting that the ADA also protects individuals who do not have a disability in certain circumstances including (1) those associated with an individual known to have a disability and (2) those who are either coerced or retaliation against for assisting an individual with disabilities assert their ADA rights).

²⁹ 42 U.S.C. § 12102(1) (2008). In 2008, Congress amended the American with Disabilities Act to broaden the definition of disability under the ADA. The American with Disabilities Act Amendments Act (ADAAA) took effect in Jan. 2009. U.S. DEPT. OF LAB. THE ADAAA OF 2008: FREQUENTLY ASKED QUESTIONS, <http://www.dol.gov/ofccp/regs/compliance/faqs/ADAFaqs.htm> (last visited Oct. 18, 2014).

³⁰ 42 U.S.C. § 12112(a) (2008); *accord* Heiko v. Colombo Savings Bank, F.S.B., 434 F.3d 249, 258-59 (4th Cir. 2006); *see also* Chamberlain v. Valley Health Sys., Inc., 781 F. Supp. 2d 305, 310 (W.D. Va. 2011).

³¹ 42 U.S.C. § 12111(8) (2008).

because of the disability of such applicant or employee.”³² Discrimination also includes “not making reasonable accommodations to the known physical or mental limitations of an otherwise qualified individual with a disability who is an applicant or employee, unless such covered entity can demonstrate that the accommodation would impose an undue hardship on the operation of the business of such covered entity.”³³

B. *Nassar- Time to Reevaluate the ADA Causation Standard*

A recent decision by the Supreme Court that heightened the causation standard for Title VII retaliation cases has prompted a closer look at the causation standard under the ADA.³⁴ While the “motivating factor” standard is codified in section 2000e-2(m) of Title VII,³⁵ which covers unlawful employment practices,³⁶ Title VII’s retaliation section contains the words “because of” rather than a specific standard.³⁷ Title VII prohibits “employer retaliation ‘because of’ an employee’s participation in legal proceedings against or opposition to illegal employment practices.”³⁸ In *Nassar*, the Supreme Court interpreted the words “because of” to mean that a plaintiff bringing a retaliation claim under Title VII must prevail under the “but for” standard.³⁹

Given “the expansive reasoning employed by the *Nassar* majority” to impose a higher causation standard for Title VII retaliation claims, “there is a possibility that courts could import” the “but for” standard into the ADA because the ADA and Title VII have similar goals and similar causation language.⁴⁰ Like the retaliation section of Title VII, the ADA does not

³² 42 U.S.C. 12112(b)(1) (2008).

³³ 42 U.S.C. 12112(b)(5)(A) (2008).

³⁴ See August T. Johannsen, *Mitigating the Impact of Title VII's New Retaliation Standard: The Americans with Disabilities Act After University of Texas Southwestern Medical Center v. Nassar*, 56 WM. & MARY L. REV. 301, 303 (2014), <http://scholarship.law.wm.edu/wmlr/vol56/iss1/8>; see also Park, *supra* note 11, at 275.

³⁵ SUPREME COURT RETALIATION RULING LIKELY TO AFFECT ADA RETALIATION STANDARD, <http://www.disabilityleavelaw.com/2013/06/articles/ada/supreme-court-retaliation-ruling-likely-to-affect-ada-retaliation-standard/> (last visited Oct. 8, 2014).

³⁶ 42 U.S.C. 2000e-2(m) (2015).

³⁷ SUPREME COURT RETALIATION RULING LIKELY TO AFFECT ADA RETALIATION STANDARD, *supra* note 35.

³⁸ Johannsen, *supra* note 34, at 303.

³⁹ SUPREME COURT RETALIATION RULING LIKELY TO AFFECT ADA RETALIATION STANDARD, *supra* note 35 (noting that Title VII’s retaliation section, 2000e-3(a), states: “it shall be an unlawful employment practice for any employer to discriminate against any of his employees...because he has opposed any practice made an unlawful employment practice by this subchapter, or because he has made a charge, testified, assisted, or participated in any manner in an investigation, proceeding, or hearing under this subchapter”).

⁴⁰ Johannsen, *supra* note 34, at 303.

specify a causation standard, but the original ADA contained the words “because of.”⁴¹ Under the ADA Amendments Acts of 2008 (the “ADAAA”), employers cannot discriminate “on the basis of disability.”⁴² Courts have not yet determined whether there is a difference between “because of” and “on the basis of disability.”⁴³ While a majority of the circuits have adopted the “motivating factor” standard for employment discrimination cases under the ADA, because the Supreme Court adopted the “but for” standard for retaliation claims under Title VII, the heightened standard for Title VII may carry over into the ADA.⁴⁴ The recent *Nassar* decision by the Supreme Court has sparked interest in reevaluating the employment causation standard under the ADA.⁴⁵

II. THE ADA’S AFFIRMATIVE OBLIGATIONS & THE UNINTENDED CONSEQUENCES

Title I prohibits covered entities (employers with more than fifteen employees) from discriminating against a qualified individual (an individual who, with or without reasonable accommodation, can perform the essential functions of the job) on the basis of disability in all employment aspects.⁴⁶ For example, employers cannot require a job qualification standard that disparately impacts individuals with a disability.⁴⁷ Nevertheless, if the individual is not qualified for the job because his disability prevents him from performing the essential function(s) of the job, with or without reasonable accommodations, then the employer is permitted not to hire the individual on the basis of his disability.⁴⁸ In addition to prohibiting discrimination against qualified individuals, Title I also places an affirmative obli-

⁴¹ Park, *supra* note 11, at 275, 277-78.

⁴² Schlesinger, *supra* note 3, at 2117.

⁴³ *Id.*

⁴⁴ SUPREME COURT RETALIATION RULING LIKELY TO AFFECT ADA RETALIATION STANDARD, *supra* note 35; *Cf.*, Kendall Isaac, *Is It A or Is It The: Deciphering the Motivating-Factor Standard in Employment Discrimination and Retaliation Cases*, 1, TEX. A&M L. REV. 55, 55-82 (2013) (discussing the importance of a unified standard).

⁴⁵ Park, *supra* note 11, at 275.

⁴⁶ 42 U.S.C. §§ 12112(a)-(b)(1) (2008).

⁴⁷ *Bates v. United Parcel Serv., Inc.*, 511 F.3d 974, 982 (9th Cir. 2007) (holding that UPS could not implement a blanket qualification standard that their drivers had a certain hearing ability and required an individualized assessment of candidates, including hearing impaired applicants). However, even if a job qualification standard that disparately impacts those with a disability, the employer may still prevail under the Business Necessity Defense. The employer must show that the qualification standard is: (1) job related, (2) consistent with business necessity, and; (3) that the performance cannot be accomplished with a reasonable accommodation. *See* SUSAN GROVER, THE BUSINESS NECESSITY DEFENSE IN DISPARATE IMPACT DISCRIMINATION CASES (Faculty Publications, Paper 19, 1996), <http://scholarship.law.wm.edu/facpubs/19>.

⁴⁸ Zimmer, *supra* note 24 at 565.

gation on qualified employers to reasonably accommodate⁴⁹ applicants and employees with disabilities.⁵⁰ Examples of reasonable accommodations codified in the ADA include: modifying the office and the individual's workspace to ensure its accessibility, "job restructuring, part-time or modified work schedules, reassignment to a vacant position, acquisition or modification of equipment or devices, appropriate adjustment or modifications of examinations, training materials or policies, the provision of qualified readers or interpreters, and other similar accommodations for individuals with disabilities."⁵¹

Employers must make reasonable accommodations to otherwise qualified individuals with disabilities unless the employer can prove one of two defenses.⁵² An employer does not have to provide a reasonable accommodation if the employer can prove accommodation(s) would be an undue hardship.⁵³ An "undue hardship" is "an action requiring significant difficulty or expense," including the cost of the accommodation and the financial resources of the employer.⁵⁴ Alternatively, under limited circumstances, the ADA may not require the employer to provide an accommodation under the direct threat defense, which exists when there is a significant risk of substantial harm to the health or safety of the individual or others. If the individual with a disability is a "direct threat," then the employer must provide the reasonable accommodation unless the employer can prove that accommodation will not eliminate the "direct threat."⁵⁵

Even though the ADA prohibits disability discrimination, because of the affirmative obligations placed on employers, one unintended consequence of the ADA is that employers have a strong incentive not to hire individuals with disabilities.⁵⁶ While the ADA places an affirmative obliga-

⁴⁹ It is important to note that reasonable accommodations are not "special privileges." Reasonable accommodations only help to ensure that individuals with disabilities have the same opportunity to apply for and perform a job as those individuals who do not have a disability. U.S. DEPT. OF LAB., EMPLOYERS AND THE ADA: MYTHS AND FACTS, <http://www.dol.gov/odep/pubs/fact/ada.htm> (last visited April 2016).

⁵⁰ Nicole Buonocore Porter, *The New ADA Backlash*, 82 TENN. L. REV. 1, 14 (2014).

⁵¹ 42 U.S.C. §§ 12111(9)(A)-(B) (2008).

⁵² Zimmer, *supra* note 24 at 565.

⁵³ 42 U.S.C. § 12112(b)(5) (2008). Before the employer has the burden to prove undue hardship, in *U.S. Airways v. Barnett*, the Court held that individual requesting the accommodation must first show that the accommodation "is reasonable on its face i.e., ordinary or in the run of cases." Zimmer, *supra* note 24, at 565.

⁵⁴ 42 U.S.C. § 12111(10) (2008).

⁵⁵ 42 U.S.C. § 12111(3) (2008).

⁵⁶ 42 U.S.C. §§ 12112(a)-(b)(1) (2008); *cf.* Bagenstos, *supra* note 8 at 550-55 (noting that while the ADA does prohibit discrimination and thus encourages the employment of individuals with disability, the ADA also makes individuals with disabilities less attractive because the cost of accommodations and the risks of lawsuits; however, Bagenstos asserts that the overall decrease in employment for individuals with disabilities is "best explained by the expansion of eligibility for SSDI and SSI benefits, rather than the by the ADA" but that it is "entirely plausible that both played a role; this comment will

tion on employers to provide accommodations, the ADA does not state that the cost of providing accommodations is often reasonable and limited. The Department of Labor states that the high expense of providing reasonable accommodations is only a common myth.⁵⁷ According to the Department of Labor, only one-third of reasonable accommodations cost over five hundred dollars.⁵⁸ Other studies have found that for accommodations that did not require the use of personal assistance services the average annual cost was \$2,000.⁵⁹ For accommodations that did require the use of personal assistance services, the annual cost was \$8,000.⁶⁰ Also, many reasonable accommodations do not cost anything other than a modification to workplace practices or the way in which the job is performed.⁶¹

While most reasonable accommodations may not be more than a couple thousand dollars per year, most employers are not aware of the costs of various types of accommodations⁶² and employers are prohibited from asking about the cost of an accommodation during the hiring process.⁶³ Thus, employers are mandated to provide accommodations, but they cannot ask what accommodations they will have to provide to a potential employee or how much those accommodations will cost. This contributes to the fear of the unknown.

More than 80% of employers surveyed listed the following as the top three reasons for not hiring an individual with a disability: “the cost of accommodation, lack of awareness as to how to deal with workers with disabilities and their accommodation needs, and fear of being stuck with a worker who cannot be disciplined or fired because of the possibility of a lawsuit.”⁶⁴ Only 43% of employers listed “that job applicants with disabili-

operate under the premise that the ADA has caused unintended consequences for individuals with disabilities because Bagenstos also admits that “the SSDI explanation cannot fully exonerate the ADA as a potential cause of the decline in employment among people with disabilities; rather “the ADA could be encouraging employers to discriminate against people with disabilities, who are then forced to apply for SSDI when they cannot find work”); see also, Thomas DeLeire, *The Unintended Consequences of the Americans with Disabilities Act*, REGULATION, Vol. 23, No. 1, at 21, 24 (2000) (argues that the ADA is counterproductive and is a “striking example of the law of unintended consequences”).

⁵⁷ OFFICE OF DISABILITY EMPLOYMENT POLICY, EMPLOYERS AND THE ADA: MYTHS AND FACTS, U.S. DEPT. OF LAB., <http://www.dol.gov/odep/pubs/fact/ada.htm> (last visited Oct. 8, 2014).

⁵⁸ *Id.*

⁵⁹ Tatiana I. Solovieva, Richard T. Walls, Deborah J. Hendricks, & Denetta L. Dowler, *Cost of Workplace Accommodations for Individuals with Disabilities: With or Without Personal Assistance Services*, 2 DISABILITY & HEALTH J. 196, 196 (2009).

⁶⁰ *Id.*

⁶¹ *Id.*; see also Thomas N. Chirikos, *Will the Costs of Accommodations Workers with Disabilities Remain Low?*, 17 BEHAV. SCI. & L. 93, 104 (1999) (however, if indirect costs are taken into account with direct costs then few accommodations are truly “costless”).

⁶² H. Stephen Kaye, Lita H. Jans & Erica C. Jones, *Why Don't Employers Hire and Retain Workers with Disabilities?*, 21 J. OCC. REHAB. 526, 529, 533-34 (2011).

⁶³ 42 U.S.C. § 12112 (2008).

⁶⁴ Kaye, Jans & Jones, *supra* note 62, at 528.

ties don't have the necessary skills and experience" as a reason why they had declined to hire an individual with a disability.⁶⁵ Thus, employers are twice as likely not to hire individuals with disabilities because of the affirmative obligations placed upon them by the ADA than because the individual with the disability lacked the qualifications for the job.⁶⁶ For almost 80% of employers, the reasons for not retaining employees with disabilities were the same as the reasons for not hiring individuals with disabilities.⁶⁷ Empirical evidence also suggests that the cost of accommodations has decreased the employment prospects of individuals with disabilities at medium-sized firms.⁶⁸ Thus, the unintended consequence of the ADA is that individuals with a disability are less attractive employees because the ADA places an affirmative obligation on employers to reasonably accommodate individuals with disabilities.⁶⁹

While there are seven different tax credits available to employers who hire individuals with disabilities to offset the cost of reasonable accommodations, less than 20% of human resource professionals reported familiarity with any of the tax credits.⁷⁰ The Work Opportunity Tax Credit (WOTC) is the most used tax-incentive program to offset the cost of hiring an individual with a disability.⁷¹ The WOTC is a federal tax credit program employers can use to offset the cost of hiring an individual with a disability if the individual falls within a WOTC designated target group,⁷² including vocational rehabilitation referred individuals,⁷³ unemployed disabled veterans (whose

⁶⁵ *Id.* at 529.

⁶⁶ *Id.*

⁶⁷ *Id.* at 530.

⁶⁸ Daron Acemoglu & Joshua D. Angrist, *Consequences of Employment Protection? The Case of the Americans with Disabilities Act*, 109 J. POL. ECON. 915, 941-44 (2001) (finding that employment prospects for people with disabilities fell more sharply in medium-sized firms than in small or large firms in the post-ADA period); see also W.E. UPJOHN INST. FOR EMP'T RESEARCH, *THE DECLINE IN EMPLOYMENT OF PEOPLE WITH DISABILITIES: A POLICY PUZZLE* 391 (David C. Stapleton & Richard V. Burkhauser eds., 2003) (noting that "medium-sized firms are the ones most affected by the cost of accommodations").

⁶⁹ Acemoglu & Angrist, *supra* note 68, at 941-44; Maroto & Pettinicchio, *supra* note 2, at 370-74.

⁷⁰ *Employer Tax Incentives Could Do More to Help Disabled*, 20 EMP'T ALERT, no. 11.12 (West Group), May 22, 2003 [hereinafter EMP'T ALERT]. This Comment will only focus on the four most used tax credits available.

⁷¹ 26 U.S.C. § 51 (a)-(b) (2015); see also EMP'T ALERT, *supra* note 70.

⁷² WORK OPPORTUNITY TAX CREDIT – ELIGIBLE NEW HIRES, <http://www.doleta.gov/business/incentives/opptax/eligible.cfm> (last visited Oct. 29, 2014) (WOTC-targeted individuals include: "Unemployed Veterans (including disabled veterans), Temporary Assistance for Needy Families (TANF) Recipients, Food Stamp (SNAP) Recipients, Designated Community Residents (living in Empowerment Zones or Rural Renewal Counties), Vocational Rehabilitation Referred Individuals, Ex-Felons, Supplemental Security Income Recipients, Summer Youth Employees (living in Empowerment Zones)").

⁷³ VOCATIONAL REHABILITATION SERVICES, <http://www.in.gov/fssa/ddrs/2636.htm> (last visited Nov. 3, 2014) (Vocational Rehabilitation Referred Individuals participate in services provided by Bu-

disability is service related), and Supplemental Security Income (SSI)⁷⁴ recipients.⁷⁵ The WOTC is only available for the first year of employment during which period the employee must work at least 120 hours.⁷⁶ Employers may receive tax credit of between \$1,200 and \$9,600 per employee, depending upon (1) the target group of the employee, (2) the wage paid to the employee in the first year, and (3) the number of hours that the employee worked.⁷⁷

While the WOTC is the most used tax incentive program to offset the cost of hiring individuals with disabilities, the WOTC is not particularly beneficial to employers who wish to offset the cost of hiring or retaining an individual with disabilities. First, the WOTC can only be applied to an individual with a disability if he or she falls within a WOTC target group. Only three WOTC eligible groups specifically target individuals with disabilities: vocational rehabilitation referred individuals, unemployed disabled veterans whose disability is service related, or SSI recipients.⁷⁸ There are many individuals with disabilities who do not fit into a WOTC target group because not all individuals with disabilities are vocational rehabilitation referred individuals, unemployed disabled veterans whose disability is service related, or SSI recipients. Thus, an employer may not be able to apply for the WOTC even if he or she hires an individual with a disability because the new hire does not fit into a WOTC target group. For example, if an employer hires a deaf individual the employer would not be able to apply for the WOTC tax credit unless that deaf individual was also a vocational

reau of Rehabilitation Services, which include “quality individualized services to enhance and support people with disabilities to prepare for, obtain or retain employment”).

⁷⁴ SUPPLEMENTAL SECURITY INCOME (SSI) ELIGIBILITY REQUIREMENTS, <http://www.ssa.gov/ssi/text-eligibility-ussi.htm> (last visited Nov. 12, 2014) (not all SSI recipients are disabled but to be a SSI recipient an individual must be older than sixty-five, blind, or disabled; for SSI purposes a disabled individual over the age of eighteen means an individual who has “a medically determinable physical or mental impairment (including an emotional or learning problem) which: results in the inability to do any substantial gainful activity; and can be expected to result in death; or has lasted or can be expected to last for a continuous period of not less than 12 months”).

⁷⁵ CHRISTINE SCOTT, CONG. RESEARCH SERV., RL30089, THE WORK OPPORTUNITY TAX CREDIT (WOTC) 6-8 (2013), <https://www.fas.org/sgp/crs/misc/RL30089.pdf>.

⁷⁶ U.S. DEP’T OF LABOR, HELP PUT AMERICA TO WORK AND EARN FEDERAL INCOME TAX CREDITS FOR HIRING NEW EMPLOYEES (2013), http://www.doleta.gov/business/incentives/opptax/PDF/employers_wotc_program_brochure_5_24_12.pdf; *see also* WORK OPPORTUNITY TAX CREDIT – EMPLOYERS, <http://www.doleta.gov/business/incentives/opptax/wotcEmployers.cfm> (last visited Oct. 29, 2014).

⁷⁷ U.S. DEP’T OF LABOR, *supra* note 76.

⁷⁸ WORK OPPORTUNITY TAX CREDIT – ELIGIBLE NEW HIRES, *supra* note 72 (noting that WOTC is also applicable to individuals that do not have disabilities from the following eligible groups: Unemployed Veterans, Temporary Assistance for Needy Families (TANF) Recipients, Food Stamp (SNAP) Recipients, Designated Community Residents (living in Empowerment Zones or Rural Renewal Counties), Ex-Felons, Summer Youth Employees (living in Empowerment Zones)); SCOTT, *supra* note 75, at 6-7.

rehabilitation referred individual, an unemployed disabled veteran whose disability is service related, or a SSI recipient.

Second, the WOTC only encourages the hiring of certain individuals with disabilities because it is a “selective or categorical hiring subsidy; that is, it attempts to steer employers toward hiring members of prescribed groups from whom they would otherwise have shied away.”⁷⁹ The WOTC only encourages employers to hire individuals with disabilities if they fit into one of the following WOTC groups: vocational rehabilitation, disabled veterans, or SSI recipient.⁸⁰ Again, not all individuals with disabilities are vocational rehabilitation referred individuals, unemployed disabled veterans whose disability is service related, or Supplemental Security Income (SSI) recipients.

Third, since the WOTC reimbursement credit is based on the employee’s wage and the number of hours the employee works (rather than the additional cost of hiring and retaining an individual with a disability), the WOTC disproportionately fails to assist employers who wish offset the cost of employees with disabilities given that employees with disabilities generally earn less and work less than employees without disabilities. For example, a disabled individual may have a part time work schedule as a reasonable accommodation. Because the WOTC is not particularly beneficial to employers who wish to offset the cost of hiring an individual with disabilities, individuals with disabilities only account for a small number of total WOTC certificates issued.⁸¹ From 2009 to 2012, only five percent or less of the WOTC certificates went to eligible groups that specifically targeted individuals with disabilities.⁸²

In addition to WOTC, the Internal Revenue Service Code (IRS Code) also provides three tax incentives to employ individuals with disabilities that offset the increased costs of hiring and retaining individuals with disabilities.⁸³ Section 51⁸⁴ and Section 190⁸⁵ of the IRS Code provide certain

⁷⁹ SCOTT, *supra* note 75, at 5 & 14.

⁸⁰ *Id.* at 5.

⁸¹ *Cf., id.* at 5 & 14.

⁸² For the fiscal year 2009, the WOTC issued 719,814 certificates of which 16,380 were for vocational rehabilitation referral individuals, 190 were for disabled veterans, and 19,542 were for SSI Recipients. For the fiscal year 2010, the WOTC issued 914,491 certificates of which 16,213 were for vocational rehabilitation referral individuals, 2,452 were for disabled veterans, and 12,701 were for SSI Recipients. For the fiscal year 2011, the WOTC issued 1,160,523 certificates, of which 14,776 were for vocational rehabilitation referral individuals, 3,367 were for disabled veterans, and 12,458 were for SSI Recipients. For the fiscal year 2012, the WOTC issued 892,314 certificates, of which 12,891 were for vocational rehabilitation referral individuals, 6,642 were for disabled veterans, and 10,981 were for SSI Recipients. Thus, from 2009 to 2012, only five percent or less of the WOTC certificates went to eligible groups that specifically targeted individuals with disabilities. SCOTT, *supra* note 75, at 12.

⁸³ U.S. DEPT. OF JUSTICE, CIVIL RIGHTS DIVISION, ADA GUIDE FOR SMALL BUSINESSES (1999), <http://www.ada.gov/smbusgd.pdf>.

⁸⁴ 26 U.S.C. § 51 (1978) (“Target Job Tax Credit”); *see also* EEOC, FACTS ABOUT DISABILITY RELATED TAX PROVISIONS, <http://www.eeoc.gov/facts/fs-disab.html> (last visited April 2016).

tax deductions for all businesses and Section 44⁸⁶ provides a tax credit for small businesses.⁸⁷

Under Section 51, employers may receive a tax credit of up to forty percent of the new employee's first-year wages, with the maximum credit of \$2,400 (\$9,600 if the employee is a qualified veteran),⁸⁸ if (1) the employee "is [a] referred by state or local vocational rehabilitation agencies, a State Commission on the Blind, or the U.S. Department of Veterans Affairs, and [b] certified by a State Employment Service," and (2) the employee worked at least 120 hours during their first year of employment or has been employed for at least 90 days.⁸⁹ Thus, many of the same situations that would be eligible for the WOTC are also eligible for Section 51.

Under Section 190, all businesses that undertake physical, structural, or vehicle-related barrel removal may be eligible for a tax deduction of up to fifteen thousand dollars.⁹⁰ Section 190 "may not be used for expenses incurred for new construction, or for a complete renovation of a facility or public transportation vehicle, or for the normal replacement of depreciable property."⁹¹

Section 44 is only available to small businesses that have total revenues of \$1,000,000 or less in the previous tax year or thirty or fewer full-time employees. Under Section 44, employers are eligible for a tax credit of up to \$5,000 every year to offset any reasonable accommodation(s) for individuals with disabilities to ensure compliance with the ADA.⁹² Unfortunately, Section 44 (1) is not available to all employers,⁹³ (2) only refunds expenses that ensure compliance with the ADA,⁹⁴ (3) cannot be used to offset the costs of new construction or building modification,⁹⁵ and (4) only

⁸⁵ 26 U.S.C. § 190 (1976) ("Tax Deduction to Remove Architectural and Transportation Barriers to People with Disabilities and Elderly Individuals"); *see also* EEOC, *supra* note 84.

⁸⁶ 26 U.S.C. § 44 (1990) (as referred to as the Disabled Access Tax Credit); *see also* EEOC, *supra* note 84.

⁸⁷ SCOTT, *supra* note 75, at 5 & 14.

⁸⁸ 26 U.S.C. § 51 (1978).

⁸⁹ EEOC, *supra* note 84.

⁹⁰ U.S. DEPT. OF JUSTICE, CIVIL RIGHTS DIVISION, AMERICANS WITH DISABILITIES ACT QUESTIONS AND ANSWERS (2014), <http://www.ada.gov/qandaeng.htm>; *see also* ODEP TAX INCENTIVES FOR PROVIDING BUSINESS ACCESSIBILITY (2007), <http://www.dol.gov/odep/ietoolkit/publications/186.pdf>.

⁹¹ *Id.*

⁹² U.S. DEPT. OF JUSTICE, CIVIL RIGHTS DIVISION, AMERICANS WITH DISABILITIES ACT QUESTIONS AND ANSWERS (2014), <http://www.ada.gov/qandaeng.htm>; *see also* U.S. DEPT. OF JUSTICE, CIVIL RIGHTS DIVISION, ADA GUIDE FOR SMALL BUSINESSES (1999), <http://www.ada.gov/smbusgd.pdf>.

⁹³ *Id.*

⁹⁴ U.S. DEPT. OF JUSTICE, CIVIL RIGHTS DIVISION, AMERICANS WITH DISABILITIES ACT QUESTIONS AND ANSWERS (2014), <http://www.ada.gov/qandaeng.htm>; *see also* ODEP TAX INCENTIVES FOR PROVIDING BUSINESS ACCESSIBILITY (2007), <http://www.dol.gov/odep/ietoolkit/publications/186.pdf>.

⁹⁵ *Id.*

covers half of the cost of the accommodation(s) and the accommodation(s) must be over \$250 and not more than \$10,250.⁹⁶ Thus, Section 44 is a limited tax credit that only refunds some of the money employers must expend to provide reasonable accommodations. For example, if an employer had to choose between hiring an individual who required adaptive equipment and an individual who did not, even if the adaptive equipment costs only \$250, it would still cost the employer at least \$125 more to hire the individual that required the accommodation. In addition, if the amount of credit exceeds the amount of taxes the employer owes, then the employer cannot carry forward the unused credit to the next year.⁹⁷

For the forgoing reasons, even though tax credits are available, tax credits do not sufficiently counter the unintended consequences of the ADA because (1) too few employers know about the tax credits programs, (2) the tax credit programs only refund some of the money employers must expend to provide reasonable accommodations, and (3) some of the tax programs are not renewable each year the individual with the disability is employed.

Another unintended consequence of the ADA is that employers have a strong incentive not to hire individuals with disabilities because of the added termination costs.⁹⁸ In addition to the cost of providing reasonable accommodations and/or employment modifications, under the ADA, when an employer considers hiring, employing, or firing an individual with a disability, the employer must also consider the risk of a lawsuit.⁹⁹ An ADA lawsuit has the potential to cost an employer millions of dollars. For example, in *Rodriguez v. Valley Vista Services Inc.*, the jury awarded the ADA Plaintiff almost twenty-two million dollars after her employer failed to accommodate her panic attacks with time off from work.¹⁰⁰ The employer fired Ms. Rodriguez after she sent inter-office emails offering babysitting services and subsequently did not come to work and refused to return her employer's phone calls.¹⁰¹ In *Roby v. McKesson HBOC*, the ADA plaintiff was also awarded nineteen million dollars after her employer failed to accommodate her panic/anxiety attacks with time off from work.¹⁰² While jury verdicts noted above are considerable, most employers do not need to worry about the cost of an ADA lawsuit even if their employee files an ADA discrimination claim. Generally, ADA plaintiffs are not successful under either causation standard. Professor Ruth Colker, a leading scholar

⁹⁶ U.S. DEPT. OF JUSTICE, CIVIL RIGHTS DIVISION, AMERICANS WITH DISABILITIES ACT QUESTIONS AND ANSWERS (2014), <http://www.ada.gov/qandaeng.htm>; see also U.S. DEPARTMENT OF JUSTICE, CIVIL RIGHTS DIVISION, ADA GUIDE FOR SMALL BUSINESSES (1999), <http://www.ada.gov/smbusgd.pdf>.

⁹⁷ *Id.*

⁹⁸ Bagenstos, *supra* note 8, at 550-55.

⁹⁹ *Id.* at 536.

¹⁰⁰ *Rodriguez vs. Valley Vista Services Inc.*, No. BC473793 (Cal. Super. Feb. 15, 2013).

¹⁰¹ *Id.*

¹⁰² *Roby vs. McKesson HBOC*, No. CV01573. (Cal. Super. May 3, 2004).

on disability discrimination,¹⁰³ analyzed ADA appeal claims on Westlaw and found that eighty-seven percent were dismissed or granted summary judgment in favor of the employer, at the trial court level.¹⁰⁴ Professor Colker's findings suggest that only prisoner rights cases fare worse than disability discrimination claims.¹⁰⁵ While ADA plaintiff's are not typically successful under either causation standard, because employers must ensure that they do not discriminate on the basis of disability the "ADA increases the cost of discharging protected-class members; the higher firing costs, in turn, make hiring people with disabilities a less attractive prospect."¹⁰⁶

The ADA creates perceived and sometimes real burdens on employers who hire or employ individuals with disabilities. Economists in general agree that the ADA has raised the average hiring costs (e.g., accommodations) and termination costs (e.g., consideration about a potential lawsuit) for individuals with disabilities, which makes employers less likely to hire or retain individuals with disabilities.¹⁰⁷ In other words, an unintended consequence of the ADA is that individuals with disabilities are less desirable employees.¹⁰⁸

III. THE STANDARD OF PROOF IN RELATION TO THE ADA'S UNINTENDED CONSEQUENCES

Under the "motivating factor" standard, it is easier for ADA plaintiffs to prevail because ADA plaintiffs only have to prove that discrimination on the basis of their disability was one of the factors for adverse employment

¹⁰³ See MORITZ COLLEGE OF LAW – FACULTY – RUTH COLKER, THE OHIO STATE UNIV., <http://moritzlaw.osu.edu/faculty/professor/ruth-colker/> (last visited Jan 9, 2014).

¹⁰⁴ See Ruth Colker, *Winning and Losing Under the Americans with Disabilities Act*, 62 OHIO ST. L. J. 239, 246 (2001).

¹⁰⁵ Ruth Colker, *The Americans with Disabilities Act: A Windfall for Defendants*, 34 HARV. C.R.-C.L. L. REV. 99, 100 (1999) (Colker looked at all of the cases that were available on Westlaw from 1992 to 1998).

¹⁰⁶ Bagenstos, *supra* note 8, at 536.

¹⁰⁷ Daron Acemoglu & Joshua D. Angrist, *Consequences of Employment Protection? The Case of the Americans with Disabilities Act*, 109 J. OF POL. ECON. 915, 916 (2001); Maroto & Pettinicchio, *supra* note 2, at 370-374.

¹⁰⁸ *Cf.*, Thomas DeLeire, *The Unintended Consequences of the Americans with Disabilities Act*, 23, REG. 21, 21-24 (2000); *Cf.*, Douglas Kruse & Lisa Schur, *Employment of People with Disabilities Following the ADA*, 42 INDUS. REL. 31 (2003); *cf.*, Susan Schwochau & Peter Blanck, *Does the ADA Disable the Disabled?— More Comments*, 42 INDUS. REL. 67 (2003); *cf.*, Kathleen Beegle and Wendy A. Stock, *The Labor Market Effects of Disability Discrimination Laws*, 38 J. OF HUM. RESOURCES 806, 806-859 (2003), <http://www.jstor.org/stable/1558781>; *Cf.*, Christine Jolls, *Identifying the Effects of the Americans with Disabilities Act Using State-Law Variation: Preliminary Evidence on Educational Participation Effects* 1-16 (Nat'l Bureau of Econ. Research, Working Paper No. 10528, 2004), <http://www.nber.org/papers/w10528>; *cf.*, Maroto & Pettinicchio, *supra* note 2, at 370-407.

action.¹⁰⁹ Thus, a uniform implementation of the “motivating factor” standard means that more ADA plaintiffs will be able to successfully litigate their claims. The more ADA plaintiffs prevail and win large settlements, the more likely employers are to worry about the risk of a lawsuit. While there are few frivolous ADA lawsuits, with the implementation of the “motivating factor” standard, it will also be easier for frivolous ADA lawsuits to also prevail. Because the burden of proof is much lower under the “motivating factor” standard, if the “motivating factor” standard was universally implemented then employers “will have to use greater caution, or will simply have [their] hands tied in deciding whether to take an adverse employment action against a disabled employee.”¹¹⁰ In sum, implementing the “motivating factor” standard could fuel the unintended consequences of the ADA.

Under the “but for” standard of causation it is extremely difficult for ADA plaintiffs to prevail because “to establish a ‘but for’ case, a disabled employee must therefore prove that the workplace discrimination was a necessary factor for the negative employment result that occurred.”¹¹¹ Thus, if the “but for” standard is universally implemented, then it will be very difficult to prove and consequently stop or discourage discrimination against disabled employees in the workforce.¹¹² Accordingly, if the “but for” standard is adopted, then there is less risk for an employer when the employer either denies or fails to provide a reasonable accommodation because under the “but for” standard it is less likely that an ADA plaintiff will either bring suit or successfully litigate their claim. Thus, under a universal implementation of the “but for” standard, the ADA would be less strictly enforced and the unintended consequences of the ADA would likely be either limited or reduced.

IV. THE LONG TERM IMPACT OF THE MOTIVATING- FACTOR STANDARD

Even though the unintended consequences of the ADA may be either limited or reduced with the universal adoption of the but for standard, it is not advisable to adopt the but for standard given that employees in ADA discrimination cases are already disadvantaged plaintiffs for the following reasons. First, the ADA plaintiff must prove a prima facie case.¹¹³ As previously discussed, ADA plaintiffs must demonstrate that they are (1) considered disabled under the ADA, (2) qualified for the job, and (3) subject to

¹⁰⁹ Park, *supra* note 11, at 259; *see also* Schlesinger, *supra* note 3, at 2124.

¹¹⁰ Park, *supra* note 11, at 258.

¹¹¹ Schlesinger, *supra* note 3, at 2123 (noting the definition of “but for” causation came from *Gross v. FBL Fin. Servs., Inc.*, 557 U.S. 167, 168 (2009)).

¹¹² Park, *supra* note 11, at 259.

¹¹³ *Id.*

adverse employment action on the basis of their disability.¹¹⁴ Second, under the but for standard, fewer ADA cases go to trial since it is more difficult for a plaintiff to survive an employer's summary judgment motion. Third, even though a number of circuits have a lower causation standard, employers win in ninety-three percent of ADA discrimination cases.¹¹⁵ As previously discussed, ADA plaintiffs are not successful under either causation standard. Professor Ruth Colker analyzed ADA appeal claims on Westlaw and found that eighty-seven percent were dismissed or granted summary judgment, in favor of the employer, at the trial court level.¹¹⁶ Professor Colker's findings suggest that only prisoner rights cases fare worse than disability discrimination claims.¹¹⁷ A 1998 ABA-commissioned study stated that employers are successful in ADA cases because there is a "gap between what Congress claimed it was doing in enacting the ADA and what interpretation of the actual language of the Act allows."¹¹⁸

Furthermore, hiring discrimination lawsuits in general are hard to successfully litigate¹¹⁹ and many are not brought forth.¹²⁰ ADA plaintiffs, who wish to combat hiring discrimination, face an additional set of challenges that stem from the fact that the ADA is based on an individualized assessment, including: (1) the inability to make comparisons between the employer's treatment of individuals with different disabilities, (2) the large range of disabilities, (3) the independent impact of each disability on the individual, and (4) the lack of statistical proof showing discrimination given that a few people apply for the same position with the same disability and/or accommodations needed.¹²¹ For the forgoing reasons, it is not advisable to add the additional hurdle of the but for standard given that employees in ADA discrimination cases are already disadvantaged plaintiffs.

Based on the Social Model of Disability, belief that disability results from the interaction between an individual's physical or mental characteristics and the social choices and attitudes that attach disadvantage to these

¹¹⁴ 42 U.S.C. § 12112(a) (2008).

¹¹⁵ Park, *supra* note 11, at 275.

¹¹⁶ See Colker, *supra* note 104, at 246.

¹¹⁷ Colker, *supra* note 105, at 100 (Colker looked at all of the cases that were available on Westlaw from 1992 to 1998).

¹¹⁸ Schlesinger, *supra* note 3, at 2116.

¹¹⁹ Bagenstos, *supra* note 8, at 538.

¹²⁰ THE DECLINE IN EMPLOYMENT OF PEOPLE WITH DISABILITIES: A POLICY PUZZLE 369, 396 (David Stapleton & Richard Burkhauser eds., 2003) (noting that individuals with disabilities who have experienced hiring discrimination are not likely to bring suit because (1) rejected applicants have a difficult time detecting discrimination and/or proving that they are capable of performing the job for which they applied, and (2) rejected applicants 'probably [have] less incentive to pursue a lawsuit than the typical victim who is an existing employee, for a variety of reasons (less chance of success, a desire to focus their energy on searching for other jobs, fear of creating a negative reputation for themselves, lack of support from fellow employees or employee organizations, and perhaps others)).

¹²¹ Bagenstos, *supra* note 8, at 538.

characteristics,¹²² there are more long term benefits to all individuals with disabilities if the motivating factor standard is implemented as opposed to the but for standard. The Social Model of Disability is a shift from the Medical Model, which only acknowledged “mental and physical impairments,” to a model that looks “at a disabled individual’s highly complex relationship to society as a whole.”¹²³ The Social Model of Disability considers “influential environmental factors, cultural attitudes, and social biases that affect the ways disabled individuals are both permitted and able to partake in society.”¹²⁴ Congress adopted the ADA after Social Model of Disability had gained widespread acknowledgement and acceptance.¹²⁵ The ADA’s affirmative obligation on employers is rooted within the Social Model of Disability framework.¹²⁶ It is not that individuals with disabilities need to be cured, rather the ADA calls for employers to recognize that they collectively have created an employment environment that makes some mental and physical conditions disabling.¹²⁷

Under the motivating factor standard, ADA plaintiffs will have an easier time proving that their employer failed to comply with ADA’s affirmative obligation to provide for reasonable accommodations.¹²⁸ More employers will be forced to provide reasonable accommodations.¹²⁹ More employers will be forced to acknowledge that their practices and employment offices created a failed longevity for an individual with a disability and workplaces will be modified.¹³⁰ Hopefully as more workplaces are modified and employees with disabilities are given the opportunity to thrive, more employers will realize that their previous actions contributed to an environment that made certain mental and/or physical conditions disabling.¹³¹ The ability the ADA has to “affect employer attitudes and labor market outcomes is contingent upon” the courts’ interpretation and the enforcement of the ADA generally.¹³²

¹²² Bagenstos, *supra* note 28, at 4.

¹²³ Schlesinger, *supra* note 3, at 2120.

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ Bagenstos, *supra* note 28, at 4.

¹²⁷ *Cf.*, 42 U.S.C. §§ 12112(b)(5) (2008).

¹²⁸ Park, *supra* note 11, at 258.

¹²⁹ *Cf., Id.*

¹³⁰ *Id.*

¹³¹ *Id.*

¹³² Maroto & Pettinicchio, *supra* note 2, at 374-75.

V. THE ADA IS FLAWED¹³³

Arguably the ADA has not lived up to the employment expectations of individuals with disabilities because it is flawed.¹³⁴ The ADA is flawed for two reasons. First, the ADA does not contain a uniform causation standard. The ADA creates a conflict of interest between unemployed individuals with disabilities (who may benefit if the but for standard is adopted) and the employed individuals with disabilities (who may benefit if the motivating factor standard is adopted).¹³⁵ Second, an unintended consequence of the ADA is that individuals with disabilities are less desirable employees. The ADA is a flawed statute because employers have affirmative obligations towards individuals with disabilities, which makes the hiring and employment of individuals with disabilities more expensive; but the ADA fails to address the increased cost of employees with disabilities, and neither the ADA nor supplemental tax incentives provide adequate incentives to offset the costs of hiring and/or retaining individuals with disabilities.¹³⁶ Given these flaws, disability advocates focusing on the judicial interpretation of the ADA may not be as useful as an amendment to the ADA or supplemental legislations (e.g., additional or modifications to tax incentives for employers that hire individuals with disabilities) that would account for the unintended consequences of the ADA and promote the economic well being of individuals with disabilities in general.¹³⁷

If disability advocates oppose motivating factor standard as the preferred standard of proof because it may increase the unintended consequences of the ADA, then disability advocates should improve tax incentives so that they more effectively offset the cost of accommodations.¹³⁸ 88% of employers surveyed in a recent study said that tax breaks would be helpful policy strategy to increase the hiring of and retention of individuals

¹³³ This comment has been written under the premise that the ADA has not improved the economic of well-being of individuals with disabilities because Title I of the ADA has not been interpreted in a way that best promotes the economic interests of individuals. This comment operates under the framework that a realization of the purpose of the ADA to improve the economic interest of individuals is at least partially dependent upon proper judicial interpretation.

¹³⁴ Cf., JW Perry, *Disabling the Rights of Americans with Disabilities- What Should Be Done Next?* 29 MENTAL & PHYSICAL DISABILITY L. REP. 518, 518 (2005) (arguing that the ADA has not lived up to the expectations of individuals with disabilities because is a flawed document itself).

¹³⁵ *Id.*

¹³⁶ Cf., Daron Acemoglu & Joshua D. Angrist, *Consequences of Employment Protection? The Case of the Americans with Disabilities Act*, 109 J. OF POL. ECON. 915, 916 (2001); Maroto & Pettinicchio, *supra* note 2, at 370- 374.

¹³⁷ Cf., JW Perry, *supra* note 134, at 518.

¹³⁸ *Id.* at 561 (improving tax incentives is of critical importance because empirical evidence suggests that “subsidies may be required to assure that employers actually provide accommodations to all who are ‘entitled’ to them”).

with disabilities.¹³⁹ First, given that so few human resources representatives are aware of and/or understand all of the business tax credits that are currently available, there should be more advertisement of and education about current business tax incentives. In order to increase the use of current tax incentives disability, the “lack of familiarity with the incentives and perceptions regarding the amount of effort required to qualify for them” must be addressed.¹⁴⁰ For example, there could be an increase of and an improvement of “government outreach and education efforts, including improvements regarding government coordination and clarification of tax incentives requirements.”¹⁴¹

There should also be a continuation of tax incentives for one-time expenditures, including Section 190. Accommodations that involve a one-time expenditure are often useful to many individuals with disabilities beyond the original requestor.¹⁴² For example, the installation of a ramp is not only beneficial to the individual that requested the ramp, rather the ramp could benefit other prospective employees and/or customers.¹⁴³

Tax incentives should provide a high reward for the first accommodation provided by the business. The first accommodation provided by a business is the most expensive because “once employers have made such an accommodation (whether in response to the request of a specific prospective employee or in response to the provisions of the ADA's public accommodations title, which imposes various accessibility requirements on commercial facilities), the marginal cost of providing it to any future employee drops dramatically.”¹⁴⁴

Tax incentives should provide a larger award during the first year and should be subsequently renewable for ongoing expenditures. There should be a large reward during the first year because “even where accommodations involve ongoing expenditures, their costs should fall over time as employers and others develop, disseminate, and refine techniques of accommodating people with a range of disabilities in a range of contexts and as courts develop a body of case law that reduces uncertainties in the ADA's application.”¹⁴⁵

Tax incentives should expand “the types of workers eligible for the [WOTC], the size of the businesses for [Section 44], and accommodations that qualify a business to receive the credits or deduction for barrier remov-

¹³⁹ Kaye, Jans, & Jones, *supra* note 62.

¹⁴⁰ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-03-39, BUSINESS TAX INCENTIVES: INCENTIVES TO EMPLOY WORKERS WITH DISABILITIES RECEIVE LIMITED USE AND HAVE AN UNCERTAIN IMPACT 21 (2002).

¹⁴¹ *Id.*

¹⁴² Bagenstos, *supra* note 8, at 556.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

al deduction [Section 190].”¹⁴⁶ The WOTC could be expanded to include what administrative agencies have defined as individuals with “targeted disabilities.” Targeted disabilities include total deafness in both ears, complete loss of vision, missing extremities, partial/ complete paralysis, epilepsy, severe intellectual disability, psychiatric disability, and dwarfism.¹⁴⁷ Section 44 should also be expanded to include all businesses.¹⁴⁸ Section 190 should be amended to include, “accommodations to address electronic and communications barriers in the workplace.”¹⁴⁹ For example, Section 190 could be expanded to include a screen reader for those with vision impairment.¹⁵⁰

CONCLUSION

The ADA’s prohibition against disability discrimination, combined with the affirmative obligations placed upon employers, results in the unintended consequence of making individuals with disabilities less desirable employees than those without disabilities. Thus, an unintended consequence of the ADA is that individuals with disabilities are less desirable employees. Implementing the motivating factor standard may fuel the unintended consequence of the ADA. However, the motivating factor standard should still be the preferred ADA causation standard because, under the Social Model of Disability framework, there are more long term benefits to individuals with disabilities if the motivating factor standard is universally implemented as opposed to the but for standard. If the motivating factor standard becomes the preferred causation standard for the ADA, then more effective tax incentives may minimize the unintended consequences of the ADA.

¹⁴⁶ U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 140, at 21.

¹⁴⁷ U.S. OFFICE OF PERSONNEL MGMT., SF 256 Self- Identification of Disability (2010), http://www.opm.gov/forms/pdf_fill/sf256.pdf.

¹⁴⁸ U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 140, at 26.

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*