

# ANTITRUST IN DUBIOUS BATTLE

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*When this article was written the Antitrust Division, under a new administration, had announced and launched a major campaign against conglomerate mergers. Partly because of the direct effects of that campaign and partly because of the implications of the Division's rhetoric, this seemed to many people a most unpromising start, and we said so. Whether or not the outside criticism had any effect, somebody or something apparently did. The campaign against conglomerates seems to be in at least temporary abeyance, and the Antitrust Division, headed by Mr. McLaren, appears to be moving rather more in the direction suggested in the next to last paragraph of this article. It would be unfair to permit a reprinting without admitting what I perceive as a real improvement in the Division's policies. The main argument of this piece remains relevant, I believe, both because much more reform in antitrust is called for and because others, if not Mr. McLaren, continue to urge severe limitations upon conglomerate mergers.*

In antitrust policy the Nixon Administration has sprinted away to a fast start in the wrong direction. The Antitrust Division of the Department of Justice appears in danger of not only missing a rare and invaluable opportunity to reform this sadly decayed field, but — if its unreflective assault on conglomerate mergers is a taste of the future — making a bad situation much worse. If it wishes to pursue a course that is responsible and constructive, this Administration had better pause and take serious thought about the proper goals of antitrust and the means by which they can be achieved.

There has grown up in recent years the pernicious notion that antitrust is some sort of open warrant for prosecutors to roam the business world like knights-errant, deciding for themselves, often in defiance of conventional anatomical indicia, which are the damsels and which the dragons. Right now the chief of the Antitrust Division, Richard W. McLaren, seems to think he sees a lot of conglomerate mergers exhaling flames. Before he slays them, it is fair to ask his reasons, since he sometimes sounds as if the antitrust laws were his mandate to pursue every social policy except the prevention of lascivious carriage.

Among other things, he has mentioned that conglomerate acquisitions may be tax-motivated, may involve the issuance of dubious securities, are causing something called a "radical restructuring" of the economy, and result in "human dislocations."<sup>1</sup> Valid or not, these objections have nothing to do with antitrust policy. Take "human dislocations," for example. What precisely, does McLaren have in mind?

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<sup>1</sup> In *Hearings on H.R. 7489 Before House Ways and Means Committee*, 91st Cong., 1st Sess., pt. 7, at 2392 (1969) (testimony of Assistant Att'y Gen. McLaren).

When the headquarters of one or two large companies are removed from the nation's smaller cities to New York or Chicago or Los Angeles, I think we all recognize that there is a serious impact upon the community. The loss is felt by its banks, its merchants, its professional and service people — accountants, lawyers, advertising agencies. The community loses some of its best-educated, most energetic and public-spirited citizens. I am concerned that even some of our larger centers may become "branch house cities," whose major business affairs are directed by absentee managers . . .

As I have indicated earlier, these are results which contravene the national policy as repeatedly expressed by Congress.<sup>2</sup>

Every lawyer loves a skillful gambit, and attributing to Congress a clear-cut policy it never voted on has always been considered good, clean legal fun, the sort of ink cloud you shoot out when neither the statute nor the facts of the case support your position. But this is going a little too far. McLaren is now more than an advocate: he is a policymaking official.

It is time somebody spoke the magic words "law and order." Members of this Administration must certainly display a positive reaction to that phrase, and law, we surely need not remind them, imposes restraints upon prosecutors and courts quite as much as upon ordinary citizens. The creative flair of the Antitrust Division must be kept within the bounds of the statutes it has been given to enforce. Congress has never, much less "repeatedly," enacted a keep-'em-down-on-the-farm statute that makes the illegality of a merger depend upon its contribution to some interstate brain drain.

It may be admitted that the opinions expressed in the congressional debates on the merger statute, section 7 of the Clayton Act as amended in 1950,<sup>3</sup> display the same richness of variety as the contents of a fruitcake, so that you can pry a fragment of almost any social policy out of them. But the statute Congress actually voted on calls solely for the preservation of "competition" and the avoidance of "monopoly." It forbids acquisition of one company by another, that is, only where the effect "may be substantially to lessen competition or tend to create a monopoly." With the aid of a little basic economics, you can make a law out of that — taking the terms, as is natural and sensible, to refer to the desirability of efficient use of economic resources in the interest of consumers. But should the Antitrust Division attempt to judge conglomerate mergers by weighing gains in efficiency and competitive vigor (which McLaren admits are relevant) against losses to the certified public accountants of Keokuk, mixing in sociological speculation whether that city or Chicago more urgently needs a particular lot of public-spirited citizens, the result can only be uninformed, ad hoc political guesswork, not anything remotely recognizable as law.

Such a result would violate not merely the wording of the statute but, more fundamental, the ideal of law. Antitrust is a hybrid policy science,

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<sup>2</sup> *Id.*

<sup>3</sup> 15 U.S.C. § 18 (1964).

being composed of both law and economics. I use the word "science" deliberately. We are too little accustomed to thinking of law as a science, and indeed in current practice there is little enough to suggest the concept, but it should be obvious that law must develop the characteristics of a policy science if the ideal of the rule of law is even to be approximated. At the center of any science of law must stand a normative model of judicial behavior, which is to say a system of understood constraints upon the values judges may consider in deciding cases and the methods by which they may reason from proper values to the decision of specific controversies. To a large extent that model must be based upon the specialized function of courts as against the explicitly political role of the legislature.

Antitrust, unlike many other fields of law, already possesses the rudiments of such a science, but failure to follow its principles consistently has led to much that is wrong, and even perverse, in current judge-made law. To start with the bright side, the Supreme Court has resolutely refused to judge the legality of pricing agreements by the general "reasonableness" of the prices charged.<sup>4</sup> To do so would have mired the Court, without criteria fit for judicial use, in a grossly political balancing of the interest of consumers in low prices against the interest of producers in high prices. Any such compromise between the conflicting claims of interest groups belongs to the legislature. But the Court in recent years has failed to recognize that it commits the very error it avoided in pricing cases when it undertakes to balance the interest of consumers in increased efficiency against the interest of what the Court calls "viable, small, locally owned businesses." This is what the Supreme Court has done in some merger cases.<sup>5</sup> This case-by-case legislative compromise is not only an improper function for courts applying statutes, but also one at which they are not at all adept. In antitrust, when inconsistent values have been let in, it has been the consumer interest that has gone under. And yet this is the primary value that antitrust's protection of competition is intended to serve.

#### THE FIRST REQUISITE OF REFORM

It hardly needs saying that the same value constraints are relevant to prosecutors. If, for example, a judge is not properly free under amended section 7 of the Clayton Act to determine the legality of a corporate acqui-

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<sup>4</sup> This has been the general rule since the first price-fixing case to reach the Supreme Court: *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897). But the rule has constitutional dimensions as well. *See, e.g., United States v. National Dairy Prods. Corp.*, 372 U.S. 29 (1963); *United States v. Cohen Grocery Co.*, 255 U.S. 81 (1921); Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 74 *YALE L.J.* 775, 829 *et seq.* (1965).

<sup>5</sup> *See Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962). Balancing the interest of consumers in superior efficiency against the interest of small business in survival or profitability requires precisely the same case-by-case choice between rival philosophies that the Court refused to undertake in the guise of determining reasonable prices. *See cases cited note 4 supra; United States v. Trenton Potteries Co.*, 273 U.S. 392, 398 (1927).

sition according to the dollar worth of the corporation's assets, it is certainly not proper for a prosecutor either to try to persuade the judge to do just that, or to bring actions, motivated by such considerations, that will at the least have harassing effects. That amalgam of muddled thinking, social mythology, and sentimental rhetoric known to its intimates as "the social purposes of antitrust," however sonorously it may ring upon ritual occasions for mock-Jeffersonian oratory, must be excluded from judicial and prosecutorial decisions about actual cases. The first requisite of antitrust reform, therefore, is the identification of and principled adherence to proper goals. *The only legitimate goal of our present statutes is the maximization of consumer welfare.* And that is true, I stress, not because antitrust is economics, but because it must be, first and foremost, deserving of the name of law.

Businessmen can seek profits in two quite different ways that impinge upon consumer welfare. One is the method of monopoly — gaining market control in order to increase net return by restraining output and raising prices. Monopoly misallocates resources with the result that the economy as a whole produces less than it otherwise could, a clear disservice to consumers. The other and altogether different method is the creation of efficiency — by cutting costs, opening new markets, offering new or modified products and services, or in other ways vying successfully for consumer dollars. The whole task of a consumer-oriented antitrust policy is to estimate which of these opposing effects predominates in any specific market behavior or structure.

Since neither misallocation of resources nor efficiency can be directly measured, there is absolutely no merit to the common proposal to decide cases by studying all relevant performance factors. To illustrate, we cannot begin to quantify a claimed future improvement (or decline) in the performance of Jones & Laughlin resulting from its acquisition by Ling-Temco-Vought, because that would require, among other impossibilities, precise statements about differences in quality of future decisions concerning problems that cannot now even be identified.

#### THE PHILO VANCE APPROACH

Correct analysis employs what has been called, with misplaced sarcasm, "the Philo Vance approach to antitrust." Since courts cannot measure efficiency or misallocation directly, they must rely on probabilities, framing general rules on the basis of economics. Where economic theory tells us that certain business behavior is likely to result in monopoly profits and misallocation of resources, such behavior should be illegal. All other behavior should be lawful so far as antitrust is concerned, since, in relation to consumer welfare, it is either neutral or motivated by considerations of efficiency. A tax-propelled conglomerate merger, for example, is neutral since courts have no means of judging what impact, if any, it will have upon

consumer welfare. They should, therefore, leave the situation to the tax laws or to any other statutes Congress may enact. *Efficiency-motivated mergers deserve the law's protection. The market will penalize those that do not in fact create efficiency.*

Economics provides one other lesson that should be written in red letters across every antitrust prosecutor's bathroom mirror: injury to *competitors* is irrelevant to the question of injury to competition and consumer welfare. Much antitrust argument today seizes upon the fact of competitor injury and treats it as not merely relevant but decisive. The antitrust enforcer, with a massive *non sequitur*, leaps from observed fact to inferred significance as nimbly as did the apocryphal fundamentalist: "Believe in baptism? Why, man, I've seen it done!"

You may see injury to a competitor; you will never see, as raw fact, injury to competition. The presence of the latter can be inferred only on the basis of economic theory. A company's loss of sales — which is all that is ever meant by injury to a competitor — is fully consistent with a gain in efficiency by a rival company. Because antitrust law has confused the fact with the inference, many of its most cherished doctrines strike directly at efficiency as a threat to competition. In such cases, and they are increasing in number, the law itself inflicts upon consumers the kinds of losses that it is intended to prevent.

Unhappily for those of us who make a living out of antitrust's mysteries, the truth is that the law almost always, regardless of context, uses one of two basic theories of how competition may be injured:

1) Competitors may agree to remove the rivalry existing between themselves; or

2) Competitors may inflict injury on rivals and thereby ultimately injure the competitive process.

Cartels and large horizontal mergers fall within the first theory, which, though it has been drastically over extended, contains an important core of validity. The second theory — that of supposedly "exclusionary" practices — is the sole support for the present stern rules concerning vertical mergers, tying arrangements, exclusive dealing contracts, and price discrimination, as well as for the developing harsh treatment of conglomerate mergers and reciprocal buying. This large and growing structure of law rests upon an exceedingly flimsy foundation, for in the version used by the law the idea of exclusionary practices as a threat to competition is fallacious.

#### ADD TWO AND ZERO AND GET FOUR

The fallacy lies in counting the same thing twice — in this case, the same market power. The nature of the error, which is basic to antitrust's current confusions, can be simply illustrated. Frank Carruthers, let us suppose, owns the only motion-picture theatre in the remote hamlet of Lakeville, Connecticut. Having a monopoly, he drives the price of films down to

\$800 while exhibitors in New Haven must pay \$1,000 for a film of equal quality. Carruthers expands by purchasing one of the New Haven theatres, thinks the situation over, and telephones a distributor to announce that he wants better-quality films for his newly acquired theatre in order to gain an advantage over the opposition. "Delighted," the distributor replies, "I can let you have them for \$1,200 each."

"You don't understand," says Carruthers. "I want the better films in New Haven for \$1,000 or I won't show any of your films in Lakeville."

According to the prevalent antitrust thinking, the distributor has no choice but to say yes to this demand, but I think we may confidently rely upon him to say no. Of course, it is worth something to the distributor not to be excluded from Lakeville. But — and this is the overlooked point — Carruthers has already exacted that something, in the form of the \$200 discount on \$1,000 films. Carruthers cannot eat his cake in Lakeville and have it in New Haven too. In demanding a \$200 discount in Lakeville *and* a \$200 discount in New Haven, he is demanding that the distributor pay for the same thing twice, pay \$400 for a market advantage worth \$200. It won't work.<sup>6</sup>

Presumably, Carruthers could, if he chose, give up the discount in Lakeville in exchange for a \$200 discount on better films in New Haven, but that would bring him no unfair advantage. Rival exhibitors in New Haven would have to pay \$1,200 for better films, and so would Carruthers — \$1,000 plus the \$200 given up in Lakeville.

Under one guise or another, the fallacy of counting the same market power twice pervades antitrust law. It turns up, for example, in the precedent-making suit that the Antitrust Division filed against I.B.M. in the closing days of the Johnson Administration. The charge, laid under section 2 of the Sherman Act,<sup>7</sup> is monopolization. I.B.M.'s share of industry revenues has varied, according to the complaint, from about 69 to 80 percent in recent years. These figures suggest superior efficiency, but the complaint attempts to avoid this natural inference by alleging that I.B.M. denied its rivals the opportunity to compete.

I.B.M. did this, it is alleged, through such devices as quoting a single price for computers and software. But since I.B.M. can charge all its computer is worth in the price of the computer, it cannot get more than the combined worth of computer and software by selling them together, any more than Carruthers could get more than the combined worth of his positions in Lakeville and New Haven by negotiating for them together. Does the selling of computer and software together improperly inhibit the ability of rival computer makers to compete? Of course not. If they can compete with I.B.M. in computers, they can either produce the necessary

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<sup>6</sup> This hypothetical, of course, is based upon the Supreme Court's rationale in *United States v. Griffith*, 334 U.S. 100 (1948).

<sup>7</sup> 15 U.S.C. § 2 (1964).

software themselves or find other companies that can. Then the customer can choose the package he likes best. To assume that competitive software is not available to I.B.M.'s rivals is to assume that I.B.M.'s market strength lies not in computers but in software, and, therefore, that the government has the case backward. Chances are I.B.M.'s single-price package was a convenience or contributed to the total service the company sold, in either case a form of efficiency — which does, to be sure, make life harder for rivals. But it is impossible to see the practice as a means of improperly preventing competition, and with that idea out of the way, the government's suit stands revealed as an attack on outstanding commercial success as such.

Although numerous economists point to the double counting of market power as an obvious error, antitrust prosecutors continue to assert, in one context after another, the equivalent of the proposition that a seller can add \$200 and zero and get \$400. Clearly, this peculiar form of new math is wrong — the questioned behavior has other motivations and other effects. Since double counting forms the mainspring of antitrust reasoning about exclusionary effects, a large body of antitrust doctrine, including the existing and emerging rules against vertical and conglomerate mergers, must be considered to stand unjustified.

#### CONGLOMERATE MERGERS — PHANTOM THREAT

The Nixon Administration's announced determination to wage war on conglomerate mergers — with special but by no means exclusive attention to the acquisitions of the top 200 manufacturing companies — must rank as one of the bleakest, most disappointing developments in antitrust history. An Administration that could have initiated pro-consumer reforms has chosen instead to accentuate and extend some of antitrust's most irrational economic theories. The campaign against conglomerate mergers is launched in the teeth of the conclusion reached by the task force that President Nixon himself appointed to study and report on antitrust policy. The task force, headed by George J. Stigler, professor of economics at the University of Chicago, said of conglomerate mergers: "Vigorous action on the basis of our present knowledge is not defensible."<sup>8</sup> It most certainly isn't. And yet since the submission of that report we have had not only announcements that vigorous action is to come, but also the filing of suits against L-T-V's acquisition of Jones & Laughlin, I.T.T.'s acquisition of Canteen Corp., and Northwest Industries' attempt to purchase effective control of Goodrich.

If McLaren succeeds in sustaining the theories of these cases in court — and in recent years the Antitrust Division has been able to get almost any theory upheld in the Supreme Court — he may have succeeded in destroying the last vestiges of rationality in the antitrust laws. If conglomerate mergers can be held a threat to competition, anything can. Other diversified

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<sup>8</sup> 1969 PRESIDENTIAL TASK FORCE REPORT ON PRODUCTIVITY AND COMPETITION, 115 CONG. REC. 6476 (daily ed. June 16, 1969) [hereinafter cited as STIGLER TASK FORCE REPORT].

companies, and our economy is full of them, had better take a hard look at what is happening to conglomerate mergers, for there is little in McLaren's theories that would not apply equally to companies that have become conglomerate-like through internal growth or whose mergers are years or even decades old. One lesson the study of antitrust teaches is that the law is capable of adopting wrong premises, freezing onto them despite repeated demonstration of their error, and then reasoning inexorably to what a few years earlier would have seemed to be impossibly bizarre results. Each time this happens, the threat seems to have been totally unforeseen by those who are hurt.

By definition, conglomerate mergers put together companies that are not competitors. The motivation for such an acquisition cannot be monopoly profit, since the merger does not increase market share. The motivation for conglomerate mergers, therefore, probably either lies outside the domain of antitrust (*e.g.*, promoters' profits or tax advantages) or rests upon expectations of increased efficiency.

Against these obvious considerations, those who advocate an antitrust attack upon conglomerate mergers raise a variety of debaters' points that can, I believe, be characterized as essentially frivolous. The most commonly urged points against conglomerate mergers are that they increase a general concentration of ownership in the American economy, raise the possibility of reciprocal buying, and create — dread phrase — “barriers to entry.” The first of these points is, at its strongest, irrelevant; the second describes a practice that is either harmless or beneficial; and the third raises a specter that is just that, an incorporeal apparition.

#### A PROPHECY THAT NEVER CEASES TO FRIGHTEN

The imminent concentration of all ownership in a few giant corporations, with the accompanying demise of sturdy, locally owned small business, is the standard, Mark I, all-weather antitrust hobgoblin. It serves not only against conglomerate mergers, of course, but against any merger involving a very large company, even where the acquired company is far from large. This congealing of the economy has been prophesized freely at least since 1890 on the basis of perceived trends, and it never happens. It also never ceases to frighten people. The evil of the predicted economy-wide concentration is supposed to be both so self-evident and so enormous that counter-argument is overwhelmed. Nothing about the prediction is self-evident, not the statistics, the correctness of the extrapolation, or the assumed sociological, political, or economic consequences.

These all deserve examination, but the point to be emphasized here is that the superconcentration issue, whether genuine or synthetic in other aspects, is a *bogus antitrust issue*. It has no proper place whatever in enforcement decisions under the present statutes, because it is irrelevant to competition in particular markets and to the allocation of resources by the



market mechanism. Consistent with the consumer-welfare standard, it is *market* concentration, not economy-wide concentration, that is the subject of the Clayton Act's provisions concerning "competition" and "monopoly." Congress could write a statute about the sociological implications of economy-wide concentration achieved through mergers—a statute that would perhaps be phrased in terms of the size of merging companies' assets. But Congress has not done so. If superconcentration is a matter of concern, Administration officials should appear before the appropriate congressional committees to ask for a political decision, expressed in the form of a statute, on how superconcentration should be dealt with, and how much economic benefit we are willing to sacrifice in the process.

Another hobgoblin is reciprocity, the business practice of buying from those who buy from you. Though it has probably been going on since men traded arrowheads for mammoth hides, it has only recently been discovered to be anticompetitive. The discovery comes at an opportune time for the anti-conglomerate campaign—the more diversified a firm becomes, the more likely that somewhere in its complex dealing it will find the chance to practice reciprocity. Attorney General John N. Mitchell has indicated that the potential for reciprocity will be a key argument in the attack on conglomerate mergers. He characterized the practice as "[o]ne of the most easily understandable dangers posed by the conglomerate merger."<sup>9</sup>

On the contrary, in economic terms the "danger" is not understandable at all, much less easily. As the Stigler task force reported, the "economic threat to competition from reciprocity (reciprocal buying arrangements) is either small or nonexistent."<sup>10</sup> The objection to reciprocity involves the Carruthers fallacy—counting a quantity of market power more than once. If a company is using its position as an important customer to bargain the best possible prices from its suppliers, then that company has no market power left to force the suppliers to buy from it on noncompetitive terms.

The rhetoric of "barriers to entry" is the latest conceptual fig leaf used by the enforcement agencies to hide the obtrusive fact of life that commercial success is usually due to superior efficiency. So far this rhetoric, too, has been highly successful. It persuaded the Supreme Court<sup>11</sup> to strike down Procter & Gamble's acquisition of Clorox on the theory that any addition to Clorox's effectiveness in the market for household liquid bleach would raise barriers to entry.<sup>12</sup> In the long course of that litigation, nobody—not the FTC, the Antitrust Division, the Solicitor General, or the Court—ever explained even once how a "barrier to entry" differed from superior efficiency.

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<sup>9</sup> Address by Att'y Gen. Mitchell, Georgia Bar Ass'n, June 6, 1969, in 5 TRADE REG. REP. ¶ 50,247, at 55,507 (1969).

<sup>10</sup> STIGLER TASK FORCE REPORT 6476.

<sup>11</sup> FTC v. Procter & Gamble Co., 386 U.S. 568 (1967).

<sup>12</sup> See Bork, *The Supreme Court Versus Corporate Efficiency*, FORTUNE, Aug. 1967, at 92.

The case centered on the "barrier" that would be created if Clorox shared in the quantity discounts that Procter was supposed to receive from the television networks. Nobody ever showed why the ability to get such discounts should not be considered an efficiency. And now, most humiliating development of all, it begins to appear from the separate researches of David Blank, a vice president of C.B.S., and John L. Peterman, a professor at the University of Chicago Law School, that the crucial quantity discounts may have suffered from the even more serious defect of not existing.<sup>18</sup> This whole episode has an air of satire: a major merger was dissolved, an unsound concept was embedded in the law, and a vital precedent was established—all on the application of an erroneous theory to an apparently nonexistent "fact."

The only way a company can make entry more difficult through a conglomerate acquisition is by increasing efficiency, and that is beneficial. But if the Antitrust Division succeeds in inhibiting conglomerate mergers with these theories, it will have erected real, and truly anticompetitive, barriers to entry. A successful legal attack would deny us the benefits these mergers can confer: revitalizing sluggish companies and industries; improving management efficiency, either through replacement of mediocre executive or reinforcement of good ones with aids such as superior data retrieval or more effective financial-control systems; transferring technical and marketing know-how across traditional industry lines; meshing research or distribution; increasing ability to ride out fluctuations; adding needed capital; and providing owner-managers of successful small companies with a market for selling the enterprises they have created, thus encouraging other men to go into businesses of their own.

#### MISTAKING HORIZONTAL FOR VERTICAL

The same sort of confusion that characterizes antitrust arguments against conglomerate mergers also shows up in arguments against vertical mergers. A vertical merger, of course, is one in which the acquired company is, actually or potentially, a customer or supplier of the acquiring company. The courts, at the urging of the Antitrust Division, treat vertical mergers with a ferocity wholly unjustified by economic analysis. The law supposes that a manufacturer, *M*, with 5 percent of a market, can "foreclose" his rivals and "lever" himself to a competitively unjustified market share by acquiring a retailer, *R*, who has 1 percent of the market and has been selling other manufacturers' products. This is the Carruthers double-counting fallacy again. The theory assumes that *R* can both enjoy whatever market position it had established and simultaneously transfer its enjoyment to *M*. It is assumed, in other words, that by forcing its goods on *R*, *M*

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<sup>18</sup> Blank, *Television Advertising: The Great Discount Illusion, or Tonypandy Revisited*, 41 U. CHI. J. BUS. 10 (1968); Peterman, *The Clorox Case and Television Rate Structures*, 11 J. LAW & ECON. 321 (1968).

picks up an additional 1 percent of the market in manufacturing, while *R* keeps its 1 percent in retailing.

But whatever considerations of price, quality, consumer preference, etc., had previously persuaded *R* not to specialize in *M*'s goods are still operative. If *M*'s goods are forced on *R*, then the retailer loses the profits that the manufacturer gains. The law's theory of foreclosure, then, turns out to be mistaken. The only sensible explanation for the vertical merger of *M* and *R* is that through economies in distribution, management, and the like, it creates profitable efficiencies, which are socially beneficial.

Apologists for tough rules against such mergers (joining manufacturers and merchants in the same line of goods) usually prefer to argue an extreme case. Suppose *M* should buy 100 percent of the retailers, they say; that surely confers the ability to gain a manufacturing monopoly. As an objection to vertical merger, this argument is spurious — the case as stated is horizontal, not vertical. The problem in such a situation is not the foreclosure of rival manufacturers but the elimination of rivalry at the retail level. To be clear about that, ask yourself whether the situation would be any better if, instead of *M*, a complete stranger to the industry had bought all the retailers. The answer, clearly, is no: in either case a horizontal monopoly has been created at the retail level.

What I am suggesting is that vertical mergers should be judged by horizontal-merger standards. Thus any acquisition by a manufacturer of a single retail firm should be lawful, because it does not increase market power at the retail level. If the manufacturer acquires two or more retailing companies, horizontal merger standards should be applied to the share created in retailing. I am further suggesting that a manufacturer's acquisition of retailers in the same line of goods should be judged by the same standards as would apply to their acquisition by a newcomer to the industry.

#### AVOIDING BOTH KINDS OF MISALLOCATION

Size or market concentration created by horizontal merger (merger between actual or probable rivals) is a completely different animal from size achieved by internal growth or by conglomerate or vertical merger. Growth demonstrates superior efficiency; horizontal merger to a very large market share does not — it may have been motivated primarily or even solely by a desire to reap monopoly profits. Conglomerate and vertical mergers cannot create the ability to increase profits with restricted output; large horizontal mergers can. On the other side, however, monopoly profit cannot be the motivation for horizontal mergers that add up to only a small share of a market.

To take a clear case: when companies each having 1 percent of a fragmented industry merge, they cannot be supposed to have monopoly profit in mind. As in the case of conglomerate and vertical mergers, their motivation must be either increased efficiency or some effect irrelevant to antitrust.

It is, therefore, intelligible policy to set limits on market shares achievable by horizontal merger, but the limits must not be so narrow that their predominant effect is to ban mergers motivated by valid business considerations. Error in either direction will be costly. Allowing horizontal mergers that are too large invites resource misallocation through deliberate restriction of output. Allowing only horizontal mergers that are very small enforces resource misallocation through lowered efficiency.

We are dealing with a spectrum, and it must be confessed that the proper place to cut it is not at all clear. Unfortunately, our guidelines are few and uncertain. But rough observations are enough, I think, to indicate that present law about horizontal mergers is far too harsh.

#### A CONCESSION TO A PHOBIA

The purpose of limiting horizontal mergers to market shares far smaller than those that would be required for monopoly profits is to guard against "oligopolistic" erosion of competition, *i.e.*, the possibility that a few dominant companies may restrict output through noncollusive mutual restraint. (The term "noncollusive" is essential here, for collusive restraint of competition is illegal *per se*.) In a concentrated industry, according to some theories of how oligopolies work, it is possible for supposed rivals to soften rivalry through "conscious parallelism." By following an industry leader, or by acting in accordance with what they know of each other's policies, it is said, these companies move in lockstep in matters of production levels and pricing without actually communicating with each other.

But even if one assumes this picture to be accurate for some industries, that still does not justify the stringency of the present rules on horizontal mergers. Judging from such indications as the eagerness of oligopolists to engage in actual collusion despite the considerable legal dangers, the frequency with which even elaborately negotiated and policed collusive schemes break down under the temptations and pressures of the marketplace, and the dramatic drop in prices that often occurs when even a two-company situation replaces a one-company situation, I would estimate that noncollusive restriction of output is usually not a serious problem where there are as many as three substantial companies in a particular market. (I am not asserting that it is necessarily a serious problem where there are only two.)

As a tactical concession to current oligopoly phobia, I am willing to weaken the conclusion that should follow from that and propose a rule permitting horizontal mergers up to market shares that would allow for other mergers of similar size and still leave *four* significant companies in the market. In a fragmented market, this would indicate a maximum share attainable by merger of about 30 percent. In a market where one company already has more than 30 percent, the maximum would be scaled down somewhat. For example, where one company has 50 percent, no other com-

pany could go above about 20 percent by merger (barring some exceptional case, such as the imminent failure of one of the merger partners).

I do not claim that such a rule, or any other I might devise, would either completely prevent noncollusive restriction of output or completely avoid needless destruction of efficiencies. Some such welfare losses are inevitable in any policy that can be framed with respect to horizontal mergers. But I am reasonably confident that this rule, whatever its imperfections, would strike a much better balance between the factors impinging upon consumer welfare than the present judge-made proscription of horizontal mergers creating market shares as small as 5 percent. The harmful effects of that rule upon consumers may be imagined if one realizes it is equivalent to saying that when there are a hundred lawyers in a town no law firm may contain as many as five. Such a rule obviously cuts far too deep into the efficiencies of integration.

The rules on mergers, it should be clear, urgently require reform. And the need for antitrust reform extends beyond merger rules, to fields it has not been possible to discuss here. To put the matter bluntly, we have now reached a stage where the antitrust laws, as they are being interpreted and applied, are simply not intellectually respectable. They are not respectable as law or as economics, and, because they proceed to stifle competition while pretending to protect it, they are not even respectable politics.

#### THE MISSING DISCUSSION

Most of the rules that should be changed were made over the years by the Supreme Court, usually at the urging of the Antitrust Division, and reform can quite legitimately come in the same way. The antitrust statutes lay down very little hard law. The courts remain free to change the subsidiary rules they constructed, and the head of the Antitrust Division should play a key role in that process.

Reform should have an ideal in view, and an ideal consumer-oriented law would, for the most part, strike at large horizontal mergers and at cartel agreements among competitors. I agree with the recommendation of the Stigler task force that more resources and ingenuity should be devoted to a drive against price-fixing and market-division cartels, since there appear to be many that enforcement of the law does not now reach. An enforcement drive against collusion in national, regional, and local markets would pay high dividends in consumer welfare, particularly since cartels, being subject to a rule of *per se* illegality, are among the least difficult and least expensive offenses to prosecute.

Beyond the reformation of existing antitrust law there is a broader and potentially far more important role that lies waiting to be seized by a bold and creative antitrust administration. The original antitrust philosophy of open markets and free competition that underlies the rule against cartels should be steadily expanded to cover other fields of economic behavior

where control of entry, price-fixing, and similar eliminations of competition now occur *with governmental blessing*. The Antitrust Division should make itself the spokesman for antitrust ideals throughout the economy, by testifying on proposed legislation, by intervening in federal and state regulatory processes, and by other means. The opportunities are innumerable — in the regulation of trucking, banking, communications, drug retailing, and in many other fields where regulation often acts less to protect consumers than to preserve business fiefdoms from competitive challenge. A positive antitrust program such as this would elicit enough outraged screams from protected companies to dispel any notion that the policy is narrowly “pro-business.”

Some readers may suppose that the views I have expressed here are extreme. They are not. Far from being personal or idiosyncratic, they represent, in their general outline, a broad and growing school of thought about antitrust policy. Views in many respects quite similar to mine are presented, for example, in the Stigler report, which the Administration has so far assiduously ignored. Reform is a necessity, and, regardless of his own views, Richard McLaren could contribute greatly by using his office to start and focus a systematic discussion of antitrust goals and economics. Without reappraisal and reform, antitrust is likely to go on fighting — and, worse, winning — ever more dubious battles.