

# Why Not Abolish Antitrust?

Fred L. Smith, Jr.

**D**EREGULATORS APPEAR to be of two minds about antitrust. They denounce the actual practice of its enforcement. Yet, almost without exception, they endorse it in principle. Most want to continue to ban "excessive" horizontal mergers, price fixing, and other "anti-competitive" business practices. And most want to extend antitrust regulation to sectors of the economy that have heretofore been partially exempt, such as trucking, shipping, and airlines.

In other areas of regulation, economists have discovered that the market is far more robust in protecting consumer welfare than was once thought and that, conversely, government is highly prone to failings once thought reserved for the market (along with having some special failings of its own). Thus economic reformers have not only criticized the administration of regulatory statutes, but called for deregulation. But although they want to get rid of the Interstate Commerce Commission (ICC) and the Civil Aeronautics Board (CAB), they almost never apply the same analysis to the Federal Trade Commission (FTC) or the Antitrust Division of the Department of Justice. Antitrust may be the last refuge of the notion of "enlightened" regulation: it is thought of as a target for regulatory reform, not deregulation.

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The continued scholarly support for antitrust in principle is all the more surprising because of the tremendous erosion in support for its particular applications. Many actions once banned by antitrust enforcers, and many others still banned, are now recognized as enhancing efficiency. "Big" is no longer invariably seen as "bad," and the notion that collusive arrangements occur every day in the business world has been discredited. Antitrust is beginning to receive the same type of empirical scrutiny that George Stigler, a recent Nobel Prize winner in economics, and others have applied to consumer regulation. Yet few perceive that these waves of revisionist thinking will manage to wash away the remaining pillars of antitrust theory.

My purpose here is not to explain this inconsistency, but to review the case against antitrust and to explain why the call for complete antitrust deregulation deserves more attention than it has received. Most of my illustrations will be taken from the one area, price fixing, where nearly all economists still believe antitrust should be retained.

ECONOMISTS' SUSPICION of the efforts of businessmen to restrain trade dates back at least as far as Adam Smith's oft-quoted comment: "People of the same trade seldom meet to-

gether, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices" (*The Wealth of Nations*). But Smith doubted both the efficacy and the morality of enacting any laws on the matter: "It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice." And then he concluded: "[T]hough the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies; much less to render them necessary."

Smith's view—the view that prevailed through most of the nineteenth century—was that the dangerous sort of market power was the monopoly power that emerged from government-granted protection. Most economists, accordingly, were cool to the new idea of antitrust legislation at the time the Sherman Act passed; they did not come to endorse it with any enthusiasm until the second decade of this century, by which time the notion we all absorb from childhood—that business rapaciousness is curbed only by antitrust laws—had been popularized by the Muckrakers. And it was not until the 1960s that support for adventurist antitrust enforcement became widespread in the profession. Politically, antitrust was peaking around this time, too: in 1968 a White House task force on antitrust policy (the Neal task force) recommended laws to break up leading firms in concentrated industries, and the FTC and Department of Justice reached a zenith of enforcement activity.

That enthusiasm, however, was short-lived. Before long economic scholarship began to reveal that all sorts of antitrust policies once applauded by economists were harmful to consumer welfare. Now the critics range, among economists, from Lester Thurow on the left ("The costs [antitrust] imposes far exceed any benefits it brings," *The Zero-Sum Society*) to Milton Friedman on the right ("I am inclined to urge that the least of the evils is private, unregulated monopoly . . .," *Capitalism and Freedom*). The leading critics in recent years have been members of the Chicago School—in particular, Yale Brozen, Richard Posner, Harold Demsetz, and Robert Bork. Bork's conclusions in *The Antitrust Paradox* are reasonably representative:

[M]odern antitrust has so decayed that the policy is no longer intellectually respectable. Some of it is not respectable as law; more of it is not respectable as economics; and . . . a great deal of antitrust is not even respectable as politics.

Bork presents cogent justifications for a whole range of practices questioned by conventional antitrust theory: small horizontal mergers, all vertical and conglomerate mergers, vertical price maintenance and market division agreements, tying arrangements, exclusive dealings and requirements contracts, "predatory" price cutting and price "discrimination." He would also ignore firm size if it came about through internal growth or acceptable mergers. Moreover, he defends agreements between competitors on prices, territories, refusals to deal, and other "suppressions of rivalry" that are "ancillary" to some economic efficiency. All of these practices, Bork finds, can enhance the competitive process and have foolishly been discouraged by antitrust regulation in the past. Since it is only lately that these bastions of orthodoxy have fallen, one might expect experts to maintain a seemly humility in the case of the few remaining policies that have not yet been—but may in the future be—discredited. After all, a full repudiation of the antitrust concept itself would represent only a moderate change compared to the shifts in intellectual opinion that have already occurred.

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Yet Bork wishes not to abolish antitrust, but only to reform it so that it "advances rather than retards competition and consumer welfare." He would still ban horizontal mergers that are "too" large and arrangements to fix prices or divide markets that do not contribute to efficiency. Similarly, Richard Posner and George Stigler advised the incoming Reagan administration to "throttle back" on antitrust,

but to retain the "healthy core of federal anti-trust policy . . . the prohibition of horizontal price fixing (collusion) and large horizontal mergers." These core policies, they said, enjoy the support of "a consensus of economists of all political persuasions." Stigler's views come especially oddly from an economist who once pointed out that most economic reforms go wrong because "we don't know how to get there" (*The Citizen and the State*), who is noted for looking at the results of regulation—not its intent—and who has observed that "regulation and competition are rhetorical friends and deadly enemies" (*Can Government Protect the Consumer?*).

### The Case against Antitrust

The full case against antitrust can only be sketched in a brief essay. It has at least five versions. In reverse order of their general acceptance, they are: (1) the libertarian view that the right to fix prices is part of a general and inviolable right to dispose of one's property as one sees fit; (2) the Austrian view that the neo-classical economic rationale for antitrust, based on the equilibrium perfect-competition model, is flawed; (3) the historical argument that efforts to fix prices have in practice generally been futile and are always likely to prove so; (4) the view of some neoclassical economists that price agreements help coordinate the plans of buyers and sellers (that is, provide offsetting efficiency gains); and (5) the public choice argument that antitrust, like other forms of regulation, gives private parties a way to cripple their competition through political influence, rather than market superiority.

**Individuals Have the Right to Use Their Property as They Wish.** Liberty is a neglected aspect of antitrust discussion. Why should a businessman not be free to restrain his own trade if he wishes, alone or in combination with others? The activities prohibited under antitrust laws are invariably *peaceable* activities—whatever their merit under an efficiency standard—and thus should be allowed in a free society. In Adam Smith's view, and in the view of many others, an individual rights or justice standard is at least as compelling as an efficiency standard in judging policy.

Bork, too, notes that "when no affirmative case for intervention is shown, the general preference for freedom should bar legal coercion" (*The Antitrust Paradox*). Still, in general, the

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Chicago School's case for antitrust policy—and its opposition to price fixing in particular—rests solely on economic efficiency, as if rights had nothing to do with the matter—as if business had no right in principle to dispose of its property as it sees fit, but only a conditional freedom so long as it helps maximize some social utility function. That is to say, no business is entitled to its property if that property can be redeployed so as to expand output. With "conservative," "pro-business" economists taking this view, who needs social democrats?

Antitrust threatens basic rights in other ways, too, because of the unavoidable ambiguities and uncertainties in determining what behavior is efficient. These uncertainties lead to government arbitrariness and favoritism in enforcement, as well as a breakdown of the predictability that is necessary if citizens are to know when they are acting legally.

**The Flawed Theoretical Basis of Antitrust.** Antitrust was treated most skeptically by the illustrious economist Joseph Schumpeter, who saw the market not as some efficient state of static equilibrium, but as a dynamic process of "creative destruction." Schumpeter pointed out the artificial nature of the conventional neoclassical model of "perfect competition," in which markets are open, firms tiny, products homogeneous, buyers and sellers gifted with full information. Such a perfect world is always in equilibrium, and price equals marginal cost which in turn equals average cost. If any firm raises its prices above the market level, its sales disappear entirely. Otherwise the market is not perfectly competitive, and the firm is said to have "monopoly power," which reduces output and consumer welfare.

Whatever the educational value of this equilibrium model, it does not describe the processes by which equilibrium is approached. These processes are, indeed, the characteristic activities and features of real competition: product differentiation, price competition, advertising and other sales techniques, variation in the size and profitability of firms, technological innovation, and aggressive efforts to increase market share. When these elements of the competitive process do show up, the logic of the "perfect competition" model identifies them as "elements of monopoly."

In a true competitive economy, all firms have some degree of "control" over their prices and all seek to maximize profits by restricting output to some degree. But any "profit" that may result should be viewed, not as social waste, but rather as the dynamic incentive needed to move the economy toward more efficient production technologies and a closer match to consumer preferences. As Schumpeter explains in *Monopolistic Practices*:

[E]nterprise would, in most cases, be impossible if it were not known from the outset that exceptionally favorable situations are likely to arise which exploited by price, quality and quantity manipulations will produce profits adequate to tide over exceptionally unfavorable situations provided these are similarly managed. Again, this requires strategy that, in the short run, is often restrictive. In the majority of successful cases, this strategy just manages to serve its purpose. In some cases, however, it is so successful as to yield profits far above what is necessary in order to induce the corresponding investment. These cases then provide the baits that lure capital on untried trails.

Thus a finding that prices exceed marginal cost may well indicate only that the market is not in equilibrium—and in most sectors we would be very surprised if it were. In fact, these temporary high profit and restricted output levels increase competitiveness. As Schumpeter noted: "There is no more of a paradox in this than there is in saying that motorcars are traveling faster than they otherwise would because they are provided with brakes."

Although Schumpeter did not oppose all antitrust regulation, he wanted industry to have the flexibility to organize its own "advances" and "retreats":

Rational as distinguished from vindictive regulation by public authority turns out to be an extremely delicate problem which not every government agency, particularly when in full cry against big business, can be trusted to solve.

Dominick T. Armentano has in *The Myths of Antitrust* and more recently in *Antitrust and Monopoly* elaborated on the Schumpeter tradition in a way that provides the basis for rejecting even the remnants of antitrust regulation still favored by the Chicago School.

**Price Fixing Rarely Succeeds.** In the competitive process, said Adam Smith,

The real and effectual discipline which is exercised over a workman is not that of his corporation [guild], but that of his consumers. It is the fear of losing their employment which restrains his frauds and corrects his negligence.

As Armentano has shown, the historical record indicates that, unless the government enforces rate agreements or erects barriers to entry, price-fixing agreements are rarely effective—except where the government itself is the purchaser. Government seems to lack both the internal profit incentives and the external goad of competition to encourage efficient purchasing behavior.

A would-be price-fixer faces numerous and formidable theoretical difficulties: the availability of substitutes, product differentiation, changes in demand, supply, production technology and costs, the difficulty of policing the agreement, resale among buyers, and market power among buyers. And the major legal cases seem to indicate that price fixing is in fact rarely successful. Thus *Addyston Pipe* (1899), *Trenton Potteries* (1927), and the great electrical equipment conspiracy (1961) all resulted in convictions, but in each case the cartels did not in fact succeed in fixing prices. Armentano notes that the customers testified on behalf of the *Addyston* conspirators, and analysis of the price data by Almarin Phillips suggests that the prices the conspirators charged were reasonable.

In his new book, *Concentration, Mergers and Public Policy*, Yale Brozen cites evidence that the *Trenton Potteries* defendants also failed in their attempt to fix prices: "the prices offered by low bidders were not those fixed by

the cartel." Official cartel prices no more dictate what consumers pay than list price dictates what you pay for a car. Yet even Bork approvingly quotes *Addyston Pipe* and *Trenton Potteries* as well-founded applications of the antitrust rules against cartels: the "contributions [of the rule against price fixing] to consumer welfare over the decades have been enormous." This is mysterious: consumers are not damaged by ineffective cartels, and Bork cites no effective cartels.

An antitrust case against a New Jersey trucking rate bureau, recently analyzed by Bruce Allen of the University of Pennsylvania, illustrates some of these questions. The case, on the surface, would seem to support antitrust theory. The carriers in the rate bureau published official rates that averaged 10 to 20 percent higher than those of independent carriers. Whether they succeeded in wielding market power, however, is questionable. A number of important shippers were not among the "cartel's" customers, and some independent carriers heavily advertised their lower rates in a bid for market share. There are also several reasons why rate bureaus may provide better service and thus command a higher price: they may lower the information costs of small shippers or pay better attention to their shipments (which may be why some large shippers used the large independent carriers). Most crucial, perhaps, the official bureau prices may not have been the prices actually charged by the member carriers. Unfortunately, data were not available on what shippers actually paid or how much traffic was actually carried at the higher rates.

If there is little empirical evidence that price fixing harms consumers even in such suspicious circumstances, it is no wonder that it cannot be proved significant in ordinary business settings.

**Price Coordination Enhances Efficiency.** Why might restrictive arrangements serve efficiency goals? One reason is that they provide firms with information that allows them to plan their production and marketing more efficiently. Friedrich Hayek and Thomas Sowell, for their part, say that the market's most vital and misunderstood role is that of creating information. Price discussions are one way to reduce the costs of information exchange. Truckers often

claim that mutual discussions and common tariffs facilitate some discounts, product quality differentiation, and new services by providing a universally understood basis for bargaining and informing competitors of the state of the market. Such information might be supplied to the industry in other ways, by outsiders such as trade associations, consulting firms, or the trade press. But the market may be trying to tell us that the firms in the industry are best equipped to develop this information. To bar them from doing so does not deprive them of the market information, but merely increases needlessly the cost of providing it.

Most economists have come to perceive important efficiency gains in many vertical price maintenance agreements, but in the case of horizontal agreements they credit gains only where the collaborators actually integrate their economic activities and achieve cost reductions (an exception is Richard Posner's testimony on railroad rate bureaus and economic efficiency before the ICC on July 16, 1980). Bork discusses a number of ways, long ignored by antitrust scholars, in which rate fixing that is "ancillary" to the integration of economic activity can lead to important economic gains. Thus he concedes that rate cartels may reduce the costs of obtaining market information; but "the possible savings seem minuscule compared to the certainty of output restrictions"—although, as we have already seen, cartels do not always reduce output. Since there is no way to know beforehand how much the coordination of information is worth, how can we be sure that the efficiencies will be trivial? Bork does not tell us.

Outside observers find it hard to verify that "efficiency" has or has not improved in any instance, and harder to quantify its extent. Bork admits that this is a very subjective and subtle area, but he is willing to condemn price fixing anyway because he believes its only significant efficiency advantages are associated with some integration of other economic activities. But the survival of cartel arrangements in some open markets for long periods, despite open entry, suggests they must be providing efficiencies to shippers important enough to justify the higher rates.

No one can be sure what business arrangements will efficiently serve consumers even ten minutes from now, let alone in the year 2135. Antitrust laws, in their static way, typically ban

activities for which officials and scholars have not yet discovered the rationale; markets are more dynamic than that. The Justice Department and FTC now say that their antitrust policy has changed, and that in future they will allow most efficiency-enhancing arrangements—except for those that encourage price fixing.

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Aside from the inherent difficulty of making the latter judgment, it must be noted that in the past trustbusters have seen price fixing almost everywhere, so that it is doubtful that they will allow many new arrangements.

**Antitrust Encourages Business to Look to Government.** As Bork and others have shown, antitrust has often protected inefficient producers. These producers invoke government help to squelch their low-cost competition—much as truckers file ICC complaints against rate discounters. From July 1976 to July 1977, private parties filed 1,600 antitrust suits in federal courts, while government filed only 78. Antitrust encourages firms to win their competitive fights by relying on Washington lawyers and lobbyists instead of engineers, scientists, and computer experts.

William Breit and Kenneth Elzinga, two commentators relatively sympathetic to antitrust, note nonetheless that it “affords inducements to customers to behave perversely in hopes of collecting greater damages.” Part of the problem is that buyers “can view the antitrust laws as a type of insurance policy against ‘poor purchasing’ and will at the minimum reduce their precautionary purchasing efforts.” Breit and Elzinga cite a 1951 case in which an Arkansas canner refused to accept a shipment of cans because of a minor dispute over freight pricing, and then sued the can maker for triple damages “for losses incurred partly because the canning company had no cans.” (A lower court ruled for the plaintiff, but was reversed on appeal.) Since 1951, Breit and Elzinga add, it has become much harder for defendants to

escape by citing this sort of “antitrust entrapment”—which further encourages customers to try to strike it rich in the treble-damage sweepstakes.

### Changing the Law

Any effort to challenge antitrust in principle will have to move beyond the coalition politics of trucking and airline deregulation. Libertarians—who hold that the right to reach voluntary price agreements is part of companies’ general right to economic freedom, not a special privilege—are perhaps the natural core of a coalition for antitrust deregulation. Liberals and populists, on the other hand, seem to have supported past deregulatory moves because they view price floors and entry restraints as “pro-business”—which they do not believe, at least at present, is true of antitrust. Even liberal reformers who are no fans of trustbusting want special measures to deal with big firms; though Galbraith, for example, says that big-business is here to stay, he favors federal chartering of large firms. Many populists also view antitrust as a tool to force industry into various sorts of “cooperative” arrangements with government, as by allowing mergers when firms make concessions on plant closings. It will take a big educational effort to convince liberals that business itself uses antitrust in an anti-competitive manner.

Getting rid of antitrust would also focus reformers’ energies on the true enemy of competition and consumer welfare—state-created privileges. In his recent book, Brozen notes that those structuralists who once saw low concentration and a large number of firms in a market as the essence of competition have largely changed their views: “entry barriers are the appropriate arena for antitrust action. The most significant barriers are those administered by regulatory agencies and licensing authorities.” Armentano carries the point further:

The critics of American business are right to be concerned about the manifestation of political power in society, but they are wrong to argue that monopoly power is to be associated with product differentiation or with concentration and market share. Nader, Green, and others, despite

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some promising early work, have continued to blur the essential differences between private persuasion and government coercion, between efficiency as a barrier to entry and pernicious legal barriers, between power and production, and between economic and political accountability. Large corporations in open markets—regardless of their size—must earn their market positions each day through voluntary exchange [*Antitrust and Monopoly*].

The stakes are high, as Bork points out:

Antitrust goes to the heart of capitalist theology, and since the laws' fate will have much to do with the fate of that ideology, one may be forgiven for thinking the outcome of the debate is of more than legal interest.

The most immediate ramifications of that debate are the controversies over whether to extend antitrust to previously exempt industries that are being deregulated. The trucking industry by and large wants to retain its antitrust exemption—no doubt because it hopes that exemption will prevent competition. Since this industry now enjoys more political than intellectual support, it may be able to win continued antitrust immunity without mounting any intellectual case at all. This would be unfortunate; such a victory would be widely perceived as just another instance in which industry power prevailed over the interests of the consumer.

It would therefore be a step forward if the truckers and other industries facing antitrust assault came to see that they have a more principled case for their position. To accept antitrust liability as the natural corollary of deregulation would mean the effective reregulation of every firm's price (and, in some cases, its entry) decisions. So it is only natural for the industry to resist. Which means that when truckers, travel agents, or others ask for exemption from antitrust regulation, they are not necessarily itching to organize a cartel the moment the public's back is turned. They may simply and understandably be trying to avoid a burdensome, unfair, and unproductive layer of regulation. And they may just have been reading the economic literature of the past decade. ■