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## Fishing and Selling

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## FISHING AND SELLING

VICTOR P. GOLDBERG\*

CONSUMERS are a lot like fish, out there waiting to be hooked. Like most images, this one is a caricature of reality. The choice and search effort of consumers is suppressed in order to explore the implications of selling activity by manufacturers and retailers. In particular, the fishing analogy suggests that there is a tendency toward excessive selling activity if sellers do not take into account the effects of their activity on the costs of their rivals. However, sellers, like fishermen, have an incentive to arrange their affairs to mitigate the dissipation of rents. This argument is developed in Section I. The conclusion that sellers might overspend on selling activity appears inconsistent with the observation that increased advertising frequently results in lower consumer prices; however, it is not. The apparent paradox is resolved in Section II. In Section III, some speculations on the relationship between marketing and the destruction of social capital are put forth.

### I. OVERFISHING

The common-pool problem in fishing is well known.<sup>1</sup> No one has property rights in live fish, but by capturing them a fisherman can convert the unowned resource into private property. By engaging in fishing activity, a fisherman reduces the success rate of his competitors, thereby raising their costs. Failure to take this effect into account results in “overfishing.” That is, in the absence of some institutional response, too many resources will be devoted to fishing activity.

The same argument applies to selling activity. Real resources will be

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<sup>1</sup> See H. Scott Gordon, *The Economic Theory of a Common-Property Resource: The Fishery*, 62 *J. Pol. Econ.* 124 (1954); and Ronald N. Johnson & Gary D. Libecap, *Contracting Problems and Regulation: The Case of the Fishery*, 72 *Am. Econ. Rev.* 1005 (1982).

used to convert people from potential customers (live fish) into actual customers (dead, or at least captured, fish). The customer is of no value to the seller until he is captured. The selling effort of each firm will raise the costs of its competitors, and, if the firms fail to take this into account, they will collectively overspend on selling.

The argument depends on the very reasonable assumption that price is not the only variable that sellers can manipulate to sell their goods. Only in a world of no selling costs would the argument not go through. But that is a world we have never known. A manufacturer could not compete by moving its product to places where customers are likely to gather (such as retail establishments); the manufacturer would simply put goods on the loading dock and quote low prices to people who would come and cart the goods away.

It might appear that the overfishing result involves only pecuniary externalities. Not so. That appearance is a reflection of the general neglect of selling costs by economists. Production costs involve "real" resources while selling costs apparently do not. But selling does entail the use of real resources. If one producer's increased advertising raises the noise level so that a second advertiser must spend additional resources to make its message as effective as it was before, then the increased costs are just as real as if the first producer had produced soot that impaired the second's production process.

The externality language is misleading. If transactions costs, appropriately defined,<sup>2</sup> are zero, and if all rights are costlessly defined and protected, then there are no externalities. That is just a variant on the Coase Theorem.<sup>3</sup> It does not matter if customers have the right to prevent firms from attempting to court their favor or if firms have property rights to customers. Likewise, even if the fish own themselves, the Coase Theorem efficiency result would still hold (although there would be a substantial wealth effect!). The overfishing result arises because of an implicit assumption that the nonownership of live fish is an inexorable fact of life.

The fishing analogy fails to capture a countervailing effect on the costs of rivals. One seller's efforts could result in increased sales for some other sellers. Advertising of one manufacturer's widgets can result in increased

<sup>2</sup> See Victor P. Goldberg, Production Functions, Transactions Costs and the New Institutionalism, in *Issues in Contemporary Microeconomics and Welfare* 395 (George R. Feiwel ed. 1985).

<sup>3</sup> R. H. Coase, The Problem of Social Cost, 3 *J. Law & Econ.* 1 (1960). Keith B. Leffler, The Prohibition of Billboard Advertising: An Economic Analysis of the *Metromedia* Decision, 1 *Sup. Ct. Econ. Rev.* 113 (1982), uses the Coase Theorem in analyzing the effects of a particular type of selling cost, billboard advertising.

demand for other widget makers as well; a retailer's advertising of a particular brand could increase demand for that brand at other retail outlets (the familiar free rider problem).<sup>4</sup> If firms fail to take this effect into account, there is an incentive to underprovide selling effort.

The free rider and overfishing problems are, therefore, two sides of the same coin. The selling effort of one firm affects the ability of other firms to sell. The argument is not, I confess, particularly new. Chamberlin presented a variant on it in *The Theory of Monopolistic Competition*.<sup>5</sup> Most of the arguments concerning the inefficiency of monopolistic competition implicitly have the overfishing concept at their base. For example, it is well known that under spatial competition (which is one manifestation of selling effort), if there is no coordination, firms would have an incentive to locate inefficiently.<sup>6</sup> The overfishing analogy might be what laymen have in mind with concepts such as ruinous or destructive competition.

The overfishing result is not the end of the story for the fishermen, nor should it be for the sellers. The fishermen have the incentive to seek institutional arrangements that enable them to coordinate their behavior for their mutual benefit—to mitigate rent dissipation.<sup>7</sup> The institutional response need not, of course, be a purely private one. It could entail limited government action enforcing agreements or defining and enforcing boundaries; or it could entail more extensive government involvement in the form of regulation or management of the fishery. Coordination, whether public or private, will not necessarily be easy to achieve. There will be conflict over the content of the mutually advantageous rules.<sup>8</sup> Moreover, even if the parties could agree on a set of rules, the rewards for deviating from a cooperative strategy would often make enforcement difficult and expensive. "Solving" the overfishing problem entails costs—the cures could be worse than the disease.<sup>9</sup>

Likewise, sellers have incentives to devise mechanisms to avoid the

<sup>4</sup> The Supreme Court recognized the importance of the free rider problem in *Continental T.V. Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

<sup>5</sup> Edward Hastings Chamberlin, *The Theory of Monopolistic Competition* 151–56 (8th ed. 1962).

<sup>6</sup> See Harold Hotelling, *Stability in Competition*, 39 *Econ. J.* 41 (1929).

<sup>7</sup> See Johnson & Libecap, *supra* note 1; and Steven N. S. Cheung, *The Structure of a Contract and the Theory of a Non-exclusive Resource*, 13 *J. Law & Econ.* 49 (1970).

<sup>8</sup> See Johnson & Libecap, *supra* note 1; also see Gary D. Libecap & Steven N. Wiggins, *Contractual Responses to the Common Pool: Prorationing of Crude Oil Production*, 74 *Am. Econ. Rev.* 87 (1984), on the regulation of common pool problems in oil fields.

<sup>9</sup> See Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 *J. Law & Econ.* 1 (1969), on the "Nirvana Fallacy"; see also Goldberg, *supra* note 2.

costs associated with their overfishing. Unlike the fishing context, however, the burden of adaptation does not fall entirely on the sellers. The customers can adapt as well. (The fish, I suppose, adapt in a Darwinian sense, but we can put that aside.) They can shop intelligently, travel to suppliers who engage in little selling effort, and so forth. It is convenient to treat much of the shopping behavior as a predetermined parameter, like the feeding and migratory habits of the fish. Thus, the propensity to turn off commercials and the technology for doing so (such as remote control units) can both be treated as given. Nevertheless, it is important to recognize that the costs of overfishing can be reduced by adjustments by the customers, either individually or collectively. An individual can avert his eyes from a billboard; a government can restrict the number of billboards.

For sellers, the overfishing result can arise both within brands and across brands. Consider first intrabrand overfishing. If the manufacturer were vertically integrated into selling, it would internalize all selling costs. The seller-employee's efforts would be coordinated by the firm's internal governance mechanisms. Thus, if the firm added an additional salesman in a territory, it would take into account the additional sales generated by that salesman as well as the reduced sales (higher selling costs) of its other salesmen in the territory. Instead of full integration, the manufacturer could opt for a lesser form of integration—selective distribution.<sup>10</sup> By limiting the number of retailers carrying its products and/or restricting the dimensions in which the retailers compete, the firm can control the costs of overfishing. Territorial restrictions—for example, exclusive territories, primary areas of responsibility, location clauses—could be granted to retailers licensed to sell the product. Or retailers could be restricted to certain classes of customers (for example, nongovernment or small accounts). Restrictions on certain forms of retailer competition (akin to restricting or taxing certain inputs into fishing) could alter the marginal private selling costs of the retailers, resulting in reduced selling. Vertical restrictions, in other words, can be utilized to reduce the amount of wasteful selling effort.<sup>11</sup>

This is just the opposite of the standard justification for vertical restrictions, namely, that in their absence retailing services would be underprovided because of the free rider problem. It might appear paradoxical at first that the same type of restrictions can be used to cope with both the overfishing and free rider problems, but it is easy to see why this is true. If the manufacturer simply allows all retailers to resell his product on what-

<sup>10</sup> Any system in which the manufacturer is concerned about the identity of the resellers of his product is a selective distribution system.

<sup>11</sup> For elaboration on this argument, see Victor P. Goldberg, *The Free Rider Problem, Imperfect Pricing, and the Economics of Retailing Services*, 79 *Nw. U. L. Rev.* 301 (1984).

ever terms they choose, a retailer is neither penalized for increasing the selling costs of the manufacturer's other retailers nor compensated for the benefits it confers on them. The vertical restrictions enable the manufacturer to fine tune the reward structure in both instances.<sup>12</sup>

Restraining interbrand overfishing is a more difficult problem. It is less likely that a single firm would be in a position to profit from developing an institutional arrangement that constrains the overfishing. Trade associations and other multifirm organizations could serve this role. Manufacturers could utilize a common selling agent.<sup>13</sup> For example, a local retailer selling the brands of numerous manufacturers would internalize the costs of competitive selling; or a seller could limit the number of buyers with which it deals; or a buyer could limit the number of potential bidders for a contract.<sup>14</sup>

The emerging professional consensus is that restrictions on intrabrand competition are adopted by manufacturers on efficiency grounds. In the absence of any plausible cartelization story, the restrictions are presumed to enhance the welfare of consumers. The argument can be extended to interbrand competition as well. The devices for constraining interbrand overfishing also could yield enhanced consumer welfare. The likelihood that such devices could also be used to cartelize the industry is, of course, much greater in the interbrand case. Nevertheless, it should be clear that in a world of positive selling costs (our world) some apparently anticompetitive interbrand restraints can have a plausible efficiency rationale. That is, perhaps, the next frontier of antitrust revisionism.

## II. THE MARKETING MIX

The fisherman must make a number of decisions regarding his inputs. How many boats of what size and configuration? How should the boats be

<sup>12</sup> There is a close parallel between selling and the production of information. There are incentives to free ride on the production of information by others and incentives to "rush to invent" if the first producer can privatize the benefits of invention—for example, with patents or trade secrets. See Edmund W. Kitch, *The Nature and Function of the Patent System*, 20 *J. Law & Econ.* 265 (1977); and Yoram Barzel, *Some Fallacies in the Interpretation of Information Costs*, 20 *J. Law & Econ.* 291 (1977).

<sup>13</sup> This is a possible economy associated with DeBeers serving as a single selling agent of wholesale diamonds; for another explanation of the role of DeBeers, see Yoram Barzel, *Measurement Cost and the Organization of Markets*, 25 *J. Law & Econ.* 27 (1982); and Roy W. Kenney & Benjamin Klein, *The Economics of Block Booking*, 26 *J. Law & Econ.* 497 (1983).

<sup>14</sup> Kenney and Klein argue that having a prespecified list of buyers can reduce costs; they use this argument to explain certain features of the wholesale diamond and motion picture industries. See Kenney & Klein, *supra* note 13. For a discussion of the rewards to limiting the number of bidders on a contract, see Victor P. Goldberg, *Competitive Bidding and the Production of Precontract Information*, 8 *Bell J. Econ.* 250 (1977).

manned? And so forth. His incentive to minimize costs is not altered by the overfishing problem. It does not follow, of course, that the fisherman would use the same technology as he would if the overfishing problem were costlessly resolved. Factor productivity would differ in the two regimes. Moreover, the devices for coping with the overfishing problem might include restrictions on the use of various factors—the size of boats, the fineness of the nets, the hours and days of operation, et cetera. The individual fisherman would still have the incentive to minimize costs given these restrictions. The restrictions would not necessarily be exogenous. If, for example, the resolution of the overfishing problem were by voluntary agreement, the choice of the restrictions and the inputs would be simultaneous.<sup>15</sup>

The firm's decisions on the appropriate factor mix are, therefore, colored by the overfishing problem. Nevertheless, one can, with reasonable caution, make comparative static statements about the factor mix without reference to the overfishing complications. *Ceteris paribus*, if the price of boats increases, fishermen would switch to more labor-intensive technology. Or if advances in electronics improved the performance of large boats more than small ones, there would be a tendency to switch to the larger boats.

The seller of goods also must determine the least-cost combination of inputs. The marketing mix might include national and local advertising in various media, direct mailing, packaging, and local display and point of sale effort. Similar comparative static propositions can be made. Raising the price of an input (for example, increasing postage rates on junk mail) would result in a switch away from that input. Likewise, technological improvements that reduce the costs of using a particular technology would result in its increased use. The growth of television, for example, reduced the relative cost of national advertising and has resulted in a dramatic shift of the marketing mix toward national advertising and away from local selling effort by retailers.

This last observation suggests one way to approach the question: does advertising result in increased prices? The answer depends on whether we are changing the *level* of expenditure on marketing or whether we are changing the amount of advertising *within* the marketing mix. If the former, the chances are much greater that increased advertising would result in higher prices. If the increased advertising resulted from a change to a more efficient marketing mix, then it is more likely that prices would fall. Thus, Steiner found that when toy manufacturers began advertising extensively on television, they were able to pay retailers a lower gross

<sup>15</sup> See Cheung, *supra* note 7; and Johnson & Libecap, *supra* note 1.

margin to sell them; the increased advertising of toys resulted in a decrease in the price level.<sup>16</sup> Similarly, Benham found that lifting the prohibition on advertising of eyeglasses resulted in more advertising and less local selling effort, with a net decline in retail prices.<sup>17</sup>

The result is analogous to a reduced wage rate's resulting in a larger crew size and a decline in fishing costs. But we cannot conclude that the fishing industry as a whole utilizes the efficient amount of labor. That depends on the level of fishing effort (the overfishing problem). Likewise, we cannot conclude that sellers as a whole allocate the efficient amount of resources to advertising by observing their efficient adjustment to changes in the relative cost of advertising vis-à-vis alternative marketing techniques.

### III. SOCIAL CAPITAL

Thus far we have presumed that the consequences of the fisherman's following his narrowly conceived self-interest are confined to the inefficient utilization of the fishery. However, the level of fishing activity and the techniques employed can have additional consequences that are not taken into account by the fishermen. Overfishing one species, for example, might interrupt the food chain and adversely affect the population of other species.<sup>18</sup>

There is a parallel to this "ecology" argument in the selling context. Suppose that we begin with an equilibrium marketing mix. A new technology, telephone solicitation, is then introduced. The technology succeeds initially in part because customers had developed "telephone manners" that made them likely to listen courteously to a sales presentation. After sufficient exposure to such techniques, people might develop defense mechanisms (rudeness) that make them less susceptible to telephone salesmanship. Such defense mechanisms could have the unfortunate additional effect of reducing the effectiveness (raising the costs) of other uses of the telephone.

As a second example, consider the pyramid-based retailers. Mr. X invites his friends to his house to hear about a great scheme for making lots of money by selling the product and by inducing their friends to become sellers of the product and the scheme. The success of such systems (and a number have succeeded) depends on gullibility (suckers, in

<sup>16</sup> Robert L. Steiner, Does Advertising Lower Consumer Prices? *J. Marketing*, 1973 (No. 4), at 19.

<sup>17</sup> Lee Benham, The Effect of Advertising on the Price of Eyeglasses, 15 *J. Law & Econ.* 337 (1972).

<sup>18</sup> Positive externalities would also, of course, be possible.



keeping with the fishing terminology). But it also depends crucially on a belief that good friends will not try to defraud each other. Again, people will develop defense mechanisms, such as increased skepticism, wariness, and distrust. Such a rational, adaptive response entails the destruction of “social capital”—trust, civility, et cetera.

A single seller has no incentive to take account of the effect of his marketing innovation on social capital. Moreover, once such social capital is destroyed it is not easily replaced. The destruction of such social capital is at the root of numerous critiques of advertising, marketing, and capitalism in general—for example, the writings of John Kenneth Galbraith and Vance Packard.<sup>19</sup> I am not suggesting that such critiques are either well reasoned or correct. But this argument does help explain why these critiques come about and why they often are sympathetically received. Moreover, it has implications for the timing of these critiques; they will be most favorably received when a marketing innovation is causing the rapid destruction of a particular form of social capital. After society has adjusted, the criticism will live on primarily in the form of nostalgia, a remembrance of elements of civility, lost and probably not retrievable.

<sup>19</sup> See, for example, John Kenneth Galbraith, *The Affluent Society* (1958); and Vance Packard, *The Hidden Persuaders* (1957); see also Richard M. Titmuss, *The Gift Relationship: From Human Blood to Social Policy* (1971).