CONTRASTS IN ANTITRUST THEORY: II

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The legislator who recommends an amendment to the antitrust laws, the judge who decides a case under them, or the critic who evaluates the work of either legislator or judge is an economic theorist whether he realizes it or not. The theory each applies is monopoly theory. The answer that should be sought is whether or not proscribing certain forms of business activity will lessen or increase the goods and services consumers want most.

The theories of trade restraint differ widely. They differ perhaps least with respect to horizontal collusion and most with respect to vertical integration. In the current dispute the role played by free market forces is crucial.

I. COLLUSION AMONG COMPETITORS

Price-fixing agreements among competitors, it is agreed, should be outlawed. Price-fixing is the proper subject of a *per se* rule. There is no agreement, however, about why and under what circumstances a *per se* rule should apply. We have one criterion. For a trade practice to be *per se* illegal, its sole purpose and unequivocal effect must be the restriction of production or control of price. This standard would not preclude agreement, even among competitors, if the agreement were subsidiary and necessary to an objective that enhanced competition. It is the existence of a countervailing efficiency effect that calls for further evaluation.

Professors Blake and Jones rationalize the *per se* rule differently. They say, with full signs of approval, that the rule as it has judicially been interpreted arises because "the economic objective of antitrust—maximum efficiency" is subordinated to "a political objective—the preservation of a self-policing system."

This is theory at its worst. It provides no guide at all for determining what should and what should not be in the *per se* category. If it justifies *per se* illegalities, it equally justifies *per se* legalities.

II. HORIZONTAL MERGERS

Because the effect of a merger may be efficient production resulting in lower costs for consumers, there is no dispute that a *per se* rule would be inappropriate for mergers. On the other hand, a merger may be undertaken for the same purpose and with the same effect as a price cartel. Consequently the objective of wise antitrust policy requires predicting whether efficiency effects are or are not outweighed by trade restraining effects. Neither of these effects is capable of accurate prediction; both involve tenuous assumptions. Predicting efficiency assumes that the sources of efficiency can be identified

and weighed. Predicting trade restraint assumes that oligopoly theory is reliable as applied to the post-merger market.

Horizontal mergers can make for high concentration in a market; and with very few competitors, competition might be curtailed by price leadership. It does not follow, however, that fewness *will* result in less competition. Oligopoly theory merely suggests that after some undefined point—other factors being constant—tacit collusion becomes *more likely* with decreases in numbers. The plausibility of oligopoly theory diminishes and disappears with increases in numbers and decreases in concentration. Application of oligopoly analysis to market situations such as existed in the *Brown Shoe* case¹ is grotesque.

Unlike trade restraint, efficiency is possible at all levels of market concentration. In addition, the sources of efficiency are many and diverse and not confined to a short list of "tangibles." The best evidence of widespread efficiency is the vast number of mergers taking place where market conditions make even a presumption of restrictive effect preposterous. Professors Blake and Jones, seeing oligopoly everywhere, find mergers socially undesirable because they have more faith in their list of efficiencies than they do in a free market.

III. VERTICAL INTEGRATION, FORECLOSURE AND EXCLUSION

For better or for worse, a horizontal merger has a direct effect on concentration within a market. This is not so of a vertical merger or a vertical contract. The number of market participants and their concentration remains as before. The trade restraining effects of vertical integration, if they exist, are indirect. Three explanations have been offered to show how restraints come about from vertical arrangements: (1) monopoly gaining or monopoly increasing, (2) monopoly keeping or entry barring, and (3) monopoly profit maximizing (making the most out of what you have). It is important to notice that each of these explanations rests on the assumption that substantial monopoly power already exists. Presumably, also, this power should not or cannot be attacked directly. For example, if the monopoly power upon which these explanations depend were based upon collusion among competitors, the appropriate remedy would be a per se action of the type already described.

A. *Monopoly Gaining*

The Robinson-Patman Act² and Sections 3 and 7 of the Clayton Act,³ dealing respectively with price discrimination, tying sales and exclusive dealing, and mergers, all reflect the same laudable aim of preventing practices that

1. *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

2. 49 Stat. 1526 (1936), 15 U.S.C. §§ 13-13b, 21a (1959).

3. 38 Stat. 731 (1914), as amended, 15 U.S.C. §§ 14, 18 (1959).

will cause little monopolies to grow into big monopolies—"nipping monopolies in the bud," as it is sometimes called. The incipency doctrine is another name for the same thing.

The theory of how this leveraging operation could take place is very specialized, of limited possible application and cannot unequivocally explain a single antitrust case. The law, as contrasted with the theory, assumes that competitors of the incipient monopolist are driven from the market by such devices as price discrimination and tie-in sales. These competitors, the law assumes, being foreclosed from incipient monopolists' customers, will no longer be able to offer effective competition.

Professors Blake and Jones are not disposed to take up the leverage case or to answer the hypothetical exclusive dealing example we raised. Perhaps there is no disagreement on leverage. In any event they choose to defend antitrust policy regarding vertical arrangements in terms of adverse effect upon entry.

B. *Monopoly Keeping (Barriers to Entry)*

Here again, Professors Blake and Jones expose their monopoly bugaboo by applying their version of oligopoly theory. They contend that when markets "are less than perfectly competitive," vertical integration discourages competition by imposing "financial and psychological barriers to the entry of new competitors." Entry barring is rationally undertaken only when it is a means by which increased competition is foreclosed. Competition is not foreclosed by barring entry if it can take place effectively from existing firms. Even in the unlikely event that competition from existing firms is inhibited, why would one firm incur entry barring costs for the benefit of its rivals? Blake and Jones have endowed their competing market participants with delusions of monopoly grandeur!

Their entry blocking theory is scarcely more plausible when a strong monopoly position is assumed. That vertical integration increases the "financial" cost of investment is irrelevant. Myriad factors increase costs. Before a barrier to entry theory can be plausible, there must be an explanation of how the alleged barrier to entry imposes a higher cost on the would-be rival than upon the existing firm.

Two hypothetical possibilities of increasing or maintaining monopoly by imposing higher costs on others are full line forcing and capital barriers. Blake and Jones' discussion of financial barriers exposes no theory at all. They merely note that capital markets are imperfect. What markets are not? Until nonproportional cost imposition can be established, barrier to entry claims should be ignored—for high concentration as well as for low concentration industries.

C. *Monopoly Profit Maximization*

There is general agreement that vertical arrangements are useful in maximizing profits from monopoly. Banning them on this ground would be to indulge in the sophomoric assumption that profits are what is the matter with monopoly. Proscribing a profit maximizing practice merely forces a firm to the next most profitable alternative. If that alternative further restricts output, the profit maximizing practice should be encouraged rather than banned. Only when more output can be forecast should the profit maximizing practice be prohibited. Again the prerequisite to a policy recommendation involves the efficiency-trade restraint assessment. This assessment, moreover, is just as relevant for a monopoly resulting from the "defective merger policy of earlier years" as for one resulting from any other reason.

The cases in which vertical restraints have been alleged are numerous. They provide a wide variety of examples of business behavior without apparent trade restraint. How, for example, is it possible to conclude that consumers got less or paid more for taxicab service as a result of the circumstances involved in the *Yellow Cab* case?⁴ Is it not incontrovertible that land prices were cheaper because of the tie-in in the *Northern Pacific* case?⁵ Is it the appropriate function of the antitrust laws to do justice to minority stockholders of the cab companies; or bail out the ICC? Was it not eminently clear in the *A. & P.* case⁶ that Robinson-Patman Act⁷ standards were applied in a Sherman Act⁸ case to prevent A. & P. from getting discounts which it passed on to consumers? Where was the remote possibility that A. & P. could bar entry so prices would be higher in the long run?

*Columbia Steel*⁹ provides an example of what can happen when a court finds no restraint from a vertical merger. Congress passes an amendment¹⁰ which is confidently pointed to as making such a decision impossible a second time.

The *Standard Stations* case¹¹—the key case on exclusive dealing—stands for the proposition that a foreclosure of competitors by preempting outlets is illegal under Section 3 of the Clayton Act¹² irrespective of effect on competition. The Court held it to be inappropriate to insist on proof of economic effect. In the *Motion Picture Advertising* case,¹³ the same test was applied under the Sherman Act. Similarly, the lower standard of proof (the automatic rule) said

4. *United States v. Yellow Cab Co.*, 332 U.S. 218 (1947).

5. *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958).

6. *United States v. New York Great Atl. & Pac. Tea Co.*, 173 F.2d 79 (7th Cir. 1949).

7. 49 Stat. 1526 (1936), 15 U.S.C. §§ 13-13b, 21a (1959).

8. 26 Stat. 209 (1890), as amended, 15 U.S.C. §§ 1-7 (1959).

9. *United States v. Columbia Steel Co.*, 334 U.S. 495 (1948).

10. Celler-Kefauver Act, 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1959).

11. *Standard Oil Co. v. United States*, 337 U.S. 293 (1949).

12. 38 Stat. 731 (1914), 15 U.S.C. § 14 (1959).

13. *FTC v. Motion Picture Advertising Serv. Co.*, 344 U.S. 392 (1953).

to be required of a tying contract under Section 3 of the Clayton Act¹⁴ in the *Times-Picayune* case¹⁵ was adopted as the Sherman Act test in *Northern Pacific*.¹⁶

In case after case the trend is clear. Except for the *de minimis* market percentage,¹⁷ vertical foreclosure by contract has come close to being per se illegal. And if the language in the *Brown Shoe* opinion¹⁸ is interpreted literally, vertical merger would seem to be doomed to a similar fate.

The standards characteristic of the Robinson-Patman Act have been imposed upon the original Clayton Act (and upon the amendments to that act with even greater rigor) and thence upon the Sherman Act so that protecting competitors prevails over protecting competition. The legislature, the FTC, the Department of Justice and the courts are "Robinson-Patmanizing" anti-trust law.

IV. CONGLOMERATE MERGERS

The problem of weighing the effects of efficiency against the effects of trade restraint is not at issue in conglomerate mergers. No trade restraining effects are found and efficiency is abundantly identified. That ends the matter for us, but not for Blake and Jones. They would proscribe a merger on the sole ground that they disapprove of the efficiency created. They praise the FTC decision in the *Clorox* case¹⁹ because it disapproves of the economies resulting from the large-scale purchase of advertising. It is thus proper for the Federal Trade Commission or a court to impose its anti-advertising bias on those who happen to appear before it in an antitrust case.

CONCLUSION

Apart from the intellectual frolic afforded Blake and Jones by an advertising example, their entire case against our charge of "crisis in antitrust" rests on "barriers to entry," for which they have neither a theory nor an example.

14. 38 Stat. 731 (1914), 15 U.S.C. § 14 (1959).

15. *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 608-10 (1953) (dictum).

16. *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958).

17. See *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961).

18. *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

19. *Procter & Gamble Co.*, 3 TRADE REG. REP. ¶ 16673 (FTC 1963).